



City of Portland

Temporary Advisory Committee on Socially Responsible Criteria for Direct Investments in Corporate Securities

Office of Management and Finance
Public Finance and Treasury
March 2014

Who we are/what we do

City Treasurer

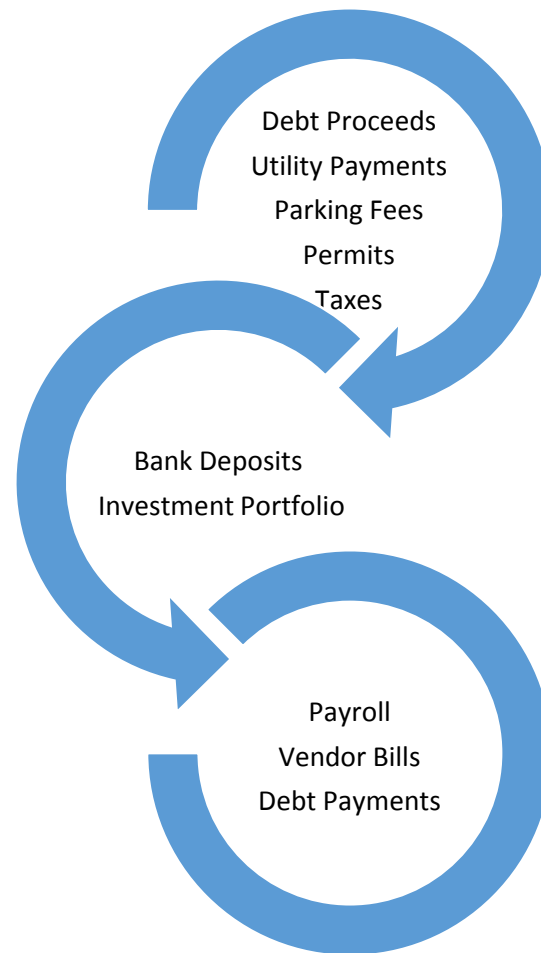
City Code 3.08

- Custodian of City funds
- Authorized to open/close City bank accounts
- Authorized to invest City funds

Manager of Public Finance and Treasury division of Office of Management and Finance

- Debt Management
- Treasury
 - Banking services
 - Merchant services
 - Investment activities

City Funds = Operating Cash



City Funds = Operating Cash*

Operating cash balances fluctuate.

Operating cash ranges from \$940 million to \$1.29 billion, averaging \$1.08 billion during the year.

Operating cash is deposited in City bank accounts and/or invested in City's portfolio. Determinants are City's liquidity needs, level of interest rates, and eligible investments available.

*Operating cash does not include pension funds or deferred compensation funds.

Investment Activities

Performed in-house

- City is self-directed institutional investor
- Investment Officer technical expertise
- Specialized resources and broker/dealers
- Coordinate with cash management staff / bureau customers

Centralized function to ensure:

- Operational efficiencies
- Economies of scale
- Financial control and accountability
- Legal compliance

Investment Earnings Pay for Treasury Operations

Treasury operations are self-supporting:

- Treasury recovers its operating costs by charging an administrative fee
- Admin fee covers all expenses related to delivering City's banking services, merchant services, investment activities
- Admin fees covers personnel costs, all bank fees, rent, supplies, etc.
- Admin fee is deducted from gross earnings of investment activities

Treasury operates on a breakeven basis:

- Investment earnings net of admin fee are distributed to all City funds

Net Investment Earnings Distributed

- FY 08-09 \$15,698,000
- FY 09-10 \$9,638,000
- FY 10-11 \$6,035,000
- FY 11-12 \$5,265,000
- FY 12-13 \$4,273,000
- FY 13-14 \$3,330,000 (through 2/28/14)

What we can invest in

ORS Legal Limitations

Investments are limited to those permissible under Oregon State Law:

ORS 294 *County and Municipal Financial Administration*

294.035 *Investment of surplus funds of political subdivisions; approved investments*

