



Investing for Florida Governmental Entities

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TODAY'S AGENDA

Florida statute requirements for Local Government Investment Policies –

- Areas of focus for written investment policies
- Types of authorized investments
- Risks associated with investments
- Benefits of a cash flow analysis
- Primer on investing bond proceeds and arbitrage
- Trivia questions
- Questions?

LOCAL GOVERNMENT INVESTMENT POLICIES

Florida Statutes 218.415 -

- Written plan is not required, but having one allows you to take control of how
- you invest
- Meant to put parameters on your investment activities
- Revise periodically to reflect current conditions
- Look at Florida peers

LOCAL GOVERNMENT INVESTMENT POLICIES

Written investment policies must address the following 15 points adopted by the Government Body (e.g. Ordinance, and/or Resolution)

- Scope
- Investment Objectives
- Performance Measures
- Prudence & Ethical Standards
- Authorized Investments
- Maturity & Liquidity Requirements
- Portfolio Composition
- Risk & Diversification
- Authorized Broker/Dealers
- Third-Party Custodial Arrangements
- Master Repurchase Agreement
- Bid Requirements
- Internal Controls
- Continuing Education
- Reporting Requirements

LOCAL GOVERNMENT INVESTMENT POLICIES

Scope –

Applies to funds in excess of those required to meet current expenses (does not apply to pension funds or funds related to debt where other policies or indentures apply)

Investment Objectives (in priority order) –

- Safety - “Will I get my principal back?”
- Liquidity - “Can I access my funds when I need them?”
- Yield - Am I receiving an appropriate return?

Transparency is key as well!

LOCAL GOVERNMENT INVESTMENT POLICIES

Performance Measurement –

Shall specify performance measures that are appropriate for the nature and size of the portfolio.

Investment performance of funds will be compared to appropriate indexes that have a duration and asset mix that approximates the portfolio such as:

- ICE BofA 1-3 Year U.S. Treasury Index
- Bloomberg 1-3 Year Government Index
- Bloomberg 1-5 Year US Government / Credit Index

LOCAL GOVERNMENT INVESTMENT POLICIES

Key Return Concepts – What These Rates Telling Us

Portfolio Returns –

- **Effective Rate of Return** - What are we actually earning if all income is reinvested at the effective rate and compounded over time?
- **Risk-Adjusted Return** - Are we being compensated fairly for the risk we're taking?
- **Total Return** - What's our overall return when we factor in both income and price changes?

LOCAL GOVERNMENT INVESTMENT POLICIES

Investment Returns –

- **Coupon Yield** - What's the bond paying based on its face value?
- **Current Yield** - What's the yield based on the bond's current market price?
- **Discount Yield** - For short-term instruments like Treasury bills that don't pay interest but are sold at a discount - What's our return based on the difference between what we paid and what we'll receive at maturity?

LOCAL GOVERNMENT INVESTMENT POLICIES

Investment Returns –

- **Yield to Maturity (YTM)** - If we hold this bond to maturity, collecting every interest payment and the principal, what's the total return we can expect?
- **Option-Adjusted Yield (OAY)** - Some bonds come with options, like call features. How does that optionality affect our yield? The option-adjusted yield accounts for the likelihood that the bond might be called early.
- **Yield to Call (YTC)** - What's our return if the bond is called at the first possible date?

“Prudent Person Standard” –

Investments should 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 probable income to be derived from the investment.

LOCAL GOVERNMENT INVESTMENT POLICIES

Prudence and Ethical Standards –

Conflicts of Interest:

Activities which could conflict with the proper execution and management of the investment program or could impair the ability to make impartial decisions.

Maturity and Liquidity Requirements –

The investment policy shall require that the investment portfolio is structured in such a manner as to provide sufficient liquidity to pay obligations as they come due.

To the extent possible, an attempt will be made to match investment maturities with known cash needs and anticipated cash-flow requirements

LOCAL GOVERNMENT INVESTMENT POLICIES

Authorized Investments –

Investment policy shall list authorized investments; investments not listed are prohibited

Typical Authorized Investments:

- Cash and Cash Equivalents
- Local Government Surplus Funds Trust Fund (Florida PRIME)
- United States Government Securities
- Federal Instrumentalities (United States Government Sponsored Enterprises)
- Interest Bearing Time Deposit, Certificates of Deposit or Savings Accounts – Qualified Public Depositories Only)
- State and /or Local Government Taxable and/or Tax-Exempt Debt
- Registered Investment Companies (Money Market Mutual Funds) AAAM
- Intergovernmental Investment Pools AAAM
- Commercial Paper
- Corporate Bonds

LOCAL GOVERNMENT INVESTMENT POLICIES

Portfolio Composition -

Establishes guidelines and limits on security:

- Issues
- Issuers
- Maturities

Sets the structure of your portfolio.

