

**INVESTMENTS
(Chapter 7)**

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INTRODUCTION

Investing is an important way to use district funds responsibly and maximize resources. Even small districts with limited expertise can take advantage of investment opportunities that have been created specifically for small public entities.

Priorities for investment of public funds are, in this order: (1) safety (no appreciable risk the investment will fail); (2) liquidity (the investment can be easily converted to cash if needed); and (3) rate of return.

Special districts are authorized to invest by Oregon Revised Statutes (ORS) chapter 294, "County and Municipal Financial Administration." That chapter specifically describes the types of investments that are permitted. If an investment is not specifically authorized in the chapter, it is not permitted. In addition to requiring statutory authority, all investments must be approved by the district's board of directors.

In most cases, the district board appoints an investment officer, who is usually a staff member such as the manager or chief financial officer. The board also approves an investment policy. The policy should be in writing; state the statutes that apply; and provide parameters and guidelines for the types of investments that the district will make, including guidelines for diversification, liquidity, and maturity of investments.

RESOURCES AND GUIDANCE

Oregon Short Term Fund Board. The Oregon Short Term Fund Board, which is managed by the Oregon State Treasury, provides investment advice and resources to local governments. [See "The Investment Policy," below.]

Local Government Investment Pool. Established in 1973, the Local Government Investment Pool (LGIP) is an open-ended, no-load diversified portfolio offered to eligible participants, which include -- but are not limited to -- any municipality, political subdivision, or public corporation of Oregon that by law is made the custodian of, or has control of, any public funds. The pool is commingled with state funds in the Oregon Short Term Fund (OSTF).

Any county, municipality, school district, political subdivision, public corporation, or tribal government is eligible to participate in the LGIP. An entity eligible to participate in the pool may have some or all of the following characteristics:

- Participation in the Oregon Public Employees Retirement System (PERS).
- Subject to audit laws under ORS chapter 297.
- Subject to public meeting or records laws.
- Subject to local budget laws under ORS chapter 294.
- Officers and board members subject to government ethics laws under ORS chapter 244.

CASH MANAGEMENT

Investing is part of the district's cash management program. The objective of cash management is to have sufficient liquidity to pay obligations when they are due while minimizing borrowing expenses and maximizing investment revenues from surplus funds.

Surplus funds are monies that temporarily exceed cash flow requirements. Typically, these funds are reserved for capital expenditures, fall tax turnovers (when a large percentage of annual revenue is received in a short period of time and will not be disbursed until later in the year), bond sale proceeds, carryover funds from the previous fiscal year (cash on hand), system development charge (SDC) income, grant proceeds, etc.

Good cash management practices encourage the investment of monies, which in turn increases revenue. Reasonable rates of return on investments can be obtained while maintaining security and liquidity. In some cases, the application of investment earnings can allow districts to reduce tax rates or user charges.

FIDUCIARY RESPONSIBILITIES OF BOARD MEMBERS

Board members can be held personally liable for handling or managing public money in a way that violates the law. Board members should take the following steps to protect themselves from this exposure:

- Understand the board's powers, responsibilities, and legal limitations.
- Understand the principals of investment so that the board can manage the district's investment manager.
- Have a written investment policy and follow it.
- Insist on adequate financial reporting from staff.
- Seek expert advice before taking any action that the board lacks reasonable competence to handle.
- Purchase appropriate liability insurance coverage for board members. Note: If you do not currently have this coverage, SDIS has coverage options available to members.

INVESTMENT METHODS AVAILABLE

Oregon law restricts special districts to specific types of investments. The following investments are permitted pursuant to ORS 294.035, 294.040, and ORS 294.810:

- US Treasury Obligations: U.S. Treasury and other government obligations that carry the full faith and credit guarantee of the United States for the timely payment of principal and interest.
- US Agency Obligations: Senior debenture obligations of US federal agencies and instrumentalities or U.S. government sponsored enterprises (GSE).
- Oregon Short Term Fund.
- Corporate Indebtedness
- Commercial Paper issued under the authority of section 3(a)2 or 3(a)3 of the Securities Act of 1933.

- Corporate Bonds
- Repurchase Agreements
- Municipal Debt
- Bankers Acceptances
- Qualified Institution Time Deposits/Savings Accounts/Certificates of Deposit

In addition, Oregon statutes permit certain other investments and transactions for special purpose funds in limited circumstances. For example, fixed or variable life insurance or annuity contracts, guaranteed investment contracts, and, for deferred compensation funds, share and savings accounts in credit unions and trusts. Seek advice of legal counsel or other professional familiar with public investments if your district is contemplating these types of investments.

INVESTMENT RESTRICTIONS

According to ORS 294.145, the custodial officer may not:

- Make a commitment to invest funds or sell securities more than 14 business days prior to the anticipated date of settlement of the purchase or sale transaction;
- Enter into any agreement to invest funds or sell securities for future delivery for a fee other than interest;
- Lend securities to any person or institution, except:
 - On a fully collateralized basis; and
 - When the lending is specifically permitted under an investment policy adopted pursuant to ORS 294.135 (1)(a);
- Pay for any securities purchased by the custodial officer until the officer has received sufficient evidence of title to the securities. Evidence of title must be consistent with modern investment, banking and commercial practices and may include physical possession, book entry and automated recordation of such title. However, the custodial officer may instruct one or more custodial agents or banks to accept or release securities as that custodial officer considers advisable to be held in safekeeping for collection of principal and interest or other income; or
- Deliver securities to the purchaser of the securities upon sale prior to receiving payment in full for the securities. However, the custodial officer may deliver the securities to any custodial agent or bank upon instructions to hold the securities pending receipt by the custodial agent or bank of full payment for the securities.

