Banks to Bonds: A Practical Path to Sound School District Investing

Texas State Comptroller Carole Keeton Rylander has eight statutory education-related responsibilities including conducting performance reviews of Texas school districts for efficiency and effectiveness. During these reviews of school districts across the state, the Comptroller's Texas School Performance Review (TSPR) has identified and recommended thousands of ways for school districts to save money and improve operations.

In 1999, the 76th Texas Legislature charged the Comptroller with providing technical assistance to school districts, singling out investments of public funds as an area that required specific attention. Rider 18 to the General Appropriations Act explained that the Comptroller's assistance to schools may include advice specific to the investment of public funds, including highlighting best practices of school districts or similar political jurisdictions, investment options available to school districts, the development of investment policies, and the fiscal implications of investment decisions. Rider 15 to the General Appropriations Act authorized the Comptroller to work in conjunction with the Texas Education Agency, Regional Education Service Centers and other educational organizations to provide research materials, educational policy proposals and technical assistance to school districts in order to maximize funding for classroom instruction as well as create a Web site and develop other products to assist school districts to better manage their finances.

To comply with this legislative intent and facilitate technical assistance for school districts based on the Comptroller's performance reviews, and with the help from a number of experts in the field, the Comptroller's Office has identified 10 key steps necessary to developing and monitoring an effective investment program.

Public School Investments

Because of the way school districts are funded in Texas, nearly every district has excess funds at certain times of the year that are not needed to pay expenses of the district for days, weeks or even months.

In 1999-2000, Texas school districts received an average of 50.5 percent of their funds from local property taxes and other sources, 46.1 percent from the state and 3.4 percent from federal sources. Under the state's "share the wealth" school finance plan, the amount of money a district receives from any given source depends on a number of factors including such variables as local property tax values and the number of students participating in various state and federally funded programs.

Property-rich districts, for example, receive the majority of their revenues from local property taxes; consequently most of their revenues arrive early in the calendar year when property taxes are due. Property-poor districts receive most of their revenues from the state, and state monies are distributed at scheduled intervals throughout the year. In both cases, the school districts receive large sums of cash that will be used over time to pay salaries, buy goods and services and pay for other district expenses.

Until the money is needed, wise districts invest this excess cash in accounts or instruments that mature or are available in time to meet their anticipated expenses. The idea is to leave funds fully invested until the money is needed.

IMPORTANT NOTICE: The information in this document is presented solely as technical assistance and as a resource available to school districts. The information does not serve as a substitute for legal advice nor replace the independent judgement of a district's governing body concerning its investments. A district should consult its attorney or other appropriate counsel such as its investment adviser to resolve questions about its investment transactions.

1. Comply with state and federal laws.

State and federal laws set the rules within which all school districts are expected to operate when investing public funds. It is important for every district to know, understand and comply with these laws. If experts in these laws are not available within the district, expertise should be obtained to advise and direct the district on these important issues. Investment training is also available and required for school district investment officers. The Public Funds Investment Act (the "Act"), codified at Chapter 2256 of the Texas Government Code identifies the basic requirements for training, written investment policies and authorized investments. A full text of the Public Funds Investment Act is available at: http://tlo2.tlc.state.tx.us/statutes/go/go225600toc.html

Training

Section 2256.008 of the Government Code requires the treasurer or chief financial officer and the investment officer of a school district to attend initial investment training within 12 months of assuming duties, and to attend recurring investment training at least once every two years.

Written Investment Policies

Section 2256.005 of the Government Code requires school districts to annually adopt written local investment policies. Among other things, the local investment policy must be written, primarily emphasizing the safety of principal and liquidity and address investment diversification, yield, maturity and the quality and capability of investment management. Investment policies are discussed in greater detail in Step 2: Establish Sound Policies, of this document.

