



ESTABLISHED 1889

OFFICE OF THE TREASURER-TAX COLLECTOR

September 26, 1994

Board of Supervisors
10 Civic Center Plaza
Santa Ana, CA 92701

SUBJECT: Annual 1993-94 Summary Financial Statement

This is my 22nd annual Financial Statement. Although it is officially sent to your Honorable Board, a great percentage of the 187 different agencies for whom we invest are not under the control of your Honorable Board. We manage funds for 28 cities in Orange County and 6 cities outside of Orange County, 32 school districts, 5 community college districts and 53 special district accounts of which four are outside of Orange County. There are 31 different agencies that are governed by your Honorable Board of which the largest revenues for investments are from the County General Fund, the John Wayne Airport, Environmental Management Agency and the Integrated Waste Management Department. There are also very large sums of money that are sent to us by the municipal and superior court systems throughout Orange County for investment until needed.

HIGHLIGHTS OF THE SUMMARY FINANCIAL STATEMENT: We earned an average yield for the fiscal year of 7.74% based upon an average monthly investable balance of \$7.177 billion, a \$2.480 billion increase average over the previous fiscal year. Our average yield for the fiscal year of 7.74% can be favorably compared to the U.S. Treasury 30-year maturity bond average yield of 6.65% for the same fiscal year period. The 2-year U.S. Treasury Note, which compares to our 2.5 years average maturity, yielded for the same fiscal year 5.03%. The 5-year maturity U.S. Treasury yielded an average 5.96% for the same 1993-94 fiscal year. The State of California Treasury with an average monthly balance of \$25.449 billion had an average yield of 4.39%. In comparing these interest yields, it should be stated that the State investment pool average monthly maturity for the fiscal year was 392 days (one year, one month); whereas, the Orange County Treasury average monthly maturity was 834 days (two years, five months). The Orange County Treasury has participants that tend to leave their monies longer invested than with the State. The State operates like a mutual fund, where large sums of funds go in and out daily; whereas the County Treasury is able to manage its cash flows more effectively and invest longer out on the yield curve. The following indicates the consistency we have earned in yearly yields. From January '91 thru June '94 (42 months) our average yield was 8.64%. In the last six fiscal years from 1988-89 thru 1993-94, our average yield was 8.65%. In the previous 10 fiscal years, our average yield was 8.90%.

ROBERT L. "BOB" CITRON
COUNTY TREASURER-TAX COLLECTOR

ADMINISTRATION
HALL OF FINANCE & RECORDS
RM. G76, 12 CIVIC CENTER PLAZA
P.O. BOX 4515
SANTA ANA, CALIFORNIA 92702

(714) 834-2911
FAX: (714) 834-2912

The total interest earnings received and paid out from investments was an all time high of \$665,868,000. The total interest earnings are prorated amongst our governmental clients based upon the average daily balance that they have on deposit in the County Treasury. Our investors are charged an investment fee which is approximately 7/100% (7 basis points). This fee covers the cost of providing investment services. This investment fee is less than investors would pay to professional management companies, who often charge as much as 90 basis points. For example, during the past year, a \$10 million investment in our treasury pool would have earned \$774,000 of interest income and would have been charged \$7,000 for investment management services. The same \$10 million would have been charged as much as \$90,000 in management fees by a private investment manager or mutual fund.

The actual net amounts of receipts that we received was \$9,768,171,000. This is accounted for as follows:

	<u>AMOUNT</u>	<u>% OF TOTAL</u>
TAX COLLECTIONS	\$2,121,850,000	21.725%
SHORT TERM LOANS	935,184,000	9.574%
BONDS (NOTES)	44,580,000	.456%
STATE SUBVENTIONS	1,861,387,000	19.056%
INTEREST RECEIVED	665,868,000	6.816%
OTHER (Court Fines/Fees, Recorder Fees, Licenses & Permits, etc.)	<u>4,139,302,000</u>	<u>42.373%</u>
TOTAL	\$9,768,171,000	100.00%

The total receipts (cash flow) from all sources including the rollover or reinvestment of securities was \$300.894 billion, an increase of \$70.669 billion over the previous fiscal year.

We continue to use Reverse Repurchase Agreements as part of our investment strategy. In the fiscal year just ended, we earned an additional \$251,334,000 through Reverse Repurchase Agreements which is the equivalent of adding a 2% yield to our portfolio.

During the past year, concerns have been raised about investment funds taking "paper" losses which represent the difference between the original cost of securities and the current market value of those securities. In periods of rising interest rates, securities purchased one year ago are worth less today than when they were originally purchased. The losses are called "paper" losses because they are based upon accounting adjustments in which investment portfolios are adjusted to reflect current market values. An actual gain or loss would only be incurred if the investor sells the security prior to its maturity date.

