



HISTORIC  
FRANKLIN  
TENNESSEE

ITEM #17  
WRKS 04/12/2011

## MEMORANDUM

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April 7, 2011

TO: Board of Mayor and Aldermen

FROM: Eric Stuckey, City Administrator *ES*  
Russ Truell, Assistant City Administrator/CFO

RE: Contract with Portfolio Services for Government, LLC

### **Purpose**

The purpose of this item is to consider approval of a contract with Portfolio Services for development of a request for proposal (RFP) for investment advisory services, and for analysis of those proposals.

### **Background**

Last year the Finance Committee agreed unanimously with City staff to arrange for an outside professional to conduct a search for an investment advisor for our non-pension investment assets. That search involves development of an RFP plus coordination and analysis of the ensuing proposals.

A contract with Portfolio Services for Government LLC has been written and the City Attorney has reviewed and approved as to form.

The goal is to have an investment advisor identified and under contract before interest rates begin to rise.

### **Financial Impact**

The contract amount of \$13,500 would be funded through the existing Finance Department budget across fiscal year 2011 and fiscal year 2012.

### **Recommendation**

Staff recommends approval of the contract.

**Service Agreement  
between  
Portfolio Services for Government, LLC  
and  
The City of Franklin, Tennessee**

This Agreement is made this \_\_\_\_\_ day of \_\_\_\_\_, 2011, between **Portfolio Services for Government, LLC**, an Oregon company having its principal place of business at 704 SE 38<sup>th</sup> Drive, Gresham, Oregon 97080, hereafter referred to as "PSG," and the **City of Franklin, Tennessee**, a municipality with its principal place of business at 109 Third Avenue, South, Franklin, TN 37064, hereafter referred to as "City."

City hires PSG to provide services and PSG agrees to provide services to City under the terms set forth herein.

**TERM**

1. This Agreement shall be for a period of not more than six (6) months, commencing on or before July 1, 2011.

**SERVICES**

2. PSG will provide services as described in Exhibit A of this Agreement. City agrees to pay PSG for services rendered in accordance with the rates specified therein.

**USE OF AGENTS OR ASSISTANTS**

3. To the extent reasonably necessary to enable PSG to perform its duties hereunder, PSG shall be authorized to engage the services of such other persons or businesses to aid or assist PSG in the proper performance of its duties. The cost of the services of such agents or assistants shall be chargeable directly to PSG, and paid by PSG.

**FACILITIES**

4. PSG shall furnish the facilities and equipment that may be required to perform the services under the agreement.

**INVOICING AND PAYMENT**

5. PSG will issue an invoice on completion of each of three (3) project components, as noted in Exhibit A – Fee Agreement, and unless objected to or amended within 30 days, the invoice shall be accepted as correct. Billing is due and payable with thirty (30) calendar days of invoice date. In the event of the termination of this Agreement prior to the completion of the project specified herein, PSG shall be entitled to the compensation earned prior to the date of termination as provided for in the Agreement up to and including the date. PSG shall be entitled to no further compensation as of the date of termination. Should the City require additional services not included in this Agreement, any such additional services shall be negotiated and paid separately.

**STANDARDS OF WORK**

6. It is agreed by PSG that the services provided under this Agreement shall be done in a workmanlike manner. Any projects provided hereunder will be deemed accepted and correct unless PSG is notified to the contrary by City within thirty (30) days of the date service was provided.

**FAILURE TO PERFORM**

7. PSG shall not be considered in default due to any failure in performance of this Agreement, in accordance with its terms, should such failure arise out of causes beyond its control and without its fault or negligence. Such causes shall include, but are not limited to, acts of God or a public enemy, acts of any government or authority, federal, state or local, whether sovereign, proprietary or Agreemental capacity, fires, floods or other disaster, epidemics, quarantines, strikes, freight embargoes, degradation of telephone or other means of communication service, and unusually severe weather conditions.

however, an omission of the reference to same shall not affect its applicability. In no event shall either party be bound by any terms contained in any purchase order, acknowledgement, or other writings unless: (a) such purchase order, acknowledgement, or other writings specifically refer to the Agreement or to the specific clause they are intended to modify; (b) clearly indicate the intention of both parties to override and modify the Agreement; and (c) such purchase order, acknowledgement, or other writings are signed, with specific material clauses separately initialed, by authorized representatives of both parties.

