County Treasury

To: Fund Financial Managers

From: Eric Arellano, Deputy CFO

Date: December 1, 2016

Subject: Interest Rate Forecast – FY 2018

This memo provides some background information on the County's investment portfolio and offers the Treasury unit's interest rate forecast for the upcoming fiscal year. It is designed to provide guidance in establishing revenue estimates for interest earnings to County staff who manage dedicated funds. Short term interest rates remain relatively low but have increased steadily since last December. For the second half of fiscal year 2016 the benchmark, three month T-bill had been trading (avg.) at more than 27 basis pts (.27%) up from 8 basis pts (.08%) for the first half of the year. Markets are predicting that the Federal Reserve Board (FRB) will raise the benchmark federal funds rate by a quarter point at the December 13th meeting which has caused T-Bill rates to rise. The three month T-Bill was trading at .48% in November.

The County's average daily balance of cash invested was approximately $496 million as of June 30, 2016. Balances have increased in recent years although interest yields have declined up until fiscal year 2015 as highlighted in the following table:

	% Yield	Earnings	Avg Balance
FY 2009	1.91%	$5,289,259	$305,547,599
FY 2010	.70%	$2,176,608	$311,992,320
FY 2011	.58%	$1,883,850	$326,326,968
FY 2012	.48%	$1,755,927	$361,278,878
FY 2013	.45%	$1,779,308	$392,439,251
FY 2014	.39%	$1,724,869	$438,185,207
FY 2015	.43%	$2,121,725	$496,792,151
FY 2016	.62%	$3,079,016	$495,709,053
FY2017 (Thru Oct)	.80%	$1,034,756	$382,333,964

The investment of public funds is governed by state statute (ORS, Chapter 294). The primary goal of the statutory guidelines is the preservation of principal. For this reason, the types of investments that public agencies can make are generally limited to instruments of the U.S. government and its agencies, highly rated corporate debt, municipal debt, and time certificates of deposit. The Oregon Treasury also manages a Local Government Investment Pool (LGIP) which the County participates in.

The mix of investments in the County's portfolio varies from month to month but follows guidelines described in the Investment Policy which is updated annually. Per the policy, the percentage of the portfolio that can be held in investments authorized by statute is: (***note**: State statue allows up to 35% in Corporate Debt, County is more restrictive on Corporate Debt*)

Type	% Allowable
U.S. Treasury Issues	Up to 100%
U.S. Agencies	Up to 100% and 25% per issuer
Municipal Debt	Up to 10% and 5% per issuer
Savings Accounts	Up to 50% and 25% per institution
Certificates of Deposit	Up to 20% and 10% per institution
Banker's Acceptances	Up to 10% and 5% per issuer
Corporate Debt	Up to 25% and 5% per issuer
Commercial Paper	Up to 10% and 5% per issuer

The limit in the LGIP is established in statute. It is currently set at approximately $47.4 million and that is the amount the County usually maintains in the pool.

The FRB is expected to raise the Federal Funds Rate by a quarter point in fiscal year 2017. As seen in the recent market activity the FRB policy change will cause short term yields to rise. Given the types of investments the County is allowed to make and the limited duration (under the existing policy investments can be made for no longer than five years but weighted average maturity cannot exceed 1.5 years) it is likely that we will see a moderate increase in yield in the upcoming year. The U.S. Economy has been steadily improving but the strong dollar and weaker economies outside of the U.S. will limit the pace of growth. There remains a lot of market uncertainty with the new presidential administration. US Gross Domestic Product (GDP) grew by 3.2% for Q3 of 2016 up from a 1.4% growth rate in the previous quarter. It was the highest growth rate in two years as consumer spending, exports and investment in structures rose faster than expected. Gross Domestic Product (GDP) is growing at an annual rate of 1.6%. The unemployment rate is down to 4.9%. Nonfarm payroll, jobs added, has averaged 176,000 over the last three months. Hourly earnings are up 2.8% over the year.

Other parts of the portfolio earn higher yields. The LGIP, for example, is currently yielding an annualized rate of 1.030 percent. Treasury continues to look for ways of maximizing investment earnings but always with the primary goal of preserving principal in mind. The County manages its investment portfolio in two separate funds, core fund and liquidity fund. The core is operating cash balances which exceed current year liquidity needs. Core funds are invested longer than one year on the yield curve to diversify the maturity structure. The liquidity fund is invested shorter term and targets to meet current year liabilities with an established contingency.

The Treasury forecast takes a cautious approach and recommends that departments use an **annualized average rate of 85 basis points (.85%)** in estimating interest earnings. Interest rates will rise slightly in FY 2018 but there is a lot of unknown at the federal level with the new executive administration. Treasury produces a monthly investment report that is posted to the Finance & Risk Management commons site monthly. Should you have any questions regarding the County's Investment Policy, portfolio, or this forecast please contact me at x86718.