SAMPLE PORTFOLIO COMPOSITION

Authorized Investment – Sector Type	Minimum Rating Requirement	Maturity Limits	Maximum Allocation	Individual Issuer Limit
Cash and Cash Equivalents	N/A	N/A	100%	N/A
Local Government Surplus Funds Trust Fund (Florida PRIME)	AAAm	N/A	25%	N/A
United States Government Securities	N/A	5 years	100%	N/A
Federal Instrumentalities (United States Government Sponsored Enterprises)	N/A	5 years	50%	30%
Interest Bearing Time Deposit, Certificates of Deposit or Savings Accounts – Qualified Public Depositories Only	N/A	1 year	10%	10%
State and /or Local Government Taxable and/or Tax-Exempt Debt	Aa3 and AA-	5 years	25%	5%
Registered Investment Companies (Money Market Mutual Funds)	AAAm	N/A	50%	10%
Intergovernmental Investment Pools	AAAm	N/A	100%	N/A

Risk and Diversification –

Investments held should be diversified to the extent practicable to control the risk of loss resulting from overconcentration of assets.

Risk & Diversification ensures your portfolio composition structure actually results in a well-balanced, resilient portfolio.

Ongoing review and adjustment - for example: A particular corporate issuer gets downgraded to the lowest allowable credit rating under policy.

Risk & Diversification asks: Even though we are still in compliance, should we proactively reduce exposure to this issuer before further deterioration?

LOCAL GOVERNMENT INVESTMENT POLICIES

Authorized Investment Institutions and Dealers –

Recommended Minimum Qualifications:

- (a) Designated as a “primary dealer” by the Federal Reserve Bank of New York;
- (b) Qualified as a regional dealer under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule);
- (c) Capital of no less than \$10,000,000;
- (d) Registered as a dealer under the Securities Exchange Act of 1934;
- (e) Member of the Financial Industry Regulatory Authority, Inc. (FINRA);
- (f) Registered to sell securities in Florida;
- (g) Engaged in the business of effecting transactions in U.S. government and agency obligations for at least five (5) consecutive years; and
- (h) In good standing with FINRA and the Securities and Exchange Commission.

LOCAL GOVERNMENT INVESTMENT POLICIES

Custodial Agreements –

Lay out appropriate arrangements for the holding of assets.

No withdrawal of securities, except by an authorized staff member of the unit of local government.

“Delivery vs. Payment”

Master Repurchase Agreement –

IPS shall require all approved institutions and dealers transacting repurchase agreements to execute and perform as stated in the Master repurchase agreement.

Consistent legal and operational standards

Competitive Bidding -

Best practice – obtain 3 quotes

Held in confidence until winning bid is determined

If 3 bids aren't feasible, may use comparison to current market price – acceptable providers include:

- Telerate Information System;
- Bloomberg Information Systems;
- Wall Street Journal or a comparable nationally recognized financial publication providing daily market pricing; and
- Daily market pricing provided by the entity's custodian or their correspondent institutions.

LOCAL GOVERNMENT INVESTMENT POLICIES

Internal Controls –

Designed to prevent loss

The internal controls shall be reviewed by independent auditors as part of any financial audit periodically required of the entity. The written internal controls should address, at a minimum, (a) transfers of all funds, (b) recordkeeping, (c) custodial safekeeping, (d) delegation of authority and supervisory control of employee actions, (e) written confirmation of telephone transactions, (f) repurchase agreements, (g) separation of transaction authority from accounting and recordkeeping, (h) wire transfer agreements, (i) banking service contracts, (j) collateral/depository agreements and (k) "delivery-vs-payment" procedures.

LOCAL GOVERNMENT INVESTMENT POLICIES

Continuing Education –

Investment officials must annually complete 8 hours of continuing education in subjects or courses of study related to investment practices and products.

Reporting –

Provide for appropriate annual or more frequent reporting of investment activities.

