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, February 11, 2022

Re: Finance Office Updates

Investment Portfolio

With interest rates being so low during 2021, high-yielding investment options for city funds were non-existent.

That wasn't the end-of-the-world, as Safety is always the first tenant in the investment of public tax dollars.

A case can be made that Liquidity is the second tenant in the investment of public tax dollars. It's great if an investment instrument is yielding a high return, but if those funds are needed but can't be accessed because they are tied up in a longer-term instrument, that somewhat negates the benefits of that higher yield.

Therefore, the third tenant in the investment of public tax dollars is Yield, or Return. Thankfully, public investment managers don't have the option of chasing yields at the sacrifice of safety. The safety of principal is priority one in the investment of public tax dollars – Yield comes after.

That being said, public investment managers can and certainly do attempt to achieve the highest yields possible, but all within the context of that "Safety" cocoon that envelops "Yield."

In 2021, the City invested some available funds in a number of one-year bond anticipation notes (BAN's) of various public entities in Ohio. Because the yields on those notes were quite low (generally ranging between 0.20% and 0.40%, which were still quite a bit higher that the less-than 0.10% yield available at the time with funds on deposit with StarOhio), the city's total interest income in 2021 reflected that fact.

Anyone following the economy, the Federal Reserve Bank (The Fed) and national politics knows that The Fed recently announced that it would commence a series of interest rate increases to attempt to combat inflation rates that haven't been seen since the early 1980's.

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Investment Portfolio Continued

Why the Fed and some in the federal government couldn't see inflation happening in 2021 already, and why those same entities couldn't have projected that adding trillions of dollars into an already strong economy would be like pouring fuel on the inflation fire, is a discussion topic for another day!

The effects of inflation have and will negatively impact the City with the purchase of goods and services. But the upside to rising interest rates are the higher yields the City will be able to obtain on investments it makes now.

As those one-year notes discussed above start maturing here in 2022, the plan is to start reinvesting the proceeds into higher yielding instruments that all fall under the umbrella of the City's Investment Policy.

Safety is the #1 tenant of public tax dollars? Just this week, some of those maturing one-year 2021 notes were reinvested in U.S. Treasuries, as safe as it gets. The yield-to-maturity of the just-expired one-year note? 0.21%. The yield-to-maturity of the funds re-invested this week?

- $1 million U.S. Treasury Note Mature 08/31/2022 0.75% Yield
- $1 million U.S. Treasury Note Mature 11/30/2022 0.95% Yield
- $1 million U.S. Treasury Note Mature 02/28/2023 1.14% Yield

The "layered" maturities of six-months, nine-months and one-year is intentional. In a rising interest rate environment, which is currently the situation, it's not the best strategy to keep funds tied up for very long periods of time.

The goal of this layered strategy is to reinvest funds at steadily increasing interest rates. It doesn't always work out exactly as planned, but with the announced upcoming start to the Fed increasing interest rates and the increase in them already out in the marketplace, it's at least a short-term trend that is likely to continue for a still-to-be-determined period of time.

Finally, as Independence attempts to take advantage of rising interest rates on the investment side of the equation, the decision in late 2020 to convert the City's short-term debt that was subject to a high degree of interest rate risk because of this rising interest rate environment, into fixed-rate, long-term debt, is looking better and better every day.

In a rising interest rate environment, the ideal is to have investments in short-term instruments to take advantage of those increasing yields, while having debt owed locked in at a low interest rate. At least here in the short-run, Independence is achieving exactly that!