

To: Benjamin I. Myers, City Manager

From: Melissa R. Marsh, Deputy City Manager

Date: January 17, 2018

RE: Investment Report for the 2nd Quarter of Fiscal Year 2018

A summary of the investments for the City of Madison Heights as of December 31, 2017 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.

Investment Overview:

The December Federal Open Market Committee (FOMC) meeting minutes, when the Federal Reserve (FED) increased the interest rate .25 of a percent, were acknowledged as a bit on the “hawkish side”. Most of the Fed officials supported the gradual increase in borrowing costs and have stuck to their estimate of three rate hikes in 2018 on the grounds of strong job creation and a record low unemployment level. However, weak inflation could serve as the primary barrier for the pace of rate hikes. The Fed also debated the impact of the \$1.5 trillion tax bill signed in by President Trump noting the “fiscal stimulus” as one of the primary risks, which may overheat the economy and warrant faster rate hikes than currently planned.

Important to the City’s investment return are fixed income investments where longer term yields are staying mostly flat with intermediate term investments rising modestly. For example, the U.S. Treasury Yield curve followed the trend in 2017 and flattened during the month of December. Yields have increased along the three-month and two-year terms increasing between .09 and .13 of a percent.

Locally, we are staying the course with diversification of investments and balancing maturity dates with cash flow needs. 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.

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 on the following page details the amounts at December 31, 2017. 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	12/31/2016 Annual Yield to Maturity	12/31/2017 Annual Yield to Maturity
Fixed Income Assets									
Government Bonds	2,922,388	\$ 2,919,816	\$ 3,152,860	\$ 233,043	\$ 14,798	\$ 51,141	10.6%	1.26%	1.76%
Securities	4,780,429	4,051,992	3,961,373	(90,619)	8,407	106,889	14.5%	3.92%	4.27%
Municipal Bonds	2,535,000	2,600,696	2,532,816	(67,879)	17,960	96,016	9.2%	2.16%	2.73%
Certificates of Deposit	1,248,000	1,248,000	1,245,539	(2,461)	6,809	16,300	4.6%	1.63%	1.64%
Local Government Investment Pool/Money Market									
	16,761,649	16,761,649	16,761,649	(0)	17,875	183,708	61.2%	0.66%	1.15%
				\$ 27,654,236				100.0%	
Cash and Equivalents									
				311,807					
				\$ 27,966,043					

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.

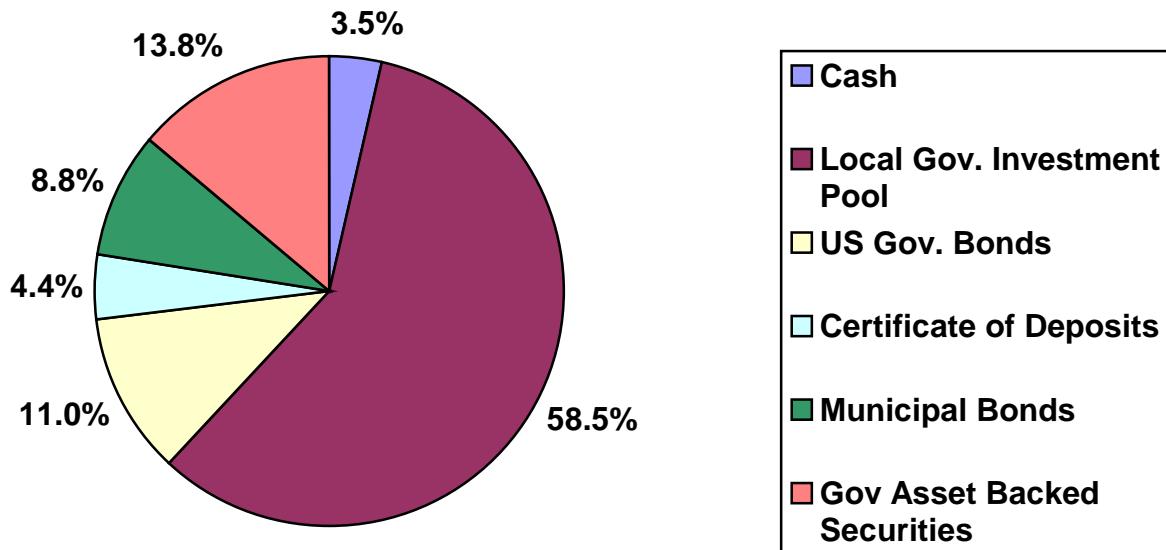
Quarter Investments:

As of December 31, 2017, 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	\$ 703,775
Total amount in Investments	<u>27,966,043</u>
	\$28,669,818

The chart on the following page details the diversification of the City investments as of December 31, 2017.

Diversification – Second Quarter of Fiscal Year 2018
Last Day of the Quarter



Cash and Investments by Fund

Fund	Amount at 12/31/2016	Amount at 12/31/2017
General Fund	\$15,760,747	\$14,347,882
Major Road	(373,713)	(442,528)
Local Road	2,424,395	2,791,605
Downtown Development Authority	41,310	82,241
Drug Forfeiture	83,834	142,058
Community Development Block Grant	(13,341)	(12,289)
Special Assessment	1,190,667	826,354
Fire Station Bond	391,427	402,968
Water and Sewer	11,512,964	9,578,733
Chapter 20 Drain Debt Service	0.0	780,646
Escrow	191,676	172,146.79
Total Cash and Investments	\$31,208,966	\$28,669,818

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