Understanding Public Investment Reporting

A Handbook for Local Elected Officials

State Treasurer Phil Angelides, Chair
Understanding Public Investment Reporting

A Handbook for Local Elected Officials

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION
Commission Members

Phil Angelides, State Treasurer and Chair
Gray Davis, Governor
Steve Westly, State Controller
Mike Machado, State Senator
Charles Poochigian, State Senator
Judy Chu, State Assembly Member
Susan Leal, Treasurer,
   City and County of San Francisco
Donna Linton, Assistant County Administrator,
   Alameda County
The California Debt and Investment Advisory Commission

The California Debt and Investment Advisory Commission (CDIAC) provides research, education, and technical assistance to local public agencies and other public finance professionals on the topics of public debt and investments.

CDIAC was created in 1981 with the passage of Chapter 1088, Statutes of 1981 (AB 1192, Costa). AB 1192 established CDIAC as the State's clearing-house for public debt issuance information and required it to assist state and local agencies with the monitoring, issuance, and management of public debt. Chapter 833, Statutes of 1996 (AB 1197, Takasugi) expanded CDIAC's mission to include public investments.

CDIAC's principal goals include assisting local governments to reduce the cost of debt issuance and maximize the security and benefits of their debt and investment transactions. CDIAC achieves this through education, research, and data collection.

More information is available on the CDIAC website at www.treasurer.ca.gov/cdiac.
In California, the legislative body of a local agency serves as a trustee and, thereby, bears the “fiduciary” responsibility for investments made by the agency. While the legislative body may delegate the authority to invest the agency’s funds to a treasurer for a period of one year, in most cases the legislative body continues to act as fiduciary.

To assist the legislative body of a local government to meet its fiduciary obligation, state law requires treasurers or chief fiscal officers of a local agency to submit a quarterly report to their chief executive officer, their internal auditor, and the legislative body of their local agency within 30 days of the end of the quarter covered by the report. It also requires treasurers to whom investment authority has been delegated to report on a monthly basis to the legislative body the transactions made during the previous reporting period.

The California Debt and Investment Advisory Commission has produced this “quick-reference guide” to help elected and appointed local government officials, investment oversight committee members, and the agency’s legislative body, review and interpret investment reports. The main body of this guide discusses some of the basic principles of public funds investing and the nature and content of public investment reports. Reviewing and interpreting investment reports depends upon a basic understanding of the mechanics and theory of investing contained in this section. A more technical treatment of many subjects is provided in areas set apart from the main body of the text. These discussions are designed for those seeking a deeper understanding of public funds investing.

It should be noted that because differences exist between local agencies some topics contained within this guide do not apply to all organizations.
### I. Who Is Responsible For Investing Public Funds?  
1

- Fiduciary and Other Responsibilities of a Governing Body Investing Public Funds  
  1
- Investment Services and Providers  
  2

**Take-Aways** – “Who is responsible for the investments my agency makes?”  
3

#### Short Subjects
- A Prudent Investor Defined  
  1
- Local Agencies Defined  
  1
- Types of Investment Service Providers  
  2
- Delegating Authority to Investment Advisors  
  4

### II. What Are The Objectives Of Public Fund Investing?  
5

- Safety  
  5
- Credit Ratings  
  6
- Table 1 – Credit Ratings for Long-term Debt  
  8
- Table 2 – Credit Ratings for Short-term Debt  
  9
- Liquidity  
  11
- Market Risk  
  12
- Reinvestment Risk  
  13
- Yield  
  14

**Investment Policies Can Address the Balance Between Safety, Liquidity, and Yield**  
14

**Take-Aways** – “What must my agency consider when investing its public funds?”  
16

#### Short Subjects
- Investments and Ratings  
  10
- Credit Risk Versus Liquidity Risk  
  11
- Minimizing Credit, Liquidity, and Market Risk  
  12
- Return and Risk  
  13
- Calculating Yield  
  14

### III. What Public Funds May Be Invested?  
17

**Take-Aways** – “Which public funds can my agency invest?”  
18

#### Short Subjects
- Types of Public Funds  
  17
Table of Contents
(continued)

IV. How May Public Funds Be Invested?  19
   Table 3a – Allowable Investment Instruments
       (Applicable to all local agencies)  20
   Table 3b – Allowable Short-term Investment
       Instruments (Applicable to counties or a city
       and county)  22
   Investment Policies Should Set Limits  24
   Cash Flows Affect the Selection of Investments  25
   Take-Aways – “In what securities can my
       agency invest?”  26

   Short Subjects
   Examples of Investment Limits Set
       by Investment Policies  24

V. What Do Investment Reports Contain?  27
   Required Filing Periods  27
   Required Contents of Investment Reports  27
   Reviewing Quarterly Reports  29
   Take-Aways – “What information should be included
       in my agency’s investment report?”  30

   Short Subjects
   Investment Policy Versus Quarterly Reports  27
   Investment Report Required Contents Pursuant
       to California Government Code
       Section 53646  28
   Approaches to Reporting Compliance with
       Investment Policies in the
       Quarterly Report  28

VI. What Tools Are Available To Evaluate The
       Performance Of A Portfolio?  31
   Benchmarking  32
   Take-Aways – “What should my agency consider
       when evaluating its portfolio performance?”  34
Table of Contents
(continued)

<table>
<thead>
<tr>
<th>Short Subjects</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Dangers of Comparing Portfolios</td>
<td>33</td>
</tr>
<tr>
<td>Checklist For Evaluating Your Agency's Investment</td>
<td>35</td>
</tr>
<tr>
<td>Reporting Activities</td>
<td></td>
</tr>
<tr>
<td>Summary Of Relevant Government Code Sections</td>
<td>37</td>
</tr>
<tr>
<td>Glossary Of Selected Terms</td>
<td>41</td>
</tr>
<tr>
<td>Glossary Of Investment Instruments</td>
<td>45</td>
</tr>
<tr>
<td>Selected Resources And Reference Materials</td>
<td>48</td>
</tr>
</tbody>
</table>
A PRUDENT INVESTOR DEFINED

Government Code Section 53600.3 states that a prudent investor is expected to use "care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency." The Uniform Prudent Investor Act, contained in California Probate Code Sections 16045 to 16054, sets forth the statutory duties and powers of trustees.

LOCAL AGENCIES DEFINED

Government Code Section 53600 defines local agencies as a "county, city, city and county, school district, community college district, public district, county superintendent of schools, or any public or municipal corporation." Throughout this guide we refer to local agencies, local entities, and local governments synonymously. We also use the terms "legislative body" and "governing body" to refer to county boards of supervisors, city councils, boards of education, and boards of directors of a special district or other local agency.

California Government Code Sections 27000.3 and 53600.3 designate the governing bodies of all local agencies and persons authorized to make investment decisions on behalf of local agencies to be trustees and, therefore, fiduciaries subject to the "prudent investor standard." The prudent investor standard is founded upon the presumption that a fiduciary will make the same decisions with respect to the use of public funds that a prudent person, seeking to maintain principal and meet the agency's cash needs, would make if provided the same information. The courts have strictly interpreted the fact that fiduciaries must act in the same manner as a prudent person who is familiar with public investing.  

Fiduciary and Other Responsibilities of a Governing Body Investing Public Funds

In general, a governing body may delegate the authority to invest, but it cannot completely delegate its fiduciary responsibility. It remains obligated to meet the prudent investor standard whenever the local agency invests, reinvests, purchases, acquires, exchanges, sells, or manages public funds. It also must ensure that those carrying out their authority comply with this standard and all applicable legal requirements.

Government Code Section 53607 allows the legislative body of a local government to delegate for a one-year period its authority to invest or reinvest funds to sell or exchange securities held by the agency. Subject to Section 53607, Government Code Section 27000.1 allows a board of supervisors to delegate investment authority to the county treasurer. By doing so, Section 27000.3 states that the county treasurer shall serve as a fiduciary, not the board of supervisors. Following the delegation

1 Restatement, 3d, of Trusts (Prudent Investor Rule), American Law Institute, 1992.
TYPES OF INVESTMENT SERVICE PROVIDERS

Broker – Brokers mediate exchanges between buyers and sellers of securities, but seldom own the securities that are offered to buyers. A broker’s compensation is derived from the difference between the bid and offer price applied to a transaction. The bid price is the price at which a buyer is prepared to purchase a security while the offer price is the price at which a seller is prepared to sell a security. Brokers and broker/dealers may act in an advisory capacity, as well. The fees paid for such services may be based upon the services provided or a percentage of the assets under management much like the remuneration paid an investment advisor (see discussion below.)

Broker/Dealers – Dealers, sometimes referred to as market makers, maintain an inventory of securities that they have purchased from issuers or other broker/dealers. A dealer’s inventory becomes the storehouse of securities offered to buyers. A broker/dealer is a dealer who may perform broker functions alongside their dealer activities. Like brokerage firms, dealer firms derive their compensation from the difference between the bid and offer price of securities in secondary market transactions. In the case of new issuance or in the process of underwriting new securities, the dealer firm receives a takedown or concession from the issuer of the securities. The term "broker/dealers" is defined in

Investment Services and Providers

Government Code Section 53601.5 requires local agencies to purchase the investments authorized pursuant to Section 53601 or 53601.1 from the issuer or an institution licensed by the state as a broker/dealer, a member of a federally regulated securities exchange, a national or state-chartered bank, a savings or federal association, or a brokerage firm designated as a primary government dealer by the Federal Reserve bank. In addition to selling securities, investment professionals assist local governments to establish and manage their investment portfolios. The relationship between a local agency and a provider of investment services varies according to the individuals involved.

