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City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 10, 2002

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: PHILIP SUNDERLAND, CITY MANAGER PS

SUBJECT: BUDGET MEMO # 20 : INTEREST EARNINGS ON CITY'S SHORT-TERM INVESTMENT PORTFOLIO

During the March 20, 2002, City Council Budget Work Session, Councilman Euille requested an explanation of the City's investment policy, together with the interest revenues earned on the City's short-term investment portfolio for the past ten years. The short-term investment portfolio discussed in this memorandum represents the investment portfolio of pooled cash from the City's various operating funds, as well as the non-bond cash from the City's capital funds. It excludes pension fund investments.

In December 1988, the Finance Department issued the City's investment policy to identify investment objectives, define risk tolerance, assign responsibility, and establish control over the investment process (Attachment I). The policy has been updated since then. It requires that all City funds be managed and invested with the highest public trust, with safety of principal, liquidity, diversification and yield (listed in order of priority) being the primary objectives. All investment transactions and procedures provide maximum security of principal, and conform to all applicable state statutes governing public fund investment. These state statutes conservatively limit state and local governments' short-term investment options.

The policy also requires that the "prudent person" standard be applied to the investment of the City's overall portfolio. The standard states:

> "Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the expected income to be derived."

The City's investment policy limits investments to the instruments described below. The investments are chosen in a manner that promotes diversity of issuer and maturity. The choice of high-grade government instruments is designed to ensure the marketability of those investments should liquidity needs arise.

a. Obligations of the United States Government, and its agencies and instrumentalities, not to exceed three years to stated maturity. Examples of active issuers of instrumentality debt securities are Federal Home Loan Mortgage Corporation (Freddie Mac or FHLMC), the Federal National Mortgage Association (Fannie Mae or FNMA), or the Federal Home Loan Bank (FHLB).

b. Repurchase Agreements, collateralized by U.S. Treasuries, not to exceed 180 days to stated maturity. An executed Public Securities Association (PSA) Master Repurchase Agreement must be on file with the City of Alexandria and the counter party bank or primary dealer. A Repurchase Agreement (Repo) is a simultaneous transaction whereby an investor purchases securities (collateral) from a bank or dealer for cash, and the bank or dealer contractually agrees to repurchase the collateral security at the same price (plus interest) at a mutually agreed-upon future date. When the repurchase agreement is executed, the parties agree to a specified interest rate.

c. Prime Quality Commercial Paper, with a maturity of 270 days or less, of issuing corporations organized under the laws of the United States, or any state thereof, including paper issued by banks and bank holding companies. Commercial paper is a short-term, unsecured promissory note issued for a specified dollar amount with a fixed maturity not to exceed 270 days. Commercial paper is issued by a wide variety of domestic firms, including finance companies, banks, utilities and industrial firms, and may be backed by a bank line of credit.

Although authorized by the investment policy, the City has currently temporarily suspended investment in commercial paper. As stated at the budget work session, the City's Investment Committee (comprised of the Assistant City Manager for Fiscal and Financial Affairs, the Finance Director and City Treasurer) felt this was prudent in light of commercial paper defaults by Southern California Edison and Pacific Gas & Electric during the California energy crisis, and recent concerns with the debt limits of a major issuer of commercial paper (General Electric). Some of these market concerns are detailed in a March 28 article from the Wall Street Journal (Attachment 3).

For additional security, all investment transactions, including collateral for repurchase agreements, entered into on behalf of the City of Alexandria, are conducted on a delivery versus payment basis. This practice ensures that no funds are at risk, as City funds are not released until the securities are delivered. The City has safekeeping arrangements with third-party custodians, who are independent from the investment transaction. Once purchased on the City's behalf, obligations of the U.S. Government and its agencies/instrumentalities are held on behalf of the

City in SunTrust Bank's trust account at the Atlanta Federal Reserve Bank, while collateral for repurchase agreements is held in the City's name at Chase Manhattan Bank.

To ensure sufficient liquid assets to meet operating expenses, the City prepares and closely monitors cash forecasts, as well as diversifies the maturity of securities in its investment portfolio. The City does not make direct investment decisions but employs a professional money management firm (Fiduciary Trust Company International) to run its portfolio on a day-to-day basis. For daily cash needs, approximately $15 million is invested in securities that mature within one to three days. No more than $30 million is invested in securities with more than 30 months to maturity, and no money is invested in securities with more than 36 months to maturity. The City's short-term investment portfolio fluctuates in size throughout the year, with the smallest balances occurring just prior to the real estate tax due dates, and the largest balances occurring just after the due dates. While the goal is to maintain an average weighted maturity between six months and one year, the current average weighted maturity is closer to six months in anticipation of a rise in short-term interest rates.

