

To: Benjamin I. Myers, City Manager

From: Melissa R. Marsh, Deputy City Manager - Administrative Services

Date: January 25, 2016

RE: Investment Report 2nd Quarter of Fiscal Year 2016

A summary of the investments for the City of Madison Heights as of December 31, 2015 is included in this memo. The requirements of the City of Madison Heights Investment Policy and P.A. 20 of 1943, as amended, govern the investments held by the City.

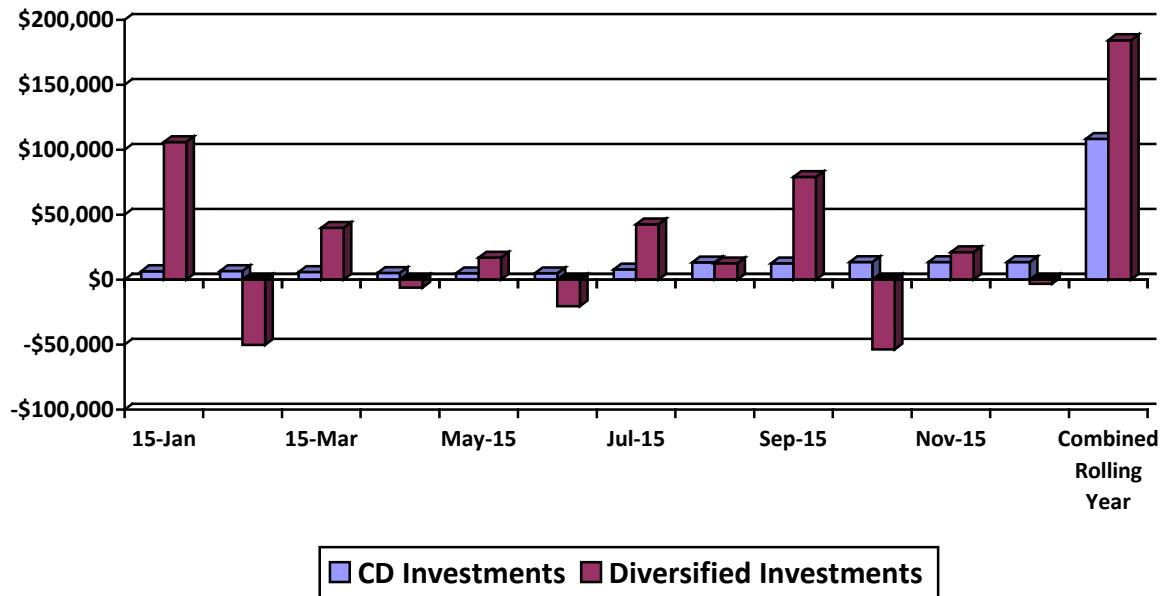
Interest Rate Overview:

Current oil prices, a potential rate hike by the Federal Reserve, and economic growth prospects in China have dominated the attention in the market through December 2015. As a result, the S&P 500 equity market index in December experienced one of the most volatile months this year. U.S. stock prices nevertheless moved lower in December after starting the quarter strongly. Prices on the 10-year U.S. Treasuries fell during the quarter, pushing yields up past 2.25 percent and the Fed raised rates for the first time in nearly a decade. It is important to note that these conditions may cause a reduction in the market yield of our bonds but will not result in a loss of original principal.

Locally we continue to diversify investments instead of moving to vehicles such as 100% Certificates of Deposit. This is due to the long term nature of our fixed rate investments and the higher rate of return we will realize by holding these fixed rate vehicles such as bonds and treasuries until either the call date or maturity. As explained in previous reports, in any given quarter, the method of marking investments to market value (which refers to accounting for the fair value of an asset or liability based on its current market price) may result in loss; however, holding bonds until maturity would result in the total return of investment. I have included a chart below that compares our current returns with what our returns would be if we were invested 100% in Certificates of Deposit at the rate of 0.56% for 12 month investment during the October - December period (the average rate of return for CDs). Investing completely in CDs for the fiscal year to date would have yielded approximately \$78,000 in investment earnings; instead we earned \$128,658 through December by following our diversified investment plan.

The chart on the next pages shows the differential between investments 100% in certificates of deposit vs. the City's diversified investment strategy:

Investment Earnings



Risk:

Interest rate risk is the risk that interest rates will change and adversely affect the fair value of the investment of the government's cash flows. The City attempts to limit exposure to a possible decline in fair market value by diversifying maturity dates.

Credit risk is the risk that the investment will not fulfill its promise to pay the investor when required. There is a credit risk associated with all financial institutions, brokers and investment vehicles. The City attempts to limit exposure to credit risk by diversifying the holders of investments, maintaining a high credit rating for investments, and restricting Certificates of Deposit investments to those with financial institutions that are members of the Federal Deposit Insurance Corporation (FDIC).

