




Surfing the Liquidity Wave in Any Market Environment

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“You can’t stop the waves, but you can learn to surf.”

—Jon Kabat-Zinn,
mindfulness teacher

TODAY’S OBJECTIVES:

- List California Government Code-permitted options for short-term investing.
- Identify best practices for utilizing pooled investment options in California.
- List characteristics of the current investment environment and how they impact liquidity options.

Considerations for Cash and Operating Investments

- Bank Deposits
- Investment Pools (LGIPs)
- Short-Term Securities (Portfolio)



Investment Objectives: Liquidity is a Priority

Preserve principal

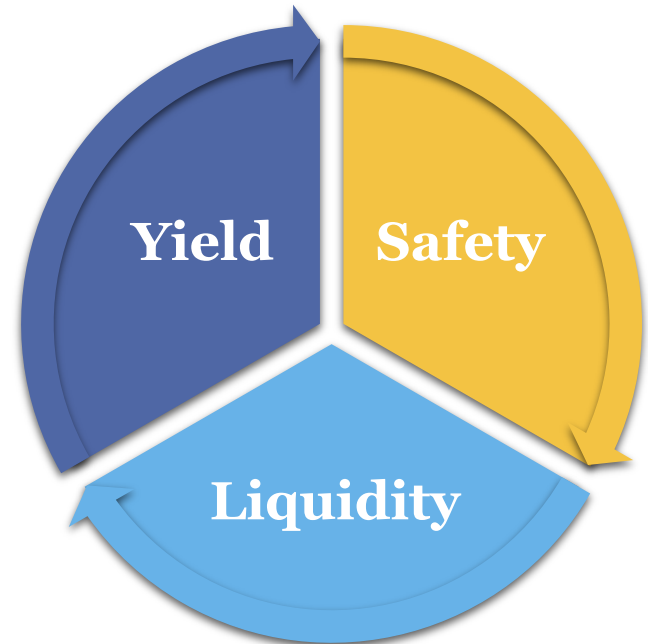
Comply with permitted investments under California Government Code