Throughout the year, the Finance Department compares the performance of the City's portfolio against benchmarks such as the Federal Funds Rate or the three-month Treasury Bill. Although a market rate of return is secondary to safety and liquidity requirements, the City's short-term investment portfolio has exceeded the average annual 3-month Treasury Bill rate for each of the past ten years. Attached is a chart that shows the ten-year history of the City's average portfolio, average rate of return, and the interest earned (Attachment 2). Over the period from FY 1992 to FY 2001, the City earned $49.1 million on the investment of its portfolio. This chart also compares the City's average annual rate of return with the average annual 3-month Treasury Bill rate.

ATTACHMENTS:

Attachment 1: City of Alexandria Short-Term Investment Policy
Attachment 2: City of Alexandria Short-Term Investment Portfolio Performance For the Past Ten Years
Attachment 3: Cash Drought: A Dwindling Supply of Short-Term Credit Plagues Corporations The Wall Street Journal, March 28, 2002

STAFF:

D.A. Neckel, Director of Finance
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FINANCE DEPARTMENT
POLICIES & PROCEDURES MANUAL

Chapter/Section: 3-1
Effective Date: 12-88
Revised: 6-21-99

POLICY

Investment

1. Policy Statement

It is the policy of the City of Alexandria that the administration of its funds and the investment of those funds shall be handled as its highest public trust. Investments shall be made in a manner that will provide the maximum security of principal invested and conform to all applicable state statutes governing the investment of public funds. The portfolio shall consist of U. S. Treasuries, Agencies, commercial paper, and repurchase agreements; with an average maturity of one year, while remaining liquid to meet the daily cash flow needs of the City. The receipt of a market rate of return will be secondary to safety and liquidity requirements.

2. Scope

This investment policy applies to all the financial assets and funds, excluding pension funds, held by the City of Alexandria. The City commingles its funds into one pooled investment fund for efficiency and maximum investment opportunity. These funds are defined in the City of Alexandria's Comprehensive Annual Financial Report (CAFR) and include:

General Fund
Special Revenue Fund
Capital Project Fund
Enterprise Fund
Internal Service Fund

The City will commingle any new funds unless specifically exempted by the City Council and this policy.

3. Objective and Strategy

It is the policy of the City of Alexandria that all funds shall be managed and invested with four primary objectives, listed in order of their priority: safety, liquidity, diversification, and yield.

Safety of Principal. Safety of principal is the foremost objective of the City of Alexandria. Investments of the City shall be undertaken in a manner that seeks to insure the preservation of capital in the overall portfolio.

Liquidity. The City of Alexandria's investment portfolio will remain sufficiently liquid to enable it to meet all operating requirements that might be reasonably anticipated.

Diversification. The portfolio will be diversified by maturity and issuer, and will include the use of a number of brokers/dealers. Competitive bidding will be used on each sale and purchase.

Yield. The City of Alexandria's investment portfolio shall be structured with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the City's risk constraints and the cash flow of the portfolio. "Market rate of return" may be defined as the average yield of the current one-year U. S. Treasury Bill.

4. Legal Limits, Responsibilities, and Authority

Specific parameters for the investment of public funds in Virginia are found in Sections 2.1-327 and 2.1-328 of the Code of Virginia.

5. Delegation of Investment Authority

The Director of Financial and Information Services, the Director of Finance, and the Treasury Division Chief are designated as the Investment Committee of the City of Alexandria and are responsible for investment management decisions and activities. The Investment Committee may delegate the daily investment activities to an external cash manager procured through the competitive bidding process. The Investment Committee is responsible for considering the quality and capability of the City's staff and external cash managers involved with investment management and procedures. All participants in the investment process shall seek to act responsibly as custodians of the public trust.

The external cash manager shall develop and maintain written administrative procedures specific to the City of Alexandria's investment program, which are consistent with this investment policy. These procedures will include PSA Master Repurchase Agreements, master custodial agreements, wire transfer agreements, banking services contracts, internal controls, authorized investments, authorized dealers, diversity and maturity limitations, safekeeping and collateralization, delivery versus payment, and other investment-related activities. The written procedures will be approved initially, and reviewed annually, by the Investment Committee and the City's independent auditors.