Investment professionals may fill one of several roles, including brokers, dealers, and broker/dealers of financial securities, and investment advisors or managers of investment funds or pools.

In describing these roles, we refer to the firm and not the individual who may carry out the functions assigned to a particular role. The fiduciary responsibility for investment transactions conducted through brokers or broker/dealers remains vested in the public official who has contracted for their services. One difference between brokers and investment advisors rests on the extent to which each assumes some fiduciary responsibility alongside the public agency. In most cases, brokers and public officials represent opposing sides of an investment transaction.
Section 25004 of the California Corporations Code as "any person engaged in the business of effecting transactions in securities in this state for the account of others or for his own account." The term "also includes a person engaged in the regular business of issuing or guaranteeing options with regard to securities not of his own issue."

**Investment Advisors** – Investment advisors are professional consultants who make investment recommendations to local agencies in concert with the agency’s investment policy. Unlike brokers and dealers, who are compensated on the basis of transactions they execute, investment advisors are usually paid on a fee-for-service basis. Investment advisors require no license or certification, but, depending upon the type of clients served or the amount of funds managed, must register with the Securities and Exchange Commission or the California Department of Corporations. The titles investment advisor, investment consultant, money manager, and investment manager are often used interchangeably.

**Investment Fund Managers** – Investment fund managers are professional money managers who administer pooled investments on behalf of local governments. The Local Agency Investment Fund (LAIF), managed by the State Treasurer’s Office, is an example of a pooled investment. Private investment fund managers are registered investment advisors.

**WHO IS RESPONSIBLE FOR INVESTING PUBLIC FUNDS?**

Investment advisors and investment fund managers who are authorized to make investment decisions on behalf of a local agency, on-the-other-hand, share a fiduciary obligation with the public agency and are expected to put that agency’s interests ahead of their own. This is not to say that brokers and broker/dealers do not recognize the local agency’s investment limits or risk profile when carrying out trade orders. To maintain a longstanding relationship, it is in the broker or broker/dealers best interest to listen and work closely with a local agency to best serve their investment needs.

**Take-Aways**

Who is responsible for the investments my agency makes?

1. Does your legislative body understand the "prudent investor" standard and the implications it contains with respect to investment expertise?
2. Is your legislative body aware of the different types of investment professionals and is it using the right combination to achieve its goals?
3. Has your legislative body delegated the authority to invest the agency’s funds?
4. Taking into account provisions that allow county boards of supervisors to delegate to a treasurer its fiduciary responsibility, does your legislative body realize that it should maintain the fiduciary responsibility for all investment transactions made by brokers and broker/dealers on behalf of the public entity?
DELEGATING AUTHORITY TO INVESTMENT ADVISORS

Local agencies may differ with regard to the authority they provide to investment advisors to invest public funds. A local agency may delegate discretionary or non-discretionary authority to an advisor.

Discretionary authority allows the advisor to make trades proactively in compliance with a set of investment criteria. As long as the advisor meets the investment criteria, the advisor may make trades without receiving the public agency's approval before each trade.

With non-discretionary authority the investment advisor has a working partnership with the local agency to set investment objectives and implement investment strategies, but must get the local agency's approval to exercise investment transactions.

In addition, a local agency may choose to use an investment advisor to give the agency advice on its investments and investment practices, including the selection of other investment professionals. Finally, a local agency may use an investment advisor to review the performance of the portfolio on a periodic basis and make recommendations that may improve performance or reduce risk.
II. What Are The Objectives Of Public Fund Investing?

The investment of public funds is driven by three primary objectives as prescribed by Government Code Section 53600.5. Local agencies must first safeguard the principal invested, then meet the liquidity needs of the agency, and, finally, achieve a return. To meet these objectives, local agencies must develop investment programs that control their exposure to risk, including credit risk, liquidity risk, market risk, and reinvestment risk. We discuss each of these in their appropriate context. In focusing on these four types of risk, we do not discount other risks that affect public investments, including event risk or the chance that something unexpected will impede the ability of an issuer of a security to meet its obligations.

Safety

The foremost goal of any governing body investing public funds is to preserve and protect capital. A local agency’s ability to safeguard investment principal is primarily a function of its ability to account for credit risk among other things. Credit risk is the possibility that an issuer or guarantor of a security will be unable to make scheduled payments of interest and principal. Another aspect of credit risk is the potential that the market’s perception of the issuer’s credit will cause the fair market value of the security to decline even though a default is not imminent.

The illustration on the following page characterizes authorized public investments in California according to their underlying credit risk. It must be interpreted generally and with the understanding that the credit risk of a particular security may be a function of factors other than the financial condition of the issuer, including general market conditions or the issuer’s financial management practices.
Credit Ratings

Credit ratings provide an important tool to measure credit risk by characterizing an issuer’s ability to make future payments of the interest and principal owed on outstanding debt obligations in a timely manner.

Credit rating agencies provide an independent appraisal of credit quality and the likelihood of timely repayment of debt. Rating agencies charge fees for ratings that are paid by the issuer and may charge fees to investors for receiving credit reports. The three most widely cited bond rating agencies are Moody’s Investor Services (Moody’s), Standard & Poor’s, and Fitch Ratings.

Each major rating agency maintains a separate rating scale for long-term debt (generally defined as debt with a maturity over one year) and short-term debt (maturing within one year). The highest ratings assigned to long-term debt are "Aaa" (Moody's) or "AAA" (Standard & Poor's and Fitch Ratings). Issuers receiving these ratings provide the greatest assurance of timely debt repayment. For California local agencies, the lowest long-term credit rating allowed for public funds investment is an "A" rating. Issuers rated lower than "A" are deemed to be less likely to meet their obligations on outstanding debt.

The three credit rating agencies also utilize distinct rating systems for short-term debt. The following tables illustrate the long-term and short-term ratings systems currently in place.
**TABLE 1**

**Credit Ratings for Long-term Debt**

<table>
<thead>
<tr>
<th>Moody’s Bond Rating</th>
<th>Standard &amp; Poor’s Long-Term Ratings</th>
<th>Fitch Ratings Long-Term Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aaa</td>
<td>AAA</td>
<td>AAA</td>
</tr>
<tr>
<td>Aa</td>
<td>AA</td>
<td>AA</td>
</tr>
<tr>
<td>A</td>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td>Baa</td>
<td>BBB</td>
<td>BBB</td>
</tr>
<tr>
<td>AAA/Aaa:</td>
<td>Highest quality, smallest degree of investment risk. Usually applied to borrowers with large margins for payment of debt service.</td>
<td></td>
</tr>
<tr>
<td>A:</td>
<td>Upper-medium grade quality that provides adequate security, but with the possibility of credit impairment in the future.</td>
<td></td>
</tr>
<tr>
<td>BBB/Baa:</td>
<td>Medium grade, adequate security, susceptible over time to changing economic conditions and impairment. The financial community recognizes &quot;BBB/Baa&quot; to be investment grade even though California law prohibits public agencies from investing in securities with this rating.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Moody’s Bond Rating</th>
<th>Standard &amp; Poor’s Long-Term Ratings</th>
<th>Fitch Ratings Long-Term Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ba</td>
<td>BB</td>
<td>BB</td>
</tr>
<tr>
<td>B</td>
<td>B</td>
<td>B</td>
</tr>
<tr>
<td>Caa</td>
<td>CCC</td>
<td>CCC</td>
</tr>
<tr>
<td>Ca</td>
<td>CCC</td>
<td>CCC</td>
</tr>
<tr>
<td>C</td>
<td>C</td>
<td>C</td>
</tr>
<tr>
<td>D</td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td></td>
<td></td>
<td>DDD, DD, D</td>
</tr>
</tbody>
</table>

3 California Debt Issuance Primer; California Debt and Investment Advisory Commission, April 1998. Letter ratings may also contain a +/- to denote variations within a rating category.
**TABLE 2**

<table>
<thead>
<tr>
<th>Credit Ratings for Short-term Debt</th>
<th>Moody’s Prime Rating System</th>
<th>Standard &amp; Poor’s Commercial Paper Ratings</th>
<th>Fitch Ratings’ Short-Term Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>P-1</td>
<td>A-1</td>
<td>F1</td>
<td></td>
</tr>
<tr>
<td>P-2</td>
<td>A-2</td>
<td>F2</td>
<td></td>
</tr>
<tr>
<td>P-3</td>
<td>A-3</td>
<td>F3</td>
<td></td>
</tr>
<tr>
<td>Not Prime</td>
<td>B</td>
<td>B</td>
<td></td>
</tr>
<tr>
<td></td>
<td>C</td>
<td>C</td>
<td></td>
</tr>
<tr>
<td></td>
<td>D</td>
<td>D</td>
<td></td>
</tr>
</tbody>
</table>

For those ratings at the top of each column there are established cash flows, superior liquidity support, or demonstrated ability to refinance and a strong capacity to make a timely payment of principal and interest. Generally speaking, the lower the number modifier following a letter grade, the higher the quality and the lower the investment risk. The higher the number modifier, the lower the quality and the higher the investment risk. The lower the rating generally, the more vulnerable the issue is to changes in financial circumstances. Issues rated at the bottom of each column have a speculative capacity to pay principal and interest.