**GOVERNING LAW**

16. The validity of this Agreement and of any of its terms or provisions, as well as the rights and duties of the parties hereunder, shall be governed by the laws of the State of Tennessee.

**CITY OF FRANKLIN**

By: \_\_\_\_\_  
Dr. Ken Moore  
Mayor

Date: \_\_\_\_\_

Attest:

By: \_\_\_\_\_  
Eric Stuckey  
City Administrator

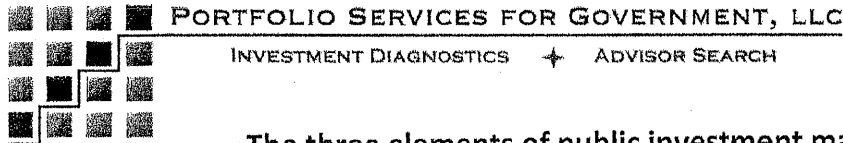
Approved as to form

By: Shauna R. Billingsley  
Shauna R. Billingsley  
City Attorney

**PORTFOLIO SERVICES FOR GOVERNMENT, LLC**

By: Terry McCall  
Terry McCall  
President

Date: 3/29/11



### 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, 3<sup>rd</sup> 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.

(over)

## 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

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.

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#### 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**

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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.*

- [An Introduction to Investment Advisers for State and Local Governments, Second Edition, Sofia Anastopoulos, GFOA, 2007.](#)
- [Investing Public Funds, Second Edition, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.](#)
- [Selection of Investment Advisers for Non-Pension Fund Assets, GFOA best practice.](#)
- Girard Miller has several research papers available that provide more extensive information and additional considerations, available upon request at [millerg@pfm.com](mailto:millerg@pfm.com) or 310-795-1354.

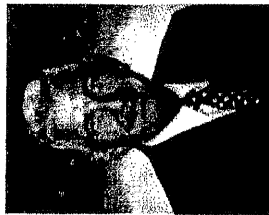
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## About Terry McCall

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."

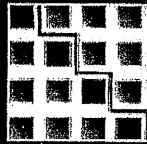
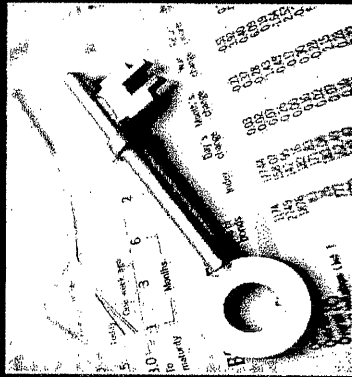
Bonnie Ridley Kraft, Past President  
Government Finance Officers Association  
& Former City Manager, Gresham, Oregon

For more information, please visit

[www.ps4gov.com](http://www.ps4gov.com)

or call Terry McCall at 503.667.5407

# 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

**Investment Portfolio Diagnostics**  
Portfolio Services for Government (PSG) will review your organization's investment portfolio and policies, if policies are in place. Not all states require municipalities to 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, you should consider hiring an investment advisor.

**Portfolio Services for Government can help you by:**

- Developing and distributing your request for proposals.
- Helping you evaluate the proposals.
- Assisting you in selecting your investment advisor.
- Helping negotiate the advisory services contract.

## Benefits to You

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

## The three elements of public Investment management:

Safety  
Liquidity  
Yield

Manage these three elements well and you will have a model investment program.



### Portfolio Services for Government

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 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.

October 18, 2010

Mr. Russell B. Truell, Chief Financial Officer  
City of Franklin  
109 Third Avenue South  
Franklin, TN 37064

Dear Russ:

As we discussed earlier today, I am pleased to present you with a proposal to facilitate the issuing of a Request for Proposals (RFP) for investment advisory services.

In my role as the City's representative, I would issue the RFP on your behalf and execute the various steps that would lead to the hiring of an investment advisor. Your role would be to review and approve the processes and documents integral to the advisor search. I recognize that the RFP structure is of major importance and I can accordingly work with you and Brian Wilcox to assure compliance with City purchasing rules. The major steps of the entire process are outlined in the attached proposal.

Additionally, I am attaching a draft service agreement which some organizations use instead of a contract, depending on contract fee thresholds. I am comfortable with using it or your City contract if you prefer.