The external cash manager shall be responsible for all transactions undertaken and shall establish controls to regulate the activities of subordinate officers and staff. The external cash manager shall designate a liaison/deputy in the event circumstances require timely action when the external cash manager is not available.

No officer or designee may engage in any investment transaction except as provided under the terms of this policy and the external cash manager's written procedures, once they are approved by the Investment Committee.

6. Prudence

The "prudent person" standard shall be applied with respect to investment of the City's overall portfolio. The standard states:

"Investments shall be made with judgement and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the expected income to be derived."

Limitation of personal liability. The Investment Committee, and those delegated with investment authority under this policy, when acting in accordance with the written procedures and this policy, and in accordance with the Prudent Person Rule, shall be relieved of personal responsibility and liability in the management of the portfolio.

7. Internal Controls

The external cash manager shall establish written internal controls that will be reviewed annually by the Investment Committee and by the City of Alexandria's independent auditors. The controls shall be designed to prevent loss of public funds due to fraud, employee error, misrepresentation by third parties, unanticipated market changes, or imprudent actions by employees of the City of Alexandria or of the external cash manager.

Cash-flow Forecasting. Cash-flow forecasting is designed to ensure adequate liquid funds to meet the City of Alexandria's cash-flow requirements. Supplemental to the financial and budgetary systems, the Investment Committee and the external cash manager will maintain a cash-flow forecasting process designed to monitor and forecast cash positions for investment purposes.

8. Authorized Investments

Under this policy, investments shall be limited to the instruments listed below. The investments are to be chosen in a manner that promotes diversity of issuer and maturity. The choice of high-grade government instruments is designed to ensure the marketability of those investments should liquidity needs arise.

a. Obligations of the United States Government, its agencies and instrumentalities, and government sponsored enterprises, not to exceed three years to stated maturity.

b. Repurchase agreements, collateralized by U. S. Treasuries, not to exceed 180 days to stated maturity. An executed PSA Master Repurchase Agreement must be on file with the City of Alexandria and the counterparty bank or primary dealer.

c. "Prime Quality" commercial paper, with a maturity of 270 days or less, of issuing corporations organized under the laws of the United States, or of any state thereof including paper issued by banks and bank holding companies. "Prime Quality" shall be as rated by at least two of the following: Moody's Investor Services, Inc., within its NCO/Moody's rating of prime 1, by Standard & Poor's, Inc., within its rating of A-1, by Fitch Investor's Services, Inc., within its rating of F-1, or by Duff and Phelps, Inc., within its rating of D-1, or by their corporate successors, provided that at the time of any such investment: 1. The issuing corporation, or its guarantor, has a net worth of at least fifty million dollars; and 2. The net income of the issuing corporation, or its guarantor, has averaged three million dollars per year for the previous five years; and 3. All existing senior bonded indebtedness of the issuer, or its guarantor, is rated "A" or better or the equivalent rating by at least two of the following: Moody's Investors Service, Inc., Standard & Poor's, Inc., Fitch Investor's Services, Inc., or Duff and Phelps, Inc.

Competitive Bidding Requirement. Securities will only be purchased or sold after (3) offers/bids are taken to verify that the City of Alexandria is receiving fair market value/price for the investment. Records will be maintained of the bids offered, the bids accepted, and the justification for each investment decision. Only securities whose prices are published in the Wall Street Journal are eligible for investment.

Delivery Versus Payment. All security transactions, including collateral for repurchase agreements, entered into by, or on behalf of, the City of Alexandria, shall be conducted on a delivery versus payment (DVP) basis. Receipts for the confirmation of trades of authorized securities must be received by the external cash manager and Treasury Division Chief within three business days of the trade. The confirmation will include the trade date, par value, maturity, interest rate, price, yield, settlement date, description of securities purchased, issuer's name, amount due, and third-party custodial information.

9. Unauthorized Investments

a. The City will not "sell short," i.e., sell something it does not own in hope of buying it later at a lower price.

b. The City will not buy on margin.

c. The City will not contract for future delivery.

d. The City will not deal in futures or options of any kind.

10. Authorized Financial Dealers and Institutions

The Investment Committee and external cash manager shall maintain a listing of banks, brokers, and dealers which are approved for investment purposes. The following criteria must be met by those firms on the list:

a. Provide an audited financial statement for the most recent period.

b. Proof of certification by the National Association of Securities Dealers.

c. Proof of current registration with the State Securities commission.

d. Completion of the city of Alexandria's broker/dealer questionnaire.

