

The three elements of public investment management:



Manage these three elements well and you will have a model investment program. PSG can help assess the overall effectiveness of your portfolio by comparing it to appropriate benchmarks. While preservation of principal and maintaining appropriate liquidity should always be your foremost objectives, it is also responsible stewardship to pay attention to yield. This can be accomplished through effective duration management (managing portfolio maturities.)

Investment Portfolio Diagnostics

PSG will review your organization's investment portfolio and investment policies, if policies are in place. Some states do not require that municipalities have investment policies, depending on portfolio size or duration. However, it is always prudent to have policies in place and kept current. PSG can assist in the development or review of these guiding policies.

Investment Advisor Search

Regardless of portfolio size, large or small, you should consider hiring an investment advisor. PSG can help you by:

- ✓ developing and distributing your request for proposals
- ✓ helping to evaluate the proposals
- ✓ assisting you in selecting your advisor
- ✓ helping to negotiate the advisory services contract

Benefits to you:

- ✓ **Peace of Mind**
...that comes with added confidence in the safety of your portfolio.
 - ✓ **Shared Fiduciary Responsibility**
...with your investment advisor.
 - ✓ **Increased confidence**
...due to professional third party view and support.
 - ✓ **Enhanced Reputation**
...to you and your organization.
 - ✓ **Save Valuable Staff Time**
...by outsourcing the search process.
 - ✓ **Improved Performance**
...normally resulting from advisory services. (Even a slight yield improvement typically more than offsets fees.)
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10 ways PSG will ease this process for you:

1. Develop the Request for Proposals (RFP) and issue it on your behalf or provide copy to you to issue directly.
 2. Provide any needed addendums to the RFP and respond to proposer questions.
 3. Review and qualify the proposals for conformance to your requirements.
 4. Develop clear comparisons between proposals in order to facilitate your smooth decision-making process.
 5. Review proposals with you and your evaluation team in order to determine the best qualified proposals. This step is intended to narrow the field of firms to be interviewed.
 6. Coordinate and participate in interviews with finalists.
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7. Assist you in selecting the Investment Advisor to be awarded your contract.
 8. Provide draft contract for your organization to negotiate with selected advisor, and help you negotiate the final agreement. If your purchasing rules allow, PSG will also assist in negotiating final pricing if it appears practical to do so.
 9. Assist you in developing any material needed to gain governing body approval for contract award.
 10. Be available to answer follow-up questions and to review overall satisfaction with your Investment Advisor relationship after one year of service.

Why should you hire an Investment Advisor?

✓ Active versus Passive

By using an *active management strategy*, you would sell some investments, when it would work to your advantage to do so, before they mature versus using a *passive strategy*, which is to buy and hold each investment until maturity. An Investment Advisor will be able to recommend when and how to accomplish this on an investment-by-investment basis. Both active and passive approaches are acceptable, depending on your institution's philosophy. However, overall yield often improves when moving from a passive to active approach.

✓ Policy Development & Refinement

Your investment policy drives *how* you invest. An Investment Advisor will assist you in periodic investment policy review and refinement. Also, if approval by the governing body or another government agency is required, your Investment Advisor can assist with its presentation and help answer any questions pertaining to it.

✓ Increase Governing Body Confidence in Your Operation

Governing bodies respect professional money management, and tend to have more confidence in this vital arena when you add this professional layer of advice and experience to your operation.

✓ Diversification

Your Investment Advisor will help you determine if further diversification is needed, and would customize it to your investment policy. If you maintain all or some of your holdings in an investment pool, your portfolio may not be as well-diversified as it should be. Your Investment Advisor will help you determine how much should be in the pool to meet your operating and liquidity needs, and how much could be optimally deployed in other investments.

✓ Global, 3rd party view

Investment Advisors bring to you the advantage of serving a wide variety of public clients. Your advisor can bring this global perspective to help your operation. This gives you the advantage of having a municipal investment professional to discuss all aspects of investing and of economic conditions. You may find that a new strategic or tactical direction would be in order as the economy shifts.

✓ Presentations to Governing Body, Other Key Citizens & Staff

It is often helpful to have your Investment Advisor make investment presentations to governing bodies, other policy makers such as finance committees, budget committees and investment committees, as well as to senior management. They can answer questions that are often best left to people who work with investments constantly, and who have the global view that comes with multiple clients, often spanning the region or the country.

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Services/Benefits Provided by Investment Advisors

Extensive experience with ongoing public sector portfolio management. (Numerous and broad variety of public clients)

Manages the organization's portfolio in a non-discretionary role within its investment policy parameters (The organization retains control of each investment - advisor seeks approval for all transactions.)

