Ohio Township Association
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Borrowing and Investing for Small Governments

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Borrowing for Small Governments

- Debt and Borrowing
- Overview of Debt Issuance Process
- Eligible Projects
- Types of Debt
- Debt Limits
- Types of Securities
- Credit Ratings
- Continuing Disclosure and Post Issuance Compliance
- Working Group
Debt and Borrowing

• A duty or obligation to pay money, deliver goods or render service under an express or implied agreement

• Example: obligation to make annual payments, plus interest for the cost associated with the reconstruction of a township facility

• Repayment terms evidenced by a Note

Debt Issuance Process

• Rules for Townships dictated by State law
  • Limits the amount of debt that can be issued
  • Places fiscal responsibility on its officials
  • Protects taxpayers from unlimited debt burden

• Legislation to authorize borrowing required

• Legislation authorizes security, source of repayment and other terms
Debt Issuance Process

- Constitutional and Statutory Authority
- Board of Township Trustees authorize resolution
- Resolution outlines purpose of project
- Method of sale
  - Private Placement
  - Negotiated Sale
  - Public Bid
- Certification to Fiscal Officer and County Auditor

Eligible Projects

- Townships may borrow:
  - To acquire equipment, buildings and sites or construct buildings for any lawful township purpose
  - To acquire lands and materials to establish a township park
  - To buy police equipment, buildings and sites to house police equipment (applies to township police districts)
  - Tax Increment Financings – limited obligation revenue financing
- Special Assessment Debt
What are General Obligations?

- Ohio Revised Code Chapter 133
- Permanent improvements
- Security and Source of Payment
  - General property taxing power which are pledged to the repayment of debt charges
  - Paid from ad valorem property taxes, unless paid from other sources (within the 10 mill limit if unvoted)
- Debt Limitations

Debt Limits

- Limited home rule townships may issue unvoted general obligation up to 5 ½% of its assessed valuation and;
- May not incur total debt, voted and unvoted in excess of 10 ½% of its assessed valuation
- Example: Prairie Township full value $796,187,942
- Assessed value (35% of full value): $278,665,780
- 5 ½% unvoted limit: $15,326,617
- 10 ½% voted limit $29,259,906
Debt Limits

• Townships shall not incur indebtedness unless authorized by a vote of the electors and shall not incur indebtedness in excess of 5% of its tax valuation unless authorized by other sections of the ORC

• Ten-Mill Limit:
  • Indirect debt limit applies to overlapping subdivisions
  • Total millage of the Issuer and overlapping subdivisions pledged to debt service may not exceed ten mills in the aggregate

Types of Securities

Bond Anticipation Notes

• Issued in anticipation of specified revenues or permanent financing.
• Usually mature within 13 months.
• Can be marketed quickly and inexpensively.
• Low interest rates.
• Deferment of permanent financing.
Types of Securities

Bonds

- Permanent financing
- Usually mature over longer period (20 years)
- Marketing that takes longer and more expensive
- Higher interest rates

Interest Rates & Yield Curves

AAA GO MMD vs. AA GO MMD
As of 9/11/2015
SOURCE: Thompson Reuters
What is a Credit Rating?

- Provides a third party analysis (and rating) of the issuer’s credit
- There are three primary rating agencies:
  - Standard & Poor’s (S&P)
  - Moody’s Investor Service
  - Fitch Ratings

Credit Ratings

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<tr>
<th>Investment Grade</th>
<th>Moody’s</th>
<th>Standard &amp; Poor’s (S&amp;P)</th>
<th>Fitch</th>
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<td>AAA</td>
<td>AAA*</td>
<td>AAA</td>
<td>Highest Quality</td>
</tr>
<tr>
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<td>Aa+</td>
<td>AA*</td>
<td>AA</td>
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<td></td>
</tr>
<tr>
<td>Ba1</td>
<td>BBB+</td>
<td>BBB+</td>
<td>BBB+</td>
<td>Below Average</td>
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<tr>
<td>Ba2</td>
<td>BBB</td>
<td>BBB</td>
<td>BBB+</td>
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</tr>
<tr>
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<tr>
<td>B1, B2, B3</td>
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<td>D</td>
<td>DDD, DD, D</td>
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</table>
Rating Methodologies