Issuers rated "P-3," "A-3," or "F3" have an acceptable or adequate source of repayment. Those rated "not prime" or "B" and below are considered speculative.

A "D" rating issued by Standard & Poor or Fitch Ratings is applied to issues is in actual default.

---

4 California Debt Issuance Primer; California Debt and Investment Advisory Commission, April 1998.
INVESTMENTS AND RATINGS

Government Code Sections 53601 and 53601.7 limit certain local agency investments according to the rating of the security or the issuer. These include the following limits.

- Commercial paper of "prime" quality or of the highest letter and numerical rating, namely "A-1/P-1." The issuing U.S. corporation must have total assets in excess of $500 million and carry an "A" rating or higher on debt issued other than commercial paper.

- Mortgage pass-through securities, collateralized mortgage obligations, mortgage-backed or other pay-through bonds, or consumer receivable-backed bonds must be rated "A" or higher. Issuers of this type of debt must be rated "AA" or better.

- Medium-term notes issued by corporations organized and operating within the U.S. or by depository institutions licensed and operating in the U.S. must be rated "A" or better.

- Companies managing shares of beneficial interest (e.g., money market funds and mutual funds) must have, with limited exceptions specified by law, the highest rating issued by not less than two nationally recognized agencies.

- Corporate and depository institutional investments purchased by counties or a city and county as a part of their short-term portfolio must maintain a short-term debt rating of "A-1/P-1/F-1" and, if the issuer has issued long-term debt it must be rated "A" or better.
CREDIT RISK VERSUS LIQUIDITY RISK

Local agencies may face a greater challenge from liquidity risk than from credit risk because liquidity needs may occur quickly due to unforeseen cash shortfalls. As a result, local agencies should commit resources to studying their cash position and understanding and predicting their cash needs. The local agency's investment decisions should reflect its cash flow patterns so that it reduces liquidity risk and avoids limits to its ability to buy or sell investment securities quickly and at the best price. This understanding should underlie all investment decisions the agency makes.

A decline in credit quality typically occurs over a longer period of time and can be anticipated with some success with the assistance of credit ratings and the regular review of financial statements. Mitigating credit risk is possible if an investor selects only highly rated securities and continues to monitor the credit rating of the issuer.

Mitigating liquidity risk is more difficult and can be achieved only if local agencies regularly analyze their cash flows. The California State Legislature has acknowledged the importance of cash flows in reducing liquidity risk by requiring that treasurers and fiscal officers include in their quarterly investment reports a statement that the agency is able to meet its cash needs for the next six months.

Liquidity

Public agencies often seek to generate earnings by investing the cash that they hold in reserve or that is not otherwise dedicated to a specific purpose. When an investor purchases an investment security with cash, however, he reduces his access to that same cash should it be needed for other purposes in the future. To describe the relationship between an investment security and the ease with which it may be exchanged for cash, analysts use the concept of liquidity.

Liquidity is commonly understood to be both a function of the maturity of an investment and its marketability. In an economic sense, all investments maintain a store of value that can make them liquid. In a practical sense, however, not all investments can be exchanged for cash without losing some of the amount originally invested. Liquidity risk is the possibility that an investor will not be able to exchange an investment for cash or sell it without loss of principal or value.

Liquidity risk is due, in part, to market forces that affect the pricing of a security, including the supply and demand for the security. Certain investment securities require the holder to pay a penalty if they redeem the security prior to maturity. By purchasing investments that are regularly traded in the secondary markets, investors can minimize potential losses that are due to liquidity risk.

The following diagram illustrates relative differences in the liquidity risk of various investments. In applying it, however, it is important to understand that the ability to exchange an investment for cash may be a function of several factors apart from the security. These factors include the market conditions that prevail at the time of sale and the demand for the security being offered for sale.
**MINIMIZING CREDIT, LIQUIDITY, AND MARKET RISK**

For most local agencies, loss of principal or asset value is unacceptable. To minimize the effects of credit, liquidity, and market risk local agencies can employ different management strategies. The most basic strategy involves purchasing only the highest investment grade instruments (credit risk), purchasing investments that trade actively in the secondary market (liquidity risk), or matching the maturities of investments to cash needs (market risk.) A more active strategy requires the local agency to carefully select and monitor the ratings and exposure to market forces presented by its individual investments. Reducing credit and market risk would require the agency to sell or exchange those securities that may be exposed

---

**Market Risk**

The fact that an investment may lose value as a result of a shift in the market provides the basis for what is termed market risk. Market risk is the possibility that an asset’s economic value will fall as a consequence of changes in the market, including interest rates or supply. As a result of an oversupply, for example, the market may value a particular security at a lower price than the investor originally paid. Likewise, a rise in interest rates may cause the market to drop the price of a bond holding a coupon interest rate that is lower than an investor could obtain from a bond purchased today.

Market risk is a function of time. The longer a security takes to mature, the greater the possibility that condi-
to rating changes or a falloff in demand. A still more active strategy requires that the local agency diversify its portfolio to account for the varying and unpredictable levels of credit, liquidity, and market risk inherent in the portfolio’s individual investments.

While these three approaches provide a hedge against credit, liquidity, and market risk, more active portfolio management is associated with higher administrative costs and greater volatility in price and returns. As a result, local agencies should acknowledge the benefits and costs associated with different strategies in choosing the one that meets its investment objectives and administrative and budget capacities.

**RETURN AND RISK**

In order to consider the relationship between return and risk, we will define return as the rate of growth (or loss) that distinguishes the value of the investment at the beginning of the period from the value at the end of the period.

\[
\text{Return} = \frac{\text{Value of Investment (Ending)} - \text{Value of Investment (Beginning)}}{\text{Value of Investment (Beginning)}}
\]

The expected return from an investment portfolio is highly correlated with the risk taken on by that portfolio. The higher the risk, the greater the expected return.

<table>
<thead>
<tr>
<th>Low Risk</th>
<th>High Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Return</td>
<td>High Return</td>
</tr>
</tbody>
</table>

**WHAT ARE THE OBJECTIVES OF PUBLIC FUND INVESTING?**

Market risk is of less concern to an investor that plans to hold a term-based investment until it matures. If an investor purchases a $1,000 bond and holds it until maturity, he will still receive $1,000 (and accrued interest) upon delivery of the bond even though interest rates may have changed and those changes have caused the value of the bond to fluctuate over this period.

**Reinvestment Risk**

The prospect of reinvesting funds in a lower interest rate environment poses another form of risk called reinvestment risk. *Reinvestment risk* is the possibility that the cash derived from selling or exchanging an investment will be reinvested at a lower interest rate than the rate of the original investment. Investments that are subject to early redemption, such as securities that an issuer may call back (termed callable securities), bear greater reinvestment risk than securities with a fixed investment term. Likewise, investments with a shorter term to maturity introduce greater reinvestment risk than those with a longer term to maturity, assuming both instruments are equally able to meet the liquidity needs of the agency.
CALCULATING YIELD

Current yield (market) is obtained by dividing the annual coupon income from a security by the current market value of the security.

Current yield (cost) is obtained by dividing the annual coupon income of a security by its cost.

Yield-to-maturity is the rate of return on an investment or a portfolio that equates the future cash flow (future value) to the initial cost or purchase price (present value).

Yield-to-call is the rate of return that equates the cash flow received on a security up to the first call date specified by the security.

Yield

While safety and liquidity should be primary considerations when structuring an investment portfolio, yield or return remains an important factor.

A straightforward relationship exists between expected return and risk. The greater the level of risk assumed by an investor, the greater the investment return an investor should expect. Before committing to an investment, an investor should assess whether the potential flow of funds from an investment justifies the risks taken on by that investment.

There are multiple measures of yield that an investor may use to determine the relative benefits of different investments. These include the current yield of a security as determined by its original cost or its current market value, yield-to-maturity, or the yield-to-call.

Investment Policies Can Address the Balance Between Safety, Liquidity, and Yield

*Government Code Section 53646* requires a county treasurer or local agency treasurer or chief fiscal officer to annually submit a statement of investment policy to the appropriate legislative body. A county’s policy must be reviewed and approved by the board of supervisors at a public meeting. Similarly, the legislative bodies of other local agencies must consider their agency’s policy at a public meeting. Once adopted, these policies may only be changed upon the review and consideration of the legislative body. Finally, *Section 53646* provides the legislative body the right to request any additional information it deems necessary to carrying out its duties.

*Government Code Section 27131* requires a board of supervisors of a county or city and county that
invests surplus funds to establish a county treasury oversight committee to review and monitor compliance with the county’s investment policy. The county treasurer is required to annually submit an investment policy to the oversight committee for review. Subsequent sections require the committee to initiate an annual audit to determine the treasurer’s compliance with statutory reporting requirements. The audit may include a review of the structure of the investment portfolio and the risks assumed by the portfolio.

An investment policy establishes the procedures and guidelines that ensure the prudent management of public agency funds. Policies can provide a way for local agencies to manage the various forms of investment risk. To control for credit risk, for example, a local agency’s investment policy may limit permissible investments to a set of highly rated securities. In addition to filtering investments according to their rating, an investment policy can consider the agency’s strategy for dealing with a drop in a rating for a security the agency already holds. To limit market risk, an agency may link its buying and selling of investment securities with its cash flow projections or limit the maturity of investment securities in its portfolio. Finally, while Government Code Section 53600.5 prioritizes safety over liquidity over return, the investment policy should allow those making the investment decisions the latitude and guidance to balance the safety, liquidity, and yield needs of the agency. For example, in certain markets the agency may find that it can increase its yield by extending the maturity without increasing risk or reducing liquidity.
Take-Aways

What must my agency consider when investing its public funds?