Maintain adequate liquidity

Work to keep idle cash invested at all times

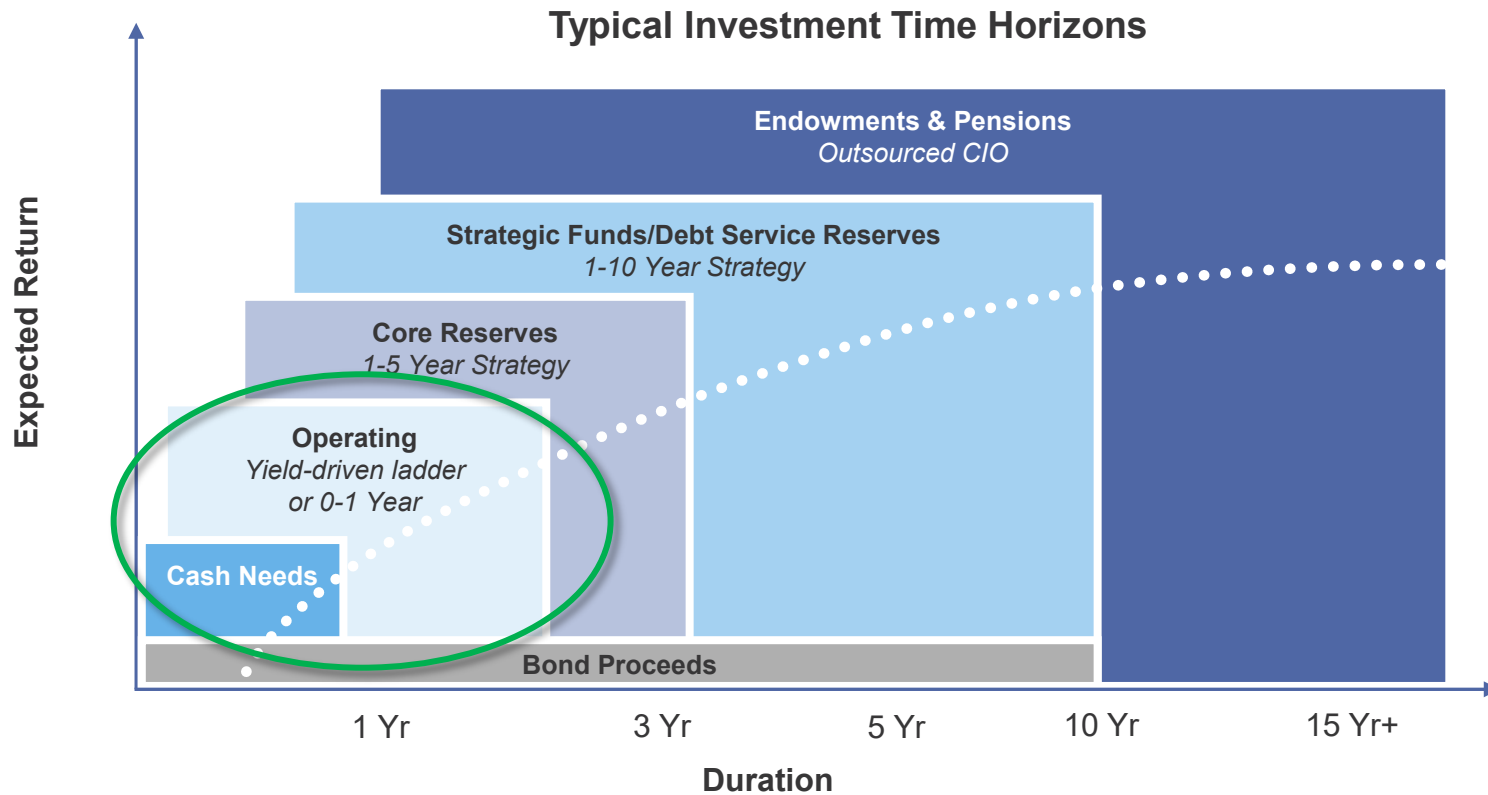
Earn competitive yield

Relative to a benchmark



Investment Horizon Informs Liquidity Strategy

- The use and objective of a fund/asset type is essential in determining a prudent and efficient investment strategy



Important Codes Related to Managing Your Liquidity

- California Government Code (Code)
- Investment Surplus (53600-53610)
- Deposit of Funds (53630-53686)

The screenshot displays the California Legislative Information website. At the top, there is a navigation bar with links for [skip to content](#), [home](#), [accessibility](#), [FAQ](#), [feedback](#), and [login](#). The main header features the California State Capitol dome logo and the text "California LEGISLATIVE INFORMATION". Below this is a "Quick Search:" box with a "Bill Number" dropdown and a "go" button. A secondary navigation bar includes links for [Home](#), [Bill Information](#), [California Law](#), [Publications](#), [Other Resources](#), [My Subscriptions](#), and [My Favorites](#). The main content area is titled "California Law >>> Code Section Group". It includes a "Code:" dropdown set to "Select Code" and a "Section:" input field, with a "Search" button and an information icon. Below this is a "Code Search" tab and a "Text Search" tab. The main content area displays the following hierarchy: **GOVERNMENT CODE - GOV**, **TITLE 5. LOCAL AGENCIES [50001 - 57550]** (Title 5 added by Stats. 1949, Ch. 81.), **DIVISION 2. CITIES, COUNTIES, AND OTHER AGENCIES [53000 - 55821]** (Division 2 added by Stats. 1949, Ch. 81.), **PART 1. POWERS AND DUTIES COMMON TO CITIES, COUNTIES, AND OTHER AGENCIES [53000 - 54999.7]** (Part 1 added by Stats. 1949, Ch. 81.), **CHAPTER 4. Financial Affairs [53600 - 53997]** (Chapter 4 added by Stats. 1949, Ch. 81.), and **ARTICLE 1. Investment of Surplus [53600 - 53610]** (Article 1 added by Stats. 1949, Ch. 81.). The text for **53600.** is: "As used in this article, 'local agency' means county, city, city and county, including a chartered city or county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation. (Amended by Stats. 1987, Ch. 887, Sec. 2.)". The text for **53600.3.** is: "Except as provided in subdivision (a) of Section 27000.3, all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with 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. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law."

California Government Code Permits Several Liquidity Options, Limits Risk

Securities		1 Day	180 Days	270 Days	1 Year	5 Years	Over 5 Years
CA Code Permitted Fixed-Income	U.S. Treasuries						Permitted with Prior Approval
	Federal Agencies						
	Municipal Securities						
	Negotiable Certificates of Deposit						
	Public Bank Debt						
	Commercial Paper						
	Bankers' Acceptances						
	Medium-Term Corporate Notes						
	Asset-Backed Securities (ABS)						
	Supranationals						
	Repurchase Agreements						
Money Market Funds/Bond Mutual Funds							
Local Government Investment Pools							
Broader Fixed Income	Foreign Sovereign						
	Fixed-Income ETFs						
	High-Yield Bonds						
	Private Placements						
	Convertibles						
	Non-U.S. Dollar Investment Grade						
	Emerging Markets Debt						
Equities	Bank Loans						
	Domestic Equities (Large, Mid, Small Cap)						
	Int'l Equities (Large, Mid, Small Cap)						
	Emerging Markets						
	Preferred Stock						
Alternatives	Equity Mutual Funds and ETFs						
	Commodities						
	Real Estate						
	Hedge Funds						
	Private Equity						
	Venture Capital						
	Tangible Assets						
Complex Derivatives, Futures and Options							

Bank Deposits

For Institutional Investor or Investment Professional
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Banks Offer Compensating Balances

- ▶ A common billing structure for municipalities
- ▶ Non-interest-bearing accounts generate “soft credits” to offset hard bank charges
- ▶ “Earnings credit rate”
 - Set by banks (aka “Managed Rate” or “Standard Rates”)
 - Have historically tracked short-term rates
 - Certain banks offer exemptions in the form of above-market rates for select clients