Some investment funds regulated by the Securities and Exchange Commission (SEC) are required to periodically adjust the cost of their portfolios to reflect current market values which may result in a paper gain or loss. Governmental accounting standards do not require municipal investment pools to make this periodic adjustment. Therefore, we are not required to record "paper" gains or losses.

An actual investment gain or loss would only occur if we were to sell a security before its scheduled maturity date. Under our reverse repurchase investment strategy, we hold nearly all of our securities until maturity and rarely have recorded actual gains or losses.

THE FUTURE: In June 1993 we made our annual estimate for budgetary purposes that we would earn a 7.50% return on investments. We earned overall for our investors 7.74%. Although past results are not always an indicator of future investment returns, we believe our portfolio will continue to perform well. At this writing, there is a controversy on the direction of interest rates. The Federal Reserve System has tightened or increased interest rates by 1.75% since last February. It is generally believed that they will increase interest rates another .25% or more after the November elections. There are many others who believe that the Federal Reserve will increase rates not only before the November elections but will increase them overall by 1% on the high side by next year. The many economic figures that are issued by the Federal government monthly sometimes show large percentage increases over what they were the previous year. But, at this writing, the figures that have come out in September in the main hardly show any increases (some down) over the figures issued in July and August. Although we have modest growth, we are beginning to see figures that may indicate that the economy may be slowing down; and I believe we will not continue to see this allegedly fast growth over what it was a year ago. Some economists believe that approximately a year from now that when these monthly economic statistics are issued by the Federal government that they will be compared to those same economic category figures issued in the third and fourth quarters of 1994 and will only show small increases in comparison to the large year-to-year increases now. The great majority of economic soothsayers have not seen the prospect of runaway inflation that, in fact, inflationary pressures have been under control. Large and medium range corporations are still restructuring. First Interstate Bank is going to downsize by 3,000 employees. Hughes Aircraft is going to lay off approximately 4,500 employees. Northrup Aircraft will downsize 9,000 nationwide. American Airlines will reduce their payroll by 3,000. You read, it seems like every week, that some large employer, not confined only to the West Coast, is still consolidating and laying off people. The national economy has seemed to be able to absorb these people as the monthly unemployment figures indicate. But wage settlements have been modest; certainly not at all inflationary. A large percentage of those that were laid off have found new positions at lower salaries than they were making in their previous positions. Although it is necessary to go back historically to indicate what occurred in business expansions that occurred after recessions, this recovery has been different. We do not have the large inflationary wage increases, run away building, both in homes, commercial, and those tall glass office buildings. Though office building vacancy rates are coming down, they are still high enough that few, if any, tall office buildings are being built. A further major difference with this recovery over previous ones is that governmental entities are not making those large capital expenditures that helped fuel the economy nationwide in previous expansions. All government entities are scrimping to find funds so as they will not have to lay off governmental employees or discontinue necessary services. They are even having tax override elections to adequately fund their public safety departments. In

the main, they are not making capital improvements to any extent than what occurred in the '70's and '80's. Historically, previous expansions lasted four years, the exception was the Reagan expansion of eight years. The current expansion is in its second year going into its third year.

The bellwether Federal Funds (Fed Funds) Rate, which the Federal Reserve system uses to reduce or increase interest rates is currently at 4.75%. I believe that at their November 15, 1994 meeting the Federal Open Market Committee (FOMC) governors will vote to raise the Fed Funds Rate to not above 5.25%. I believe that the 30 year maturity U.S. Treasury bond which, at this writing, is yielding 7.75% to 7.80% could be as high as 8.00% at the end of the year, but will come down from that level in the first and second quarter of 1995 and trade in the 7.50% to 7.75% range. The five year U.S. Treasury Note, whose yield is now considered at the middle of the interest yield curve is yielding, at this writing, between 7.15% and 7.20% and could go to 7.30% but is not sustainable above this rate. I believe that contrary to many economists predictions, the Fed Funds Rate will not go above 5.25% this year. In fact, this rate could remain in place for some time. The 3.00% Fed Funds Rate that began to rise last February to its present 4.75% was at 3.00% for 17 months, although it stayed at 3.00% for different economic reasons than are now in place. On September 24, 1994 the National Association of Manufactures declaring that their businesses are prospering and their hiring is up, urged the Federal Reserve System not to raise interest rates again this year. They said higher rates would endanger their and the nation's prosperity. The low mortgage interest rates of 1993 that fueled home buying have risen 2.00% to a point that could put a damper on home sales in comparison to what was occurring in 1993. Certainly the billions of dollars of home refinancing has ended. I do not wish to be accused of being a cassandra regarding the economy. I do believe that we have positive moderate growth. We do not see inflation to the degree that supports present day interest rates. When Allen Greenspan, Chairman of the FOMC announced the first tightening of interest rates by raising the Fed Funds Rate a quarter of a percent from 3.00% to 3.25%, he said this was a "preemptive strike" against inflation; that the Federal Reserve was going to make sure that there wasn't any inflation in the future. The "market" reacted by raising interest yields to much more than the quarter of a percent increase. The market continued to overreact to the next three interest rate rises when the Fed Funds Rate reached 4.25%. The market rallied when the Fed Funds Rate was raised 50 basis points to its present 4.75%, but interest rates have since risen from those levels, on perception on what future economic numbers will be and what the Federal Reserve will do.