1. Has your legislative body reviewed, approved, or considered, as appropriate, the agency’s investment policy and each revision at a public meeting?

2. Do your legislative body and treasurer recognize the importance of maximizing safety and liquidity, while achieving a reasonable yield on public investments?

3. Do your legislative body and treasurer understand the complementary and contrasting relationships that exist between safety, liquidity, and yield?

4. Is your legislative body or treasurer aware of the types of risk to which your portfolio is exposed?

5. Do your legislative body and treasurer track the ratings of investment securities within your portfolio and monitor them regularly?

6. Does your agency have a plan in place to address rating changes when the ratings of investments held by the agency fall below the limit set by the agency’s investment policy or state law?

7. How does your agency ensure its investments will also meet its cash flow needs?

8. How does your agency manage its exposure to changes in market conditions, including interest rate changes?
TYPES OF PUBLIC FUNDS

General Deposits – The operating revenues of public entities derived from all general and special revenue sources and held in depository or demand accounts.

Treasury Funds – Money held by a public entity but not immediately required to maintain its operations.

Pension Funds – Funds held in a trust account for the retirement or related benefits of designated pensioners.

Bond Proceeds – Funds generated through the issuance of bond securities.

Advance Refunding Proceeds – Funds generated through the sale of a refunding bond more than 90 days prior to the refunded issue’s next call date, with the refunding proceeds held in trust.

Redemption Funds – Funds held for the specific purpose of retiring an obligation of the agency, which is callable or matures in stages, or for purchasing and retiring such an obligation or portion thereof as funds become available.

Pledged Funds – Moneys held by a trustee or fiscal agency and pledged to the payment or security of bonds or other forms of obligations, including leases, installment sales, or certificates of participation in bonds or other obligations.

Government Code Section 53601, et seq. specifies that “money in a sinking fund” or money in a “treasury not required for the immediate needs of the local agency” may be invested according to the provisions specified in that section. In addition, Section 53635.2 states that “all money belonging to, or in the custody of, a local agency, including money paid to the treasurer or other official to pay the principal, interest, or penalties of bonds…may be invested in the investments set forth in Section 53601.” Government Code Section 16429.1 enables local agencies to invest surplus funds, defined as money in their treasury that is not required for immediate needs, in the Local Agency Investment Fund for investment purposes.

State law addresses the investment of other funds, as well. For example, Section 53635.2 states, among other things, that money paid to the treasurer or other official of a public agency for the purpose of paying the principal, interest, or penalties on bonds must be deposited in a bank or other specified depository institution or may be invested according to Section 53601. Section 53604 allows the legislative body of a local agency to sell, or exchange for other eligible securities, any securities purchased by the agency and reinvest the proceeds.

Public agencies must invest bond proceeds according to the terms set forth in Government Code Sections 5903(e), 5922(d), and 53601(l), which, in general, allow the public agency to follow the controlling provisions of the bond resolutions and indentures. In addition, a local agency may invest funds held by a local agency in a deferred compensation plan in the types of investments specified in Section 53601. Chapter 2, Article 1.5 of Division 2 of Title 5 of the Government Code, commencing with Section 53215 controls the
Sinking Funds – A reserve fund set-aside over a period of time for the purpose of liquidating or retiring an obligation, such as a bond issue, at maturity.

investment of public pension funds. The different requirements contained in these and other laws and documents place a burden on the local agency to consider the fit between the source of funds and the range of allowable investments applying to that source of funds.

Take-Aways

Which public funds can my agency invest?

1. Does your agency hold moneys not required for the immediate needs of the agency, pledged funds, or proceeds of bonds or pension funds?

2. If your agency invests different types of funds, is it aware of the controlling authority that determines how the agency can invest these funds?
How May Public Funds Be Invested?

**Government Code Sections 16429.1, 53601, 53601.1, 53601.7, 53635, 53638** set forth the types of securities that may be used by local agencies to invest their treasury funds and moneys held in sinking funds. They also set forth the maximum percentage of a portfolio that may be invested in certain securities. Tables 3a and 3b provide a summary of allowable investment instruments set forth by state law. **Section 53601.1** allows local agencies to include in the list of authorized investments financial futures or options contracts in any investment category listed in **Section 53601** (Table 3a).
**Table 3a**
Allowable Investment Instruments Per State Government Code (as of January 1, 2003)  

**Applicable to all local agencies**

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Maximum Maturity</th>
<th>Maximum Specified Percentage of Portfolio</th>
<th>Minimum Quality Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Agency Bonds</td>
<td>5 years</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>U.S. Treasury Obligations</td>
<td>5 years</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>State of California Obligations</td>
<td>5 years</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>CA Local Agency Obligations</td>
<td>5 years</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>U.S. Agencies</td>
<td>5 years</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Bankers’ Acceptances</td>
<td>180 days</td>
<td>40 percent</td>
<td>None</td>
</tr>
<tr>
<td>Commercial Paper—Select Agencies</td>
<td>270 days</td>
<td>25 percent of the money</td>
<td>&quot;A-1/P-1/F-1&quot;; if the agency's issuer has issued long-term debt it must be rated &quot;A&quot; without regard to modifiers</td>
</tr>
<tr>
<td>Commercial Paper—Others Agencies</td>
<td>270 days</td>
<td>40 percent of the money</td>
<td>&quot;A-1/P-1/F-1&quot;; if the agency's issuer has issued long-term debt it must be rated &quot;A&quot; without regard to modifiers</td>
</tr>
<tr>
<td>Negotiable Certificates of Deposit</td>
<td>5 years</td>
<td>30 percent</td>
<td>None</td>
</tr>
<tr>
<td>Repurchase Agreements</td>
<td>1 year</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Reverse Repurchase Agreements &amp; Securities Lending Agreements</td>
<td>92 days</td>
<td>20 percent of the base value of the portfolio</td>
<td>None</td>
</tr>
<tr>
<td>Medium-Term Notes</td>
<td>5 years</td>
<td>30 percent</td>
<td>&quot;A&quot; rating</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>N/A</td>
<td>20 percent</td>
<td>Multiple</td>
</tr>
<tr>
<td>Money Market Mutual Funds</td>
<td>N/A</td>
<td>20 percent</td>
<td>Multiple</td>
</tr>
<tr>
<td>Collateralized Bank Deposits</td>
<td>5 years</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Mortgage Pass-Through Securities</td>
<td>5 years</td>
<td>20 percent</td>
<td>&quot;AA&quot; Rating</td>
</tr>
<tr>
<td>Time Deposits</td>
<td>5 years</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>County Pooled Investment Funds</td>
<td>N/A</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Local Agency Investment Fund (LAIF)</td>
<td>N/A</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>
NOTES

1. Sources: Government Code Sections 16429.1, 53601, 53635, and 53638.

2. Municipal Utilities Districts have the authority under the Public Utilities Code Section 12871 to invest in certain securities not addressed here.

3. Government Code Section 53601 provides that the maximum term of any investment authorized under this section, unless otherwise stated, is five years. However, the legislative body may grant express authority to make investments either specifically or as a part of an investment program approved by the legislative body that exceed this five year maturity limit. Such approval must be issued no less than three months prior to the purchase of any security exceeding the five-year maturity limit.

4. No more than 30 percent of the agency's money may be in Bankers' Acceptances of any one commercial bank.

5. "Select Agencies" are defined as a "city, a district, or other local agency that do[es] not pool money in deposits or investment with other local agencies, other than local agencies that have the same governing body".

6. 10 percent of the outstanding commercial paper of any single corporate issuer.

7. Issuing corporation must be organized and operating within the U.S. and have assets in excess of $500,000,000.

8. "Other Agencies" are counties, a city and county, or other local agency "that pools money in deposits or investments with other local agencies, including local agencies that have the same governing body". Local agencies that pool exclusively with other local agencies that have the same governing body must adhere to the limits set for "Select Agencies", above.

9. No more than 10 percent of the agency’s money may be invested in the Commercial Paper of any one corporate issuer; no more than 10 percent of the outstanding Commercial Paper of any one corporate issuer may be purchased by the local agency.

10. Reverse repurchase agreements or securities lending agreements may exceed the 92-day term if the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity dates of the same security.

11. Reverse repurchase agreements must be made with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a significant banking relationship with the local agency. The issuer must have held the securities used for the agreements for at least 30 days prior to sale.

12. "Medium-term notes" are defined in Government Code Section 53601 as "all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States".

13. No more than 10 percent invested in any one mutual fund.

14. Must receive the highest ranking by not less than two nationally recognized rating agencies or the fund must retain an investment advisor who is registered with the SEC (or exempt from registration), has assets under management in excess of $500 million, and has at least 5 years experience investing in instruments authorized by Government Code Sections 53601 and 53635.

15. Must receive the highest ranking by not less than two nationally recognized statistical rating agencies or retain an investment advisor who is registered with the SEC (or exempt from registration) and who has not less than 5 years experience in investing money market instruments with assets under management in excess of $500 million.

