

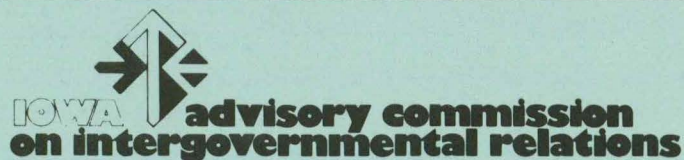
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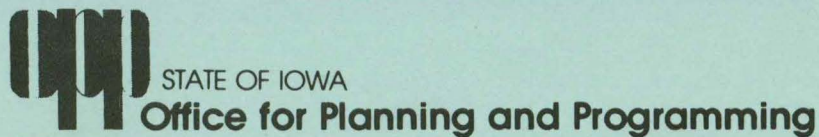
Local Government Investment Pools

Final Report

Prepared For:



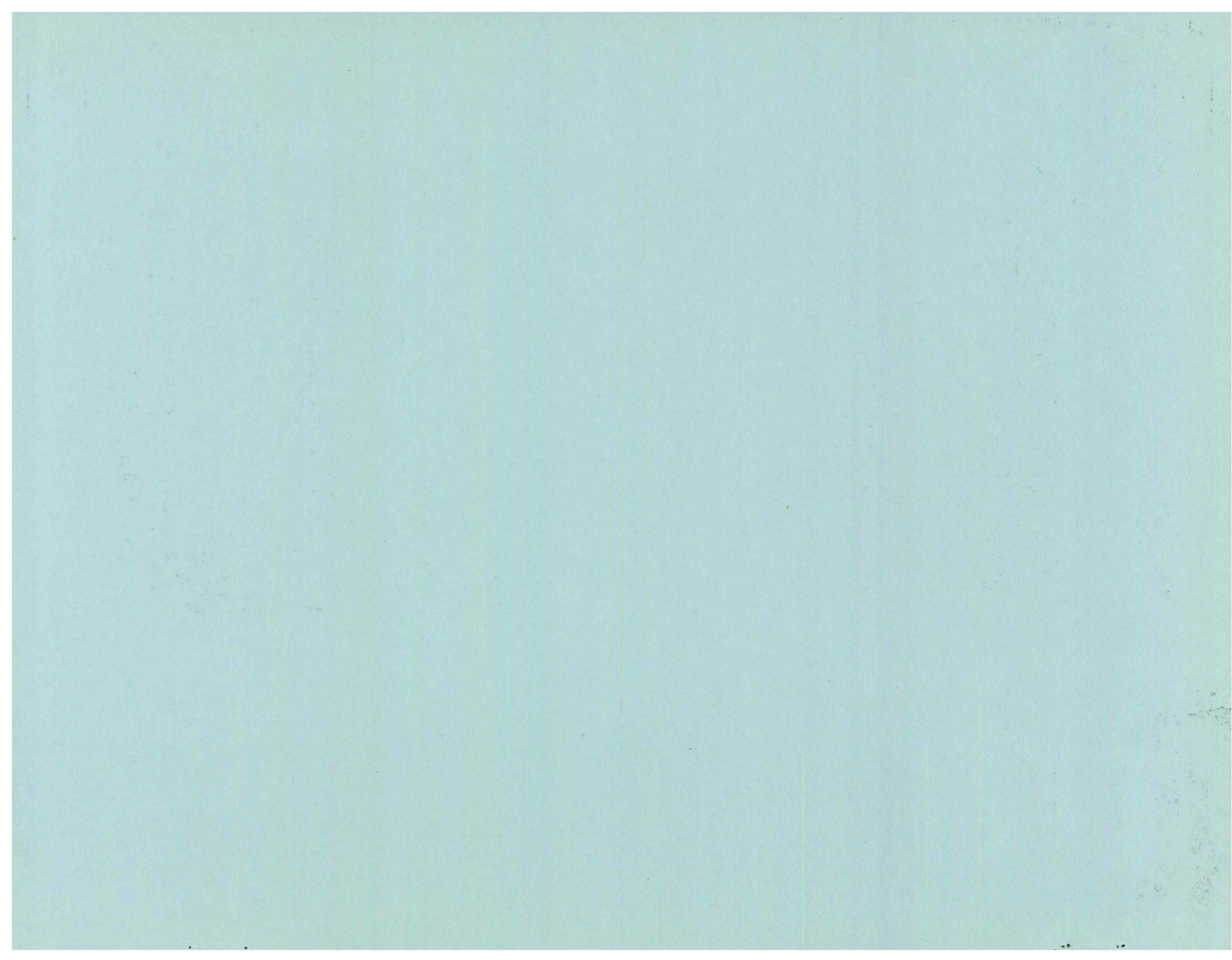
By:



Date: October 1983

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LOCAL GOVERNMENT INVESTMENT POOLS

BACKGROUND INFORMATION

Local government investment pools are voluntary associations of local governments authorized by state legislation to combine idle cash balances, those monies not needed for day to day operations, and put them to work earning income. This concept of financial management is designed to help local government improve both earnings on short term investments and the liquidity of public funds.

INTEREST TO THE COMMISSION

This issue is seen as timely and significant. The potential exists for lessening the revenue shortfall and cash flow difficulties for local government. This type of financial management is an excellent example of a cooperative action between the State and local governments. All local governments would be provided the opportunity to participate in the pool if they should choose to do so.

This particular issue has received minimal attention by the General Assembly (SB 327). Therefore, the likelihood of passing necessary enabling legislation would be difficult to determine in advance. It would seem that a broad base of support from the legislature, local government officials, and state associations would be needed.

RESEARCH AND ANALYSIS

Local Government Investment Pools should be viewed as an investment alternative for local governments. Indeed for many participants the pool is but one of many investment avenues that are used.¹ Most of the LGIPs in existence allow deposits and withdrawals at any time. The funds earn interest on a daily basis which is the net after expenses. The yields received are close and in some cases well in excess of general money market rates that are used by local governments. All

¹James E. Kerk and John C. Kreslein, "Local Government Investment Pool: An Option for South Carolina, "Public Affairs Bulletin, No. 8, April 8, p. 1

LGIPs allow participants to select virtually any denomination for their investment. By contrast, most direct market investments are available only in select denominations. States with LGIPs operating and those with enabling legislation include: California, Connecticut, Florida, Georgia, Illinois, Maryland, Massachusetts, Montana, New Jersey, North Carolina, Oregon, Pennsylvania, Tennessee, Utah, Virginia, West Virginia, and Wisconsin.²

In most states with LGIPs the local funds are combined with state idle cash resources in order to allow maximum flexibility with regard to withdrawals and interest payments.

In surveys of state and local governments involved in LGIPs the advantages of these devices have been outlined. The most often cited advantage is the professional management of funds and lower administrative costs. Secondly, these instruments allow a substantially higher rate of return for small local governments. For example, a survey by the Office for Planning and Programming during FY '83 found that small cities (which typically invest their idle cash resources in passbook accounts) receive a rate of return between 5½ to 8%. By way of comparison, the State Treasurer's Office received a rate of return in excess of 11% for FY '83. In general it was found that the larger the sum of idle cash funds (which is directly related to the size of the jurisdiction) the higher the rate of return. In other words the larger cities, counties, and schools in the state tend to have a rate of return for idle cash resources fairly close to that experienced by the State Treasurer. Therefore, in terms of the rate of return the primary benefits accrue to medium and small size local governments. Another benefit cited by state and local officials involved with local government investment pools is that it is an excellent means of recordkeeping. Participants receive a monthly statement which is much like a standard checking statement. Finally, the LGIPs offer a diversification of the investment portfolio for participants.

On the other hand, a number of concerns have been identified that may hinder the implementation of an investment pool. In the first place, Iowa law requires

²Maynard, David E. "Local Government Investment Pools: Perspectives from the Private Sector", Resources in Review, September 1981

municipalities and counties to invest funds locally. The potential removal of funds from local institutions into a local government investment pool could be opposed by the banking community.