The report shall include a breakdown of the portfolio as well as its overall performance and the current market pricing at month-end, including the following information:

- Securities by class/type
- Book Value
- Market Value
- Income Earned
- Overall Investment Performance (Total Return)

LOCAL GOVERNMENT INVESTMENT POLICIES

To Recap –

No Written Policy:

- a) Florida Prime or any intergovernmental pool
- b) SEC registered MMFs – highest credit quality rating
- c) CDs or Savings Accounts in QPDs
- d) Direct obligations of the U.S. Treasury

With a Written Policy:

The statute allows considerable flexibility – “other investments permitted by law or resolution...”

LOCAL GOVERNMENT INVESTMENT POLICIES

In Closing, a few Questions to Ask Yourself –

Are you able to allocate investments across all asset classes you deem appropriate?

Has the entity's risk profile evolved since your initial investment strategy was established?

Do you have a clear understanding of your cash flow requirements? Are you strategically investing a portion of your core funds further along the yield curve?

Are you comfortable with a certain level of price volatility, particularly if you intend to hold investments until maturity?

TRANSITIONAL SLIDE – INVESTMENT TYPES

INVESTMENT TYPES

Demand Deposit Accounts –

Transactional Checking Accounts

- Payroll, A/P

Earnings Credit Rate

- Rates applied to non-interest-bearing balances to offset services charges
- Used to calculate compensating balance
- Typically settles monthly

Savings/Money Market Accounts

- Compounding, frequency varies

INVESTMENT TYPES

Time Deposits or Certificates of Deposits –

Must be placed with Qualified Public Depositories
(F.S. Chapter 280)

Fixed term investment with specified maturity date

Penalties for early withdrawal

Negotiable certificates of deposit are prohibited under Chapter 280

CDARS are allowable under Chapter 218.415(23)

- Funds must initially be deposited in a qualified public depository

INVESTMENT TYPES

US Treasury Securities –

Treasury Bills

Issued by US. Treasury – maturities of 1-year or less; discount of face value

Government Notes

Maturities of 2 to 10 years – Purchase at par, premium or discount

Interest (Coupons) paid semi-annually

Government Bonds

Maturities of 10 to 30 years – Purchase at par, premium or discount

Interest (Coupons) paid semi-annually

INVESTMENT TYPES

Government-Sponsored Enterprises (GSEs) –

Financing entities established to support lending to specific sectors of the economy, such as housing, agriculture, and home finance.

Unsecured debt obligations with implied guarantee of US Government

Federal National Mortgage Association (Fannie Mae)

Federal Home Loan Mortgage Corporation (Freddie Mac)

Federal Home Loan Bank (FHLB)

Federal Farm Credit System (FFC)

Generally higher interest rates compared to treasuries

INVESTMENT TYPES

Local Government Investment Pools (LGIPs) –

Pooling resources to potentially achieve higher rates of return

Styles – Government & Prime

Own shares of beneficial interest in the pool / fund

Not a bank deposit; not FDIC insured

INVESTMENT TYPES

Local Government Investment Pools (LGIPs) –

Stable NAV

- Maintain \$1 in/ \$1 out
- Highest S&P rating is “AAAm”
- Short-term
- WAM to Reset < 60 days

Variable NAV

- NAV fluctuates
- Add Interest Rate Risk / Duration
- Designed to outperform overtime
- Highest S&P rating is “AAAf / S1”
- Intermediate
- WAM for bond fund > 90 days

INVESTMENT TYPES

SEC Registered Money Market Funds (2A-7s) –

Styles – Government, Prime and Muni

Market rate

Safe

Easy to get in and get out

Also, not a bank deposit or FDIC insured

INVESTMENT TYPES

Municipal Securities –

Obligation of a State, County, City, Village, School District or other special purpose district

General Obligation

- Not all GO bonds are the same
- Limited versus Unlimited Tax
- Some GO bonds have no separate tax levy Revenue

Essential service revenue bonds (water & sewer) - also, toll roads, airports, parking and many others

INVESTMENT TYPES

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INVESTMENT TYPES

Commercial Paper –

Short-term unsecured promissory note Default risk present

Industrial & financial firms are issuers of CP

CP usually offers a higher return compared to other short-term investments, compensating for the slightly higher risk

Corporate Notes / Bonds –

Similar to commercial paper, but with maturities greater than 1 year

Can offer higher returns compared to government securities

Credit risk is generally higher

Risk and return can vary greatly depending on the specific security and the issuing corporation's financial health

TRANSITIONAL SLIDE – INVESTMENT RISKS

INVESTMENT RISKS

Credit Risk –

Broad term that includes multiple factors that may impact an issuer's ability to meet its obligations:

- Default risk
- Downgrades in credit ratings
- Shifts in economic conditions
- Changes in an issuer's financial position

Default Risk –

Risk of an issuer failing to make timely payments of interest or principal on its outstanding obligations

Happens occasionally but it is rare for investment grade securities

Securities are more likely to be downgraded than to default

Must monitor security credit quality and ratings on an ongoing basis to make sure they remain appropriate investments

INVESTMENT RISKS

Interest Rate Risk –

Potential for the value of an investment to decrease as a result of changes in the level of interest rates

Affects fixed income investments such as bonds, where a rise in interest rates makes existing bonds less attractive, leading to a decrease in their prices

Measured through duration - the sensitivity of a bond's or portfolio's price to a change in interest rates

INVESTMENT RISKS

Market Risk –

Refers to the possibility of experiencing losses due to factors that affect the overall performance of financial markets.

Market risk is considered systematic risk, meaning it cannot be eliminated through diversification and affects the entire market or a broad segment of it.

Includes economic recessions, geopolitical events, monetary policy changes, and natural disasters - essentially, any factor that can broadly impact investor sentiment or market stability.

INVESTMENT RISKS

Reinvestment Risk –

The risk that yields will be lower when reinvesting cash flows such as maturities, calls, paydowns or coupons

Callable bonds may hold higher reinvestment risk because these bonds are typically called when interest rates decline

Investing to a shorter maturity than needed increases reinvestment risk

INVESTMENT RISKS

Timing Risk –

Many investors try to “time the market”, meaning they attempt to predict when the market will rise or fall

This extremely challenging even for the best and brightest in the industry

“Time In” the market typically produces better results over time than trying to time the market

It is important to invest to a plan and maintain commitment over time

INVESTMENT RISKS

Liquidity Risk –

Can you sell a security? At what price?

Must understand the liquidity of each investment you make

Factors that may contribute to liquidity risk include low trading volume, market disruptions, changes in investor sentiment or economic conditions

Some investments (think CDs) have penalties for early withdrawals

INVESTMENT RISKS

Headline Risk –

Risk that news can negatively affect investment performance or public perception.

Information can spread through various channels faster than ever.

Recent example: Silicon Valley Bank

INVESTMENT RISKS

Managing Investment Risks –

Effective Investment Planning is the best way to manage investment risks

Match assets and liabilities

- Reduces reinvestment risk
- Reduces liquidity risk
- Promotes diversification

Diversify

Limit investments to ones you thoroughly understand

Don't try to time the market

Monitor credit ratings and/or utilize a Registered Investment Advisor

IMPORTANCE OF DIVERSIFICATION

Mitigates Interest Rate Risk: As interest rates drop, existing fixed income securities with higher coupon rates become more valuable, but new issuances will offer lower yields. Diversifying across various fixed income instruments helps public governments manage and mitigate the risk of lower returns on new investments and potential capital losses on existing ones.

Enhances Yield Opportunities: Diversification into different types of fixed income securities (e.g., corporate bonds, municipal bonds, inflation-protected securities) allows governments to take advantage of varying interest rate environments and credit spreads, potentially improving overall yield in a declining rate environment.

Reduces Concentration Risk: Relying too heavily on a single type of fixed income security or issuer can expose public governments to significant risk if that segment underperforms. Diversification across multiple sectors, credit qualities, and maturities helps to spread risk and reduce the impact of any single investment's poor performance.

IMPORTANCE OF DIVERSIFICATION

Improves Liquidity Management: A diversified fixed income portfolio typically includes a mix of short-term and long-term securities, as well as varying credit qualities. This helps ensure that public governments can manage their liquidity needs effectively while still benefiting from potential returns as rates decline.

Facilitates Long-term Stability: In a declining interest rate environment, longer-duration bonds may become more sensitive to rate changes. By diversifying across various durations and fixed income types, public governments can achieve a more balanced portfolio that provides stability and consistency in income, even as the rate environment evolves.