<i>Potential Advantages</i>	<i>Potential Disadvantages</i>
<ul style="list-style-type: none">▶ Offer of “free” services in lieu of paying interest on deposit balances▶ No need to budget for banking expenses▶ Potential for above-market exception rates for select clients	<ul style="list-style-type: none">▶ Effective rate can be severely reduced by reserve requirements and balance-based charges (some banks waive reserves)▶ Banks have the ability to change rates with no notice; may deviate from market rates▶ Excess, unused earnings credits that expire represent lost value

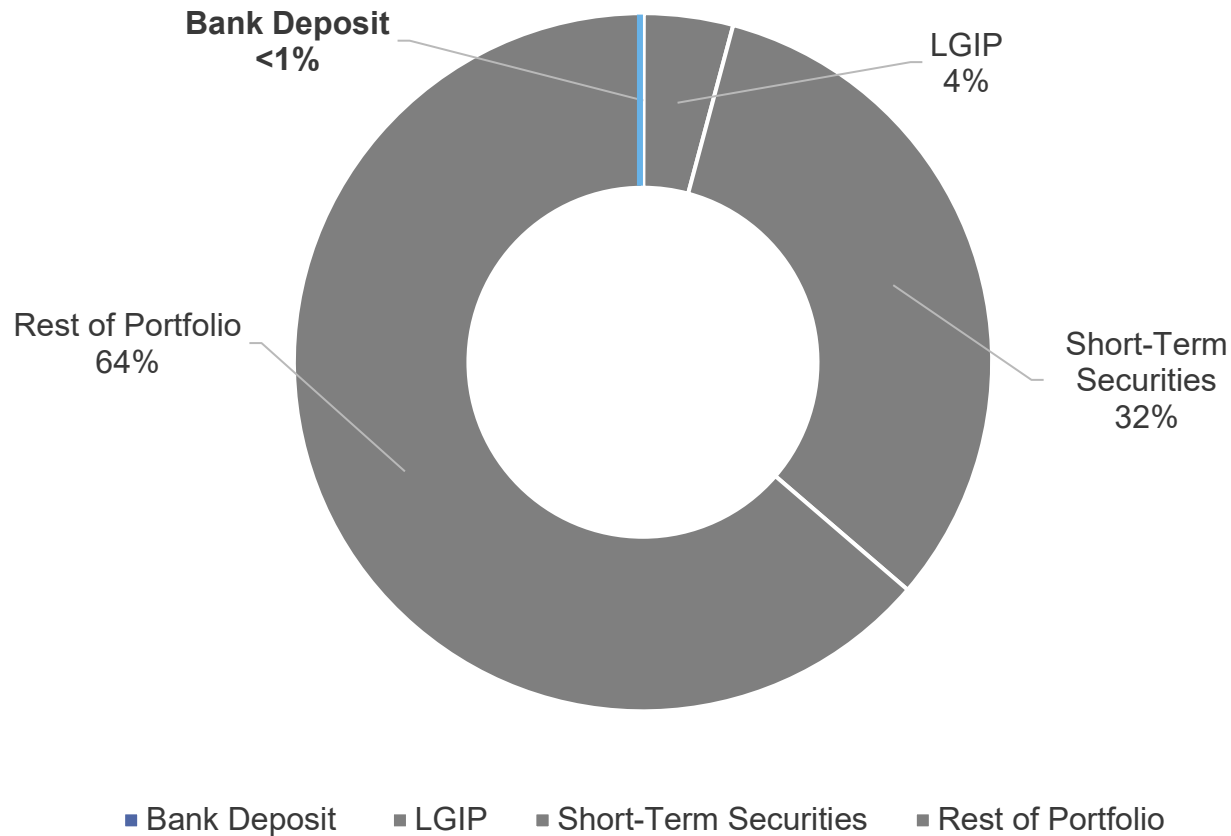
Considerations for Compensating Balances

- ▶ Stay informed about changes to prevailing short-term rates in the market
 - ▶ Know how your earnings credit or other bank rates compare to market rates
- ▶ Analyze your banking relationships regularly; monthly is best
 - ▶ Make sure to look at the rates offered as well as monthly charges
- ▶ Understand your options for short-term balances
 - ▶ Be nimble and prepared to capture increased earnings through alternative options like money market funds or LGIPs
- ▶ Maintain frequent communication with your banker(s)



County of San Diego Bank Deposits vs. Total Portfolio

County of San Diego Portfolio Statistics



Considerations for Permitted Investment Pools



Permitted Investments: Pooled Funds

- ▶ Shares of beneficial interest issued by a diversified management company [53601(l)]
 - ▶ Money market mutual funds (2)
 - 20% of portfolio
 - AAA by two or more NRSROs OR Advisor requirements
 - Net asset value (NAV) may be stable or variable depending on type of fund (government vs. prime, retail vs. institutional)
- ▶ Share of beneficial interest issued by a joint powers authority [53601(p)]
 - ▶ Local Government Investment Pools (LGIPs)
- ▶ State of California's Local Agency Investment Fund (LAIF) [16429.1]
- ▶ County Treasurers' pools [53684]

What is a Local Government Investment Pool?