Secondly, local governments may feel it advantageous to invest funds locally, for maximum utilization of public dollars in their own community. A related issue to this one is the fact that county treasurer's in the state will likely oppose formation of a LGIP. The crux of the county treasurer opposition is due to a fear that they will lose the authority they currently possess to direct county investments. County treasurers fear that enabling legislation for a LGIP will transfer the power to direct county investments to the board of supervisors. The decision to replace the authority of the treasurer with that of the board of supervisors is not inherent in the concept of LGIPs. The threat of the transfer of this power should not come entangled with the concept of LGIPs. These are separate issues and the legislature should make a decision on these issues independent of the other.

Another concern is that potential losses incurred by the investment pool must be borne equally by participants. This problem can be avoided by limiting pool investments to the safest possible instruments and reviewing investments regularly.

Lastly, there is a question of management of an investment pool. Should the pool be administered by the State, as in Illinois, Oregon and Wisconsin? Or should it be contracted to a private management firm as done in Massachusetts? How will administrative costs be paid? What services will be offered pool participants? Each of these questions should be considered in a discussion of local government investment pools.

ACTION BY THE COMMISSION

The Advisory Commission on Intergovernmental Relations after taking testimony from the League of Iowa Municipalities, the Iowa State Association of Counties, the State Treasurer's Office, and representatives of the County Treasurer's Association went on record in support of voluntary local government investment pools. Furthermore, the Commission advised staff to work with the Comptroller's

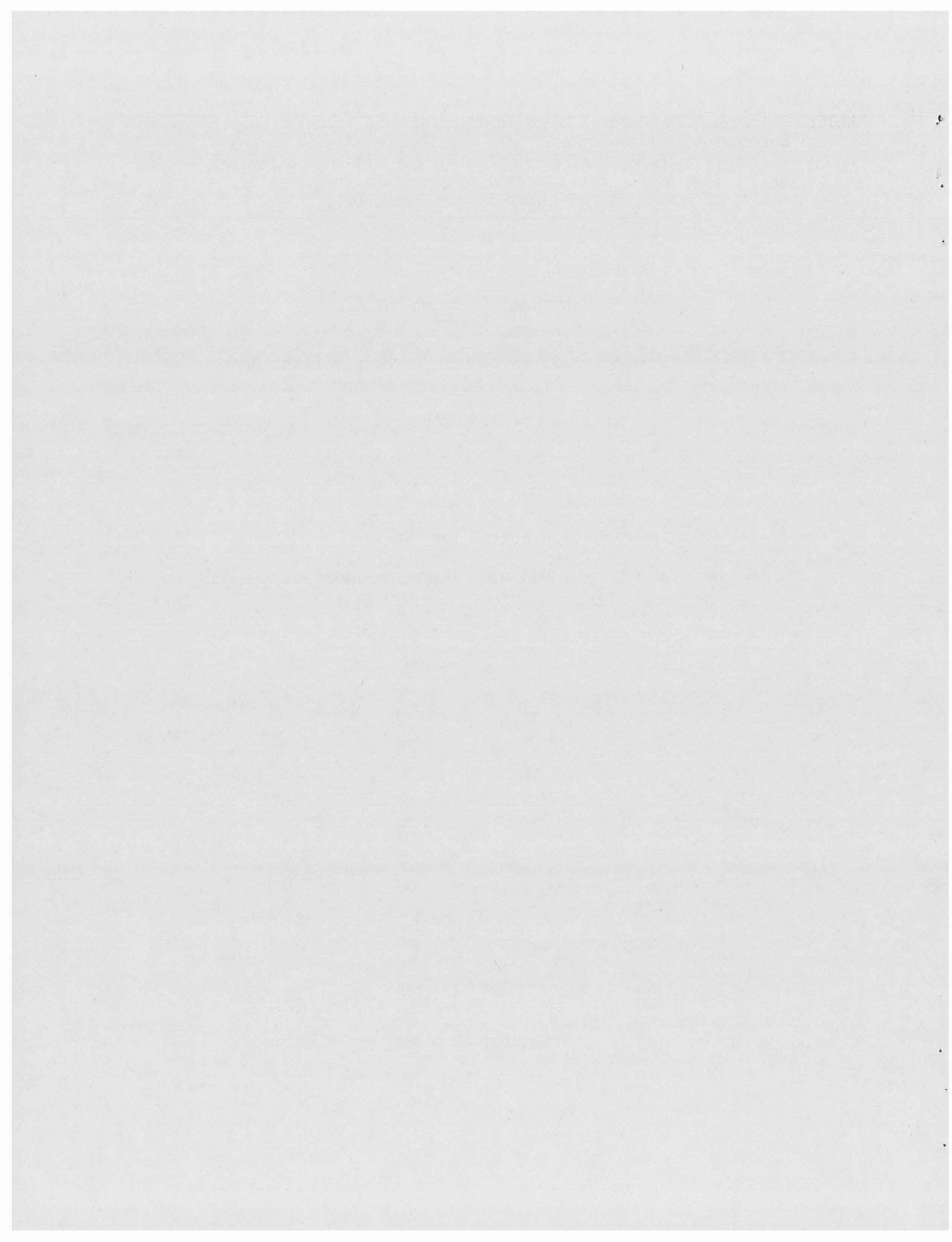
Office and the State Treasurer's Office in investigating this issue further and coming forth with a specific proposal that could be presented to the legislature. Attached is a report from the State Treasurer's Office on the subject.