Authorized Investments

The Public Funds Investment Act outlines the eight types of authorized investments that can be used by all school districts:

- Obligations of, or guaranteed by governmental entities;
- Certificates of deposit and share certificates;
- Repurchase agreements;
- Banker's acceptances;
- Commercial paper;
- Mutual funds;
- Guaranteed investment contracts; and
- Investment pools

These authorized investments are described in Sections 2256.009 through 2256.016 of the Government Code. *The types of authorized investments* *are briefly described below, but the descriptions here do not represent legal interpretations and should not be used as a substitute for the statute. Please consult your attorney or registered investment management firm for any questions as to whether a particular investment is authorized.*

A. Obligations of, or guaranteed by governmental entities: Government Code §2256.009

This category of authorized investments includes obligations, including letters of credit, of the United States or its agencies and instrumentalities such as treasury bills (T-Bills), as well as direct obligations of the state of Texas or its agencies and instrumentalities such as municipal bonds.

Obligations of states, agencies, counties, cities and other political subdivisions of any state are authorized as long as a nationally recognized investment rating firm such as Moody's Investor Service or Standard & Poor's Index (S&P's) rates the investment not less than "A" or its equivalent. A rating represents the formal evaluation of a security's credit quality and ability to honor financial commitments. An "A-rating" indicates that the security issuer has a strong capacity to meet financial obligations.

Also included in this category are collateralized mortgage obligations (CMOs), which are derivative mortgage-backed securities, created from pools of home mortgage loans. A few classes of CMOs are considered legal investments in Texas, but most of the structures available do not meet the legal definition outlined in the Public Funds Investment Act. Section 2256.009(b) of the Government Code describes unauthorized CMOs, such as those that have a stated final maturity date of greater than 10 years.

Finally, this category includes bonds issued, assumed or guaranteed by the State of Israel. Israeli bonds are securities issued by the State of Israel to help build and strengthen the nation's economy and infrastructure. While these bonds are not actively traded and as a result, are less liquid than Federal agency securities, they are available in the United States through the Development Corporation for Israel, a New York corporation and a registered National Association of Securities Dealers (NASD) broker/dealer. Israeli bonds are backed by the full faith and credit of the Government of Israel, which has maintained a perfect record of repayment of interest and principal since the first bond was issued almost 50 years ago. Israeli Bonds are rated "investment grade" by both Moody's (A2) and Standard & Poor's (A-).

B. Certificates of Deposit and Share Certificates: Government Code §2256.010

A certificate of deposit (CD) is a time deposit issued by a bank that pays interest periodically or at a specific maturity date, as shown on the certificate. The bank issues a certificate indicating that a specific dollar amount has been deposited with that bank for a fixed period of time at a predetermined interest rate. Large denomination CDs are typically negotiable; they can be sold or exchanged. There is normally a penalty for early withdrawal of a CD.

CDs are authorized if they have been issued by a state or national bank or savings bank or a state or federal credit union located in Texas and that are either:

- Guaranteed or insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Share Insurance Fund;
- Secured by obligations of or guaranteed by governmental entities described in section 2256.009(a) of the Public Funds Investment Act, but excluding those mortgage backed securities of the nature described by Section 2256.009(b) of the Act; or
- Secured in any other manner and amount provided by law for deposits of the investing entity.

C. Repurchase Agreements: Government Code §2256.011

A repurchase agreement, commonly referred to as a "repo," is an investment agreement involving the purchase of a security with a simultaneous agreement by the seller to buy back or repurchase that security at a specified price and date. Repurchase agreements may be used to earn interest income on idle cash at or near the federal funds market rate. A holder of securities sells them to an investor with a repurchase agreement. The buyer is in effect lending the seller money for the period of the agreement. The terms of the repurchase agreement are structured to compensate the buyer for the use of the cash.

Fully collateralized repurchase agreements are authorized investments if they have a defined termination date and are secured by obligations of the United States, its agencies or instrumentalities. The Public Funds Investment Act also requires that the securities being purchased by the school district be pledged to the district, be held in the district’s name and be deposited at the time the investment is made. In addition, the repurchase agreement must be placed through a primary government securities dealer or financial institution doing business in Texas. Although not identified in the Public Funds Investment Act, a repurchase agreement should be executed under a Master Repurchase Agreement, which is a written contract that covers all repurchase transactions between two parties and that establishes each party’s rights in these transactions. Such an agreement will often specify, among other things, the right of the buyer or lender to liquidate the underlying securities in the event of default by the seller or borrower.