294.805 *Local Government Investment Pool*

ORS 295 *Depositories of Public Funds and Securities*

No equities, no mutual funds, no money market funds

City's Investment Policy

- Written in accordance with ORS and Oregon State Treasury's Model Investment Policy
- Reviewed by Oregon Short Term Fund Board
- Reviewed by City's Investment Advisory Committee
 - Established in City Code 3.88 to advise City on investment policies and practices, depository limits, broker / dealer counterparties; meets quarterly
 - Three public members* who are investment professionals; appointed by Council for 2-year unpaid terms (renewable)
- Adopted by City Council annually

*Public members are required to remove conflicts of interest prior to appointment

Investment Goals, Risks, Strategies

Goals

1. Preservation of principal
2. Liquidity to fund City operations
3. Rate of return

Risks

- Interest rate risk
- Inflation risk
- Credit risk

Strategies

- Diversification
- Maturity limits
- High ratings

| Moody's | | S&P | | Fitch | | | |
|-----------|------------|-----------|------------|-----------|------------|----------------------------------|--|
| Long-term | Short-term | Long-term | Short-term | Long-term | Short-term | | |
| Aaa | P-1 | AAA | A-1+ | AAA | F1+ | Prime | |
| Aa1 | | AA+ | | AA+ | | High grade | |
| Aa2 | | AA | | AA | | High grade | |
| Aa3 | | AA- | | AA- | | High grade | |
| A1 | | A+ | A-1 | A+ | F1 | Upper medium grade | |
| A2 | | A | | A | | | |
| A3 | P-2 | A- | A-2 | A- | F2 | Upper medium grade | |
| Baa1 | | BBB+ | | BBB+ | | | |
| Baa2 | P-3 | BBB | A-3 | BBB | F3 | Lower medium grade | |
| Baa3 | | BBB- | | BBB- | | | |
| Ba1 | Not prime | BB+ | B | BB+ | B | Non-investment grade speculative | |
| Ba2 | | BB | | BB | | | |
| Ba3 | | BB- | | BB- | | | |
| B1 | | B+ | | B+ | | Highly speculative | |
| B2 | | B | | B | | | |
| B3 | | B- | | B- | | | |
| Caa1 | | Not prime | CCC+ | C | CCC | C | Substantial risks |
| Caa2 | | | CCC | | | | Extremely speculative |
| Caa3 | | | CCC- | | | | Default imminent with little prospect for recovery |
| Ca | | | CC | | | | |
| Ca | C | | | | | | |
| C | D | / | DDD | / | In default | | |
| / | | | DD | | | | |
| / | | | D | | | | |

ORS Approved Investments*

- US Treasury debt
- US Agency debt
- Oregon municipal bonds
- California, Idaho, Washington municipal bonds
- Interest-bearing deposits
- Banker's acceptances
- Corporate debt
- Repurchase agreements
- Local Government Investment Pool (LGIP)

*Various limits apply

Corporate Debt

History of City's Investment Policy re Corporate Securities

ORS 294 allows 35% of portfolio to be invested in Aa/AA rated corporate securities with 5% limit per issuer.

- Corporate securities include commercial paper and bonds
- Investment Policy has always allowed commercial paper
- 2009 – Investment Policy amended to allow federally guaranteed corporate bonds out to 3-years in maturity.
- 2010 - Investment Policy amended to increase corporates to 35% and allow corporate bonds out to 18-months in maturity.
- 2012 - Investment Policy amended to allow corporate bonds out to 3-years in maturity.
- 2013 - Investment Policy amended to allow A-/A3-rated Oregon bonds out to 3-years in maturity.

Local Government Investment Pool

- Managed by Oregon State Treasury as part of State's Short Term Fund
 - 50% maximum A-rated (or higher) corporates; 25% maximum AA-rated (or higher) foreign exposure (government and corporate); AA-rated (or higher) municipal securities.
- Used for interagency payments and fund transfers
 - State revenue sharing payments
 - Multnomah County property tax payments
 - ODOT grant funds
- Statutory limit of \$45,642,885 (as of 9/19/13)

Market considerations

Market Characteristics

- Markets are dynamic – always moving
- US Treasury securities are benchmark against which other securities are measured
- Corporates trade at spread to UST
- All else equal, spreads narrow in low interest rate environments and widen in high interest rate environments
- Historical corporate spreads are now tighter
- Primary market / secondary market
- New issues / call notifications

Market Limitations

- Not all eligible issuers are active issuers
- Not all eligible bonds trade in secondary market
 - Sources for bonds:
 - Broker / dealer inventory
 - New issues
 - Bid-wanted lists
- Investment “rate of return” goal means *good relative value*

Other considerations

Implementation

- What definition to use?
- How frequently will definition change?
- How to measure?
- How to monitor?
- How to implement?
- What is the impact?