NOTE: The Iowa ACIR supports the establishment of a voluntary Local Government Investment Pool. The specific details of such a system (e.g. management arrangements) have not been discussed by the Iowa ACIR. This proposal by the State Treasurer's Office is presented for information purposes only.

A Proposal To Establish An
Iowa Public Treasurer's Short Term Investment Pool
(IPTSTIP)

Prepared for the
Iowa Advisory Commission on Intergovernmental Relations

by the
Treasurer of State
October 13, 1983



Earnings on public funds at the state and local level are an increasingly important source for non tax revenue. For example, in FY 1983, the State Treasurer's Office earned \$40 million on invested idle funds - as much as the state's liquor store profits!

Local governments currently invest their idle funds primarily in local banks and some in government securities. These treasurers are restricted both by state law and their dollar amounts to investments which earn less than the aggregate of their funds would earn if centrally invested by fulltime professional staff in a broader range of options. This has been done successfully in 18 other states without forfeiting security or liquidity.

This proposal is for a voluntary program that will give public treasurers an additional investment option and a share in higher earnings while maintaining overnight liquidity on short term funds. The Code of Iowa will have to be amended in order for local government treasurers to be offered this investment option.

PROGRAM DESCRIPTION

1. Any public treasurer will be allowed to open one or more accounts in the Iowa Public Treasurers Short Term Investment Pool (IPTSTIP). The State Treasurer will be the trustee of the funds and administer of the program.
2. Deposits and withdrawals to the fund will be by electronic transfer through one or more banks in Des Moines designated by the administrator.

Reasonable notice requirements may be stipulated based either on the amount or timing of the transaction. For example, the administrator may require that:

- * in order for a deposit to be credited the same day a cashier must be notified by telephone before 9:30 a.m. and the funds received before noon.

- * transactions above a certain amount require a 24 hour notice.

3. Earnings from the fund will be accrued daily and credited to each account monthly. At the end of each month every depositor will receive a statement. The statement will be very similar to a checking account monthly statement showing:

- * daily balance
- * deposits and withdrawals
- * daily earning rate
- * deduction for costs of administration
- * deduction for "loss reserve account"
- * total earnings for the month

4. It may be possible for payments to pass back and forth between the state and account holders. Policy on this will have to be set by the State Comptroller.

INVESTMENTS

5. The fund will be invested in all of the same financial investments currently available to the State Treasurer's Office Pooled Money Investment, Account, which earned 11.22% in FY '83. Those investments include government securities, commercial paper, bankers' acceptance and perfected repurchase agreements. It must be clear that the pool is not an optimal investment for pension funds. Other, more appropriate investments options will be investigated for local pension funds through the State Treasurer's Office.