Definition

Local Government Investment Pools (LGIPs) are cooperative investment products for the investment of short-term funds

Goals

- 1 Access
- 2 Efficiency
- 3 Cost-Effective

Example of LGIP Governance Structure

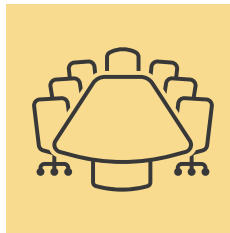
Stakeholders

INVESTORS



Decision-Makers

BOARD OF TRUSTEES



Service Providers

INVESTMENT ADVISER

CUSTODIAN BANK

TRANSFER AGENT

LEGAL COUNSEL

MARKETING/SHARE DISTRIBUTOR

AUDITOR

Do Your Own Due Diligence

Examples of useful information to review:

- Offering documents
- Investment policy
- Permitted investments
- Credit quality
- Liquidity
- Management
- Market price exposure
- Sensitivity analysis



Considerations Before Entering the Water



Is it an allowable investment per your agency's policy?

- Example LGIP language:



"Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (q), inclusive. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority. To be eligible under this section, the joint powers authority issuing the shares shall have retained an investment adviser that meets all of the following criteria:

- (1) The adviser is registered or exempt from registration with the Securities and Exchange Commission.
- (2) The adviser has not less than five years of experience investing in the securities and obligations authorized in subdivisions (a) to (q), inclusive.
- (3) The adviser has assets under management in excess of five hundred million dollars (\$500,000,000)."



How liquid is the pool?

- Example: LAIF offers same-day liquidity unless deposits and withdrawals are over \$10 million¹

OR



What are the pool's objectives?

- Does the pool have a stable or floating net asset value (NAV)?

"Shares in a California common law trust established pursuant to Title 1, Division 7, Chapter 5 of the Government Code of the State of California which invests exclusively in investments permitted by Section 53601 of Title 5, Division 2, Chapter 4 of the Government Code of California, as it may be amended."

1. Source: LAIF website. <https://www.treasurer.ca.gov/pmia-laif/answer/procedures.asp>.

Considerations Before Entering the Water (Continued)



Is the pool rated?



What is the pool's ease of use?

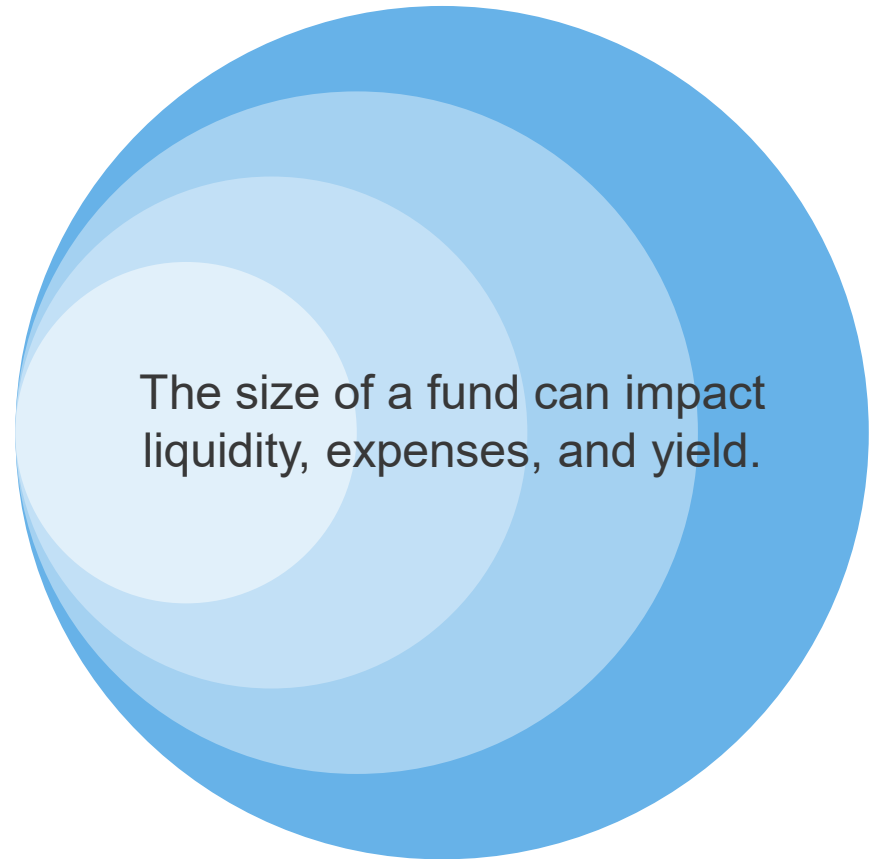
- Cut-off times
- Number of transactions
- Transaction amounts
- Online portal
- Help desk