On the flip side, a reverse repurchase agreement, commonly referred to as a "reverse repo," is an agreement under which an investor *sells* securities to a broker/dealer/bank and agrees to buy the securities back at a pre-determined price on a pre-determined date. Essentially, this is a form of "securities lending," whereby an investor receives cash from the broker/dealer/bank and agrees to pay the money back, along with a set rate of interest after a certain period of time. In theory, if the investor can reinvest the cash at a higher interest rate than what they are paying to the broker/dealer/bank, the investor can make money. But this can also backfire if the interest rate earned on the cash falls below the amount the investor is having to pay to the broker/dealer/bank. The term of any reverse security repurchase agreement may not exceed 90 days after the date the reverse security repurchase agreement is delivered, according to Section 2256.011 (c).

D. Banker's Acceptances: Government Code §2256.012

A banker's acceptance is a money market instrument that is used to finance import or export transactions. Banker's acceptances are essentially checks issued by a bank with a promise to pay the face or principal amount on a stipulated maturity date. Among other things, any banker's acceptance purchased by a public entity must have a stated maturity of 270 days or less, must be accepted by a bank organized and existing under federal or state law, and the short term obligations of the bank must be rated not less than A1/P1. "A1" is the highest short-term rating category assigned by Standard & Poor's, while "P1" is the highest short-term rating category for Moody's Investor Service.

E. Commercial Paper: Government Code §2256.013

Commercial paper is defined as unsecured short-term obligations with maturities ranging from one to 270 days issued by banks, corporations, and other borrowers to investors with large temporary cash positions. This type of investment is usually issued at a discount and carries a zero coupon. This means that the investor is not paid interest in increments over the life of the investment, but instead the security is sold for an amount less than the face value of the security. When the security reaches maturity, the investor is paid face value. For example, an investor buys a $100 security at a discount for $60. No interest is paid to the investor until the security matures, but if the investor holds the security to maturity, they are paid $100. Therefore, the investor has earned $40 in interest over the life of the investment.

State law requires that commercial paper carry a minimum credit rating of A1 or P1 as assigned by at least two national credit rating agencies or as assigned by one national credit rating agency while being fully secured by a letter of credit issued by a bank.

F. Mutual Funds: Government Code §2256.014

No-load mutual funds and no-load money market mutual funds are both authorized investments, but each of them is different, as are the requirements and restrictions for each. A no-load fund is a mutual fund offered by an investment company that does not include a sales charge (or "load") on the purchase of shares in the fund. The Public Funds Investment Act provides that school districts can only buy no-load funds.

Mutual funds are a professionally managed portfolio of investments owned by a large number of individual investors. All of the shareholders participate in the gains or losses of the fund. The value of a share is calculated based on the market value of the portfolio. This value will fluctuate, depending upon the level of risk the mutual fund assumes. Some mutual funds specialize in high-tech stocks, while others invest in more conservative and less volatile securities. But, the higher the risk, typically the higher the rate of return on the investment.

Money market mutual funds are a specific type of mutual fund that invests only in money market instruments (i.e., short-term debt instruments such as Treasury bills, commercial paper, bankers' acceptances, repurchase agreements and federal funds) as defined and registered with the Securities and Exchange Commission. There are three types of money market mutual funds: (1) Treasury, (2) governmental and (3) prime. Prime money market mutual funds are permitted to invest in commercial paper and other non-government securities. Money market mutual funds are designed to provide both safety and liquidity.

To be an authorized investment, both no-load money market mutual funds and no-load mutual funds must be registered with the Securities and Exchange Commission. Section 2256.014(a) outlines the requirements for *money market* mutual funds, while section 2256.014(b) outlines the requirements for other types of mutual funds. In addition, because other mutual funds are more risky than *money market* mutual funds, there are more restrictions applicable to the other types of mutual funds. For example, a school district cannot invest in the aggregate more than 15 percent of its monthly average fund balance in mutual funds described in Section 2256.014(b). Furthermore, a district cannot invest any of its bond proceeds, reserves and funds held for debt service in mutual funds described in Section 2256.014(b).

