



# City of Independence, Ohio

"THE HEART OF CUYAHOGA COUNTY"

6800 BRECKSVILLE ROAD

INDEPENDENCE, OHIO 44131

(216) 524-4131

## **MEMORANDUM**

To: Mayor Gregory P. Kurtz  
Members of Council

From: Finance Director Vernon Blaze

Date: Friday, April 1, 2022

Re: Finance Office Updates

### **Interest Rates**

It's no secret that interest rates of all types have been increasing rapidly since the Federal Reserve Bank started to signal its intent to raise rates to attempt to get its arms wrapped around inflation that has been raging since early-mid 2021.

The average 30-year fixed-rate mortgage stood at 4.67% this week, up from 3.22% in early January. That's a 45% increase in less than three months.

If you think that is an eye-popping percentage, it pales in comparison to the rapid rise in tax-free municipal bond offering yields.

In March of 2021, the City invested approximately \$640,000 in one-year notes issued by the City of South Euclid. The yield on those one-year notes? All of 0.20%.

Those one-year notes matured a few weeks ago in March of 2022, and South Euclid decided to re-issue new replacement bonds for another 12 months. A recent Finance Office Weekly Update Memorandum noted that Independence re-invested its approximate \$640,000 and added a few hundred thousand dollars more into that issue.

Perceptive readers will recall that the yield on this new issue last month was 1.40%. From a 0.20% yield to a 1.4% yield in one year – South Euclid incurred a whopping 600% increase in its effective interest rate in just 12 months!

And since March 15 when the South Euclid issue went to market, tax-free municipal rates have increased even more. The following local cities have issued one-year notes since then at the following yields:



# City of Independence, Ohio

"THE HEART OF CUYAHOGA COUNTY"

6800 BRECKSVILLE ROAD

INDEPENDENCE, OHIO 44131

(216) 524-4131

## Interest Rates Continued

<u>City</u>	<u>Issue Date</u>	<u>Yield</u>
Euclid	March 30, 2022	1.85%
Seven Hills	March 23, 2022	1.55%
Barberton	March 23, 2022	1.60%

Middleburg Heights went to market earlier this week, but with a 25-year issue.

Long-term bonds like the one Middleburg Heights issued are sold in tranches, with each year of the issue having a separate interest rate. The farther out the year, usually the higher the rate.

The year-one tranche of Middleburg Heights' issue yielded 1.75%, right in the range of the three cities noted above. It's year 25 tranche yielded 3.2%.

So why all the discussion on interest rates this week? Especially tax-free municipal rates?

Recall that not too long ago, Independence had material debt (over \$17 million) in short-term, one-year notes. Those notes would mature every 12 months, at which time the new interest rate/yield on them would be subject to the given market conditions at the time of maturity.

Municipal financial advisors would claim that by having so much of the City's overall debt tied up in short-term maturities of one-year exposed the City to what's called "significant interest rate risk." It was like having an adjustable rate mortgage on a personal residence where the interest rate on it would re-set every 12 months.

That strategy of having a significant portion of the City's debt in short-term, one year notes was the correct one for a period of time – when interest rates were declining-to-stable.

But even though in the fall of 2020, when the Fed was signaling no change to the existing interest rate environment at that time, the City still pulled the trigger and converted its remaining short-term, one-year notes into a 15-year fixed rate bond.

The wisdom of that strategy won't be completely determinable until many years from now, but here just about 1 ½ years after the City locked in that debt at an overall yield of just under 1.6%, it is looking better and better with each passing day.

Short-term yields have escalated quickly, even to the point that the two-year Treasury is now yielding more than the ten-year. So far, Independence has hit the right side of this current rate environment, but uncertainty surely seems to define the current economic environment.