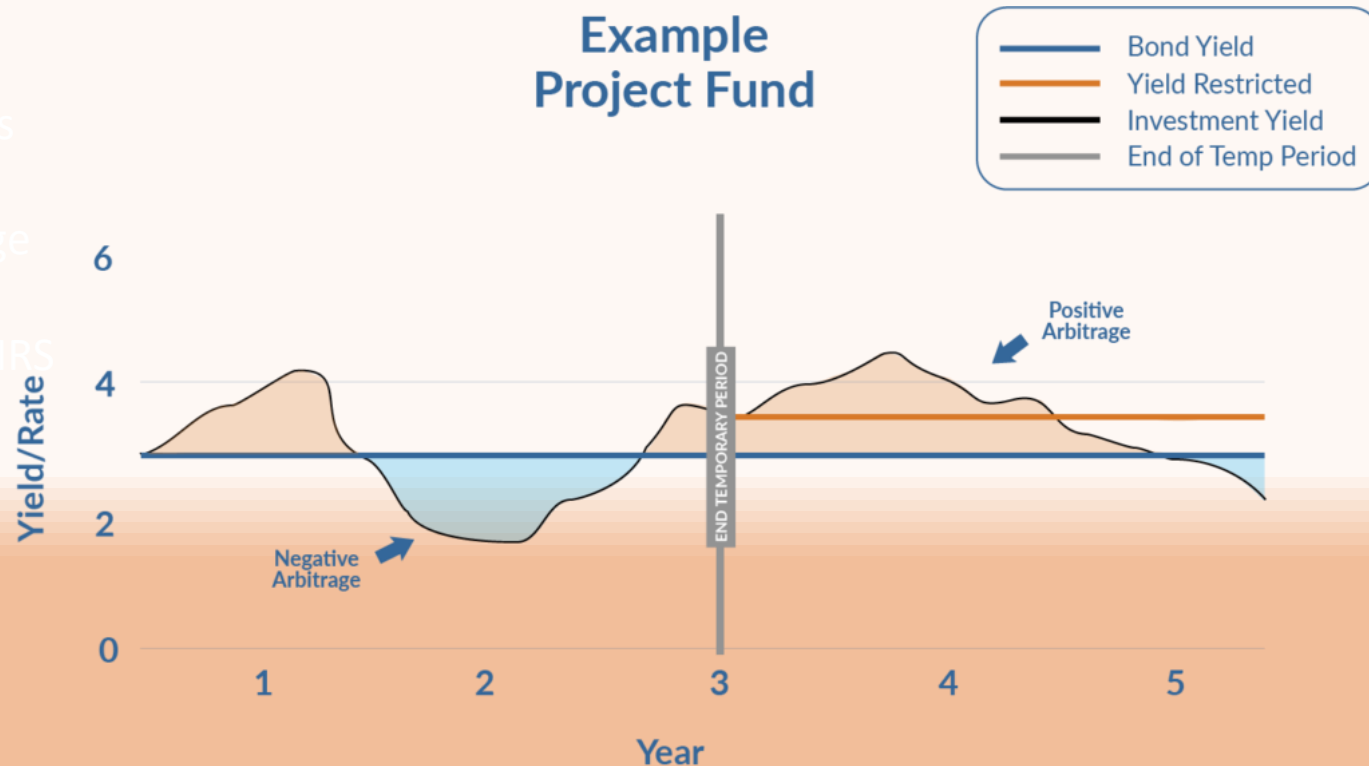


ARBITRAGE

Arbitrage is the spread between the tax-exempt borrowing rate and taxable earnings rate.

When taxable investments generate a yield more than the tax-exempt borrowing rate, the **dollar value of the difference** is paid back to the IRS as a Rebate.

Excess
Earnings
Positive
Arbitrage
Rebate
Paid to IRS



ARBITRAGE

Arbitrage rules were written into the Internal Revenue Code of 1986 and multiple versions of Regulations so borrowers would not:

- Borrow more funds than needed
- Borrow funds earlier than needed
- Borrow funds for a longer term than needed
- Borrowing tax-exempt is a special privilege from the fed government
- The government does not want its generosity abused

Non- Compliance Penalty

- Revoke Tax-Exempt Status
- Enter into IRS Settlement Agreement to pay taxpayer exposure or other amount

CASH FLOW ANALYSIS

Informed Investment Decisions:

A thorough understanding of cash flows enables public sector entities to make informed investment decisions that align with their financial needs and liquidity requirements.

By accurately assessing cash inflows and outflows, entities can better determine the suitability of fixed-rate investments and avoid potential liquidity issues.

Optimized Investment Strategy:

Using a cash flow model helps public sector entities develop and tailor their investment plans based on their specific cash flow patterns.

This ensures that investments are strategically aligned with projected cash needs, minimizing the risk of holding assets that may not be liquid when needed.

CASH FLOW ANALYSIS

Enhanced Accuracy and Efficiency:

A web-based cash flow model that integrates data inputs from accounting systems via easy-to-use templates streamlines the process of cash flow analysis.

