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CITY OF SACRAMENTO

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CITY MANAGER'S OFFICE
RECEIVED
JAN 8 1982

THOMAS P. FRIERY
TREASURER
DONALD E. SPERLING
ASST. TREASURER

January 8, 1982

City Council of the City
of Sacramento
Sacramento, California

Honorable Members in Session:

SUBJECT: Short-Term Investment Activity Report

SUMMARY

The attached are the investment activity reports for the 3rd and 4th quarter of fiscal year 1980-81 as well as the overall investment results for the fiscal year ended June 30, 1981.

RECOMMENDATION

These reports are for your information and no specific action is required.

Respectfully submitted,

Thos P. Friery

THOMAS P. FRIERY
City Treasurer

TPF/lv
Attachment

Office of the City Clerk

For City Council Information:

Walter J. Slipe

Walter J. Slipe, City Manager

JAN 19 1982

January 19, 1982

CITY OF SACRAMENTO

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OFFICE OF THE TREASURER
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THOMAS P. FRIERY
TREASURER

DONALD E. SPERLING
ASST. TREASURER

December 23, 1981

Budget and Finance Committee
Sacramento, California

Honorable Members in Session:

Subject: Interest Income Earned on Short-Term Investment Pools Managed, Apportionment of Interest Income, and Calculation of Investment Cost Recovery Fees for the 3rd and 4th Quarters of FY 1980-81 (Short-Term Investment Activity Report)

SUMMARY

In response to City Council directives, the investment activity reports for the 3rd and 4th quarter of fiscal year 1980-81 as well as the overall investment results for the fiscal year ended June 30, 1981 are transmitted:

Very briefly:

- $11.1 million in investment income was earned of the average $82.9 million per day on overall invested assets. This is equivalent to an overall rate of return of 13.30% and compared favorably to the results of other short-term investment fund managers and barometers of short-term interest rates in FY 1981. These results are benchmarks in Treasury activity. However:

    - Included in the overall results is $6.7 million interest income which was earned on the average $46.6 million per day of City of Sacramento Investment Pool A Funds. This is equivalent of a rate of return of 14.36% for the year on City Pool A Monies.

    - 2,581 investment transactions were executed with a total dollar value of $4.5 Billion in FY 1981. These results are benchmarks in Treasury activity.

    - The investment cost recovery fee on funds managed approved by Council for the City Treasurer's Office generated approximately $131,600 which reimbursed and was transferred to the General Fund to offset the City costs involved with providing the investment function by the City Treasurer's Office. This fee represents 45% of the entire City Treasurer's Budget.

It is suggested that the Committee members refer to the inside cover of each report for a description of the investment activities indicated by quarter. Further, it is suggested that the Committee members refer to Page A-3 of each report to get a bottom line perspective of results.

I request the Committee to accept our investment reports and direct them to the full Council for their information.

My staff and I are here to present this report and to respond to any questions you may have.

BACKGROUND

Transmitted herewith are the short-term Investment Activity Reports for the 3rd and 4th quarters of FY 1980-81 as well as overall investment results for the fiscal year ended June 30, 1981. These reports do not include investment activity associated with the Sacramento City Employees Retirement System and the Ann Land-Bertha Henschel Memorial Funds which are provided separately on an annual basis.

Contributory factors to the time delay in formally presenting these reports were:

- Investment Transaction Activity and dollar value of investments executed were up 170% and 150% respectively in the 3rd and 4th quarter from the 1st and 2nd quarter, primarily as a result of investment strategies which were implemented to take optimal advantage of the volatile interest rate markets. The actual 2,581 investment transactions executed for a total dollar amount of $4.5 billion for all of 1980-81 are both records in the City of Sacramento Treasury Department for a 12 month period.

- The termination of a permanent Treasury employee and an unfortunate extended serious illness to another key Treasury employee resulted in the necessity to bring on board temporary personnel who were totally unfamiliar with both Treasury and Investment reporting and recordkeeping practices.

- The continued initial learning process of Treasury staff involved with both our Moneymax Investment and Accounting System capabilities as well as issuing these investment reports which now span only 12 months of operating history.

