



New Albany Capital Partners, LLC  
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**2016  
 Local Government Officials' Conference  
 March 23, 2016**

Small Government Investment Options

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**Course Objectives**

- ▶ **Discuss Investment Policy Statements**
- ▶ **Review ORC 135 for requirements related to investments in marketable securities**
  - We'll work to keep this a very broad-based overview; Please consult legal counsel for specific ORC 135 interpretations
- ▶ **Identify permitted investment securities**
  - What is on the menu?
- ▶ **Discuss a few tricks of the trade in the modern era**
  - A few pitfalls and (hopefully) funny stories on this otherwise serious subject

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**First Step(s)  
 Set up an IPS**

- ▶ Investment Policy Statement "standard parts"
  - **Objectives**
    - Safety of principal
    - Liquidity
  - **Constraints**
    - Identify eligible investments (with intent to hold to maturity)
    - Set maturity ceilings (max 5 yrs for most governmental entities)
    - Set concentration limits (min-max) and other risk factors
  - Identify the players (investment officer, custodian, brokers, advisors, etc)
- ▶ Then...
  - Adopt it and FILE it with the Auditor of State
  - Have every vendor associated with the process sign it as well

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## What's Next?



- ▶ From a best practice perspective – think about reviewing your IPS at least annually (need to adapt to constantly evolving markets)
  - The last few years have been “interesting” to say the least
  - FDIC ceilings have changed
    - And, they were “unchanged”
  - Structures are very different
    - “Steps” are now very commonly issued from several agencies
    - They were new not that many years ago
  - And, ORC materially changed in 2014

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## What Are “Interim Moneys”?



Now that an IPS is in place, you will need to designate “interim moneys”

According to ORC 135.01(F): *Interim Moneys* are public funds available after the award of “Inactive Deposits” and are not deemed to be “Active Funds”



In English, think of these funds as your *core investment portfolio*

These funds are not needed for daily operations

Easy way to do this? Create a separate account whose purpose in life is to hold interim moneys. Best practice is to use a trust account (a “qualified trustee” as noted in ORC 135) with a firm that is not one of your traders

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## What is on the Menu of Eligible Investments?



- ▶ ORC 135 (as revised in 2014) provides a bit of latitude
- ▶ Practically, the menu of investment options boils down to a few things
  - **US Government obligations**
    - Treasuries and certain agency obligations
  - **Money market instruments**
    - STAR, STAR Plus, Some market funds (we’ll cover this shortly)
    - Commercial paper and other short-term discount notes
  - **Municipal obligations**
    - General Obligations with some newer restrictions
  - **Bank products**
    - CDs and CDARS® and similar offerings
- ▶ What follows is a bit of text of the 2014 changes to ORC 135 as well as pending notes on Dodd-Frank regulations that affect money market mutual funds
  - We’ll try to hit the material changes impacting smaller government entities

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### What is on the Menu? (Part 1)



- ▶ 2014: Legislation changed the menu of US government obligations
  - "Treasuries" have always been considered allowable instruments (subject to maturity limitations)
  - "Agencies" changed a bit
    - As amended by SB 287, ORC 135.14 (B)(2) now reads:
      - Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality, including but not limited to, the federal national mortgage association, federal home loan bank, federal farm credit bank, federal home loan mortgage corporation, ~~and~~ government national mortgage association ~~and student loan marketing association~~. All federal agency securities shall be direct issuances of federal government agencies or instrumentalities.

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### What is on the Menu? (Part 2)



- ▶ Interim money investments frequently include items within the money market sector:
  - STAR and STAR Plus
  - Certificates of Deposit
  - Certain Money Market Mutual Funds
    - We'll discuss pending 2016 changes shortly
  - Commercial Paper
    - This is the subject of some new plumbing within ORC 135
  - Banker's Acceptance

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### What is on the Menu (Part 3)



- ▶ 2014 Changes to Commercial Paper:
  - (7) Up to ~~twenty-five~~ forty per cent of interim moneys available for investment in either of the following:
    - (a) Commercial paper notes issued by an entity that is defined in division (D) of section 1705.01 of the Revised Code and that has assets exceeding five hundred million dollars, to which notes all of the following apply:
      - (i) The notes are rated at the time of purchase in the highest classification established by at least two nationally recognized standard rating services.
      - (ii) The aggregate value of the notes does not exceed ten per cent of the aggregate value of the outstanding commercial paper of the issuing corporation.
      - (iii) The notes mature not later than ~~one~~ two hundred ~~eighty~~ seventy days after purchase.
      - (iv) The investment in commercial paper notes of a single issuer shall not exceed in the aggregate five per cent of interim moneys available for investment at the time of purchase.