- Economy/Tax Base – 30%
  - Full value of all property in jurisdiction
  - Full value per capita
  - Socioeconomic factors (median income)
- Finances – 30%
  - Fund balances (cash) as % of revenues or expenses
  - Historical fund balances (cash position growing or shrinking)
- Management – Moody’s: 20% / S&P: 30%
  - Operating History, 5 year look back
  - Institutional Framework
- Debt & Pensions – Moody’s: 20% / S&P: 10%
  - Net Direct Debt/Full Value
  - Net Direct Debt/Operating Revenues
  - Current & Future pension liabilities
SEC Disclosure: Bond Issuance

• Continuing disclosure annual requirement:
  • Annual financial information and/or operating data must be provided to EMMA annually
  • After the current issuance of the security, if the issuer has an outstating GO debt of:
    • $10,000,000 or more: Financial and operating data
    • Less than $10,000,000: Only financial information (audit)

Working Group

• Where do I start?
  • Municipal Advisor
  • Bond Counsel

• Who else may be involved?
  • Bank or Underwriter and their counsel
  • Rating Agencies
  • Bond Insurer
  • Trustee, Registrar, Paying Agent, Escrow Agent
  • Verification Agent
  • Bondholders/Investors
Questions?

• Up next: Investing for Small Governments

Investing for Small Governments

• Impact of new banking service regulations on investing
• Overview of ORC 135 permissible investments
• Reviewing your internal investment policy
• Importance of cash flow for determining core investable balances
• Interest rate review
• Proactive versus reactive investing
• Active versus passive portfolio management
• Investment strategy review
• Investment provider options
• Choosing an option and implementing a strategy
• Investment accounting and reporting
• Performance evaluation
• Ongoing portfolio management considerations
A Few of the Largest Fines From the Financial Services Crisis

$25 Billion for Foreclosure processing abuses.

$9.3 Billion for Foreclosure abuses.
Thirteen Banks: Bank of America Corp., Wells Fargo & Co., J.P. Morgan Chase & Co. and 10 others

$1.9 Billion for Money-laundering
HSBC Holdings
Regulators: U.S. Department of Justice, Treasury and others (2012)

$1.5 Billion for Manipulating Libor rates.
UBS

Bank and Financial Legislation and Since 2008

- Troubled Asset Relief Program
- Transaction Account Guarantee Program; Unlimited FDIC Insurance
- Stress Testing, Orderly Resolution Plans, Heightened Standards for Large Banks, Risk Weighting of Assets
- Treasury Rescue of FNMA and Freddie Mac
- Office of the Comptroller of the Currency Assessment Increases
- New Capital and Liquidity Requirements
- Volker Rule; Restrictions on Banks
- Dodd Frank Act
- Basel III
- Municipal Advisor Rule
New Banking Regulations will Drive Changes in How Public Sector Clients Invest

Basel Accords Overview

Pillar I
Enhanced Minimum Capital & Liquidity Requirements

Pillar II

Pillar III
Enhanced Risk Disclosure & Market Discipline
What is Basel III?

Basel III regulates banks’ capital requirements as well as assets and liabilities management

Regulates Required Capital Ratios
- Ratio of equity to risk weighted assets

Regulates Asset and Liability Management
- Net Stable Funding Ratio (long term) – Seeks to ensure that banks have a minimum amount of stable funding based on the liquidity profile of their assets and activities over a one year time-frame. Also seeks to reduce asset and liability mismatches.
- Liquidity Coverage Ratio (short term) – Requires banks to hold enough liquid assets that can be easily converted into cash in private markets to survive a stress scenario.

Baseline III Implementation Timeline

- Minimum capital requirements (common equity tier 1, tier 1 and total) phased in 2013
- LCR introduced 2014
- NSFR introduced 2015
- Leverage ratio disclosure starts 2016
- Capital conservation and countercyclical buffers phased in 2017
- Basel III fully implemented 2018
- 2019 -
Impact of Basel III on Public Sector Clients

- Lower earnings credit rates in most cases
- Lower or no rates paid for non-operating fund deposits
- Higher fees for bank services
- Additional fees for banking services
- Changes in products and terms such as long term sweeps and puttable investment offerings
- Banks shifting to higher value deposits
Impact of Banking Services Changes on Public Sector Investing

• Less attractive to hold non-operating short term deposits in bank accounts
• Need to compensate for loss of earnings credits, new and increased fees
• Makes longer term investment strategies more appealing
• More need to use the services of an investment advisor to invest bond proceeds