Concentration of risk occurs when the municipality is heavily invested in one issuer. The city's largest issuer is the Local Government Investment Pool managed by Oakland County. This pool is diversified with other County investments.

Quarter Investments:

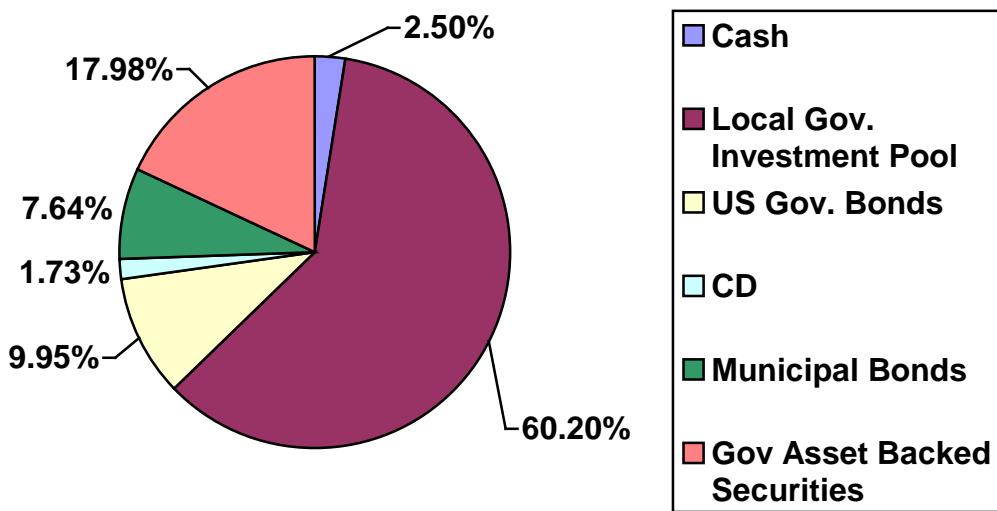
As of December 31, 2015, the City has the following Cash and Investment balances (combination of all funds, excluding pension and health care savings funds).

Total amount in the cash accounts	\$ 482,123
Total amount in Investments	<u>28,843,183</u>
	\$29,325,306

The chart below details the diversification of the City investments as of December 31, 2015.

Diversification – Second Quarter of Fiscal Year 2016

Last Day of the Quarter



In accordance with the City's investment policy, the City limits its exposure to possible decline in fair market value by maintaining diversification and controlling maturity dates. The table below details the amounts at December 30, 2015. There is a difference between the coupon rate (i.e. yield at issue date) and the estimated quarterly annual yield. When a bond is issued, it has a coupon rate until it matures. This rate is related to the current interest rates. When a bond is sold or called before maturity, the value of the bond, not the coupon, will be affected by the current market interest rates. If current interest rates are higher than the coupon, the bond will sell below its face value. When interest rates are lower, they are sold at a premium or higher than face value. A bond's estimated annual yield is related to the current prevailing interest rates. A bond's yield is its annual interest (coupon) divided by its current market price.

Investment Listing, by Security Type

Description	Amount	Adjusted Cost	Market Value	Unrealized Gain (Loss)	Accrued Interest	Estimated Annual Income	% of Total Portfolio	12/31/15 Annual Yield to Maturity	12/31/14 Annual Yield to Maturity
Fixed Income Assets									
Government Bonds	\$2,925,000	\$ 2,925,000	\$ 2,919,037	\$ (5,963)	\$ 8,233	\$ 42,625	10.0%	1.67%	1.25%
Securities	5,339,235	5,339,235	5,271,758	(67,477)	16,653	156,364	18.0%	2.97%	3.64%
Municipal Bonds	2,190,000	2,245,106	2,236,372	(8,734)	11,355	61,174	7.6%	3.05%	2.20%
Certificates of Deposit	506,986	506,986	506,986	-	638.50	2,535	1.7%	0.50%	0.50%
Local Government Investment Pool/Money Market									
	17,654,691	17,654,691	17,654,691	-	-	75,607	60.2%	0.43%	1.25%
Total Investments									
			\$28,588,844				100.0%		

Cash and Investments by Fund

Fund	Amount at 12/31/14	Amount at 12/31/15
General Fund	\$13,100,684	\$15,156,382
Major Road	224,451	(454,971)
Local Road	3,712,411	2,756,752
Downtown Development Authority	30,253	36,958
Drug Forfeiture	151,972	113,270
Community Development Block Grant	(7,403)	(16,425)
Special Assessment	1,241,539	1,230,784
Fire Station Bond	403,088	404,776
Water and Sewer	8,863,723	9,870,068
Escrow	308,882	227,712
Total Cash and Investments	\$28,029,600	\$29,325,306

* Amounts of cash/investments by fund are prior to year end closing and subject to change with necessary month-end adjustments.