16. Issuer must have an "A" rating or better for the issuer's debt as provided by a nationally recognized rating agency.
### Table 3b

Allowable Short-term Investment Instruments

*Per State Government Code (as of January 1, 2003)*

**Applicable to counties or a city and county**

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Maximum Maturity</th>
<th>Maximum Specified Percentage of Portfolio</th>
<th>Additional Quality Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Treasury Obligations</td>
<td>397 days</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>U.S. Agencies</td>
<td>397 days</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>State of California Obligations</td>
<td>397 days</td>
<td>5 percent in any one issuer</td>
<td>None</td>
</tr>
<tr>
<td>CA Local Agency Obligations</td>
<td>397 days</td>
<td>5 percent in any one issuer</td>
<td>None</td>
</tr>
<tr>
<td>Bankers’ Acceptances</td>
<td>180 days</td>
<td>5 percent in any one issuer</td>
<td>None</td>
</tr>
<tr>
<td>Commercial Paper</td>
<td>270 days</td>
<td>5 percent in any one issuer</td>
<td>None</td>
</tr>
<tr>
<td>Negotiable Certificates of Deposit</td>
<td>397 days</td>
<td>5 percent in any one issuer</td>
<td>None</td>
</tr>
<tr>
<td>Repurchase Agreements</td>
<td>1 year</td>
<td>5 percent in any one issuer</td>
<td>None</td>
</tr>
<tr>
<td>Reverse Repurchase Agreements &amp; Securities Lending Agreements</td>
<td>92 days</td>
<td>20 percent of the market value of the portfolio</td>
<td>None</td>
</tr>
<tr>
<td>Debt Securities Issued by Corporation or Depository Institution</td>
<td>397 days</td>
<td>5 percent in any one issuer</td>
<td>None</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>N/A</td>
<td>10 percent in any one issuer</td>
<td>Multiple</td>
</tr>
<tr>
<td>Money Market Mutual Funds</td>
<td>N/A</td>
<td>10 percent in any one issuer</td>
<td>Multiple</td>
</tr>
<tr>
<td>Contracts Issued by Insurance Companies</td>
<td>397 days</td>
<td>5 percent in any one issuer</td>
<td>None</td>
</tr>
<tr>
<td>Mortgage and Collateral-backed Securities</td>
<td>397 days</td>
<td>5 percent in any one issuer</td>
<td>&quot;AA&quot; Rating</td>
</tr>
<tr>
<td>SEC Rule 2a-7 Allowable Investments</td>
<td>397 days</td>
<td>5 percent in any one issuer</td>
<td>None</td>
</tr>
</tbody>
</table>
NOTES

1. Sources: Government Code Sections 53601.7

2. A county or city and county may not invest in any security under Section 53601.7 that would cause the dollar-weighted average maturity of the funds in the investment pool to exceed 90 days.

3. Unless otherwise specified, all corporate and depository institution investments must meet or exceed the following criteria at the time of purchase: 1) Short-term debt must be rated at least “A-1, P-1, F-1”; 2) If the issuer of short-term debt has issued long-term debt, the long-term debt must be rated “A” or better without respect to modifiers. Because Section 53601.7 does not define these investments, local agencies should consult with their legal counsel to determine if any investments purchased fall within this category.

4. Eligible commercial paper investments may not represent more than 10 percent of the outstanding paper of an issuing corporation.

5. Issuing corporation must be organized and operating within the U.S. and have assets in excess of $500,000,000.

6. Subject to the limits placed on depository funds specified in Government Code Section 53638.

7. Eligible certificates must be issued by a nationally or state-chartered bank or a federal association, or by a state-licensed branch of a foreign bank. Investments in certificates of deposit are subject to certain restrictions on conflicts of interest as specified in Section 53601.7(e)(7).

8. Repurchase agreements, reverse repurchase agreements, or securities lending agreements must meet the delivery requirements specified in Government Code Section 53601.

9. A security underlying a repurchase agreement or a reverse repurchase agreement may exceed the 397-day term limit placed on all investments allowed under Government Code Section 53601.7.

10. Applies to reverse repurchase agreements unless the agreement includes a guaranteed return for the entire period of the agreement.

11. Value of portfolio based upon investments owned and does not include securities subject to other agreements, such as securities lending agreements.

12. Investments in reverse repurchase agreements or similar investments can be made only with the approval of the governing body of the local agency and only with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a “significant banking relationship” with the local agency. The issuer must have held the securities used in the agreement for at least 30 days.

13. Includes securities specified as “medium-term notes” issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States.

14. The investments in securities and obligations made by the mutual fund must conform to Government Code Section 53601.7 except that the counterparty to a reverse repurchase agreement or securities lending agreement is not required to be a primary dealer of the Federal Reserve Bank of New York if the company’s board of directors finds that the counterparty presents a minimal risk of default.

15. Must receive the highest ranking by not less than two nationally recognized rating agencies or the fund must retain an investment advisor who is registered with the SEC (or exempt from registration), has assets under management in excess of $500 million, and has at least 5 years experience investing in money market instruments.

16. These include guaranteed investment contracts.

17. Category includes mortgage pass-through securities, collateralized mortgage obligations, mortgage-backed and other pay-through bonds, equipment lease-backed certificate, consumer receivable pass-through certificates, or consumer receivable-backed bonds.

18. Issuer must have an “A” rating or better for the issuer's debt as provided by a nationally recognized rating agency.
EXAMPLES OF INVESTMENT LIMITS SET BY INVESTMENT POLICIES

**Ratings** – Investment policies may limit the amount of risk a local agency may assume in its investment portfolio by requiring that all debt instruments be rated above the minimum "A" rating required by state law.

**Type of Issuer** – Investment policies may limit the type of investments a local agency may purchase from specific issuers. For example, the agency may choose to invest only in U.S. government or agency-backed securities.

**Distribution** – Investment policies may limit risk by establishing maximum proportions in different categories of investments. For example, it may require that the agency hold at least 40 percent of its portfolio in liquid assets, including cash, and invest no more than 5 percent in medium-term notes.

**Maturity** – A local agency may limit market risk by limiting the proportion or maturity of long-term investments or the maximum maturity of its portfolio. For example, the agency may specify that the weighted average maturity of its portfolio may not exceed two years or 730 days.

**Exclusions** – A local agency may limit its investment risk by excluding certain types of investments that involve greater oversight by staff to properly manage.

It is important to recognize that not all the investments appearing in Tables 3a and 3b are appropriate for all local agencies. A local agency’s investment policy may select from this list in order to reflect its capacities and investment strategy.

The investment limits set by state law that appear in Tables 3a and 3b must be applied at the time a security is purchased. Over time, local agencies may find that their portfolios do not conform to these limits due to the natural evolution of their investments as they mature or are called or the balance of their invested funds declines. This does not constitute a violation of state law. However, counties and a city and county are required to review for possible sale any security they have purchased under the authority contained in Section 53601.7 that has been downgraded below the minimum acceptable level stated in Table 3b.

**Investment Policies Should Set Limits**

A local agency’s investment policy should delineate the type of securities the agency may use when investing treasury funds. It also may set forth other limits, such as the maturity and ratings of securities by the portfolio or the maximum proportion of the portfolio committed to certain types of investments. Some types of securities allowed by Sections 53601 and 53601.7, particularly corporate securities and certain federal agency securities, require comparatively more analysis and expertise to properly employ.

Investment policies may limit the choice of securities available to the local agency depending on the agency’s willingness and capacity to manage investments in these securities. Because agency leadership, staff, and financial circumstances change, these policies must be reviewed from time to time and no less than annually to ensure that they continue...
to reflect the changing resources and experience of the agency as well as market availability.

**Cash Flows Affect the Selection of Investments**

Cash flows from investments can be an important factor in the liquidity of the portfolio and are, therefore, important when a local agency is choosing between different investment securities. The link between investment choice and cash flows was codified in 1995 when the State Legislature required that treasurers and chief fiscal officers report on the ability of the local agency to meet its pool’s expenditure requirements for the next six months. The requirement to do so is contained in *Government Code Section 53646*.

As a local agency considers its cash needs, it also coincidentally must consider its investment returns. In a normal interest rate environment, long-term investments generate higher rates of return than short-term investments when all other factors are held equal, while short-term investments offer greater flexibility at lower yields than long-term investments. Given the tradeoff between yield and liquidity (see page 11 and page 14), local agencies must balance their yield objectives with the liquidity needs of their portfolio.

As the agency’s investments mature, they provide a source of cash for operations or other uses. There are potential costs associated with not managing the agency’s investment portfolio in relation to its cash needs. These costs include the loss of principal that may result from the agency selling investments prior to their maturity or the cost of reinvesting with a more expensive alternative.
Take-Aways

In what securities can my agency invest?

1. Do the investments made by your agency conform to Government Code Sections 16429.1, 53601, 53601.1, 53601.7, 53635, and 53638?

2. Does your agency’s investment policy place the minimum restrictions as specified by state law on permissible investments?

3. If necessary, does your agency’s investment policy place additional restrictions on permissible investment to reflect a greater concern for safety and liquidity?

4. Do the investments made by your agency comply with its investment policy?
INVESTMENT POLICY VERSUS QUARTERLY REPORTS

Government Code Section 53646 refers to both investment policies and quarterly reports. While the code provides no formal definition of either term, their meanings have been established by common practice.