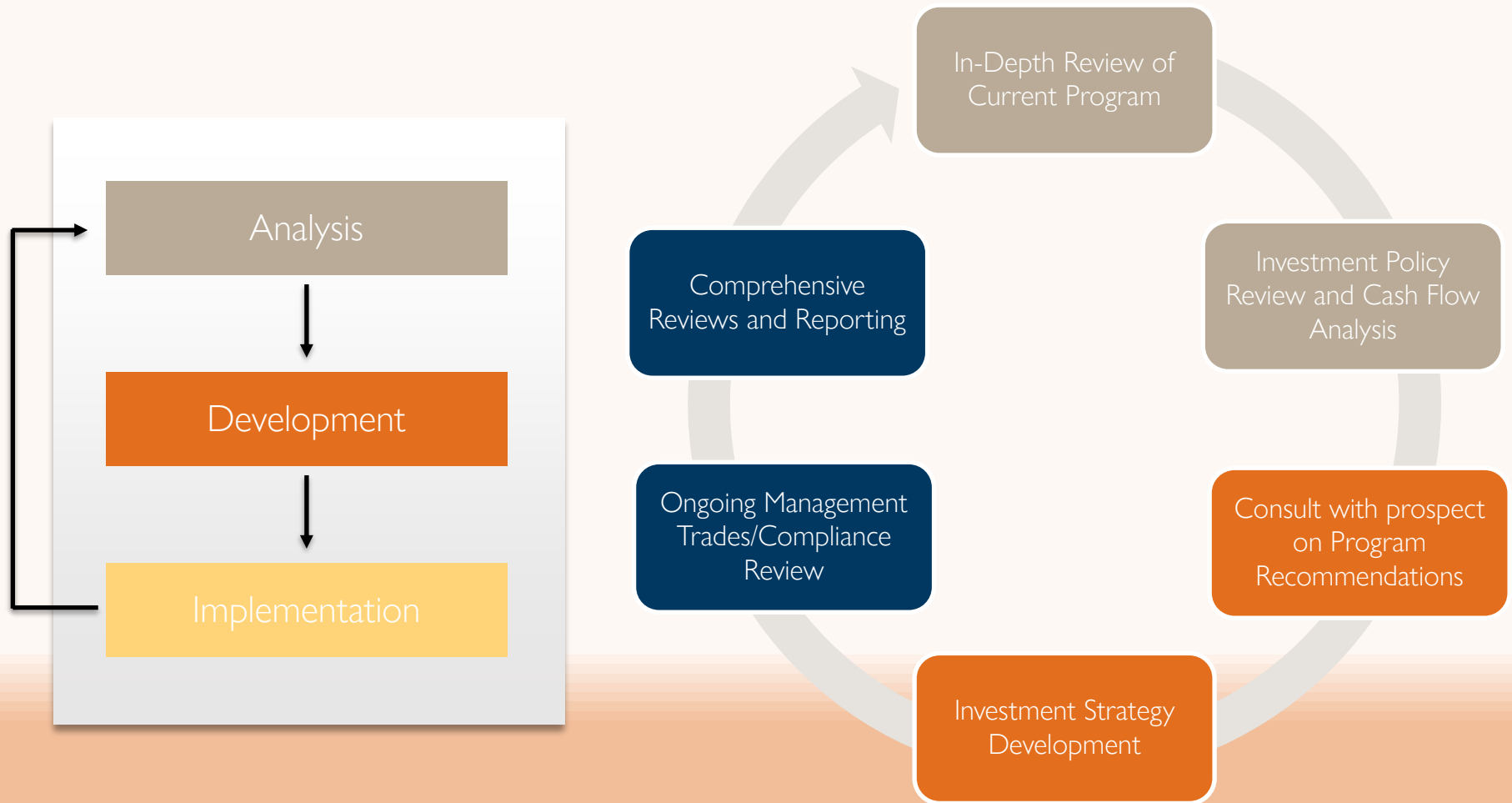
This automation reduces manual data entry errors, improves accuracy, and allows for efficient updates, making it easier for entities to maintain current and accurate financial plans.

Customizable and User-Friendly:

A customizable cash flow model designed for any unit of local government ensures that the tool can be adapted to meet the unique needs of different entities.

Staff trained in the model's use can effectively create, update, and manage cash flow projections, enhancing their ability to respond to changing financial conditions and investment opportunities.

Holistic Program Implementation




Please refer to the disclosure slide of this presentation for more information.



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