Impact of the Municipal Advisor Rule on Public Sector Investing

• The municipal advisor rule is a par of the Dodd-Frank Act and went into effect on July 1, 2014 with temporary registration extended until December 31, 2014.
• Underwriters can't provide financial advice unless it can use an exemption; underwriter, independent registered municipal advisor, request for proposal.
• Requires municipal advisors to have written contracts with clients.
• Will require disclosures of conflicts of interest.
• Imposes fees and record keeping rules that may result in higher fees to issuers.
• Rule G-23 will prevent "role switching".
• Broker/Dealer will no longer be able to give advice on investing bond proceeds unless they become an municipal advisor and take on fiduciary responsibility.
How Does Your Organization Invest Reserve Fund Balances Now?

• Bank checking and savings accounts
• Certificates of deposit
• STAR Ohio
• Money market funds
• Individual securities
  • Internally managed portfolio
  • Externally managed portfolio

Public Sector Investment Regulations
Classification of Ohio Public Sector Deposits

- Active deposit – a public deposit necessary to meet current demands of the treasury and that is deposited into a commercial checking account, NOW account, money market account.

- Interim deposit – a deposit of interim moneys which are deposits remaining in the treasury after the award of inactive deposits has been made in accordance with ORC 135.07.

- Inactive deposit – a public deposit other than an active or interim deposit.

Permissible Investments Under ORC 135.14

- United States treasury bills, notes, bonds or any other security issued by the United States treasury or any other obligation guaranteed as to principal and interest by the United States.

- Bonds, notes, debentures or any other securities issued by any federal government agency or instrumentality such as Fannie Mae, Freddie Mac, FHLB, FFCB, FHLMC, Ginnie Mae, etc.

- Municipal Bonds rated within the three highest classifications as established by at least one nationally recognized ratings agency and purchased through a registered securities broker or dealer, not to exceed 20% of the interim moneys available for investment at the time of purchase and as long as the treasurer is not the sole purchaser of the bonds or obligations at original issuance and only of the treasurer or governing board has completed training approved and supervised by the treasurer of state.

- No-load money market mutual funds consisting solely of government or agency securities as described above.
Permissible Investments Under ORC 135.14 (contd.)

• The Ohio subdivision’s fund as provided for in ORC 135.45 which was created for the purpose of acquiring, constructing, owning, leasing and operating municipal utilities as provided by ORC 715.02 and Section 4, Article XVIII of the Ohio Constitution.

• Up to 40% of interim funds can be invested in: commercial paper of an entity with assets exceeding $500 million and rated in the highest classification as established by at least two nationally recognized ratings agencies where the aggregate value of the commercial paper does not exceed 10% of the aggregate value of the outstanding paper issued by the corporation, that mature not more than 270 days after purchase, where the issue of commercial paper of a single issuer shall not exceed 5% of the interim moneys available for investment at the time of purchase and where the treasurer or governing board has completed training that has been approved and supervised by the treasurer of state.

• Bankers Acceptances of FDIC insured banks that mature in 180 days or less from the date of purchase

• Repurchase agreements with any institution eligible as defined by ORC 135.03, collateralized at 102%, market to market daily and maturing not more than 30 days from the date of purchase

Optimizing Your Investment Policy

• When was the policy last reviewed?

• Have you excluded any investment options permissible under ORC 135.14? If so, why?

• Are there geographic restrictions on who your organization will work with to provide investment options? If so, do they still make sense?

• Have your restricted the maximum maturity to less than what is provided in ORC 135? If so, why?

• Are there concentration limits in your policy? If so are they more restrictive than ORC 135? If so, why?
Importance of Cash Flow for Determining Core Investable Balances

- Sound fiscal management practice
- Keep the board informed
- Provides sound reasons to delay or cut expenses
- Reduce borrowing costs
- Increase investment income
- Identify excess liquidity and compensating balances
- Helps you avoid crisis situations

Running a Cash Flow Projection

- Review 2–5 years of historical receipts, disbursements and liquidity percentage.
- Identify and quantify fluctuations year over year and month over month.
- To the extent possible identify and integrate expected capital planning expenses.
- Use factors such as revenue growth/declines, changes in expenses, changes in staffing levels, payroll cycle changes and capital project expenses to make projections.
- Run an analysis to identify the core investable balance
- Add in a liquidity factor based on reliability of cash flow, administrative variability, risk tolerance and current market conditions.
- Consider working with a firm who can provide cash flow analysis services if time is an issue.
Federal Funds Rate 2008 – 2015

Effective Federal Funds Rate

Source: Board of Governors of the Federal Reserve System (US)

2 Year U.S. Treasury Rates from 1990 to 2015

Shaded areas indicate US recessions - 2015 research.stlouisfed.org
Where Interest Rates Are Headed?