Moreover, a school district's investment in any one mutual fund, including money market mutual funds, cannot exceed 10 percent of that mutual fund's total assets.

G. Guaranteed Investment Contracts: Government Code §2256.015

A guaranteed investment contract is a fixed rate, fixed maturity contract similar to a bond. . However, unlike a bond, a guaranteed investment contract is always valued at par (face) value. This occurs because the company issuing the guaranteed investment contract, usually an insurance company, guarantees the investment by agreeing to pay the difference between the market value and book value for the issue if the investor decides to sell it. A guaranteed investment contract may be structured in a manner similar to a flexible repurchase agreement, whereby the investor is able to draw down the balance upon written request throughout the life of the contract.

For a guaranteed investment contract to qualify as an authorized investment, the district's school board must specifically authorize guaranteed investment contracts as an eligible investment, must receive at least three bids, must purchase the highest yielding guaranteed investment contract for which a qualifying bid is received, the price of the guaranteed investment contract must take into account the reasonably expected drawdown schedule for the bond proceeds to be invested and the provider must certify the administrative costs reasonably expected to be paid to third parties in connection with the guaranteed investment contract. In addition, a guaranteed investment contract must have a defined termination date, be secured by obligations of the United States or its agencies and instrumentalities in an amount equal to the amount of bond proceeds invested, and be pledged to the school district and deposited with the district or with a third party selected by the district.

Bond proceeds, other than bond proceeds representing reserves and funds maintained for debt service purposes, may *not* be invested in a guaranteed investment contract with a term of longer than five years from the date of issuance of the bonds, according to Section 2256.015 (b).

H. Investment Pools: Government Code §2256.016

A local government investment pool is a professionally managed pool of funds composed of cash deposits from a governmental group of entities such as cities, counties, school districts and local governments. In Texas, the ability to pool assets was created under the Local Government Cooperation Act. The investment pool manager purchases a portfolio of securities with the deposits and each pool participant owns a pro rata share in the portfolio. The most common structure is similar to a money market fund in which withdrawals can be made daily. Normally the pool investment managers seek to maintain a "constant dollar," meaning that the principal is not expected to be subject to loss of value.

A public funds investment pool must be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service, or be rated no lower than investment grade by at least one nationally recognized rating service with a weighted average maturity no greater than 90 days, according to Section 2256.019.

A school district may invest its funds in an eligible investment pool if the school board authorizes by resolution such an investment in the particular pool. The investment pool is required to furnish the school district's investment officer an information statement (prospectus), transaction confirmations and monthly reports containing information specified in section 2256.016. The investment pool must also have an advisory board as required and invest in authorized investments.

Unauthorized Investments
There are specific mortgage-backed securities – collateralized mortgage obligations (CMOs), sometimes referred to as derivatives, which are NOT authorized under state law and the district may "unauthorize" any security it desires. The unauthorized securities include:

- Interest Only (IO) CMOs – whose payments represent only interest on the outstanding principal of the underlying mortgage-backed security.
- Principal Only (PO) CMOs – whose payments represent only principal from the underlying mortgage-backed security.
- Collateralized mortgage obligations with a stated final maturity date of greater than 10 years.
- Inverse CMOs (Inverses) whose interest rate is determined by an index that adjusts opposite to changes in a market index.

In addition, other unauthorized investments include investments that do not meet the criteria listed in the Act and investments that fail to meet the specific criteria for authorized investments laid out in sections 2256.009 through 2256.16 of the Government Code. Finally, unauthorized investments include any investment that the board of trustees in its investment policy specifies as not suitable for the district .

Other Restrictions
In addition to restricting school district investments to specific authorized securities, the Act sets other investment requirements for school districts, to include:

- An investment that requires a minimum rating under the Act does not qualify as an authorized investment during the period the investment does not have the minimum rating. The district must take all prudent measures that are consistent with its investment policy to liquidate an investment that does not have the minimum rating, according to Section 2256.021.

