

Investment Options and Practices in Small/Medium Size Units

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Control of Cash



Where, oh where, should we put our cash?

- ▶ Central Depository
- ▶ NCCMT
- ▶ Public Insured Money Market Accounts
- ▶ Investments

Focus on...

- ▶ Managing the receipt of cash, checks, EFT's, debit and credit card payments
- ▶ Deposit preparation and related internal control issues

Who does what? (Internal Controls)

- ▶ Who takes payments?
- ▶ Who supervises the taking of payments?
- ▶ Who balances cash drawers?
 - Security/Accountability
- ▶ Who prepares the deposit?
- ▶ Who reconciles the bank account?

The Law

- ▶ The Budget and Fiscal Control Act
 - Daily Deposits

§ 159-32. Daily deposits

- ▶ Except as otherwise provided by law, all taxes and other moneys collected or received by an officer or employee of a local government or public authority shall be deposited in accordance with this section. Each officer and employee of a local government or public authority whose duty it is to collect or receive any taxes or other moneys shall deposit his collections and receipts daily. If the governing board gives its approval, deposits shall be required only when the moneys on hand amount to as much as two hundred fifty dollars (\$250.00), but in any event a deposit shall be made on the last business day of the month. All deposits shall be made with the finance officer or in an official depository. Deposits in an official depository shall be immediately reported to the finance officer by means of a duplicate deposit ticket. The finance officer may at any time audit the accounts of any officer or employee collecting or receiving taxes or other moneys, and may prescribe the form and detail of these accounts. The accounts of such an officer or employee shall be audited at least annually. (1927, c. 146, s. 19; 1929, c. 37; 1939, c. 134; 1955, cc. 698, 724; 1971, c. 780, s. 1; 1973, c. 474, s. 27.)

Utilizing Technology

- ▶ EFT's
- ▶ Online Payments
 - Point and Pay
- ▶ OnSite Deposit
 - To shred or not to shred

Bad Checks / Debts

- ▶ CHECKtrac
- ▶ Debt Set-Off
- ▶ Collection Agency
(Credit based utility deposits)

Morganton's Investment Program

- ▶ G.S. 159-30 Investment of idle funds
- ▶ Investment policy adopted by city council
- ▶ Investment philosophy:
 - #1 - safety
 - #2 - liquidity
 - #3 - yield

Morganton's Investment Program

- ▶ Money Market Checking
- ▶ NC Capital Management Trust (NCCMT)
- ▶ CDs
- ▶ Commercial Paper
- ▶ Government Agency Securities

Morganton's Investment Policy

- ▶ Diversification by Instrument:
Percent of Portfolio
- ▶ US Treasury obligations (bills, notes, bonds) 100%
- ▶ US Government Agencies (fully guaranteed) 100%
- ▶ Commercial Paper (G.S. 147-69.1 (C4E)) 40%
- ▶ Certificates of Deposit Commercial Banks 100%
- ▶ NCCMT 50%

Morganton's Investment Policy

- ▶ Diversification by Financial Institution:
 - Commercial Paper:
 - No more than 25% of the total portfolio with any one issuer.
 - Certificates of Deposit (CDs):
 - No more than 50% of the total portfolio with one institution.
 - NCCMT:
 - No more than 50% of the total portfolio.

Morganton's Investment Policy

- ▶ Maturities shall be timed to comply with the following guidelines:
 - ▶ Under 270 days 50%
 - ▶ Under 1 year 75%
 - ▶ Under 3 years 100%

Deciding how much you will invest and for how long is the hardest part!

- ▶ Finding the right balance of short-term investments is critical
- ▶ Interest earned on Central Depository Funds
- ▶ Interest earned at NCCMT

Identify banks and/or broker/dealers you will work with for investment transactions

- ▶ Securities dealers do not charge a commission for their services. They are compensated by the traders on secondary issues and issuers on original issues.

Prepare RFP's for banking/safekeeping services

- ▶ Bid every five years
 - Remember plagiarism is the highest form of flattery!
- ▶ The days of “free” banking are basically gone..
 - New vocabulary word/phrase...
 - Earning Credit Rate
 - Rate * balance = total credit applied towards fees

Terms:

- ▶ Basis Point – A unit of measure used in the valuation of fixed-income securities equal to 1/100 of 1 percent of yield, e.g., “1/4” of 1 percent is equal to 25 basis points.
- ▶ Book Value – The value at which a security is carried on the inventory lists or other financial records of an investor. The book value may differ significantly from the security's current value in the market.

- ▶ **Callable Bond** – A bond issue in which all or part of its outstanding principal amount may be redeemed before maturity by the issuer under specified conditions.

- ▶ **Purchase** – A transaction, which calls for delivery and payment of securities on the same day that the transaction is initiated.

- ▶ Delivery versus Payment – A type of securities transaction in which the purchaser pays for the securities when they are delivered either to the purchaser or his/her custodian.

- ▶ Discount – The amount by which the par value of a security exceeds the price paid for the security.

- ▶ Premium – The amount by which the price paid for a security exceeds the security's par value.

- ▶ Safekeeping – Holding of assets (e.g., securities) by a financial institution.