In spite of this time delay, the investment results of the investment funds managed by this office compare favorably to the results of other short-term investment fund managers and indices of short-term interest rate barometers during FY 1980/81. The $11.1 million in interest income that was earned overall is equivalent to a rate of return of 13.30% on the average $82.9 million per day of all invested assets. All of these achievements are records in the history of City Treasury operations.

However, what may be of greater interest to the City Council are the results of City Investment Pool A which effectively is all of the City of Sacramento funds (including the General Fund) which are managed by this office. City Investment Pool A earned $6.7 million in interest income during fiscal year 1980/81 which is equivalent to a rate of return of 14.36% on their average $46.6 million per day of invested funds. These achievements are also records in the history of City Treasury operations and are overall weighted averaged in the figures previously reported.

As a result of Council action which authorized the City Treasury to establish an investment cost recovery fee to be accessed to the Investment Funds managed, $140,847.18 was billed to these funds during FY 1980/81. However, as opinioned by the City Attorney, such fee could not be accessed to the SCERS. The fee to SCERS for their share of funds managed would have been $9,280.26 during the fiscal year. Therefore, $131,566.92 was recovered and transferred to the General Fund to reimburse for the costs of the City Treasury's investment program. The fees transferred to the General Fund actually reimbursed 45% of the entire City Treasurer's Operating Budget.

ECONOMIC YEAR IN REVIEW

The fiscal year ending June 30, 1981 was one of the most volatile, misread and financially devastating periods in interest rate and economic history.

The year started in July 1980 with Federal Funds trading in the 8 1/2% to 9% range and by December 1980 skyrocketing to the 19 1/2% to 20% range. By March of 1981 this barometer plummeted to the 14 1/2% to 15% range, only to jump back to the 19 1/2% to 20% range by June 1981. The absolute levels, the percentage move and the volatility of the directions were without precedent in history and could not and were not anticipated or estimated by any of the so-called Wall Street and government economists.

In July and August, 1980 money supply was ballooning, leading economic indicators were strong and the consensus economic forecasts echoed, "the recession is over!" However, on the price front, inflation indices were revealing double digit numbers. In this backdrop, the upcoming Presidential elections resulted in further pressure on investment markets as the economists and market participants preoccupied themselves with the idea the Carter Administration would institute overt and political stimulative actions to prime the economy which had been weak. The perception was that if such moves were instituted, they would add fuel to the already double digit inflation numbers.

As the economy moved through the second quarter, not only did the Carter Administration <u>not move to implement stimulative fiscal actions</u>, they in fact implemented credit controls in the face of unchecked inflation and massive borrowings by the American consumer and industry. Further, routine reports were being released updating previously published estimates of economic activity that showed the earlier estimates were incorrect and too high. The economy was not as strong as the economic perception previously was.

The housing and automobile industry proceeded to record their greatest losses in history. All the finance subsidiaries of all U. S. automakers were to receive down-gradings in their credit ratings from the rating agencies by the time of this writing. This action had and will continue to increase their financing costs impacting profitability or increasing costs to the consumer. The questions were raised but are still unanswered as to whether or not several of the U. S. automakers will be able to effectively compete in the market.

The banking system, particularly savings and loans were extremely hard hit by disintermediation (savers withdrawing deposits and investing them in money market funds for higher rates of return). It is pointed out that in 1976 only $3.6 billion was in money market funds and this amount grew to $45.2 billion by 1979. However, by June, 1981 these money market funds grew to approximately $167 billion. (Not all of the increase dollars in Money Market Funds came from disintermediation from savings and loans in 1981. Banks and investment markets were also victims of this huge shift of funds.) The impact of the disintermediation created two substantial problems. Not only was the supply of money for new mortgage loans effectively reduced from the traditional lenders, but a more serious financial problem has beset the savings and loan industry (although it is emphasized that the impacts on individual savings and loans can be less than or greater than what has beset the industry as a whole). In any event, the problem facing this industry is the fact that approximately 89% of all deposits in savings and loans have already been invested by these institutions in 30 year mortgages which are producing an approximate yield of 9+%.