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### What is on the Menu? (Part 4)



- ▶ **Municipal debt is a new investment option for many municipalities** – especially taxable G.O. issues
  - SB 287 made some major “adjustments” to what is considered an eligible municipal investment:
    - (4) Bonds and other obligations of this state, or the political subdivisions of this state, provided that, with respect to bonds or other obligations of political subdivisions, **all of the following apply**:
      - (a) The bonds or other obligations are payable from general revenues of the political subdivision and backed by the **full faith and credit** of the political subdivision.
      - (b) The bonds or other obligations are **rated at the time of purchase in the three highest classifications** established by at least one nationally recognized standard rating service and purchased through a registered securities broker or dealer.
      - (c) The aggregate value of the bonds or other obligations **does not exceed twenty per cent of interim moneys** available for investment at the time of purchase.
      - (d) The **treasurer or governing board is not the sole purchaser** of the bonds or other obligations at original issuance.

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### What is on the Menu (Part 5)



- ▶ **2016 Changes in money market funds**
  - Thanks to Dodd-Frank, funds will be required to have floating values and redemption fees, attempting to prevent the rush to redemption that occurred in 2008
    - Institutions rushed to redeem while retail investors remained calmer
  - Most major funds have created nearly identical funds that avoid floating NAVs and redemption fees/gates
    - Use funds that invest 99.5% in debt meeting the definition of a government security
      - Expected to retain “stable” NAV structure (\$1.00 – just as we know them today)
      - Have the option to impose redemption fees and gates

A “government security” is backed by the full faith and credit of the U.S. government. See rule 2a-7(a)(17); section 2(a)(16).

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### Putting this together – Execution



- ▶ Yields have gone from really, really, really low to just really, really low
- ▶ But, material opportunities to earn yields above those seen in cash equivalents (STAR, STAR Plus) can still be found within the ORC 135 eligible universe – if liquidity needs are well understood
  - Both STAR and STAR Plus have enjoyed modest increases in yields following December’s FED policy change
- ▶ While there is not general target portfolio or a one-size fits all model, many governmental entities frequently invest Interim Monies in the “Big Three”:
  - CDs
  - Treasuries
  - U.S. Government Agency obligations

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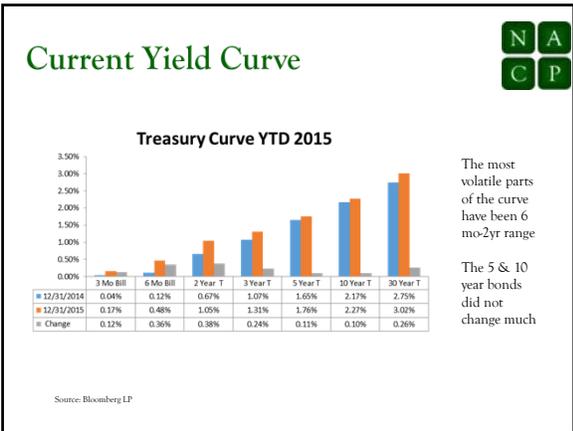
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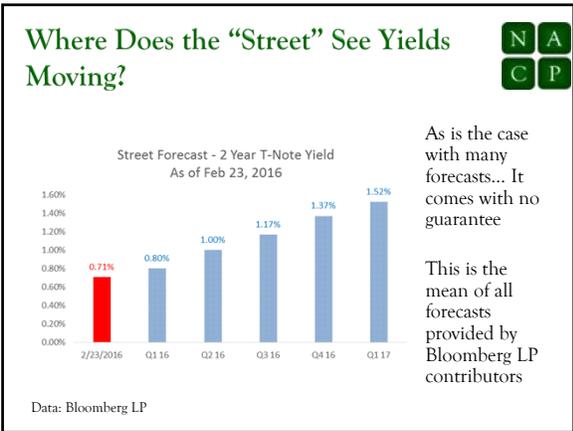
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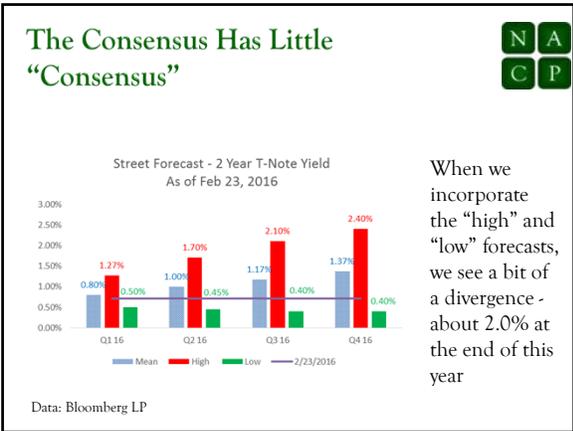
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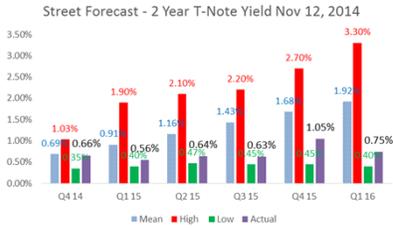
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## How Did Forecasters Do in 2015?



