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CDIAC REVIEWS SECOND QUARTER 2004 INVESTMENT PORTFOLIO REPORTS FROM COUNTIES AND CITIES

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Editors Note: This article uses information contained in investment reports and policies submitted to CDIAC in fulfillment of AB 943 to present averages and trends in city and county compliance rates, numbers of types of investments used, specific investment instruments used, returns on investments, and days to maturity (an interest rate risk measure). This is not an original research report, but rather a generalized description of the information contained in these investment reports.

Since 2001, cities and counties (with some exceptions) have been required to submit investment reports on a quarterly basis to their legislative bodies, chief executive officers, and internal auditors. Chapter 889, Statutes of 2004 (AB 2853, Laird) eliminated the requirement to submit investment reports and investment policies to legislative bodies and, instead, encourages local governments to do so. Nonetheless, if local agencies choose to continue to file investment policies and reports with their legislative bodies, they are required to file these documents with the California Debt and Investment Advisory Commission (CDIAC) for the appropriate time period. If counties and cities filed their investment policies and portfolio reports with their legislative bodies for the second quarter of 2004, they were required to submit copies of these policies and reports to CDIAC pursuant to Government Code Sections 53646 (g)–(i) by September 1, 2004. CDIAC analyzed a sample of city investment policies and reports and all county investment policies and reports that were submitted.

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 Policy Reports Filed Decreases

Investment policy reporting to CDIAC for counties decreased somewhat from the last required period's compliance rate. Counties filed 52 investment policies (90 percent) for the quarter ending June 30, 2003. For the quarter ending June 30, 2004, this response decreased to 47 investment policies (81 percent).

Investment portfolio reporting to CDIAC for counties increased somewhat from the prior period's compliance rate. Counties filed 53 portfolio reports (91 percent) for the quarter ending December 31, 2003. The response rate increased to 55 portfolio reports (95 percent) for the quarter ending June 30, 2004.

Investment policy reporting to CDIAC for cities decreased significantly from the last required quarter's compliance rate. Cities filed 365 investment policies (77 percent) for the quarter ending June 30, 2003. For the quarter ending June 30, 2004, cities filed 299 investment policies (63 percent). Investment portfolio reporting to CDIAC for cities decreased slightly from the prior period's compliance rate. Cities filed 350 portfolio reports (73 percent) for the quarter ending December 31, 2003. The response rate decreased to 338 (71 percent) for the quarter ending June 30, 2004. In general, the investment portfolio response rate for the most recent reporting period for smaller cities in the sample (population less than 25,000) was 60 percent and for larger cities in the sample (population greater than 100,000) was 87 percent. A similar response rate exists for city investment policies, where the response rate for smaller cities in the sample was 87 percent and for larger cities in the sample was 100 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 $89 million, five had one to three instruments and nine had four to six types of instruments in their portfolios. For counties with investment portfolios over $1.2 billion, one had one to three types of instruments, three had four to six, and ten had seven or more types of instruments in their portfolios. A

Figure 1
Number of Different Investment Types in County Portfolios by Portfolio Size
(Quarter ending June 30, 2004)

Types of Investments	Under $89M	$89M to $293M	$293 M to $1.2B	Over $1.2B
1 to 3	5	3	1	1
4 to 6	9	9	6	3
7 or more	0	2	6	10

Figure 2
Number of Different Investment Types in City Portfolios by Portfolio Size
(Quarter ending June 30, 2004)

Types of Investments	Under $10M	$10M to $31M	$31M to $78M	Over $78M
1 to 3	13	12	7	5
4 to 6	0	1	5	7
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 the smallest counties are more likely than the largest counties to invest in externally managed funds such as the state Local Agency Investment Fund (LAIF). 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 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 $89 million in portfolio investments.

Figure 3
Investment Instruments by County by Portfolio Size
(Quarter ending June 30, 2004)

Investment Instrument	Number of Reportees in Each Size Category	Under $89M	$89M to $293M	$293M to $1.2B	Over $1.2B
U.S. Treasury Obligations	28	57%	14%	77%	57%
U.S. Agency Obligations	55	100%	100%	100%	100%
Commercial Paper	33	7%	64%	69%	100%
Repurchase Agreements	13	0%	7%	31%	57%
Medium-term Notes	38	64%	64%	69%	79%
Money Market Funds	23	57%	36%	46%	29%
Negotiable Certificates of Deposit	22	0%	43%	38%	79%
Local Agency Investment Fund	43	79%	93%	92%	50%

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

Figure 4
Investment Instruments by City by Portfolio Size
(Quarter ending June 30, 2004)

Investment Instrument	Number of Reportees in Each Size Category	Under $10M	$10M to $31M	$31M to $78M	Over $78M
U.S. Treasury Obligations	9	0%	8%	17%	46%
U.S. Agency Obligations	27	8%	23%	83%	100%
Commercial Paper	5	0%	0%	0%	38%
Repurchase Agreements	2	0%	0%	0%	15%
Medium-term Notes	12	8%	8%	17%	62%
Money Market Funds	13	0%	38%	33%	31%
Negotiable Certificates of Deposit	9	15%	8%	17%	31%
Local Agency Investment Fund	50	100%	100%	100%	92%

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 an inverse relationship between portfolio size and average yield for counties (i.e., the larger the portfolio, the smaller the average yield). There is a stronger relationship between portfolio size and average 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

Figure 5
Yields and Days to Maturity Comparisons
Counties
(Quarter ending June 30, 2004)

Size	Number of Reportees in Each Size Category	Yield (%)			DTM (days)		
		Average	Low	High	Average	Low	High
Under $89M	14	2.6	1.8	4.0	505	42	861
$89M to $293M	14	2.4	1.5	4.1	609	139	1,149
$293M to $1.2B	13	1.8	1.3	2.3	344	98	621
Over $1.2B	14	1.7	1.2	2.7	295	61	694

Figure 6
Yields and Days to Maturity Comparisons
Cities
(Quarter ending June 30, 2004)

Size	Number of Reportees in Each Size Category	Yield (%)			DTM (days)		
		Average	Low	High	Average	Low	High
Under $10M	13	1.4	1.4	1.4	1	1	1
$10M to $31M	13	1.4	1.4	1.4	1	1	2
$31M to $78M	12	2.6	2.0	3.4	364	1	947
Over $78M	13	2.5	1.6	3.8	561	133	883

Future Outlook

CDIAC is in the process of collecting investment reports for the quarter ending December 31, 2004. In addition, CDIAC is using the data collected for the quarter ending June 30, 2004 to examine the different practices counties and cities use to report their investment policies. A report on these practices is scheduled for publication in mid-2005. A similar report, entitled Investment Portfolio Practices: An Informational Guide, which looked at the different practices counties and cities use to report their investment portfolio reports, was published in late 2004. Lastly, using the investment policies submitted for the quarter ending June 30, 2004, 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 Senior Researcher, 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.