Therefore, when depositors withdraw their funds the savings and loans are faced with a decision to package previously made loans for sale at substantial losses or borrow money to maintain the outstanding mortgages. However, the savings and loans had to pay anywhere from 15% to 22% or higher for the money they borrowed for which they are only earning 9+% on average. The difference, anywhere from 6% to 13% is resulting in operating losses that are dissipating their capital. If these problems were not serious enough, the absolute level of mortgage rates at 15% and 15%+ are resulting in a situation whereby potential homeowners cannot qualify for loans which further restrict the industry from making any loans at these historically high levels.

In this environment unemployment started to rise and the absolute level of interest rates and these economic uncertainties discouraged industry from making plant and capital investment and decisions.

The election of President Reagan and his Reaganomics Program were initially supported and well received by Wall Street although described as unacceptable by a number of local governments. The Wall Streeters hailed the approach to balanced budgets and a about turn from the last 20 years of Government deficit financing and the elimination of unnecessary cost of Government as a remedy. By the end of the fiscal year Wall Street joined a number of the opponents of Reaganomics as not supportive of the entire program as the fiscal impact of social cuts were reaccessed for its impact on the corporate bottom line and the President's tax cut would cause the Federal Deficit to increase because of the recessioning economy.

In March, 1981 the Federal Reserve implemented credit tightening moves that caused interest rates to again skyrocket. The implementation came as unemployment was rising and was effected to try to reduce the money supply which was growing uncontrollably and was perceived to be adding fuel to the runaway inflation fire.

The Reagan Administration supported the Federal Reserve's move. As the fiscal year concluded, there appeared to be some impact on inflation and the Federal Reserve appeared to hold their new tight line, rather than signalling for more restraint.

All of the problems that have surfaced in 1981 have not been resolved. If anything, the negative pressures on a number of industries and the public in general are worse.

Actions to control the rampant inflation and unacceptable level of interest rates must be dealt with in the upcoming fiscal year or there will be financial catastrophes. Our financial institutions must be restored with financial liquidity as to permit them to perform their services for the American public in a profitable fashion. Further, more important than economic numbers and all the projections is confidence by the public in not only the ability of the bold new economic program to work, but confidence in their Government and its leaders.

Reaganomics had no fiscal impact on FY 1981 as many of the programs were not to be implemented until FY 1982 and beyond. Further, it would be presumptious to think the program will resolve all of our fiscal problems in one year. However, it is clear from the prospective of June, 1981 only, that the economy was on a serious crash course resulting from a number of factors that were deep seated well before the current Administration took office.

Optimism and confidence must surface. Should the program fail, there will be no place for any one to hide from the fiscal consequences.

INVESTMENT STRATEGY DURING FISCAL YEAR

Basically, two investment strategies were implemented in FY 1980-81. During July and August, 1980, longer term investment securities previously purchased were sold in anticipation of credit tightening moves by the Federal Reserve System. These actions resulted in substantial capital gains and account for the superior investment performace in the 1st quarter.

As the first quarter ended and the volatility in interest rates surfaced, all historical market spread relationships disappeared. There was no confidence in the investment community as to the ability to control inflation and the Money and Bond Markets plummeted. Government securities from 2 to 30 years traded at levels in excess of 16%. The yield curve started the year flat and then became greatly inverted.

In all of the pessimism, 10, 20, and 30 year investment securities were providing yields of 4% to 5 1/2% greater than the inflation rate whereas historically these securities provided only 2 1/2% to 3% greater inflation premium.

Therefore, the second strategy was to acquire longer term investments for the remainder of the year when the actual inflation premium was greater than the historical averages. This strategy was intended to permit the City to lock in longer term premium returns and avoid the trap of having invested in high yielding short-term securities that were so volatile and expected to return to normal levels.

At this time we would estimate that these actions will be able to assure a rate of return for the FY ending June 30, 1982 of 13 3/4% for City Investment Pool A.

RECOMMENDATION

It is requested that this Committee accept this report and forward it to the full Council for their information.

Respectfully submitted,

THOMAS P. FRIERY
City Treasurer

TPF/lv

Attachments (2) -- on file in Council offices

For Transmittal to Committee:

Robert C Leland

JACK R. CRIST
for Director of Finance