Economics is the only field in which two people can receive a Nobel Prize for saying the exact opposite thing.

How Much Money are you Giving up due to Difficult Investment Choices?

"And that’s why I think that this is the best option for your portfolio."
## Portfolio Duration Matters

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<th>Amount and Rate</th>
<th>0.10%</th>
<th>0.25%</th>
<th>0.50%</th>
<th>0.75%</th>
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<th>1.25%</th>
<th>1.50%</th>
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<td>$1,500,000</td>
<td>$1,750,000</td>
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## What is the Cost of Waiting for Rates to Increase?

<table>
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<tr>
<th>Year</th>
<th>Core Balance</th>
<th>Fed Funds</th>
<th>2 Year to Treasury</th>
<th>3 Year to Treasury</th>
<th>2 Year to Fed Funds</th>
<th>3 Year to Fed Funds</th>
<th>4 Year to Fed Funds</th>
<th>5 Year to Fed Funds</th>
<th>Totals</th>
<th>Average Per Year</th>
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<td>2008</td>
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<td>0.51%</td>
<td>0.75%</td>
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<td>$33,000</td>
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<td>2009</td>
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<td>1.71%</td>
<td>0.89%</td>
<td>1.46%</td>
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<td>0.25%</td>
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<td>$11,000</td>
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<td>0.25%</td>
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<td>0.00%</td>
<td>0.11%</td>
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<td>2013</td>
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<td>0.38%</td>
<td>0.78%</td>
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<td></td>
<td>$458,000</td>
<td>$64,428</td>
</tr>
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Treasury rates as of 12/31 each year from www.treasury.gov
Proactive Versus Reactive Investing

- Proactive provides for an investment strategy.
- Proactive helps with rebalancing, concentration and maturity limits.
- Proactive allows for budgetary certainty.
- Proactive helps reduce reinvestment rate risk.
- Proactive provides an increased yield over time.

- Reactive strategies are driven by changing market conditions.
- Reactive may sacrifice yield due to concentration and maturity limits.
- Reactive does not help with budgetary certainty.
- Reactive increases reinvestment rate risk.
- Reactive often sacrifices investment income.

Importance of Active Management

- Portfolios can be managed either passively or actively
- Active management provides a better opportunity to be fully invested at all times
- Active management means that the portfolio to be managed on a total return versus book value return
- Active management may provide enhanced yield through securities swaps
- Active management can allow you to benefit from changes in market yields and sector spreads
Investment Strategy Options

- **Short Duration Portfolio** – Seeks to reduce the risk of not being able to invest in higher yielding options as market interest rates rise. The shorter the average weighted maturity, the lower the current interest earnings.

- **Barbell Portfolio** – Seeks to maintain liquidity for purchases as market interest rates rise and generate increased investment income at the same time with longer term investments.

- **Laddered Portfolio** – Seeks to increase current income by extending the overall average weighted portfolio maturity while setting up regular maturities to purchase securities at higher yields as interest rates increase.