For brokers and dealers of government securities, the external cash manager shall select only primary government securities dealers that report daily to the New York Federal Reserve Bank.

Investment officers shall not conduct business with any securities dealer with whom or through whom public entities have paid excessive prices or have sustained losses on investments through mismanagement by the securities dealer.

Before accepting funds or engaging in investment transactions with the City of Alexandria, the supervising officers at each depository, recognized securities broker/dealer, and the external cash investment management service shall submit certifications that they have reviewed this investment policy and agree to disclose potential conflicts or risks to public funds that might arise out of business transactions between the firm/depository and the City of Alexandria. All depositories and the external cash manager shall agree to undertake all reasonable efforts to preclude imprudent transactions involving City funds.

The supervising officer of the depositories or firms shall agree to exercise due diligence in monitoring the activities of other officers and subordinate staff members engaged in transactions with the City. Employees of any firm or financial institution offering securities or investments to the City of Alexandria shall be trained in the precautions appropriate to public sector investments and shall be required to familiarize themselves with the City's investment objectives, policies and constraints.

As investments are made, the external cash manager shall rotate from the authorized bidder's list for bids/offers. An attempt will be made to alternate to all names on the list.

11. Diversity and Maturity Limitations

It is the policy of the City of Alexandria to diversify its investment portfolio in order to minimize risk or loss from over concentration of assets in a specific maturity or specific issuer. Diversification strategies shall be established and periodically reviewed. At a minimum, diversification standards by security type and issuer shall be:

	Security Type	Maximum Percentage of the Total Funds Available for Investment
a.	U. S. Treasuries and securities with the U. S. Government's guarantee	75%
b.	U. S. Government agencies and instrumentalities	60%
c.	Repurchase agreements, fully collateralized by U. S. Treasuries	40%
d.	Commercial Paper (in total)	35%
e.	Commercial Paper of any one Issuing Corporation	5%

The external cash manager shall diversify maturities, and to the extent possible, match investments with anticipated cash flow requirements. Matching maturities with cash flow dates will reduce the need to sell securities prior to maturity, thus reducing market risk. In addition, the average maturity less than $15 million will be invested in securities with maturities of 14 days or less. No more than $30 million will be invested in securities with more than 30 days. No monies will be invested in securities with more than 36 months to maturity.

12. Safekeeping and Collateralization

All securities must be purchased on a delivery versus payment basis and held in safekeeping in a Joint Custody Pledge Account **of the third-party custodian** in the City of Alexandria's name, at the Federal Reserve Bank of Richmond, with the exception of **commercial paper, which shall be held in a segregated or pledged position in the account of a third-party custodian at the Depository Trust Company (DTC) and** collateral for repurchase agreements, which will be held in the City of Alexandria's name, at an independent third-part custodial bank. The safekeeping bank may not be within the same holding company as the bank from which the securities are pledged. At no time will the City's securities or collateral for repurchase agreements be commingled with those of other investors.

All safekeeping arrangements shall be approved by the Investment Committee and an agreement of the terms executed in writing. The third-party custodian shall issue original safekeeping receipts to the external cash manager, and duplicates to the Treasury Division Chief, listing each specific security, rate, description, maturity, and cusip number. Each safekeeping receipt will clearly state that the security is held for the City of Alexandria or pledged for the City of Alexandria.

Collateralization. The bank must pledge collateral security as specified by Virginia state law. At no time shall the amount on deposit exceed the pay value of securities pledged less maximum insurance coverage provided by the Federal Deposit Insurance Corporation. Acceptable security and specified regulations regarding collateral requirements are outlined in the Virginia Security for Public Deposits Act, set forth by the Commonwealth of Virginia Treasury Board.

To anticipate market changes and provide a level of additional security for all funds, the collateralization level required will be 102 percent of the market value of the principal and accrued interest. U. S. Treasury Notes will be the only acceptable securities for collateral.