I am also in discussions with another municipality in your region. If I can arrange travel schedules so that I can call on both of you within a day or so of each other, we may be able to split some of the travel expense. I expect that I would need to meet with you in Franklin twice.

I look forward to assisting you in this project and stand ready to answer any questions you may have.

Sincerely,

Terry McCall  
President

Attachments: Proposal  
Draft Service Agreement

## PROPOSAL

Portfolio Services for Government, LLC (PSG) is pleased to propose services to the City of Franklin, Tennessee, (Client) as follows:

Facilitate as client's representative in the selection of an investment advisor to serve in a non-discretionary role to advise the City on the management of its investment portfolio. In addition to intensive transactional research and advice, the investment advisory services would include policy review and advice, reporting, broker-dealer due diligence, GASB compliance, and training. Also, the successful firm would provide presentations and consultations to or with those individuals and groups that would be determined by the County.

### Primary elements of the selection process:

- ✓ Development of a Request for Proposals (RFP) by PSG, to be reviewed and approved by Client. This includes assisting the Client with determining the minimum qualifications for responding firms to be considered.
- ✓ PSG serves as Client's representative and issues RFP on Client's behalf.
- ✓ Proposals are directed to Client and PSG.
- ✓ PSG compiles proposing firms' responses and provides to Client the analysis of services and fees proposed.
- ✓ PSG facilitates the determination of which proposing firms to invite for interviews, and communicates the decision to all responding firms on Client's behalf.
- ✓ PSG facilitates the interviews and Client's selection of the firm to be awarded a contract, and communicates Client's decision to all interviewed firms.
- ✓ PSG coordinates the development and execution of the contract.
- ✓ PSG provides a complimentary review at the end of the first contact year to determine Client's overall satisfaction with the advisory services.

**Timeline (estimated):** See attached

**Fee:** \$21,000  
-7,500 (deducted for policy work not needed)  
**Net Fee: \$13,500**

**Travel Expenses:** Limited to two site visits with economy class air fare from Portland, OR, and \$100 lodging allowance for one night of each site visit. PSG will absorb meal costs and any other expenses.

**Terms:** 1/3 payable within 30 calendar days of RFP issuance  
1/3 payable within 30 days of written analysis of proposals  
1/3 payable within 30 calendar days of investment advisor services contract execution  
Travel expenses to be reimbursed within 30 days of delivery of receipts.

This proposal is effective through December 30, 2010.

PORTFOLIO SERVICES FOR GOVERNMENT, LLC

By Terry McCall, President \_\_\_\_\_ date

**RFP Timelines**  
(adjustable)

<b>Steps</b>	<b>Elapsed time from previous item</b>	<b>Days from advertisement</b>
1. Develop RFP for approval by client. This preparatory phase takes about 4 - 6 weeks		
2. RFP Advertised	Day 1	
3. Proposals Due	Six weeks from day 1, 2pm, PS Time or PD Time	43
4. Interviews	Four weeks after proposals due	71
5. Notice of intent to award	1 week	78
6. Governing body approval	2 weeks	92
7. Contract finalized	3 weeks	113
8. Commencement of services	4 weeks or more, depending on client preference <sup>1</sup>	141 (approximately 20 weeks)

<sup>1</sup> Client may prefer to begin on the 1<sup>st</sup> day of a fiscal quarter or a fiscal year.

## Managing Investment Risk by Using Investment Advisors

By Terry McCall

One of the most important functions of a chief financial officer, finance director, or treasurer is the direct or indirect management of the organization's investment portfolio. In my previous position, I was chief financial officer for the City of Gresham, Oregon, for 12 years. Before that, I had been a banker, and I had not been planning to make a job change; however, the city manager recruited me, and I decided it might be refreshing to change careers. And it was - but while I had extensive financial experience and was accustomed to handling large sums of money, I had never been responsible for managing an organization's investments.

When I became Gresham's CFO in 1996, the city's portfolio was about \$75 million (it has since grown to more than \$140 million). As I pondered my new responsibilities, the only area I worried over was how to know whether the portfolio was well managed, took on the appropriate level of risk, and achieved an optimal rate of return.

My early actions were to participate in Oregon's state GFOA affiliate, and to attend GFOA training and read its publications. I also reviewed state law governing municipal investments and the state treasury's recommended investment policies. Armed with this information, I was certain that I needed professional guidance to properly manage the city's investment risk.