The predictions of economists were defined by George Bernard Shaw who said, "If you take all of the world's economists and laid them end to end, they still could not come to a conclusion." I also like the definition of an economist of when you forget your telephone number, that when you ask an economist to remember it for you, he will estimate it!


I do not at all in any way, pretend to be a professional economist. The rather successful high interest yields we have obtained in previous years (as stated here previously) would indicate that we have been able to interpret current and future markets to our advantage. Like economists, we

September 26, 1994

are not always right. (Do you remember Henry Kaufman?) In last year's Financial Statement, I said we would have the maintenance of low interest rates, that high interest rates were not sustainable. I and many others did not foresee the Federal Reserve taking their "preemptive strike." There was not then, and there is not now, inflationary factors that would require the Federal Reserve to tighten credit by 1.75%, as stated previously by many economists. Former President Harry Truman once defined that a successful leader or business head made the correct decisions 80% of the time. I believe I and the great majority of those reading this report fall into this category. Where we may differ is that I realize that my decisions could be wrong as much as 20% of the time. This probability of error keeps me diligent to see that any miscalculations of economic conditions do not have an overly negative effect on our investors. We have constructed a well-balanced portfolio that we believe can withstand the impact of current interest rates. I believe that the many years of consistent positive results of our investment strategy indicates that our decisions have been correct much more than 80% of the time!

The Treasury also has performed other services to the County and its constituent agencies. We have been responsible for managing the County's short term debt issuance program, and have provided information and assistance in some long term debt issuances. While we do not provide these services for all participants in the investment pool, we have provided assistance to the school districts in Orange County who issue short term debt obligations.

To be able over the years to assist all the agencies for whom we invest by providing respectable returns on their investment dollars is very gratifying. We are proud to know that in some way we have assisted local governments in maintaining their level and quality of service. Investment earnings allow educational districts to continue to provide necessary programs to students, and has allowed cities and the County to better manage the decreasing financial support from the State. To be able to have such a beneficial impact on the citizens of Orange County is extremely satisfying to me, and more importantly to my remarkably professional Treasury staff.



Robert L. Citron
Treasurer-Tax Collector

RLC:jg

Attachment

cc: School Business Directors
City Treasurers/Finance Directors
Special District Treasurers
and Finance Directors

ORANGE COUNTY TREASURER-TAX COLLECTOR

ACCOUNTABILITY INDICATED DATES (000s OMITTED)

	FISCAL YEARS ENDED		
	JUNE 30	JUNE 30	JUNE 30
	1994	1993	1992
CASH AND BANK ACCOUNTS	535,768	376,681	179,546
COMMINGLED FUNDS INVESTED	5,127,141	4,177,531	3,476,015
SPECIFIC FUNDS INVESTED	1,820,581	924,055	136,201
TREASURER'S TOTAL ACCOUNTABILITY	7,483,490	5,478,267	3,791,762

CASH ACTIVITY INDICATED DATES (000s OMITTED)

	FISCAL YEARS ENDED		
	JUNE 30	JUNE 30	JUNE 30
	1994	1993	1992
BEGINNING OF YEAR CHECKING ACCOUNTS AND CASH	38,181	60,984	39,933
TOTAL RECEIPTS-FISCAL YEAR	300,855,990	230,163,584	172,114,104
SUBTOTAL	300,894,171	230,224,568	172,154,037
TOTAL DISBURSEMENTS-FISCAL YEAR	(300,843,403)	(230,186,887)	(172,093,053)
END OF YEAR CHECKING ACCOUNTS AND CASH	250,768	38,181	60,984