The Pessimists were more accurate than the others.

Data: Bloomberg LP

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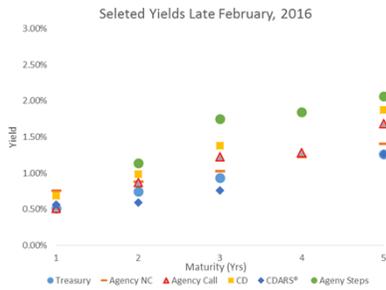
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## Selected Yields 2/28/16\*



\*CD yields are the average of the 5 highest reported yields for Ohio CDs as of 26 FEB 2016 (APY offered by community and banks may be materially higher). CDARS yields are advertised APY provided by Everbank and Peoples Bank; All other yields are YTM calculations per Bloomberg, LP

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## A Bit of Homework to Avoid Being the Weekend's News



- ▶ With any substantial financial transaction, don't be afraid to investigate the backgrounds of your potential dance partners
- ▶ Some public disclosure sites include:
  - FINRA
    - Regulates brokerage sales personnel
  - SEC
    - Regulates independent investment advisers
  - MSRB
    - Regulates independent municipal advisers
  - The Google...

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## What sort of “Things” Can You Find on FINRA’s Disclosures?



Reporting Source: Firm  
 Regulatory Action Initiated By: STATE OF OHIO  
 Sanction(s) Sought: Suspension  
 Date Initiated: 07/06/2009  
 Docket/Case Number: 04-076  
 Employing firm when activity occurred which led to the regulatory action: WELLS FARGO ADVISORS, LLC  
 Product Type:  
 Allegations: ADMITTED TO 19 COUNTS OF MAKING A CAMPAIGN CONTRIBUTION IN THE NAME OF ANOTHER PERSON IN VIOLATION OF SECTION 3013.13(G)(4)(A) OF THE OHIO REVENUE CODE.  
 Current Status: Final  
 Resolution: Settled  
 Resolution Date: 08/10/2009  
 Sanctions Ordered: Suspension

- ▶ Yep, 19 counts of making a campaign contribution in the name of another person
- ▶ It is a buyer-beware environment

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## Advisors and Brokers



- ▶ Advisors and brokers operate very differently; Yet both industries serve the needs of municipal entities, large and small
- ▶ Advisors (SEC or State Registered)
  - Fiduciary duty of loyalty to client
  - Fee based (generally)
  - Duty of “best execution”
    - Required by SEC rulemaking to select the best combination of service and price
  - Appeals to entities seeking to delegate management responsibilities to an independent fiduciary
- ▶ Brokers (FINRA Registered Representatives)
  - Regulatory requirement is a suitability standard
    - FINRA Rule 2111 simply requires that brokers “...must have a reasonable basis to believe” that a transaction is suitable for the customer
  - Compensated as a function of transaction size and volume
    - Depending upon the transaction, transparency may be difficult to determine
  - Generally appeals to entities with infrequent transaction needs (and/or limited resources to justify retaining an independent adviser)

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## If I haven’t Made You Hide In the Corner



- ▶ Or leave the room...
- ▶ There are actual investment opportunities out there
- ▶ Remember, you are probably the person charged with taking this stuff seriously
  - So..., don’t screw it up! ☺
- ▶ Whether you engage a fiduciary as an advisor or use a broker, what are the two most important things you need to do?
  - Check their background
  - Have him/her sign your IPS

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## To Wrap Up



- ▶ We reviewed ORC rules (and changes) associated with investing in many of the securities frequently associated with municipal government portfolios
- ▶ We reviewed pending Dodd-Frank changes to money market instruments
- ▶ We discussed market conditions and "Street" expectations published as of the end of 2015
- ▶ We reviewed some very real world due diligence tools that are available to anyone with a "Google"
- ▶ And..., I hope we have saved time for questions before lunch
- ▶ Many thanks!

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## Rick Wayman, CFA, CTP



With more than three decades of analytic experience, Rick has served as a buy-side, sell-side, and fee-based research analyst.

With a focus on regional small-cap names, Rick managed a fee-based research firm that he co-founded in 2000. Later, he served as the Vice President and Portfolio Manager for Sweetwater Asset Management, LLC, and its related hedge fund, Sweetwater Capital Partners, L.P.

In his career, he has appeared in *Barron's*, *The Wall Street Journal*, *Forbes.com*, *Investopedia.com*, *MultexInvestor*, and numerous local papers across the U.S. He has also spoken at NIRI and CFA Institute conferences and society meetings.

Rick is a Chartered Financial Analyst, an active member of the CFA Institute, and a former President and Board Member of the Columbus Society of Financial Analysts.

Rick received a BA in Political Science and International Relations from Wittenberg University, an MBA in Finance/International Business from Kent State University and a master's degree in accounting from the University of Phoenix. He also holds the CTP (Certified Treasury Professional) designation from the Association of Financial Professionals (AFP).

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