Investment Policy - A statement of the local agency’s objectives and methods of investing public funds. An investment policy may include a list of investment securities that the legislative body has approved for use by the local agency. It also may include performance measures or benchmarks that will be used to evaluate the return on investments, standards of care for the management of funds, and minimum credit quality requirements for investment securities. Government Code Section 27133 sets forth the contents of an investment policy prepared by a county treasurer for an investment oversight committee.

Quarterly Reports - A statement of investments held, fund balances, activity, and return on investments made by the local agency. Quarterly reports should reflect the current position and past performance of a portfolio of investments for the period of time under consideration.

Required Filing Periods

With some exceptions, California Government Code Section 53646 requires treasurers and chief fiscal officers of local agencies to submit a quarterly investment report to the chief executive officer, the internal auditor, and the legislative body of the local agency within 30 days following the end of the quarter covered by the report. Section 53646 also provides that a legislative body of a local agency may elect to receive the report on a monthly basis.

In addition to the reporting requirement set forth by Section 53646, a local agency treasurer who has been delegated authority to invest or reinvest funds of the local agency by the legislative body under Government Code Section 53607 must submit a monthly report to the legislative body accounting for transactions made during the prior reporting period. This report is separate and distinct from the quarterly report submitted under Section 53646.

Required Contents of Investment Reports

Government Code Section 53646 mandates that the quarterly investment reports of a local agency contain certain items. These include the type of investment, the issuer’s name, the date of maturity of the security, the par amount of the instrument, market value, and the dollar amount invested in each security. The report also must reference all funds that are under the management of investment providers, such as investment advisors, investment managers, and the investment advisory functions of banks and brokers and dealers. A local government’s quarterly report also must state the portfolio’s compliance with the agency’s investment policy required under Government Code Section 53646.
INVESTMENT REPORT REQUIRED
CONTENTS PURSUANT TO
CALIFORNIA GOVERNMENT
CODE SECTION 53646

1. Type of investment
2. Issuer name
3. Date of maturity
4. Par amount
5. Dollar amount invested in all
   securities
6. Investments and moneys held by
   the local agency
7. Description of any of the local
   agency’s funds, investments, or
   programs under the management
   of contracted parties.
8. Current market value of all funds
   held by the local agency and
   under the management of any
   outside party that is not also a
   local agency or the California
   Local Agency Investment Fund
   and the source of that value.
9. Statement of compliance with
   local agency investment policy.
10. Statement of the local agency’s
    ability to meet its cash flow
    needs for six months.

APPROACHES TO REPORTING
COMPLIANCE WITH
INVESTMENT POLICIES
IN THE QUARTERLY REPORT

A common practice among treasurers and fiscal officers is to provide a quick check of the portfolio’s compliance with the agency’s investment policy as a part of their quarterly investment reports. The purpose of doing so is to allow the legislative body to confirm that the agency’s investment policies are being met.

The quarterly investment report must include a statement regarding the local agency’s ability to meet its cash flow needs for the next six months. A local agency may pay for operations and projects with invested funds that have matured or been sold or exchanged. In the latter case, a local agency risks the possibility that securities that are sold or exchanged to meet these expenditures will be exposed to market and liquidity risk that jeopardize both the yield and asset value of these invested funds. To avoid this potential problem local agencies can develop a strategy for investing funds that matches their short- and long-term cash needs. This strategy may appear as a component of the investment report.

Government Code Section 53646 allows the treasurer or fiscal officer of a local agency that invests solely in the Local Agency Investment Fund (LAIF), an investment pool administered by the State Treasurer’s Office, county pools, or other insured accounts specified by law to provide to the legislative body of the agency the most recent statement of the applicable fund, pool, or account in place of the quarterly report. This provision exempts the treasurer or fiscal officer from the task of restating the information contained in an earnings statement in the same manner addressed above. The law presumes that the earnings statement contains sufficient information to allow the legislative body to review the activities of the portfolio.

Quarterly investment reports may contain information in addition to that required by Section 53646. This information may be of particular interest to the legislative body or to the reporting officer. It may include, for example, a list of approved brokers and dealers or a reconciliation of cash flows used for investment purposes. A reconciliation of cash flows
Some treasurers and fiscal officers state whether or not the portfolio complies with the agency's investment policies by making a single, comprehensive statement in the quarterly report. Others provide a more detailed account of compliance that compares each investment or category of investment with the agency's policy statement. For example, when reporting compliance with a policy that limits investments according to the credit rating of the security or the issuer of the security, a quarterly report might list the rating of each security or category of security held by the agency.

When verifying a portfolio's compliance with the agency's investment policy, it should be recognized that, after an investment is purchased, the investment might fall out of compliance with the agency's investment policy. That is, an investment may have complied with the policy when it was purchased, but, for example, because of a credit rating downgrade the investment no longer complies with restrictions on credit rating.

Where a percentage limit is specified in Government Code Section 53601, a local agency must comply only at the time of purchase. Non-compliance as a consequence of changing conditions and values within a portfolio may be cause for evaluation but are not violations of Section 53601.

might entail a record of transfers to and from various cash accounts along with details on the uses and sources of each transfer. The report may go so far as to tie each disbursement to the appropriate trade confirmation received from a broker or dealer. While local agencies account for cash transfers as a part of their comprehensive financial reporting, paying special attention to these transfers in the context of a quarterly report increases accountability and supports the efforts of fiduciaries to meet their obligations.

**Reviewing Quarterly Reports**

Although state law does not specifically require the members of a legislative body to take action on the quarterly report, their fiduciary obligations make it incumbent upon them to review and understand its contents. With certain exceptions, the legislative body of a local agency cannot delegate its fiduciary responsibility although it may delegate the day-to-day authority to make investment decisions.

When evaluating information provided by the report that is beyond that required by *Government Code Section 53646* the legislative body should refer to the guidance provided by the agency's investment policy or other statements that reveal the rationale for providing the information. The legislative body may use a list of approved brokers and dealers, for example, to determine whether the agency has used professional services appropriately. The legislative body may track cash transfers reported in a quarterly investment report to verify that investment purchases and payments to brokers and dealers match. Finally, the legislative body may include investments made using funds other than those reported under *Section 53646* in a comprehensive evaluation of the safety and liquidity needs of the local agency, as well as its yield goals.
Take-Aways

What information should be included in my agency’s investment report?

1. Does your agency’s quarterly investment report contain all the information required by Government Code Section 53646, including type of investment, name of issuer, maturity date, market value, and par and dollar amounts invested?

2. Does your agency’s quarterly investment report provide sufficient information for the legislative body to fulfill its fiduciary obligations?

3. If applicable, do the statements provided by LAIF, a county pool, or another insured provider and incorporated into your agency’s quarterly investment report contain sufficient information for your legislative body to fulfill its fiduciary obligation?

4. Does your local agency provide additional information within its quarterly investment report beyond that which is required by Section 53646? Is this information relevant and useful to a review of the investment activities of the local agency? Is there other information that would be helpful if included?

5. While state law requires that a treasurer or chief fiscal officer report on treasury funds only, your agency’s quarterly report may include other funds. Does your agency report investments made using funds other than treasury funds?

6. Were all public funds included in the quarterly report invested in a manner that was consistent with the investment policy of the agency and with state laws or other controlling documents, including bond indentures or notes of obligation?

7. Does your quarterly report state that the local agency can meet its cash flow needs for the next six months?
Since state statutes clearly set forth safety, liquidity, and yield as the objectives of public investing, public agencies should seek to measure their investing activities with respect to these three factors. How they choose to do so may vary.

In the simplest terms, safety, liquidity, and yield are functions of risk (see Chapter 2, for a discussion of safety, liquidity, and yield.) Accounting for risk, then, provides an indirect measure of the performance of an agency’s portfolio with respect to safety, liquidity, and yield. For example, a local agency may evaluate the safety of its investing activities by monitoring the ratings of its investments or the ratings of the issuers of the securities the agency holds. A local agency may assess the liquidity of its portfolio by calculating the average maturity of its investments, which reflects the length of time before the agency receives its money from those investments. Alternatively, it may calculate the cost and benefits from selling securities for cash needed to meet short-term objectives, including the opportunity costs associated with these transactions.

Notwithstanding safety and liquidity, one of the most common measures of investment performance is yield. One negative outcome of using yield as a performance measure, however, is the propensity to compare portfolio yields. Since portfolios differ in composition, maturity, size, and liquidity needs, however, yield comparisons that do not account for these factors may prove more misleading than productive.

To account for differences between portfolios, investors have sought out benchmarks whose composition, maturity structure, and risk characteristics are known and similar to the
agency’s portfolio. Working backwards, then, investors can interpret differences between their portfolio’s yield and the yield of a benchmark with similar portfolio characteristics.

**Benchmarking**

By definition, a benchmark is a passive index that represents the expected returns and expected risks that correspond to the investment objectives of the local agency’s portfolio. Among the commonly accepted benchmarks for public agency investment portfolios are 3-month Treasury bills and a 1-year to 3-year Treasury bond index. Because these benchmarks represent safe and relatively liquid assets, they provide a reference point from which to assess the relationship between performance and risk.

A local agency can use a benchmark that closely approximates a local agency’s pool of allowed investments as stated in its investment policy to measure the effect of that policy on performance and risk management. Differences between the benchmark and the portfolio can be evaluated in terms of the costs and benefits of increasing yield performance or reducing risk.