Investment Earnings

- Portfolio is approached conservatively
- Each additional 10 basis points in investment return will add \$1,000,000 in earnings to be distributed
- Bureaus rely on investment earnings as part of their budgets

City Investment Policy Permitted Investments

Including portfolio, issuer, maturity and rating limits

US Treasury Debt

| | |
|--|----------|
| Maximum percent of portfolio | 100% |
| Maximum maturity | 7 years |
| US Treasury Inflation Indexed Securities | 10 years |

US Agency Debt

| | |
|---|---------|
| Maximum percent of portfolio | 100% |
| Maximum percent of portfolio per issuer | 35% |
| Maximum maturity | 5 years |

Examples

Federal National Mortgage Association (Fannie Mae)

Federal Home Loan Mortgage Corporation (Freddie Mac)

Federal Home Loan Bank (FHLB)

Federal Agricultural Mortgage Corporation (Farmer Mac)

Federal Farm Credit Bank (FFCB)

Repurchase Agreements

(secured by US Treasury or US Agency Debt)

| | |
|------------------------------|---------|
| Maximum percent of portfolio | 25% |
| Maximum maturity | 90 days |

Example

City invests excess cash and is collateralized at 102%

Interest-Bearing Deposits

(in banks and credit unions in compliance with ORS 295)

| | |
|---|--------|
| Maximum percent of portfolio | 50% |
| Maximum percent of portfolio per issuer | 25% |
| Maximum maturity | 1 year |

Deposits in banks and credit unions not participating in OST Public Funds Collateralization Program are limited to amounts insured by FDIC/NCUA; depository must have a head office or branch in Oregon.

Bankers' Acceptances

(issued by financial institutions in compliance with ORS 294.035)

| | |
|---|----------|
| Maximum percent of portfolio | 25% |
| Maximum percent of portfolio per issuer | 5% |
| Maximum maturity | 6 months |

Corporate Debt

(commercial paper and corporate bonds)

Maximum percent of portfolio (total) 35%

Maximum percent of portfolio (per issuer) 5%

Commercial Paper

Maximum maturity 9 months

Minimum ratings (at least one) A-1,P-1,F-1

Corporate Bonds

Maximum maturity 3 years

Minimum ratings (at least two)* AA-, Aa3

*Oregon issuers may be A-, A3

Corporate Debt Guaranteed by US Government / FDIC

| | |
|---|---------|
| Maximum percent of portfolio | 25% |
| Maximum percent of portfolio per issuer | 5% |
| Maximum maturity | 3 years |

Oregon Municipal Bonds

(taxable and tax exempt)

| | |
|---|---------------|
| Maximum percent of portfolio | 25% |
| Maximum percent of portfolio per issuer | 5% |
| Maximum maturity | 3 years |
| Minimum ratings | |
| short term (at least one) | A-1, P-1, F-1 |
| long term (at least one) | AA, Aa2 |

Local Government Investment Pool

LGIP is managed by Oregon State Treasurer:

- Open-ended, no-load diversified portfolio offered to eligible participants that includes, but is not limited to, any municipality, political subdivision or public corporation of the state that by law is made the custodian of, or has control of, any public funds.
- Created by Oregon Laws 1973, Chapter 748
- Deposit limit set by ORS 294.810 (increases with CPI)*
- Objectives are safety, liquidity, yield
- Comingled with other state funds in Oregon Short Term Fund (OSTF)
- Facilitates money transfers between eligible participants

*maximum \$45,642,885 (9/19/13)

Limits on Portfolio Maturity

Maturity

0 – 2 years

2 – 10 years

Percentage of funds

50 – 100%

0 – 50%

Portfolio weighted
average maturity

18 months (maximum)