Definitions and Characteristics of Investments:

US Treasury Securities – “Treasuries”

- ▶ Debt obligations of the U S Government, which are exempt from default on a specific maturity. They are risk-less instruments, which have the lowest rates of return of all fixed-income credit instruments.

US Government Agency Securities – “Agencies”

- ▶ Debt instruments issued by the US government agencies, departments, and government-sponsored corporations. The US Treasury does not guarantee the principal and interest on most government sponsored corporation issues, although the debt is fully guaranteed by the issuing corporations. The underlying credit worthiness of the organizations is considered extremely sound. Typical issues are by:

- ▶ **FFCB** – Federal Farm Credit Bank System supports agricultural loans. Offer discount notes with specific maturities.
- ▶ **HLB** – Home Loan Banks provide a credit system for thrift institutions engaged in residential mortgage financing.

- ▶ **FHLMC** – Federal Home Loan Mortgage Corporation (Freddie Mac) purchases residential mortgages from members of the Home Loan Bank system and issues pass-through securities.
- ▶ **FNMA** – Federal National Mortgage Association (Fannie Mae) issues corporate obligations to finance its purchases of conventional mortgages.

Agencies:

- Eligible per G.S. 159–30 (c)(1) or (2)
- Issue short-term instruments called discount notes, which are sold at a discount and longer-term notes and bonds bearing coupons.
- Low credit risk
- Excellent secondary market

Common Types in NC local governments

- Step-Ups – Notes with two or more interest rates, Typically pay a lower rate the first period and then have the option of being called or stepped up to a higher rate.
- Agency Callables – Securities with a feature that allows the issuer to call or mature the investment on specific dates.

Commercial Paper

- ▶ Maturities from 3 to 270 days
- ▶ Interest Bearing
- ▶ Discount Basis – Receive par at maturity
- ▶ Pay par and receive interest at maturity
- ▶ Marketed through issuers direct and through dealers.
- ▶ Rated by national rating services – Must be A1, P1 rated
- ▶ Minimum denomination – \$100,000

Mutual Funds

- ▶ Money market fund whereby the investor owns share of the entire fund and not individual securities.

Mutual Funds

- ▶ North Carolina Capital Management Trust (NCCMT)
- Cash Portfolio – Short-term investment with preservation of principal (1 basis point)
- Term Portfolio – Longer-term investment with fluctuating net asset value (6 basis points)
- ▶ SEC registered

Certificate of Deposit

- ▶ Time deposit in a financial institution documented by a certificate that bears a specific dollar amount of the deposit, a specified maturity date and a specified interest rate.

Let's switch gears...

If my unit of government has always placed
all idle funds at the NCCMT how do I go
about moving to a diversified portfolio?

What would Dr. Phil have
to say?

The difference between a
goal and a dream is a
plan.

10 step
program

Step 1

- ▶ **Meet with City/County Manager and ask for input and support.**

Step 2

- ▶ **If there is a Finance Committee I would meet with them to discuss what role they want to play in both decision making and reporting**

Step 3

- ▶ **Assess everyone's tolerance for investment risk.**

Step 4

- ▶ **Search for an existing investment policy. If one exists, I would review it and decide (given local and national economic conditions) whether or not it needs to be updated.**

Step 5

- ▶ **Research whether any existing trading agreements are in place**

Step 6

- ▶ **After I was confident with my updated policy, I would issue an RFP for safekeeping services.**
 - ▶ **Can do at the same time all banking services are bid or bid separately.**
 - ▶ **Remember to keep it simple...**

Step 7 (step 6 continued...)

- ▶ **“The City is required to maintain a third-party safekeeping account with an organization independent of the corporate structure of the City's primary bank. The account must be maintained in the name of the City. Currently, the City's safekeeping account is not maintained with the primary bank. If a third-party safekeeping account could be provided as part of the service proposal, please include costs for this service on a per transaction basis. The City reserves the right to place its safekeeping account with the institution awarded this contract or to maintain the status quo. Inability to propose a third-party safekeeping arrangement will not be considered an inability to provide adequate banking services.”**

Step 8

- **If you do not currently chart cash flows, you would need to develop a simple, yet practical strategy. Start by reviewing deposits on bank statements and A/P check runs. Map your significant inflows and outflows so you will know when you will need investment maturities and how much cash is actually available for investing.**

Step 9

- **At this point, everyone above you has approved the idea and you have safekeeping and broker agreements in place. You have analyzed your cash needs so you know how much you have to invest and when you need those investments to mature.**

Step 10

- ▶ **make the call to a broker you trust and proceed with the transaction.**

REMEMBER !

- ▶ Safety
- ▶ Liquidity
- ▶ Yield

Decisions, decisions, decisions...

- ▶ Will you purchase what you are being shown or will you competitively bid?

Make/take the call(s)!

Arrange for safekeeping of investments

- ▶ Safekeeping – (Delivery versus payment)
Funds are not transferred until the securities are delivered.

Other Investment Responsibilities...

- ▶ Reporting Requirements
 - LGC 203
 - Compliance with Investment Policy

Resources for Public Investors

- ▶ NCGS 159-30
- ▶ School of Government
- ▶ Local Government Commission
- ▶ NC Local Government Investment Assoc.
- ▶ NCGFOA & GFOA
- ▶ Finance Directors
- ▶ NCCMT
- ▶ Investment Brokers and Banks

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Questions ???