The strength of a benchmark as a point of comparison is a function of the differences between the benchmark and the agency’s portfolio with respect to the types of securities and their respective maturities, ratings, and underlying credit characteristics. If the agency’s portfolio is strongly similar to the benchmark, changes in the portfolio’s performance with respect to the benchmark will be a function of market values. However, if the portfolio is not strongly related to the benchmark, a change in performance may result from other conditions, including credit risk and
other forms of risk (i.e. market and reinvestment risk) within the portfolio.

In reality, few portfolios are composed of the exact same securities as their benchmark. This is because most benchmarks contain either a greater percentage of U.S. Treasuries and federal agency securities than most public agency portfolios or they include securities that are not allowed under Government Code Section 53601 or 53601.7. Local agency portfolios also are subject to constraints that do not exist within a benchmark, including liquidity needs and future liabilities. If a portfolio’s performance differs from that of its benchmark, it is critical to understand why. There may be good reason for the difference, including liquidity needs and future liabilities.

Because the portfolios of most local agencies do not replicate available benchmarks, many agencies use the comparable maturity Treasury security as a basis from which to assess the performance of their portfolios. In other words, a portfolio with an average maturity of 90 days may be compared to the yield on a 3-month Treasury bill. Agencies that adopt this approach should be careful to account for the difference between their portfolio and the Treasury benchmarks by evaluating returns over a long period of time rather than one or two quarters.

THE DANGERS OF COMPARING PORTFOLIOS

Portfolios are subject to the natural desire of individuals to compare. While comparison is appropriate to some extent, it should never become an overriding factor in choosing investments or an investment strategy. Local agencies will differ in many ways, and attempts to meet a benchmark, or yield of similar portfolios, can lead to poor decisions, especially when the comparisons include returns achieved over short periods of time. Local agencies should avoid any attempt to over emphasize the return achieved on their portfolio with respect to the returns of other portfolios except in so far as such comparisons may provide an acceptable range of performance for their portfolio. Substantial differences in returns from the returns of other portfolios may indicate a problem, but should not provide a basis for drastically revising the agency’s investment policy.
Take-Aways

What should my agency consider when evaluating its portfolio performance?

1. Are the agency’s yields being compared to that of other local agencies? If so, does the comparison control for factors such as agency cash flow needs, portfolio structure, and relative risk?

2. Is benchmarking of the portfolio used to regularly evaluate the performance of the portfolio?

3. What benchmarks are used and why were they chosen?

4. How does my agency’s portfolio compare to its benchmark over time, in particular, over a period of one to three years?
Members of the local agency’s legislative body or its investment oversight committee can use the following checklist to evaluate the investment reporting activities of their agency.

Does your local agency have an investment policy?

Is the policy reviewed at least annually?

Does your local agency report its investment activities at least quarterly?

Does the quarterly investment report provided to your legislative body contain the information required by Government Code Section 53646?

Do the investments made by your local agency conform to state law and your agency’s investment policy?

Has your treasurer or fiscal officer indicated in the quarterly report whether the portfolio is in conformance with state law and your agency’s policy?

Has your treasurer or fiscal officer identified those investments, if any, that have fallen out of compliance with the agency’s investment policy?

Does your agency have a plan for dealing with investments that are not in compliance?

Are your agency’s investments sufficiently diversified to guard against the loss of principal?
Does your local agency deposit funds in a third party custodial account? Does your agency receive reports from the custodian that are clear and comprehensive? Are these reports incorporated into your agency’s quarterly report or included as an attachment?

If an investment professional makes investments on behalf of your agency, does the agency have sufficient controls in place to guarantee that the investments conform to the agency’s policies and to state law?

Does your local agency regularly review the services provided by your broker/dealer or investment advisor to determine whether they are providing the necessary services in a cost-effective manner?

Has your agency instituted controls or accounting procedures that may include comparing the agency’s bank statements with the trade confirmations provided by brokers and dealers of investment securities?

Has your treasurer or fiscal officer stated in the quarterly investment report whether or not the agency can meet the expenditure needs of all investment pool participants over the next six months?

Does your agency use a benchmark to assess the performance and risk implied by its portfolio of investments? Does your legislative body understand the differences in characteristics between this benchmark and the agency’s portfolio of investments with respect to performance and risk?

If your agency is using a benchmark, how is your agency’s portfolio performing relative to the benchmark?
Creation of fund; investments; proceeds of bonds, etc.; distributions, report of investments

Summary – Creates the Local Agency Investment Fund and authorizes local agencies to deposit money held in the treasury and not required for immediate needs and proceeds of bonds, notes, or other forms of indebtedness in the fund for investment purposes.

Prudent investor standard; use in transactions with public funds

Summary – Establishes the board of supervisors as a fiduciary subject to the prudent investor standard with regard to county funds deposited in the county treasury. If the board of supervisors has delegated its authority to invest county funds according to Government Code Section 53607, it no longer serves as fiduciary and is not subject to the prudent investor standard. Requires a county treasurer or board of supervisors, as applicable, to exercise care, skill, prudence, and diligence when investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds.

County treasury oversight committees—Establishment; determination of size and membership

Summary – Requires the board of supervisors in each county or city and county, if that entity is investing surplus funds, to establish a county treasury oversight committee. The committee may be composed of 3 to 11 members selected by the board from a list of categories specified in law.

Periodic investment policy; preparation by treasurer; committee review and oversight

Summary – Sets forth the contents of an investment policy that is prepared annually by a county treasurer in a county that has established an investment oversight
committee. The investment policy is to be reviewed and monitored by the investment oversight committee.

**SECTION 27134**

**County treasury oversight committees—Periodic audits by committee; article compliance**

Summary – Requires a county treasury oversight committee to initiate an annual audit to determine whether the county treasurer has complied with the provisions of state law relating to preparing an investment policy and submitting it for review and monitoring by an investment oversight committee.

**SECTION 53600.3**

**Prudent investor standard; investments on behalf of local agencies**

Summary – Assigns trustee status to all governing bodies and persons authorized to make investment decisions on behalf of local agencies. Along with this status comes the fiduciary responsibility to protect the principal and maintain the liquidity of funds invested. The actions of fiduciaries are subject to the prudent investor standard. Furthermore, fiduciaries must reflect certain attributes, including skill, care, prudence, and diligence when making investment decisions.

**SECTION 53600.5**

**Objectives; managing public funds**

Summary – The primary objective of a trustee when investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, shall be to safeguard the principal of the funds under its control. The secondary objective shall be to meet the liquidity needs of the depositor. The third objective shall be to achieve a return on the funds under its control.

**SECTION 53601**

**Authorized investments; circumstances**

Summary – Defines the authorized investment securities in which a local agency may invest sinking funds or moneys in its treasury that are not required for immediate use by the local agency. Certain local
agencies are provided additional authority by *Section 53635* when investing in commercial paper.

**SECTION 53601.1**

**Investment in financial futures or financial options contracts**

Summary – Includes in the list of authorized investment securities financial futures or financial option contracts in any of the investment categories listed in *Section 53601*.

**SECTION 53601.5**

**Investments; qualified purchase agent**

Summary – Requires a local agency to purchase authorized investment securities from either: 1) the issuer; 2) an institution licensed by the state as a broker/dealer; 3) a member of a federally regulated securities exchange; 4) a national or state-chartered bank; 5) a savings association or federal association; or 6) a brokerage firm designated as a primary government dealer by the Federal Reserve Bank.

**SECTION 53601.6**

**Prohibited investments**

Summary – Restricts local agencies from investing in certain types of investments, including inverse floaters, range notes, or mortgage-derived, interest-only strips. Further restricts local agencies from investing in any security that could result in zero interest accrual if held to maturity.

**SECTION 53601.7**

**Local agency investments**

Summary – Defines authorized short-term investments that a county or city and county may invest any portion of funds within its control. This authority provided in *Section 53601.7* is separate and distinct from the authority provided local agencies to invest funds under *Section 53601* or *53635*. *Section 53601.7* differs from these sections by including guaranteed investment contracts with insurance companies as authorized investments for local agencies that are a county or a city and county.
SECTION 53607  
Delegation of duties to treasurer; monthly report

Summary – Allows a legislative body to delegate its authority to invest or reinvest funds of the local agency to the treasurer of the local agency. The treasurer, once delegated, assumes full responsibility for all transactions and must make a monthly report to the legislative body. The delegation of authority may be renewed annually.

SECTION 53635  
Local agency investments; commercial paper

Summary – Authorizes a county, city and a county, or other local agency that pools money in deposits or investments with other local agencies, other than local agencies that have the same governing body, to invest in the same securities listed under Section 53601. Expands the flexibility of these agencies when investing in commercial paper.

SECTION 53646  
Investment policy statement; review and approval; legislative body or oversight committee; reports

Summary – Requires the treasurer or chief fiscal officer of a local agency to annually submit a statement of investment policy to the respective legislative body. The county board of supervisors is required to “review and approve” the policy at a public meeting while other legislative bodies are required to “consider” the policy at a public meeting. The same, applicable review process is to be used whenever either type of agency changes the policy.

This section also requires the treasurer or chief fiscal officer to submit a quarterly report to the chief executive officer, the internal auditor, and the legislative body of a local agency. Finally, it sets forth the minimal content of the report and provides exemptions to certain local agencies.
While the following terms may have other uses, the definitions given here correspond to their usage in this document.