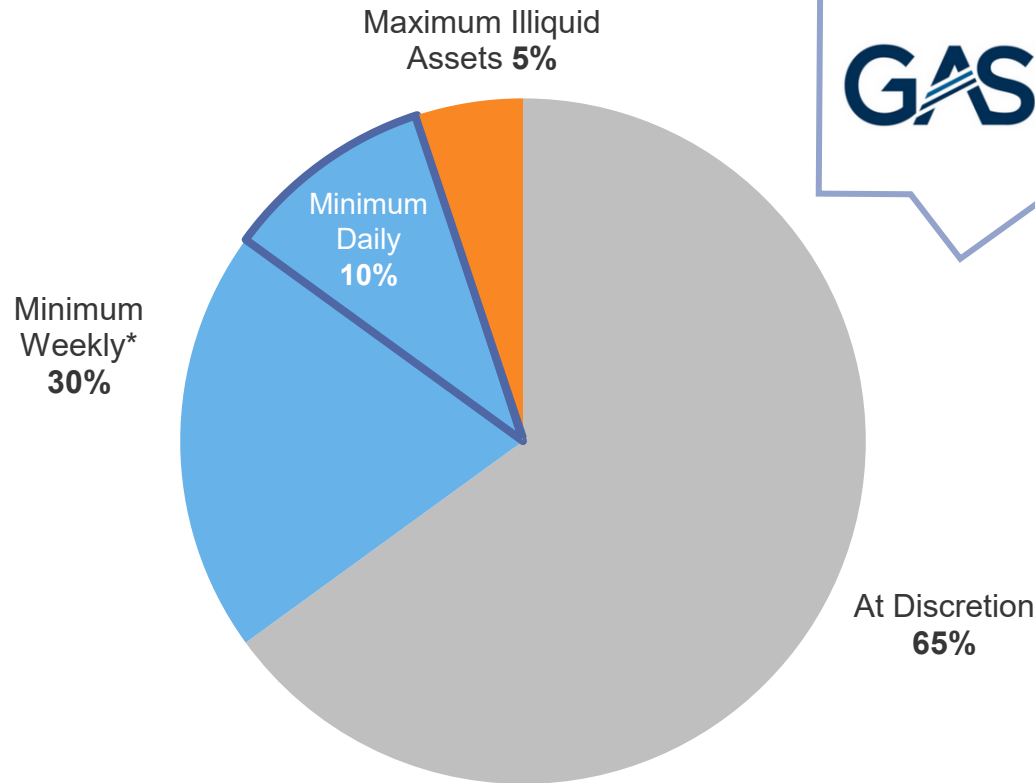
What is the size of the pool or fund?



Does the pool or fund follow Governmental Accounting Standards Board (GASB) rules?



GASB Statement 79 – LGIP Portfolio Liquidity Guidelines



GASB GOVERNMENTAL
ACCOUNTING
STANDARDS BOARD

*The percentage of the LGIP's portfolio that must consist of cash and instruments payable or redeemable on a daily or weekly basis. Subject to investment permissions/restrictions. Source:

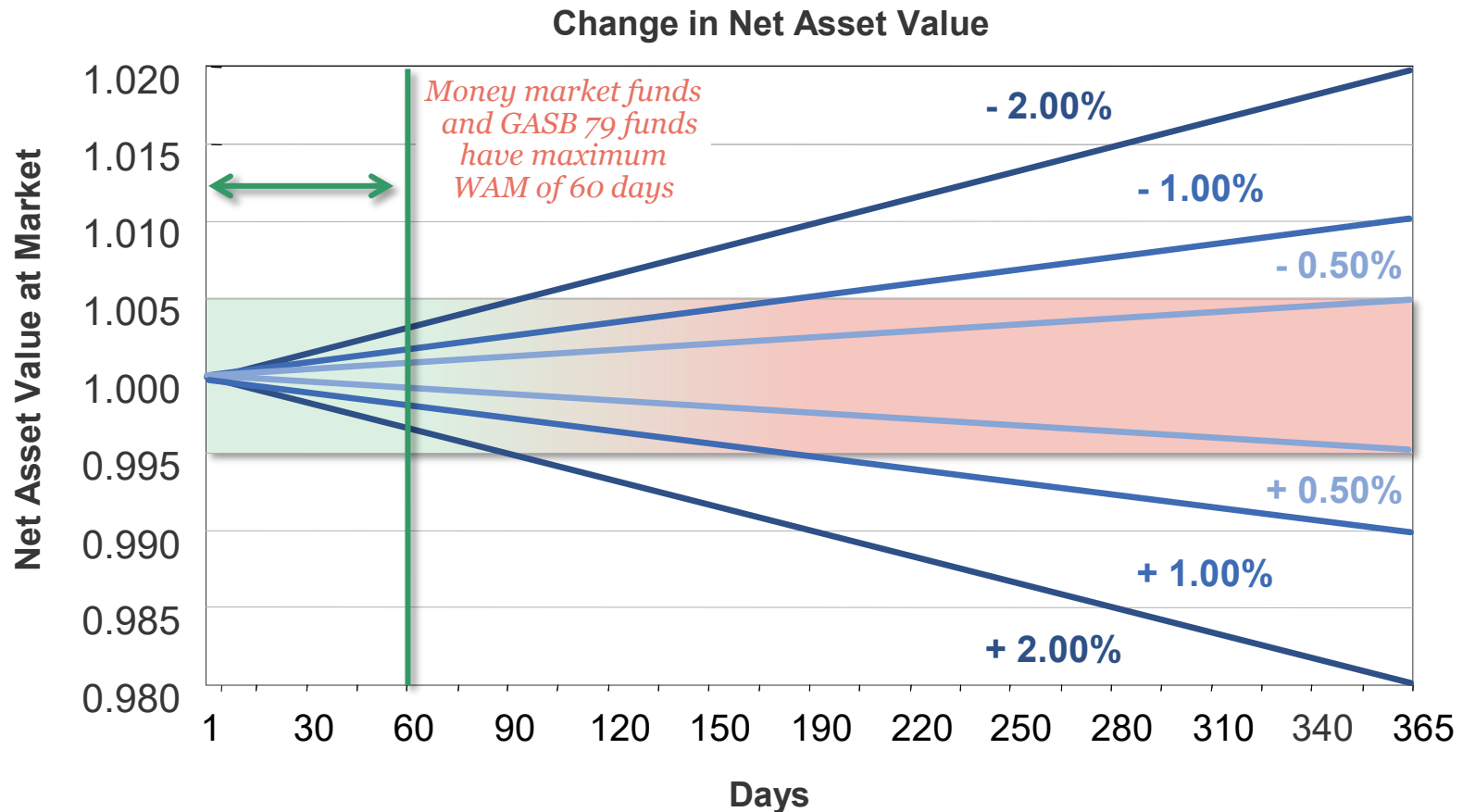
https://gasb.org/page/ShowDocument?path=GASBS_79.pdf&acceptedDisclaimer=true&title=GASB+Statement+No.+79%2C+Certain+External+Investment+Pools+and+Pool+Participants&Submit=, page 30.

Why is GASB 79 Compliance Important for Your Agency?

- Participants in pools that follow GASB 79 can use **amortized cost** in their financial reporting and do not need to adjust their investments to fair value.
- This is possible because the pool meets GASB 79 criteria for:
 - Portfolio maturity
 - Credit quality
 - Diversification
 - Liquidity
 - Shadow pricing (per share price of a portfolio based on the market value of the securities)

The use of the amortized cost method allows pools to maintain a **stable \$1 NAV** per share.

Weighted Average Maturity: A Tool for Anticipating the Waves



Common Considerations for Pooled Investing

Advantages *of Pools**

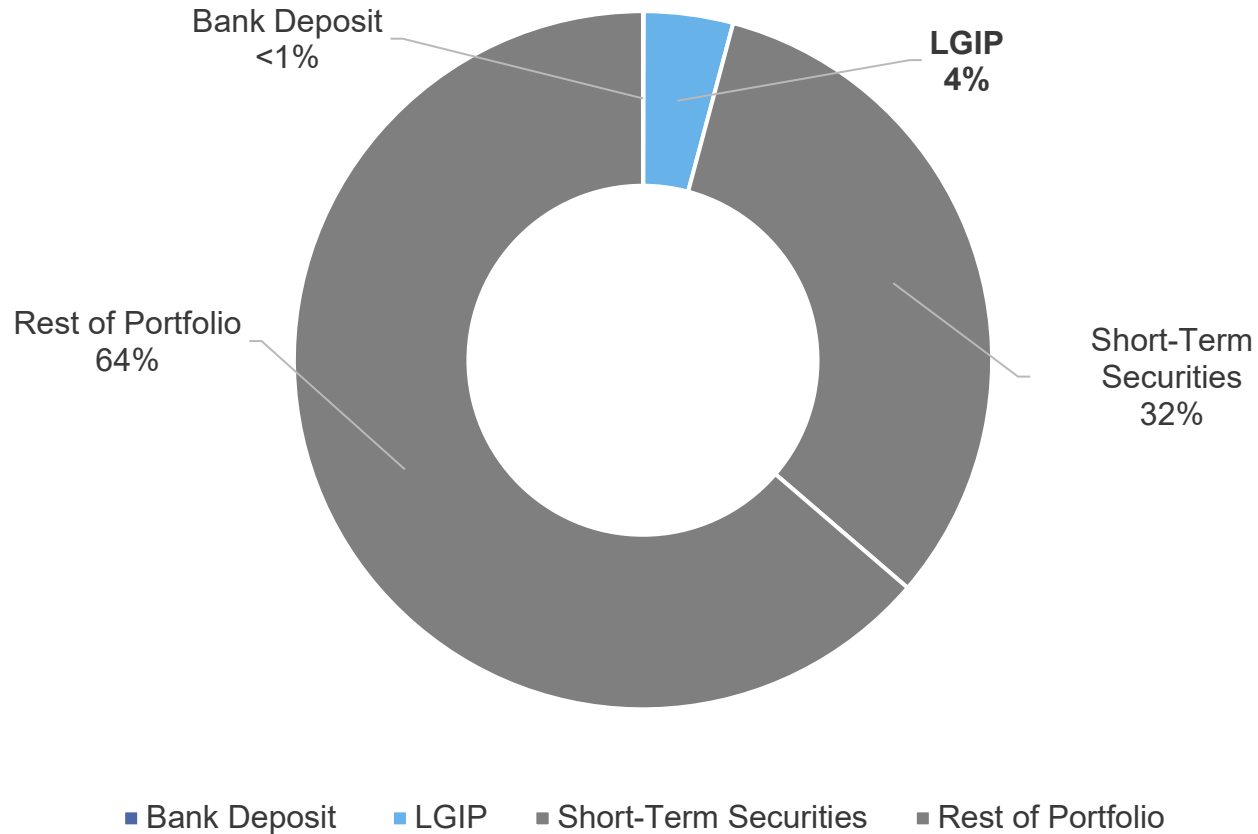
- Efficient investment approach
- Economies of scale
- Highly liquid
- Reduced market risk (WAM-dependent)
- Expenses netted from yield
- Simplified accounting and reconciliation