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Sample Laddered Portfolio

<table>
<thead>
<tr>
<th>Investment</th>
<th>Amount</th>
<th>Time</th>
<th>Type</th>
<th>Estimated Rate</th>
<th>Estimated Interest Earnings</th>
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<tr>
<td>Initial Investment</td>
<td>$1,000,000</td>
<td>1 month</td>
<td>Treasury/Agency</td>
<td>1.00%</td>
<td>$2,500</td>
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<td>Initial Investment</td>
<td>$1,000,000</td>
<td>2 months</td>
<td>Treasury/Agency</td>
<td>1.00%</td>
<td>5,000</td>
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<td>Initial Investment</td>
<td>$1,000,000</td>
<td>3 months</td>
<td>Treasury/Agency</td>
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<td>7,500</td>
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<td>Initial Investment</td>
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<td>4 months</td>
<td>Treasury/Agency</td>
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<td>10,000</td>
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<td>5 months</td>
<td>Treasury/Agency</td>
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<td>12,500</td>
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<td>Initial Investment</td>
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<td>6 months</td>
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<td>20,000</td>
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<td>10 months</td>
<td>Treasury/Agency</td>
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<td>25,000</td>
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<td>Initial Investment</td>
<td>$1,000,000</td>
<td>11 months</td>
<td>Treasury/Agency</td>
<td>1.00%</td>
<td>27,500</td>
</tr>
<tr>
<td>Initial Investment</td>
<td>$1,000,000</td>
<td>12 months</td>
<td>Treasury/Agency</td>
<td>1.00%</td>
<td>30,000</td>
</tr>
<tr>
<td>Initial Investment</td>
<td>$1,000,000</td>
<td>13 months</td>
<td>Treasury/Agency</td>
<td>1.00%</td>
<td>32,500</td>
</tr>
<tr>
<td>Initial Investment</td>
<td>$1,000,000</td>
<td>14 months</td>
<td>Treasury/Agency</td>
<td>1.00%</td>
<td>35,000</td>
</tr>
<tr>
<td>Initial Investment</td>
<td>$1,000,000</td>
<td>15 months</td>
<td>Treasury/Agency</td>
<td>1.00%</td>
<td>37,500</td>
</tr>
</tbody>
</table>

Total Estimated Interest Earnings: $225,000

*Estimated Net Interest Rate during Initial Two-Year Period: 1.00%*

*Weighted Average Maturity (excluding liquid funds): 5.67 years*

*A should not be assumed that recommendations made in this letter will be profitable or will equal the performance of the securities in this letter.

Prepared by Umbaugh Cash Advisory Services, LLC October 12, 2013 (Projections - Subject to Change. Not Intended for Sale.)
Investment Product Provider Options

• Banks
  • Basel III pushing costs up and short-term rates down
  • Large investable balances may be hard to manage with certificates of deposit

• Broker/Dealers
  • Markups may have large variations
  • No fiduciary responsibility to client
  • Product and transaction focused

• Registered Investment Advisors
  • Fiduciary responsibility to client
  • Can work to get best executed prices
  • Can provide strategies as well as assistance with cash flow projections, investment accounting and reporting

How Can Using an Investment Advisor Help You?

• Free up your time associated with researching, evaluating, buying, tracking and reporting on investment options.
• Provide access to market tools and information like Bloomberg, TradeWeb, Treasury Direct etc.
• Enable you to get better executed prices on securities purchases which equals more return for your organization.
• Provide budgetary certainty with regard to investment income.
• Reduce investment risks such as liquidity, market and reinvestment.
• Review your investment policy for potential enhancements that increase returns.
• Assist you with cash flow projections and identifying your core investible balance.
• Suggest investment strategies based on current and expected market conditions to help you increase interest income.
• Monitor and rebalance your portfolio as investments mature, internal cash flow and external market conditions change.
• Position your portfolio as proactive and not reactive to reduce risks and enhance returns.
Choosing and Implementing an Option

- Consider investment as an alternative to checking accounts, savings accounts and certificates of deposit.
- Determine the degree of assistance you want based on organizational resources, experience with investments, size of fund balance and cash flow.
- Understand the nuance differences between banks, broker/dealers and registered investment advisors.
- Consider the degree of assistance you want with cash flow projections, reporting, board meetings etc.
- Decide how you want to review and evaluate alternatives.
- Choose an option and set a time frame for performance review and evaluation.

Investment Accounting and Reporting

- GASB 40 disclosures and reporting
- Mark-to-market considerations
- Premium, discount and accrued interest reporting and reconciliation
- Investment account and custodial statements
- Advantages of a consolidated statement
- Investment earnings projections and other customized reporting
Performance Evaluation

• Is the portfolio passively or actively managed?
• Is the portfolio managed for book value return or total return?
• Is the portfolio benchmarked and if so to what?
• Is the benchmark appropriate?
• How have the actual returns compared to the returns projected?
• Are the fees justified by the returns?
• What level of services has been provided versus what was expected?
• How does the performance compare to other options?
• What is the comfort level of the staff and board at your organization?

Ongoing Portfolio Management Considerations

• Fund balance and cash flow projections
• Investment policy considerations and changes
• Market conditions and interest rate environment
• Active versus passive
• Book value returns versus total return
• Portfolio investment strategy review
• Accounting and reporting
• Level of satisfaction with investment returns
Questions?

Success means being prepared when opportunity knocks