**BENCHMARK**
A passive index used to compare the performance, relative to risk and return, of an investor’s portfolio.

**CASH FLOW**
A comparison of cash receipts (revenues) to required payments (debt service, operating expenses, etc.).

**CREDIT RISK**
The chance that an issuer will be unable to make scheduled payments of interest and principal on an outstanding obligation. Another concern for investors is that the market’s perception of a corporation’s credit will cause the market value of a security to fall, even if default is not expected.

**CREDIT RATING**
Various alphabetical and numerical designations used by institutional investors, Wall Street underwriters, and commercial rating companies to give relative indications of bond and note creditworthiness. Standard & Poor’s and Fitch Ratings use the same system, starting with their highest rating, of AAA, AA, A, BBB, BB, B, CCC, CC, C, and D for default. Moody’s Investors Service uses Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C, and D. Each of the services use pluses (+), minuses (-), or numerical modifiers to indicate steps within each category. The top four letter categories are considered investment grade ratings.

**DURATION**
A measure of the timing of cash flows to be received from a security that provides the foundation for a measure of the interest rate sensitivity of a bond. Duration is an elasticity measure and represents the percentage change in price divided by the percentage change in interest rates. A high duration measure
INVESTMENT OVERSIGHT COMMITTEE indicates that for a given level of movement in interest rates, prices of securities will vary considerably.

FIDUCIARY An individual who holds something in trust for another and bears liability for its safekeeping.

INVESTMENT OVERSIGHT COMMITTEE A committee of three to eleven members formed under Government Code Section 27131 to monitor and review a county’s investment policy by causing an annual audit and discussing its finding at an open meeting. Although cities and other local agencies are not required to compose an investment oversight committee, the State Legislature has declared that all local agencies “should participate in reviewing the policies that guide the investment of those funds.”

LIQUIDITY The ease with which an investment may be converted to cash, either by selling it in the secondary market or by demanding its repurchase pursuant to a put or other prearranged agreement with the issuer or another party.

LIQUIDITY RISK The chance that a security, sold prior to maturity, will be sold at a loss of value. For a local agency, the liquidity risk of an individual investment may not be as critical as how the overall liquidity of the portfolio allows the agency to meet its cash needs.

MARKET RISK The chance that the value of a security will decline as interest rates rise. In general, as interest rates fall, prices of fixed income securities rise. Similarly, as interest rates rise, prices fall. Market risk also is referred to as systematic risk or risk that affects all securities within an asset class similarly.
<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Maturity</strong></td>
<td>The stated date on which all or a stated portion of the principal amount of a security becomes due and payable.</td>
</tr>
<tr>
<td><strong>Net Present Value</strong></td>
<td>An amount that equates future cash flows with their value in present terms.</td>
</tr>
<tr>
<td><strong>Par Amount or Par Value</strong></td>
<td>The principal amount of a note or bond which must be paid at maturity. Par, also referred to as the “face amount” of a security, is the principal value stated on the face of the security. A par bond is one sold at a price of 100 percent of its principal amount.</td>
</tr>
<tr>
<td><strong>Pooled Investment</strong></td>
<td>A market institution authorized under various sections of state law that represents the combined deposits of more than one local agency and pays returns based upon each local agency’s share of investment in the pool.</td>
</tr>
<tr>
<td><strong>Portfolio</strong></td>
<td>The combined holdings of all investment assets held by an investor.</td>
</tr>
<tr>
<td><strong>Principal Amount</strong></td>
<td>The face amount or par amount of a bond or issue of bonds payable on stated dates of maturity.</td>
</tr>
<tr>
<td><strong>Put</strong></td>
<td>The ability of a holder of an investment security to sell at a specified time and for a specified price the security back to the issuer or prior holder.</td>
</tr>
<tr>
<td><strong>Return</strong></td>
<td>The principal plus interest on an investment or portfolio of investments. In certain unfavorable market environments or due to risk factors, income derived from principal and interest may be less than the original amount invested.</td>
</tr>
</tbody>
</table>
RISK
The uncertainty of maintaining the principal or interest associated with an investment due to a variety of factors.

YIELD
For the purposes of this publication, return and yield are synonymous.
(Note: The following glossary is not intended to identify investment instruments authorized for use by California local governments. For a list of authorized investments, please refer to Tables 3a and 3b in this document.)

<table>
<thead>
<tr>
<th>Investment Instrument</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSET-BACKED SECURITIES</strong></td>
<td>Securities that are supported by pools of assets, such as installment loans or leases, or by pools of revolving lines of credits. Asset-backed securities are structured as trusts in order to perfect a security interest in the underlying assets.</td>
</tr>
<tr>
<td><strong>BANK NOTE</strong></td>
<td>A senior, unsecured, direct obligation of a bank or U.S. branch of a foreign bank.</td>
</tr>
<tr>
<td><strong>BANKER’S ACCEPTANCE</strong></td>
<td>Normally, a short-term bill of exchange that is accepted as payment by banks engaged in financing trade of physical assets or merchandise.</td>
</tr>
<tr>
<td><strong>BOND</strong></td>
<td>A debt obligation of a firm or public entity. A bond represents the agreement to repay the debt in principal and, typically, in interest on the principal.</td>
</tr>
<tr>
<td><strong>CALLABLE SECURITY</strong></td>
<td>An investment security that contains an option allowing the issuer to retire the security prior to its final maturity date.</td>
</tr>
<tr>
<td><strong>CERTIFICATE OF DEPOSIT</strong></td>
<td>A short-term, secured deposit in a financial institution that usually returns principal and interest to the lender at the end of the loan period. Certificates of</td>
</tr>
</tbody>
</table>

---

6 Sources include: CDIAC’s California Debt Issuance Primer, CDIAC seminar materials, CDIAC’s Investment Primer (in draft) as well as guidance provided by several text books, including “Fundamentals of Futures and Options Markets”; John C. Hull; Prentice Hall, 4th edition, 2002 and “Investments”; Zvi Bodie, Alex Kane, and Alan J. Marcus; McGraw-Hill/Irwin; 2002.
Deposit (CDs) differ in terms of collateralization and marketability. Those appropriate to public agency investing include:

**Negotiable Certificates of Deposit** – Generally, short-term debt instruments that usually pay interest and are issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. The majority of negotiable CDs mature within six months while the average maturity is two weeks. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

**Non-Negotiable Certificates of Deposit** – CDs that carry a penalty if redeemed prior to maturity. A secondary market does exist for these non-negotiable CDs, but include a transaction cost that reduces returns to the investor. Non-negotiable CDs issued by banks and savings and loans are insured by the Federal Deposit Insurance Corporation up to the amount of $100,000, including principal and interest. Amounts deposited above this amount may be secured with other forms of collateral through an agreement between the investor and the issuer. Collateral may include other securities including Treasuries or agency securities such as those issued by the Federal National Mortgage Association.

**Commercial Paper**

A short-term, unsecured promissory note issued by a large corporation.

**Corporate Notes and Bonds**

Debt instruments, typically unsecured, issued by corporations, with original maturities in most cases greater than one year and less than ten years.
| **FEDERAL AGENCY AND INSTRUMENTALITY OBLIGATIONS** | Obligations issued by a government-sponsored entity or a federally regulated institution. |
| **MORTGAGE PASS-THROUGH OBLIGATIONS** | Securities that are created when residential mortgages (or other mortgages) are pooled together and undivided interests or participations in the stream of revenues associated with the mortgages are sold. |
| **MUNICIPAL NOTES, BONDS, AND OTHER OBLIGATIONS** | Obligations issued by state and local governments to finance capital and operating expenses. |
| **NOTES** | Debt obligations of a firm or public entity, usually maturing in less than ten years. |
| **REPURCHASE AGREEMENTS** | From the perspective of a local agency, the short-term, often overnight, purchase of securities with an agreement to resell the securities at an agreed upon price. |
| **REVERSE REPURCHASE AGREEMENTS** | Differs from a repurchase agreement in the sense that a reverse repurchase agreement is an agreement to sell securities in return for cash with an agreement to repurchase the securities at an agreed upon price. |
| **STATE AND LOCAL INVESTMENT POOLS** | The combined deposits of state and local agencies organized and operated by a state treasurer or a local official. These pools operate much like a mutual fund, with local agencies investing money together in order to increase efficiency and reduce costs. |
| **STATE NOTES, BONDS, AND WARRANTS** | Obligations of the State of California or another state government with different maturity lengths. |
| **ZERO-INTEREST BOND** | A bond on which interest is not payable until maturity (or earlier redemption), but compounds periodically to accumulate to a stated maturity amount. Zero-interest bonds are typically issued at a discount and repaid at par upon maturity. |
Selected Resources and Reference Materials


City Treasurer’s Handbook (California Municipal Treasurer’s Association, 2002)
Acknowledgements

This publication was written by Mark Campbell, Senior Research Specialist in CDIAC’s Policy Research Unit. CDIAC acknowledges the contributions of several individuals and organizations in the production of this document. They include: Lisa M. Harris, Kristin Szakaly-Moore, and Robert Ingenito at CDIAC; California Deputy Treasurer Barbara Lloyd; Lester Wood, Cherie Raffety, Kay Chandler, Deborah Higgins, Zenda James, Nancy Jones, Bill Blackwill; the California Municipal Treasurers Association; the California Association of County Treasurers and Tax Collectors; and the California Society of Municipal Finance Officers.