13. Performance Evaluation and Reporting

By the fifth of each month, the external cash manager shall submit monthly reports to the Investment Committee containing sufficient information to permit an informed outside reader to evaluate the performance of the investment program. Also, by July 5 each year, the external cash manager shall submit an annual report to the Investment Committee. The reports will summarize investment activity and include, at a minimum, the following information:

Market Sector Breakdown

Par amount by sector
Average yield by sector
Average coupon or rate by sector

Monthly Activity

Beginning par, book and market values
Total maturities
Total sales
Total purchases
Total coupon interest received
Ending par, book and market values

Portfolio Earnings Summary

Interest earnings accrued
Amortization/accretion
Total earnings for the month and fiscal year-to-date

Performance Comparison

Reported yield on the current one-year U. S. Treasury Bill and the current monthly average Federal Funds Rate

D. A. Neckel
Director of Finance

Attachment 2

CITY OF ALEXANDRIA
SHORT-TERM INVESTMENT PORTFOLIO PERFORMANCE
FOR THE PAST TEN YEARS

(Amounts in millions)

FY	Average Daily Investment Portfolio[1]	Average Annual Rate of Return	Average Annual 3-Month Treasury Bill (Benchmark)	Interest Earned[2]
1992	$87.5	5.22%	4.50%	$4,437,030
1993	$92.3	3.75%	3.09%	$3,302,500
1994	$98.1	3.66%	3.41%	$3,542,048
1995	$102.5	5.82%	5.43%	$5,785,024
1996	$101.9	6.10%	5.29%	$5,943,202
1997	$91.3	6.20%	5.19%	$5,330,496
1998	$87.3	5.65%	5.18%	$5,141,079
1999	$79.8	5.27%	4.61%	$3,537,575
2000	$93.2	5.98%	5.40%	$4,745,719
2001	$129.5	5.62%	5.27%	$7,290,238
2002 Estimated	$144.0	3.30%	2.17%	$5,200,000

[1] Average Daily Investment Portfolio includes average cash totals from all operating funds, as well as non-bond proceeds of capital funds. It excludes pension fund investments. The funds primarily represent expected and budgeted operating and capital resources, balance sheet accrued obligations and liabilities (such as purchase order encumbrances), as well as designated and undesignated reserves.

[2] Excludes interest earnings from bond proceeds invested in a state managed, state-wide municipal bond investment pool (SNAP), and interest earnings in Pension Plans.

Cash Drought

A Dwindling Supply Of Short-Term Credit Plagues Corporations

Market in Commercial Paper Is Hurt by Enron Fears, Dealing Economic Blow

Church Ladies of Wall Street

By GREGORY ZUCKERMAN
Staff Reporter of THE WALL STREET JOURNAL

For years, the commercial-paper market has served as the corporate world's automated teller machine, spitting out a seemingly endless supply of cash for businesses at super-low interest rates.

But now, amid financial jitters caused by Enron Corp.'s collapse, that machine is sputtering, sending a surprising number of companies of all sizes scrambling to find money for their most basic needs, from paying salaries to buying office supplies. Some are paying higher interest rates so they can keep selling paper. But others, after getting the cold shoulder from commercial-paper investors, have turned to raising debt by other, costlier, means. These companies include Qwest Communications International Inc., Sprint Corp., Gap Inc. and Computer Associates International Inc.

Tyco's New Costs

Last month, amid investor concerns about accounting at Tyco International Ltd., the conglomerate had to draw on a backup line of credit from its banks to come up with cash it needed. The move to replace cheap commercial paper with the more expensive bank line will cost Tyco about $400 million in additional after-tax, annual borrowing expenses, slicing about five cents per share from first-quarter earnings, which were expected to come in at 80 cents per share.

The commercial-paper "market has always been low-cost, ready capital—it was always there for you," says Brad McGee, a Tyco executive vice president, who says the accounting concerns are overblown. "When a market like this dries up, it puts you in a position of greater risk."

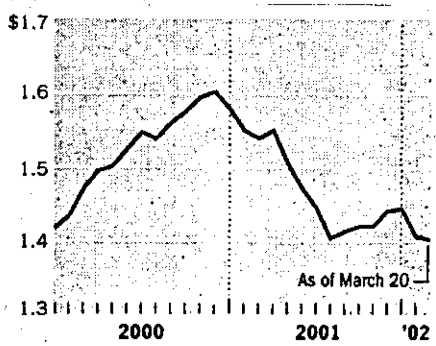
For an economy still in the tentative stages of a turnaround, the problems in the commercial-paper market underscore the profound effect Enron's collapse has had on basic workings of American finance. Increasingly skittish about corporate-accounting practices, the ultra-conservative investors who control the commercial-paper market have cut back on a key source of liquidity. Economists worry that the troubles could help put a lid on capital spending, as companies scramble to save cash—a move that could delay or even reverse the recovery.