Disadvantages *of Pools**

- Inability to customize investment strategy
- Actions of other investors can affect the pool
- Fees are pre-determined

*The percentage of the LGIP's portfolio that must consist of cash and instruments payable or redeemable on a daily or weekly basis. Subject to investment permissions/restrictions. Please refer to the Important Disclaimer at the end of this presentation.

County of San Diego Portfolio Statistics



Considerations for Staying Afloat

- ▶ Diversify
- ▶ Read
- ▶ Understand
- ▶ Monitor
- ▶ Select funds that meet your investment objectives

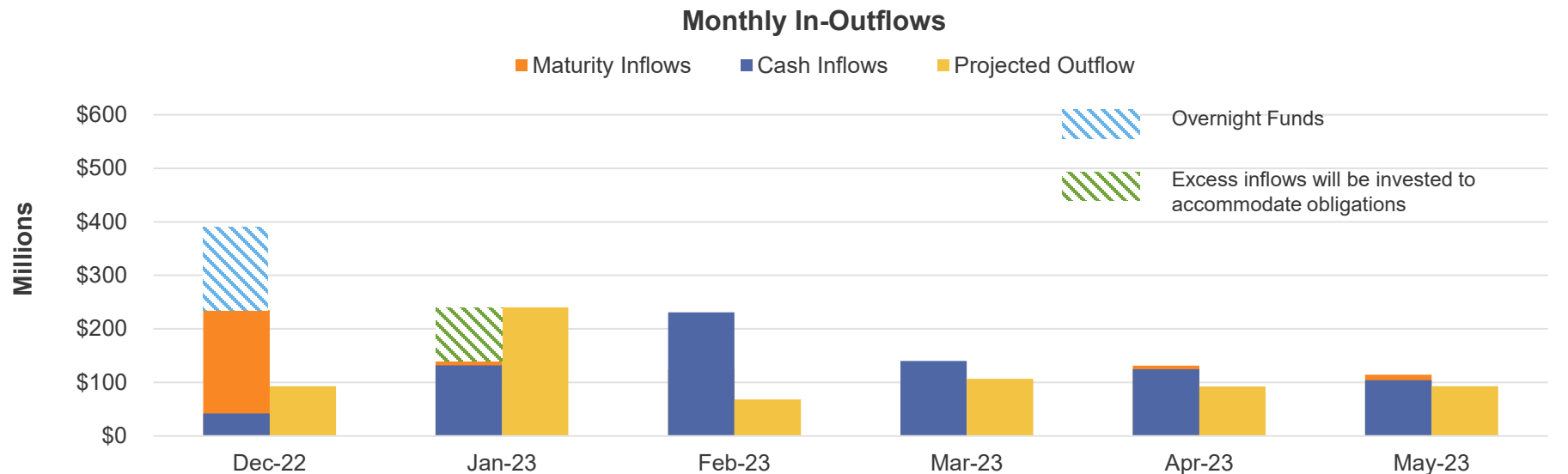
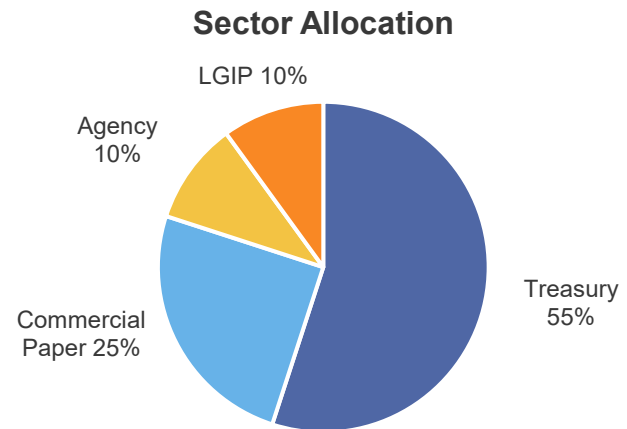


