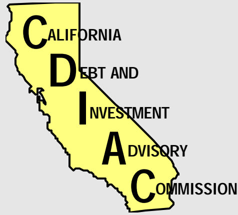

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CDIAC REVIEWS SECOND QUARTER 2003 INVESTMENT PORTFOLIO REPORTS FROM COUNTIES AND CITIES

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Government Code Sections 53646(g)-(i) [added pursuant to Assembly Bill 943 (Dutra), Chapter 687 (Statutes of 2000)] 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 and assist CDIAC in providing more relevant research products, education programs, and technical assistance services.

Counties and cities were required to submit their second quarter 2003 investment policies and portfolio reports to CDIAC by September 1, 2003. CDIAC analyzed a sample of 56 city portfolios and policies that were submitted. All county investment policies and reports received were analyzed.

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 overview of local agency portfolios in California.

Moreover, CDIAC discourages local agencies from making direct 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.

Number of Investment Reports Filed Increases

Investment policy reporting to CDIAC for counties increased substantially from the last required period's compliance rate. Counties filed 46 investment policies (79 percent) for the quarter ending June 30, 2001. Due to a change in law, there were no investment policies required in calendar year 2002. For the quarter ending June 30, 2003, this response rate increased to 52 investment policies (90 percent).

Investment portfolio reporting to CDIAC for counties also increased somewhat from the prior period's compliance rate. Counties filed 53 portfolio reports (91 percent) for the quarter ending December 31, 2002. The response rate increased to 57 (98 percent) for the quarter ending June 30, 2003.

Investment policy reporting to CDIAC for cities increased dramatically from the last required quarter's compliance rate. Cities filed 274 investment policies (58 percent) for the quarter ending June 30, 2001. For the quarter ending June 30, 2003, cities filed 365 investment policies (77 percent). Investment portfolio reporting to CDIAC for cities also increased substantially from the prior period's compliance rate. Cities filed 334 portfolio reports (70 percent) for the quarter ending December 31, 2002. The response rate increased to 392 (82 percent) for the quarter ending June 30, 2003. In general, the investment portfolio response rate for the most recent reporting period for smaller cities in the sample was 73 percent and for larger cities in the sample was 95 percent. A similar response rate exists for city investment policies, where the response rate for smaller cities in the sample was 66 percent and for larger cities in the sample 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 were analyzed into quartiles based on their portfolio size. Figure 1 shows that for counties with investment portfolios under $76 million, four had one to three instruments, nine had four to six, and one had seven

or more types of instruments in its portfolio. For counties with investment portfolios over $1.1 billion, one had one to three types of instruments, five had four to six, and eight 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 June 30, 2003)

Types of Investments	Under $76M	$76 M to $248M	$248M to $1.19B	Over $1.18B
1 to 3	4	2	1	1
4 to 6	9	7	8	5
7 or more	1	5	6	8

Figure 2
Number of Different Investment Types in City Portfolios by Portfolio Size
(Quarter ending June 30, 2003)

Types of Investments	Under $8M	$8M to $23M	$23M to $64M	Over $64
1 to 3	14	9	12	5
4 to 6	0	5	2	8
7 or more	0	0	0	1

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 almost a 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 this 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

Figure 3
Investment Instruments by County by Portfolio Size
(Quarter ending June 30, 2003)

Investment Instrument	Number of Reportees in Each Size Category	Under $76M	$76M to $248M	$28M to $1.1B	Over $1.1B
U.S. Treasury Obligations	29	71%	7%	60%	57%
U.S. Agency Obligations	53	79%	100%	93%	100%
Commercial Paper	31	14%	50%	60%	86%
Repurchase Agreements	12	0%	0%	47%	36%
Medium-term Notes	38	57%	79%	60%	71%
Money Market Funds	23	43%	36%	33%	50%
Negotiable Certificates of Deposit	24	7%	43%	40%	71%
Local Agency Investment Fund	47	93%	93%	87%	50%

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 repurchase agreements, commercial paper, and negotiable certificates of deposit than those counties with under $76 million in portfolio investments.

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

Figure 4
Investment Instruments by City by Portfolio Size
(Quarter ending June 30, 2003)

Investment Instrument	Number of Reportees in Each Size Category	Under $8M	$8M to $23M	$23M to $64M	Over $64M
U.S. Treasury Obligations	14	0%	14%	29%	57%
U.S. Agency Obligations	31	7%	43%	79%	93%
Commercial Paper	5	0%	0%	7%	29%
Repurchase Agreements	2	0%	0%	7%	7%
Medium-term Notes	8	0%	7%	14%	36%
Money Market Funds	11	7%	29%	0%	43%
Negotiable Certificates of Deposit	15	29%	36%	14%	29%
Local Agency Investment Fund	53	86%	100%	100%	93%

Yield and Days to Maturity Comparisons

CDIAC also tried to discern whether any relationship exists between size of portfolio, average portfolio maturity, and portfolio yield. In theory, counties and cities with larger portfolios have the ability, through economies of scale and increased 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, investments with longer maturities would garner an increased yield. The results of CDIAC's analysis, however, show little relationship between portfolio size and yield for counties. There is a stronger relationship between portfolio size and yield for cities. There is an even 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 287 and 506 days. Figure 6 shows a somewhat different result for cities that is more in line with the hypothesisdiscussed above. The average portfolio yield for cities grows from 1.7 percent to 2.8 percent as portfolio size grows. Similarly, average days to maturity increases from 10 days to 502 days as portfolio size increases.

Figure 5
Yields and Days to Maturity Comparisons
Counties
(Quarter ending June 30, 2003)

Size	Number of Reportees in Each Size Category	Yield (%)			DTM (days)		
		Average	Low	High	Average	Low	High
Under $76M	14	2.5	1.8	3.7	304	1	672
$76M to $248M	14	2.4	1.7	3.4	506	160	870
$248M to $1.1B	15	2.2	1.3	4.3	287	49	815
Over $1.1B	14	1.8	1.3	2.6	301	66	876

Figure 6
Yields and Days to Maturity Comparisons
Cities
(Quarter ending June 30, 2003)

Size	Number of Reportees in Each Size Category	Yield (%)			DTM (days)		
		Average	Low	High	Average	Low	High
Under $8M	14	1.7	1.6	1.8	10	1	95
$8M to $23M	14	2.4	1.8	3.5	110	1	719
$23M to $64M	14	2.0	1.3	3.0	203	1	419
Over $64M	14	2.8	2.0	3.8	502	239	829

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 1.3 percent to 3.7 percent and city yields vary from 1.3 percent to 3.8 percent. Similarly, county days to maturity range from 1 day to 876 days and city days to maturity range from 1 day to 829 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, 2003. In addition, CDIAC is using the data collected for the quarter ending June 30, 2003 to examine the different practices counties and cities use to report their investments. A report on these practices is scheduled for publication in mid-2004. In addition, a similar report, which will look at the different practices counties and cities use to report their policies, is scheduled for publication in late 2004. Lastly, using the investment policies submitted for the quarter ending June 30, 2003, CDIAC will alert specific counties and cities that have failed to update their investment policies to reflect changes in state law.

CDIAC will continue to use the data collected from these portfolios and policies to publish articles, update seminars, and produce resource books on public investment reporting. Please contact Frank Moore, CDIAC with any questions or comments you may have regarding this data at (916) 653-4957.

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.

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