"You're making a mistake if you forecast a big pickup in capital spending, because companies feel pressure to repair their balance sheets," says John Lonski, chief economist at Moody's Investors Service.

For the past 40 years, the massive commercial-paper market has been a critical—and almost invisible—lubricant for the economy. Through the commercial-paper

Paper Cuts

The commercial-paper market is shrinking, forcing many companies to find higher-cost financing. U.S. commercial-paper market, in trillions.



Source: Federal Reserve

market, companies issue IOU's for critical short-term financing, lasting for as long as 270 days or as short as one day. The money is used to pay for their most basic, immediate needs, though in recent years it has also covered billion-dollar acquisitions. Commercial paper generally doesn't require any collateral. It is the cheapest source of debt financing, with rates that typically are several percentage points below those of longer-term bonds and loans from banks. That's because it's less risky to lend money for a short period—there's less chance for an unforeseen downturn in business.

The flexibility has always been a major plus. In good times a corporate treasurer can wake up one morning, call up a Wall Street investment bank and get it to sell commercial paper to investors to raise the exact amount the company needs. When the debt turns over, they do it again. Some large companies can even sell the debt directly to commercial-paper investors, which include money-market mutual funds, insurance companies and firms needing to park some extra cash.

Like running water, it's only missed when it stops flowing. The market first began experiencing difficulties about a year ago, as the economy slowed. Enron's collapse fueled more worry—in part because it caused credit-rating agencies to become more hawkish. Stung by criticism that both Moody's and Standard & Poor's kept Enron at investment grade until just five days before it filed for bankruptcy last fall, the rating agencies started poring over balance sheets, looking for companies that seem overdependent on commercial paper.

In the fourth quarter of last year, Moody's downgraded 17 companies that had top commercial-paper ratings, up from five downgrades in the third quarter.

"Troubles can trigger an immediate downgrade from the agencies, when in the past that wouldn't have happened," says Greg Hahn, who runs bond investments for Conseco Capital Management. "I've never seen the market so nervous."

Since money-market funds and some other investors in the commercial-paper market have rules prohibiting them from putting more than 5% of their assets in lower-rated debt, such a rating downgrade puts instant pressure on companies. Last week, Moody's released an extensive analysis of the reliance of 300 companies on short-term debt. Many interpreted this as a gentle nudge to reduce this reliance.

A New Attitude

Accounting issues have made investors such as Joseph Tully even more cautious than usual. Mr. Tully manages $60 billion at Prudential Investment Management in Newark, N.J., and is in charge of his firm's short-term investments, such as Prudential's money-market funds. Like others in this market, his job, above all else, is not to lose money. Beating his competitors is icing on the cake.

Since Enron, Mr. Tully is avoiding much of the second-tier sector of the commercial-paper market. Even when he believes in a company, lately he won't touch their debt if it's for longer than three months, he says. That's because he worries that the company's fortunes could change abruptly, meaning there's no guarantee it will be able to pay the money back.

"Twenty-five percent of the companies we used to look at aren't even open for discussion," he says. Mr. Tully says he and other investors in this market don't want to "be called in to meetings all day to explain why we own" debt of a troubled company.

This new attitude among commercial-paper investors, the church ladies of Wall Street, has led to a sharp reduction in commercial-paper issuance. Since December 2000, the overall value of commercial paper issued in the U.S. has shrunk 12%, to $1.4 trillion. That's a sharp reversal from previous annual growth rates of around 19%.

The cost is going up, too. Second-tier companies, which account for around $159 billion of borrowing, are paying annual rates of 2.24% to sell one-month debt, up from nearly 2% in late January. That's a relatively high spread compared with the 1.79% that top-rated companies are charged to borrow money for one month. Top-tier rates have also gone up some, from 1.6% in January.

The market is so bad that some lower-rated companies aren't even trying to sell new debt, realizing they wouldn't be able to find enough investors. Some foreign companies, such as ABB Ltd., Europe's biggest electrical-engineering company, also haven't been able to find enough investors to buy their short-term debt.

Other companies under pressure are finding they can find the money they need, but only by turning over every stone. Rates last month on one-week Qwest commercial paper spiked to unusually high levels, according to traders, as investors sold off their holdings, fretting over the telecom company's ability to meet its short-term expenses.