6. The experience of similar funds in other states is that the size of the fund and number of daily transactions are very volatile. Liquidity must be a priority. It is possible that large, unplanned draws from the fund could force selling some securities at a loss. Therefore, a "loss reserve account" should be established in the pool similar to IPERS. The account will reimburse the pool when a loss must be taken. The "loss reserve account" can be funded by an off-the-top allocation. A maximum size can be set for the reserve account and allocations stopped when it reaches that point.

COST OF ESTABLISHING AND ADMINISTERING THE FUND

To implement this program the State Treasurer's Office will need:

- * a cashier to handle the daily phone calls from account holders, record transactions and notify banks of wire traffic.
- * half the time of an accounting technician.

- * subscription to a national securities pricing service in order to be able to value the portfolio each day.
- * access to computer hardware and software to process the paperwork of account maintenance, securities transactions, and produce the monthly statements.
- * to make adjustments in the present accounting system in order to keep the fund's records on an accrual basis. Currently the Treasurer's accounting is all done on a cash basis. In order to calculate earnings daily and credit the accounts monthly, the accrual basis must be used.

Initially, the actual investing will take very little time on a daily basis, therefore, it will not be necessary to allocate any of the time of the present investment staff to the costs of the fund.

The additional staff and equipment that is necessary will be brought on line in two phases. The first phase is actually an overall modernization process which is being carried out now regardless of the IPTSTIP. The second phase will be implemented solely to start up and operate the fund.

At the present time, the Treasurer's Office is currently conducting a study, with the help of an outside consultant, to determine how the present systems for accounting and investing can be modernized. It will prepare a plan which will include acquiring a pricing service as well as computer hardware and software to simplify existing paperwork, generate summary reports and extend investment options. An appropriation of \$139,000 was made for this project

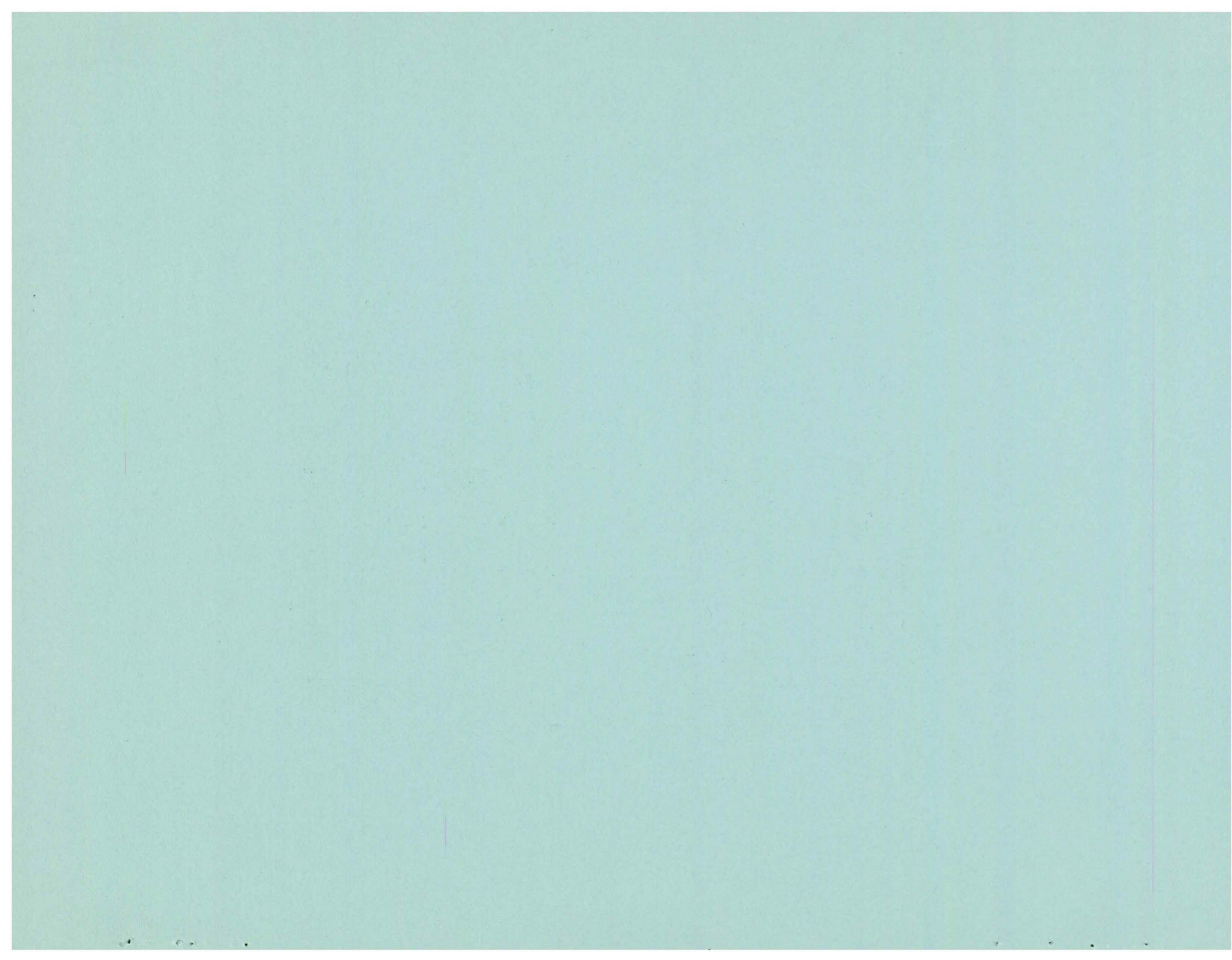
but lost when the budget cutbacks were made. Funding for this project will again be requested regardless of the status of IPTSTIP. This step is the foundation for developing the new program.