Duration management to obtain optimal yield

Active management that includes portfolio realignment when advantageous to the portfolio

Does not replace staff but adds the value of more staff via expertise and analytic tools (Bloomberg, Highline Data, etc)

Saves staff time, allowing them to complete other tasks

Reconciliation of third-party safekeeping services

Staff expertise and professional involvement

- Participates and advises in annual investment policy review
- Portfolio performance presentations to governing body and/or investment committee
- Client training and education

Broker-Dealer due diligence and relations

- Acts as intermediary between staff and broker-dealers; helps qualify them
 - Calls to/from broker-dealers for bids and offerings (time intensive)
 - Prepares and verifies transaction reports
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Portfolio performance reporting – organization reconciles records to the advisor's
Provides detailed monthly performance and transaction reports

Investment activity (time intensive)

- Economic monitoring and research capabilities and sophisticated analytic tools
- Credit analysis of securities, banks and other financial institutions
- Portfolio realignment analysis/swap analysis – monitors callables
- Spread analysis/market timing models
- Investigation and reconciliation of documentation discrepancies

Frequently “pays for itself” via improved yield performance as compared to benchmarks

California Society of Municipal Finance Officers MiniNews, May 2010

Outsourcing Investments in a Downsizing Era

By Girard Miller

Local governments nationwide are still cutting back on everything in 2010, as revenues continue to sag and one-time reserves have been exhausted. Finance departments and treasury operations are not immune to layoffs, furloughs, and hiring freezes. Financial professionals everywhere say they are doing the work of two people, and sometimes three, and see little relief in sight.

The outlook for 2011 is not improving in many municipalities and public agencies. Budgets next year may be even tighter, and jurisdictions are planning for more layoffs and deeper furloughs across the country.

Anyone who has overseen workforce reductions in a negative market period knows firsthand how scary it can be to maintain internal controls when the staff is shrinking. Senior management has their entire professional career reputation on the line, but they may not be assigned the resources to do the job right.

In the past year, a number of municipalities and agencies decided to outsource their investment management function. The reasons were different in each locality, but there was a common theme: They were shrinking their staff and expanding the responsibilities of financial professionals, stretching personnel and resources very thin, and had discovered that the cost of expert outside money management had declined significantly since they first looked at this idea.

When they studied the subject more carefully and spoke with the competing firms about their business practices, they discovered that the fees they would pay were readily recoverable in improved trading execution, narrower bid-ask spreads, economies of scale, shared resources, superior technology, and better access to the "inside market" where larger investors often receive the first call and better pricing than the smaller and more-remote players. After evaluating the opportunities for superior investment returns that could help provide some extra revenue, they chose to outsource.

Points to Consider

Here are some factors to consider when studying the merits of outsourced portfolio management for operating funds and treasury portfolios:

1. **Declining Costs.** In the past two decades, the fees charged by private firms to manage municipal cash have declined significantly. Meanwhile, portfolios have grown, relative to their size a decade ago. The sliding-fee schedules used widely in the industry favor larger portfolios and bring the fees down into single-digit territory for many public agencies with portfolios of more than \$100 million. Some money managers also waive fees for the portion of the portfolio invested for liquidity purposes in state treasury pools, local government investment pools, or money market mutual funds. Under that arrangement, a client pays for only the funds that are actively managed, even though the entire portfolio will get professional attention.
2. **Economies of Scale.** With more than \$100 billion of assets under management in this one sector of the public-funds marketplace, the specialized firms that work with public agencies have been able to establish trading desks fully outfitted with the most sophisticated equipment, pricing monitors, market access systems, and proprietary information and portfolio compliance systems. The costs of such operations, which would not be sustainable for most treasury management operations with assets of less than \$1 billion, can be spread over multiple clients to achieve superior economies of scale, compared to a smaller operation with a limited and shrinking budget.
3. **Superior Trading Access.** Larger investors get first shot at the big blocks and can divide up their purchases among clients so that smaller accounts can take equal advantage of their superior market access. Typically, the larger investors are called first when a seller is looking to sell a

California Society of Municipal Finance Officers MiniNews, May 2010

and undergo regulatory reviews. Many public investment offices simply compare their yields against a general market level without any real accountability for actual performance, often using the lowest denominator (U.S. Treasury yields) to set a low bogey. Further, the news gets around quickly if a money manager is underperforming or experiencing business problems, so the collegial community serves as an extra set of eyes and ears for those monitoring their advisors. A well-designed request for proposals can ensure that problems elsewhere are flushed out in your due diligence review, so you don't have to be the guinea pig.

In-House Cost-Effectiveness

The cumulative benefit of these built-in advantages to portfolio optimization can often, but not necessarily always, pay for the costs of having the funds invested externally. Some agencies with large portfolios may be able to staff and equip the portfolio function efficiently and obtain sufficient returns to warrant continued in-house management. Some public agencies with sophisticated personnel may also feel that they would be wasting internal talent by outsourcing at this time, leaving the option open for some time in the future if there is a personnel change.