Like other companies lately, Qwest decided to tap backup bank lines of credit, though banks usually make these longer-term loans more expensive and restrictive than commercial-paper financing. Qwest also sold long-term bonds, with a hefty interest rate of almost 9%, and reiterated a pledge to sell assets and reduce its capital spending. Qwest says its finances are sound.

Sprint's Squeeze

Sprint, the long-distance and cellular provider, felt the squeeze last month. The company, which had been relying on the commercial-paper market for $3 billion of its day-to-day expenses, suddenly couldn't convince gun-shy commercial-paper investors to buy its debt. The cash crunch sent Sprint shares tumbling, and had credit-rating agencies sending warnings.

The result: Sprint was forced to take on more expensive debt, including a $1 billion new loan and $5 billion in long-term bonds, costing the company almost $200 million in additional borrowing costs each year, according to analysts. Like a homeowner cutting back on spending when his variable-rate mortgage shoots up, Sprint is now slashing its capital spending by $400 million.

Sprint CEO William Esrey says he was stunned by how fast the market shifted from an open spigot to nearly disappearing.

The commercial-paper "market has shrunk, people are saying they don't want to take a chance" on lending money to many companies with issues, says Mr. Esrey. "It's very frustrating because our performance hasn't changed."

The fears have gotten so bad that Pacific Investment Management Co., the $250 billion fund company known in the bond market for its aggressive bets, has slashed its holdings of lower-tier commercial paper to just 4% of its portfolio, down from 25% at the end of 1999.

"Surprises come out of nowhere these days," says Bill Gross, PIMCOs' chief investment officer, who reasons that the rewards of holding such debt is no longer enough to offset the new risks. "We're not shrinking violets, we'll just place our bets elsewhere."

Mr. Gross last week declared his firm wouldn't even buy commercial paper from General Electric Co., which has been relying on this market for about half its financing needs. The move sent shock waves throughout Wall Street, raising questions of whether even blue-chip companies would have to pay higher rates to raise money outside of the commercial-paper market, hurting profits.

Earlier this month, GE's GE Capital unit sold $11 billion of long-term bonds with higher rates than it was paying on its commercial paper. The move is part of a strategy to shift some of the company's debt out of the commercial-paper market.

CreditSights, an independent New York-based bond-analysis firm, estimates that the shift will cost GE over $100 million in additional annual interest payments. A GE spokesman says the extra cost won't be that high and won't materially affect earnings.

As recently as a few weeks ago, most top-tier U.S. companies shrugged off the commercial-paper problems. They were able to raise money at super-slim rates of about 2%, even while lower-rated companies such as Qwest and Computer Associates struggled to find takers for their debt. Many of those that have run into some problems in the market, such as Ford Motor Co.'s Ford Motor Credit and General Motors Corp.'s GMAC, have been able to "securitize" their commercial paper, turning their low-rated debt into higher-rated commercial paper by backing it with credit-card receivables or other assets. Companies with these assets have found ample investors: Such secured deals have grown to 52% of the entire commercial-paper market.

But now even first-tier companies are worried that the market just might not be there when they need it, even if they're having no trouble placing the debt right now. Verizon Communications Inc., a top-rated company that's having no problems selling $12.8 billion in commercial paper, nevertheless is preparing for the worst.

Verizon has sold $5 billion of longer-term debt in recent months, even though it had to pay higher rates that will cost the company about $100 million in additional annual interest. And the company is cutting capital spending to between $15 billion and $16 billion this year from $17.4 billion last year, in part to avoid having to turn to commercial-paper investors, says company spokesman Robert Verettoni.

"We saw this was going to be an issue months ago, so we've been acting ahead of time," says Mr. Verettoni, referring to the market's problems.

Other investment-grade companies, such as J.P. Morgan Chase & Co. and Household International Inc., have taken the unusual step of holding conference calls with investors to highlight their strong liquidity positions.

But for lower-tier companies, there's little good news to talk about. Tougher scrutiny by ratings agencies has produced a vicious cycle: Earlier this month, Standard & Poor's lowered its credit rating on Chicago-based GATX Corp., which leases rail cars and aircraft. The reason? The company's access to the commercial-paper market was curtailed, due to a downgrade by rival Moody's, which cited concerns about volatility in the aircraft-leasing business. Robert Lyons, the company's vice president of investor relations, said GATX has never been as dependent on the commercial-paper market as other companies, noting, "We have never viewed commercial paper as a quasi-permanent source of funding."