Considerations for Short-Term Securities (Portfolio)



Short-Term Portfolio Considerations

- An asset/liability matched short-term managed portfolio will help to meet known cash flow needs while also optimizing value
- Maintaining a portfolio of liquid securities will help to meet unknown cash flow needs as they arise



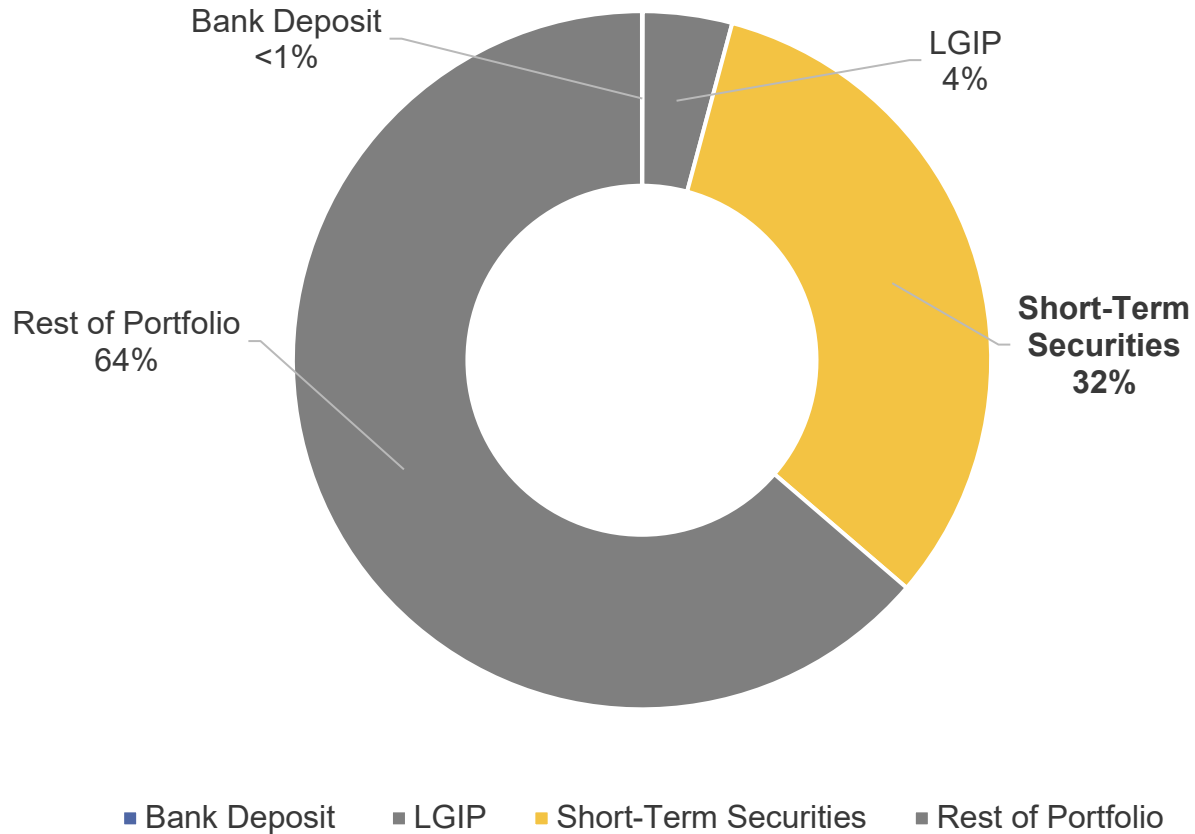
For illustrative purposes only.

Typical Investment Types for Short-Term Portfolios

- ▶ U.S. Treasuries (b)
- ▶ Federal Agencies (f)
- ▶ Commercial paper (h)
- ▶ Negotiable CDs (i)
- ▶ Repurchase and reverse repurchase agreements (j)
- ▶ Medium-term notes (k)

County of San Diego Short-Term Securities vs. Total Portfolio

County of San Diego Portfolio Statistics



Time to Drop In!



Communicate, Communicate, Communicate!

- ▶ Ensure that critical components of your agency's investment program are conveyed to directors/managers and elected officials
 - ▶ Internal controls
 - ▶ Investment policy/risk tolerances
 - ▶ Overall investment strategy
- ▶ Tailor communications to audience
 - ▶ Elected Officials: Big-picture, 30,000-foot summaries
 - ▶ Director/Manager: Detailed, fact-filled, yet concise reports
- ▶ Be prepared to educate
 - ▶ New market conditions
 - ▶ Available liquid investment vehicles



Getting in the Water

- ▶ Liquidity is a top investment priority and required objective for your agency's investments
- ▶ Timing of cash needs, market dynamics, and risk/return preferences should guide liquidity strategy and investment choices
 - Supported by access to resources and due diligence practices
- ▶ Liquidity strategy and investing should be proactive, not set it and forget it



Questions?



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