In addition, as a general rule, according to ORS 294.135 investments may not have a maturity in excess of eighteen months unless the governing body adopts a written investment policy, and that policy is reviewed by the Oregon Short Term Fund Board. The investment policy must include guidelines concerning maximum investment maturity dates and require readoption, not less than annually.

THE INVESTMENT POLICY

Every district that invests public funds should have an adopted investment policy for the board of directors to follow when it considers and approves investments. The policy should be written so it can be easily understood by individuals with or without investment expertise.

The investment policy can:

- Increase investment flexibility.
- Reduce investment risk.
- Improve the board's understanding of the investment process.
- Allow the board to deal with the investment policy in a consistent and clear manner.
- Acquaint the investment officer with the investment preferences of their board, and with rules to avoid misunderstanding and liability.
- Provide written guidance to new or substitute investment officers who may not be familiar with investment or the district's past practices, and who might otherwise make inappropriate investments.

Key elements of an investment policy are as follows:

- Scope: Identifies funds under the authority of the policy.
- Objectives (prioritized):
 - Safety
 - Liquidity
 - Return
- Standards of care:
 - Prudence (Prudent Person Standard)
 - Ethics and conflicts of interest

 - Indemnification for investment decisions
 - Delegation of authority
 - Internal controls
 - o Separation of investment decisions and recordkeeping
- Safekeeping and custody:
 - Delivery vs. payment protocol
 - Safekeeping/custody by third party
- Authorized investments: Specific authorized investment types should be listed.
- Risk parameters:
 - Credit risk:
 - o Ratings requirements
 - o Exposure limitations

- Interest rate risk:
 - o Maximum investment maturity
 - o Maximum average maturity
- Concentration risk:
 - o Diversification requirements
- Liquidity risk:
 - o Minimum liquidity guidance
 - o Maturity buckets
- Transaction counterparties:
 - Minimum requirements to approve broker/dealers
 - Minimum requirements to approve investment advisers
- Policy compliance:
 - Reporting requirements:
 - Required data
 - Periodicity of reporting
 - Recipients of reports
 - Guideline violation resolution
- Policy maintenance:
 - Periodic policy review

The Oregon Short Term Fund Board assists local governments in the development of investment policies concerning funds invested outside of the Oregon Short Term Fund. To aid in this process, the Board has developed a sample investment policy from which local governments may draw from when developing their own policies. A sample investment policy can be found at www.oregon.gov/treasury/public-financial-services/Documents/Public-Financial-Services-Local-Government-Resources/Oregon-Sample-Investment-Policy-for-Local-Governments.pdf.

The Board also reviews and comments on local government investment policies as required under ORS 294.135. For a summary of the review process, see www.oregon.gov/treasury/public-financial-services/Documents/Oregon-Bond-Center/LG-Investment-Policy-Review.pdf.

WRITTEN INVESTMENT PROCEDURES

While the investment policy should succinctly state the entity's investment objectives, outline the risk tolerances of the governing body, and delegate authority to investment personnel, written investment procedures should formalize the process and put the investment policy into

action. They outline the process for making investment decisions, detail the activities of the investment staff, and specify how investment decisions are to be carried out.

Investment procedures should answer the following questions:

- Who is authorized to initiate investment transactions?
- Who is authorized to approve investment transactions?
- Who is authorized to initiate fund transfers or wire transactions?
- Who will make investment bookkeeping and accounting entries?
- Who are the approved broker/dealers and financial institutions for transacting business on a day-to-day basis?
- Who is the safekeeping agent and what are the delivery instructions?

When developing written procedures, it's helpful to think through the entire investment process from beginning to end, and then document the activities that take place. Written procedures should outline or detail how investment transactions will be handled. They should begin with a review of the daily cash position and include a review of maturing investments and incoming payments. They should then detail how investment decisions will be made. How will cash flow needs be determined? What are current and expected interest rates? What other investments are in in the district's portfolio?

To help ensure compliance with the investment policy and adherence to internal controls, the procedures should include the following items:

- Governing statutes, regulations, ordinances, resolutions, and policies.
- Duties of personnel.
- Limitations of employee authority.
- Flowchart of transaction initiation and execution.
- Lists of authorized broker/dealers and financial institutions who may be called for competitive quotes on securities.
- List of relevant bank account numbers, safekeeping, and delivery instructions.
- Descriptions of relevant cycles and functions, including review and approval processes.
- Timelines for report preparation and report distribution lists.
- Methodologies and formulas for allocations, distributions, and other calculations.
- Samples of all forms and reports.
- Descriptions of back-up and disaster recovery procedures.
- Implementation dates and dates of revisions.

Some investment procedure manuals also outline what activities should take place on a monthly, quarterly, periodic, and annual basis. For example, the procedure manual might include information on how broker/dealers and financial institutions are selected, how often those institutions are reviewed for creditworthiness, and who is responsible for this review.

Written procedures should be reviewed and updated annually.

RESOURCES

County and Municipal Financial Administration (ORS 294):

www.oregonlegislature.gov/bills_laws/ors/ors294.html

Local Government Investment Pool: www.oregon.gov/treasury/public-financial-services/oregon-short-term-funds/pages/local-government-resources.aspx

Public Funds Collateralization Program: www.oregon.gov/treasury/public-financial-services/public-depository-information/Pages/default.aspx

SDAO Resource Library/Accounting: www.sdaoresourcelibrary.com