Oversight and Control

Some public agencies use their independent investment advisors for non-discretionary advice only, to help support their internal strategies while making trades themselves. Such arrangements retain a higher level of personal control, although often at the cost of lost efficiencies in trading, as the market usually doesn't wait for investors to receive a phone call, discuss the strategy, and then execute it. Thus, a number of public agencies have elected instead to retain fully discretionary investment advisors who work with them to set up the proper controls and oversight processes, portfolio policies and benchmarks, and compliance and reporting structures. Some agencies have taken a "walk before we run" approach and started out with advisory-only relationships until they gained full confidence that complete outsourcing would save money, time, and higher portfolio returns.

Not for Everyone

Outsourcing works best for public agencies that see the comparative advantages outlined above. Public investors with sufficiently large portfolios, keen awareness of their cash flows, dedicated staff resources, a reliable budget to maintain the requisite systems, expertise and depth in capital markets, and strong internal oversight procedures may prefer to keep the function in-house even after they test the market.

Do Your Homework

Although this approach to managing public funds has been around for several decades, some financial professionals are considering it for the first time this year.

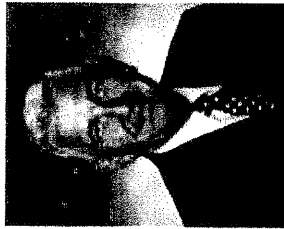
Girard Miller is senior strategist at PFM Asset Management. The opinions in this article are entirely his own and not of any organization with which he is affiliated, including the PFM Group.

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| <ul style="list-style-type: none">• <u>An Introduction to Investment Advisers for State and Local Governments, Second Edition, Sofia Anastopoulos, GFOA, 2007.</u>• <u>Investing Public Funds, Second Edition, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.</u>• <u>Selection of Investment Advisers for Non-Pension Fund Assets, GFOA best practice.</u>• Girard Miller has several research papers available that provide more extensive information and additional considerations, available upon request at millerg@pfm.com or 310-795-1354. |
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About Terry McCall

President, Portfolio Services for Government, LLC

Terry McCall was Chief Financial Officer for the City of Gresham, Oregon, a 100,000 population suburb of Portland. Among his responsibilities was overseeing the \$135 million investment portfolio. In his prior career at US Bank where he was a vice-president, he dealt with a variety of business and public finance clients, including cities, schools, colleges and special districts.



McCall is a member of the Government Finance Officers Association of the United States & Canada, where he served as vice-chair of its national Budget & Fiscal Policy Committee. He is also a member and past president of the Oregon Municipal Finance Officers Association. In May 2008, the Governor of Oregon appointed Terry to the Tax Supervising & Conservation Commission for Multnomah County, Oregon's largest.

McCall has spoken and taught at numerous national and regional public finance conferences on a variety of timely topics, including public investment management. He has also provided pro bono financial consulting to cities in Java and West Sumatra, Indonesia via the ICMA Resource Cities Program.

McCall brings his passion for excellence to public investing, and he wants to see public entities achieve the best in policy and in overall portfolio management.

What people say...

“... His insights were a major factor in our selecting our advisor. McCall’s expertise and his commitment to government excellence have made a very positive difference in Oregon.”
Greg DiLoreto, General Manager
Tualatin Valley Water District, Beaverton, Oregon

“... His background and professional approach helped us select the right fit in an advisor. McCall is definitely the go-to person in this increasingly important arena.”
Rob Massar, Assistant City Manager
City of Hillsboro, Oregon

“Terry introduced the use of investment advisors to our city in 1997. Policies strengthened, and safety and yield improved. A secondary but important outcome was management’s increased stature with our elected officials. Terry really knows his way around the municipal investment analysis and advisory business.”

Bonnie Ridley Kraft, Past President
Government Finance Officers Association
& Former City Manager, Gresham, Oregon

For more information, please visit

www.ps4gov.com

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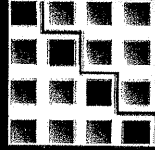
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Increase Your Municipal Investment Portfolio Effectiveness



Portfolio Services
for Government, LLC
Investment Diagnostics
&
Advisor Search

Professional portfolio consulting for public investment managers

Today, cities, counties, special districts and educational institutions are continually being scrutinized for the management and performance of the investment portfolios under their care.

Portfolio Services for Government helps public investment managers create the most professional, optimally-managed portfolios possible.



We do this by:

- ◆ **Reviewing investment portfolios** for policy development, compliance with state or other agency investment rules, investment management style, and yield performance.
- ◆ **Increasing your peace of mind** by making sure your portfolio is managed according to the high standards that citizens expect.
- ◆ **Adding credibility** to public investment management and increasing governing body confidence in your operation.

Our Services

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Safety
Liquidity
Yield

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While preservation of principal and maintaining appropriate liquidity should always be your foremost objective, it is also responsible stewardship to pay attention to yield.

This can be accomplished through **effective duration management** (managing portfolio maturities) without compromising safety. It is not uncommon for portfolios to reduce risk and improve yield through effective duration management.

Benefits to You

- Shared fiduciary responsibility
- Improved performance
- Increased confidence
- Enhanced reputation
- Save valuable time
- Peace of mind