The second phase will be adding and training the staff and developing the computer capability necessary to operate the Pool. We estimate that the program could be started up for less than \$100,000.

The annual budget for the program is difficult to determine because it will depend on the size of the fund, the number of accounts and the number of transactions. That is the reason that other states fund their program by deducting a percentage of the earnings from the fund. We estimate that the Treasurer's Office could operate a modest sized fund of \$25,000,000 - \$55,000,000 that would initially come together for \$100,000 per year. This would be financed by deducting not more than 25 basis points of the earnings on a monthly basis. This is in line with other states experience. As the fund grows the number of basis points should decline.

A time line for implementing the program will depend on funding the first phase of office modernization. If that phase is funded for FY '85 and the legislation authorizing the IPTSTIP were passed during the 1984 General Assembly, we estimate we could be operational no later than 1 year later, July 1, 1985.

In summary, we estimate the cost of starting up the IPTSTIP would be \$100,000. The annual budget won't exceed \$100,000 or 25 basis points of earnings and the program could be in operation within one year of funding.



WHAT IS THE IOWA ACIR?

The Iowa Advisory Commission on Intergovernmental Relations (ACIR) was created by the Legislature in 1982 to study and make recommendations on cross-cutting issues affecting the state, cities, counties and schools. ACIR is the only permanent body in the State of Iowa studying intergovernmental matters.

The Commission is composed of 21 members - four representing the Legislature, four representing the executive branch, four representing cities, four representing counties, four representing schools and one representing regional planning agencies. The Governor appoints 17 members. The four Legislators are chosen by the President of the Senate and the Speaker of the House. As outlined in Chapter 28C Iowa Code, some of the responsibilities of the ACIR include:

1. To study the current pattern, powers and functions of local governments, including their fiscal powers.
2. To study the allocation of state fiscal resources.
3. To study relationships among local governments in the state.

Studies undertaken by the Commission have dealt with a wide variety of subjects, such as: property taxes, cooperative purchasing, tort liability for local governments, state mandates, pension systems, and ways to encourage shared use of public facilities. ACIR is interested in hearing from all points of view, all levels of government and of course all interested citizens. Individual agencies, governments or elected officials are encouraged to submit ideas for possible ACIR investigation.

Staff support for ACIR is provided by the Iowa Office for Planning and Programming. Inquiries regarding ACIR may be directed to the Iowa Advisory Commission on Intergovernmental Relations, 523 East 12th Street, Des Moines, Iowa, 50319.