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Investment Guidelines for Political Subdivisions

The following are intended to be a benchmark of guiding principles to be followed when making an investment decision of public funds. As investment officer, you have a fiduciary responsibility when making investment decisions with regard to public funds.

1. **Security of Principal:** Your primary focus should be on the return of public funds in an amount at least equal to what was invested. While return on investment is important in managing public funds, you should never be so concerned with return as to endanger the safe return of principal. Reasonable and prudent investments should be made with this factor in mind.
2. **Liquidity of Funds:** Care should be taken to invest the funds in a manner that will provide ample liquidity to meet current and future obligations of the funds. In matching the maturity of investments to the anticipated funds usage, you will eliminate the need to liquidate investments when future needs arise, thus eliminating one risk to principal in ever changing markets.
3. **Diversity of Holdings:** While not always practical due to the amount of funds available for investment, whenever possible, the investment officer should try to invest in more than one instrument to spread market and rate risk.
4. **Refrain from Active Trading:** While it is an appropriate activity to sell a security and recognize a profit when the market has moved in your favor and profit potential exists, the investment officer should resist the temptation to actively trade an account for profit. The risks associated with such activity far outweigh the potential expected returns and can seriously jeopardize the principal amount invested. A simple best practice is to never purchase a security you do not plan on holding to maturity: if you know you will need to sell the security prior to maturity, it is an inappropriate investment.
5. **Understand the Investment:** The investment officer should clearly and thoroughly understand each investment vehicle he or she is purchasing. Do not make the mistake of investing in something that appears easily understandable without first thoroughly researching that particular investment vehicle and its behavior given certain market conditions. Any investment with unusual interest rate or redemption features warrants special scrutiny to make sure you understand exactly how those rates or features really work.
6. **Understand Credit Risk:** While there are numerous different forms of risk which you must be aware of, the single most important form of risk to be mindful of is credit risk. Different investment options carry significantly different risk profiles and you must be careful to avoid assuming that all allowable investments carry the same level of risk. In

particular, commercial investments such as commercial paper and bankers acceptances carry a significantly higher degree of credit risk than treasury bonds and agency debt. These investment vehicles require constant monitoring and a higher degree of vigilance in both the investment selection and during the instrument holding period.

7. **Understand the Market:** It is imperative the investment officer understands the market in which he or she is investing. In particular, the subtle differences between Treasuries and US Agencies as well as the differences within each type of investment such as callable versus non-callable, fixed rate versus variable rate, and current interest versus discount notes have real world impacts. The market will affect each of these investment vehicles in different ways and a clear understanding of the markets and the investment's movements based on the current economic situation are imperative in making well-reasoned investment decisions.
8. **Know your Time Horizon**: There should be a keen awareness of liquidity needs and legal investment time horizons. In times of low interest rates, it is very tempting to invest longer to achieve higher interest rates. Do not jeopardize the safety and liquidity of the investment portfolio by investing past legal limits or beyond the liquidity horizon. A careful investment officer prepares cash flow projections that include when anticipated revenues will be received and when anticipated expenditures will occur, and then plans investments to meet those expenditures, taking into account conservative estimates of the revenues.
9. **Know your Goals:** The goals of the investment officer should be clearly set forth in a statement of policy and should be strictly adhered to. It is imperative to know and understand these goals and to select appropriate investment vehicles to meet the goals.
10. **Develop a Long Term Plan:** The investment officer should have a clear and definitive long term investment plan in place to ensure the portfolio meets the needs of the political subdivision. Failure to plan is a common reason for failure and/or poor performance in the investment of public funds.
11. **Adopt a formal Investment Policy:** This policy will put concrete and definitive guidelines for the investment of public funds within the political subdivision into writing. It will serve as a guide in selecting appropriate investment vehicles as well as maximum maturities and diversification strategies.
12. **Do not Leverage the Portfolio:** The investment officer should never borrow money to invest the proceeds with the intention of enhancing portfolio yields.
13. **Understand your Permitted Investments:** A clear understanding of state law and the permitted investments for the political subdivision is essential when evaluating investment opportunities. Do not assume that an investment is allowable just because another political subdivision has invested in a particular vehicle.
14. **Understand your Collateral Requirements:** When investing in bank deposits, understand your collateralization obligations. It is imperative to understand the overall limits and requirements for collateralization as well as the allowable obligations which can be pledged as collateral.
15. **Refrain from Securities Lending:** Do not participate in a securities lending program unless you understand it and can explain, in detail, how it works to the governing board. While it can be a valuable tool for yield enhancement, you must make sure everyone understands how the program will work.

16. **<u>Use sound professional judgment:</u>** Never rely solely on the judgment of someone who is trying to sell you a particular investment. The investment officer should make their own decision as to the appropriateness of a particular investment once all of the facts are known.

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