### Thinking About Using Advisors

Also, during the early stages of my new career, I consulted frequently with the staff investment specialist. When I mentioned my interest in hiring an investment advisor, her initial reaction was somewhat defensive. I could understand

that human reaction. She was concerned that I didn't have confidence in her skills and judgment, which was not the case. She also seemed concerned about losing prestige within the organization, and she probably had doubts about job security - all understandable, yet misguided, fears.

The staff investment specialist enjoyed dealing directly with broker-dealers and banks, but she could not be certain about the total fees inherent in each transaction. But when it became apparent that we were sacrificing some of our investment earnings by paying larger hidden costs than we would by using an advisor with stated fees, she realized that using an advisor was an opportunity and not a threat. She saw that an advisor should be able to help increase her professional image by providing optimal transaction selections. Each transaction would still be hers to approve or decline, because we decided to use a non-discretionary advisory contract. (More on that later.) Having an investment advisor as a partner allowed the staff investment specialist to provide highly professional reports and other technical information to senior management, the finance committee, and the city council, enhancing her reputation with those groups. She also came to realize that using an advisor seldom means that staff can be downsized. The reality is that the advisor usually becomes the equivalent of an adjunct to staff.

...it would help bridge the experience gap that often comes with staff turnover. Using an investment advisor was also a succession planning technique.

Furthermore, the city's staff investment specialist was thinking about retiring. This was another good reason for having an advisor on board -

it would help bridge the experience gap that often comes with staff turnover. Using an investment advisor was also a succession planning technique.

I kept the city manager apprised of my interest in hiring an advisor and the actions we were planning to take. Doing so gave her an opportunity to ask early questions, let the city council know why using an advisor would make sense, and inform them of the likelihood that we would be seeking budgetary approval and,



eventually, contract approval. Those actions helped gain council approval with ease.

Getting to the point of issuing an RFP wasn't easy because we were charting new territory. We didn't have the experience to know what questions to ask or how to interpret the responses. And at the time, knowledgeable consulting services weren't available to help us in this quest. As a result, developing the RFP took some extra time. But once it was issued, we had our advisor on board in about five months.

### **Adjusting the Investment Portfolio**

The advisor's first step was to review the investment policy and recommend changes. Policy drives investment actions, so this was an essential early step. We also developed a cash flow projection to determine inflows and outflows. With the advisor, we realigned the portfolio to match the policies and expected cash flows, and moved from a passive strategy to an active strategy.

This helped maximize gains as interest rates fell and minimize losses as they rose. Our passive strategy was not really a strategy at all; it was simply a buy-and-hold style. With an active strategy, the goal is to optimize the return on the portfolio by adjusting the maturities and mix as yield and spread relationships change. The goal of an active strategy is to attain the full value of investments, not to chase yield or outperform the market. The portfolio's weighted average maturity increased slightly. That, offset by some changes in authorized investments, made the portfolio slightly more conservative, but the yield improved by a five-year average of more than 50 basis points.

Because of the appropriately heavy emphasis on safety and liquidity, some people may be uneasy about paying attention to yield, running the risk of just accepting whatever outcome occurs. The importance of yield should not be ignored; it is a legitimate aspect of investing and is why the concept of investing came into being. Public investors have a fiduciary responsibility to optimize returns while paying keen attention to safety and liquidity. At the same time,

investors should never assume that yields will improve. The state of financial markets since 2008 underscores that point.

The City of Gresham chose to enter into a non-discretionary advisory contract, where the advisor acts in a consultative role. The advisor researched each transaction and recommend buy or sell opportunities, and city investment staff made the decision. Most municipalities that use investment advisors use the non-discretionary approach - although the discretionary approach is also a legitimate option. Under discretionary management, the advisor adheres to the client's investment policies and buys and sells securities without first seeking approval. This saves time for both the client and the advisor and can result in cost savings for both. Which approach should your organization use? Unless your state has rules or laws that require direct participation in each transaction, the answer is that your organization should do what feels comfortable. Often, a good first step is to use non-

discretionary services, then to migrate to discretionary once all parties have a thorough comfort level with the concept.

### **Conclusions**

Considering an SEC-registered investment advisor is a sound step. If you choose to go this route, the advisor should have extensive experience (in years and dollar amounts involved - think billion-plus) in advising or managing municipal investment portfolios. The overall results can be gratifying.

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