There are also other restrictions on soliciting bids for investments defined in the Texas Education Code. For example:

- ***Contracts for Investment of Debt Service Funds.*** A school district may enter into a contract with a term not to exceed seven years to purchase investments with the proceeds of taxes for the purpose of paying debt service on bonds issued by the district. Before entering into such a contract, the district must solicit and receive bids from at least three separate providers. The contract may provide only for the purchase of obligations of the United States or its agencies or instrumentalities, according to Section 45.112 of the Education Code.
- Interest-bearing time deposits or bonds or other obligations of the United States in which proceeds of bonds or certificates of indebtedness are invested must be of a type that cannot be cashed, sold, or redeemed for an amount less than the sum deposited or invested by the district, according to Section 45.102(b) of the Education Code.
- ***Investment of Gifts, Devices and Bequests.*** Section 45.107 of the Education Code authorizes a district to invest any gifts, devices or bequests in accordance with the terms of the gift, device or bequest and under the guidelines of Section 113.056 of the Property Code.
- School district depository banks must be selected through competitive bidding pursuant to the requirements of Subchapter G of Chapter 45 of the Education Code, according to Sections 45.201 – 45.209 of the Education Code.

It is a good practice and imperative that all investments are competitively procured. In addition, districts may bid certificates of deposit electronically, according to Section 2256.005(c) (3) of the Government Code.

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

Legal Basis for School District Investing
(Texas Education Agency and University of North Texas)
Overview of the Public Funds Investment Act. It also cites the portions of the Texas Education Code related to investing.

Public Funds Investment Act Compliance Guide
(University of North Texas)
A questionnaire to determine if an entity (school district) is in compliance with the Public Funds Investment Act.

Types of Investments
(Comptroller of Public Accounts, Treasury Operations)
A list of the various types of allowed and disallowed investments, the advantages and disadvantages of different types of allowed investments and the associated risks.

Investment Controls
(University of North Texas)
Elements of investment controls, the purpose of the school district investment policy, the role of ethics and disclosure in controlling risk, relationships with investment providers and reporting requirements.

IRS Bidding Rules for Flexible Repurchase Agreements
(First Southwest Asset Management)
Internal Revenue Service bidding rules for flexible repurchase agreements.

The Basics of Arbitrage Compliance
(First Southwest Asset Management)
An overview of compliance with arbitrage requirements.

Accounting for Investments
(Texas Education Agency)
Procedures for accounting for investments that are allowed under the Public Funds Investment Act.

Public Funds Investment Act: http://tlo2.tlc.state.tx.us/statutes/go/go225600toc.html

Texas Education Code: http://tlo2.tlc.state.tx.us/statutes/edtoc.html

State and Local Government Series Securities:
http://www.publicdebt.treas.gov/spe/spe.htm

2. Establish sound policies.

School boards are responsible for setting the investment policy and the investment strategy for the district. But what is a sound investment policy? The answer can be very different for different districts; all district officials however, should understand certain basic points, regardless of their district's size.

Section 2256.005 of the Government Code requires school districts to annually review and adopt local investment policy and strategies. The local investment policy must be written, primarily emphasizing the safety of principal and liquidity, and address investment diversification, yield, maturity and the quality and capability of investment management.

The school district investment policy must include the following elements:

- a list of the types of authorized investments in which the funds of the school district may be invested;
- the maximum allowable stated maturity of any individual investment by fund owned by the school district;
- for pooled fund groups, the maximum dollar-weighted average maturity allowed based on the stated final maturity date of the portfolio of any individual portfolio managed by the school district;
- methods to monitor the market price of investments acquired with public funds; and
- a requirement for settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis, according to Section 2256.005(b)(4) of the Government Code.

A school district is also required to adopt a separate written investment strategy for each fund or pooled fund group (portfolio) under its control, according to Section 2256.005(d) of the Government Code. Each investment strategy must describe the investment objectives for the fund using the following priorities in order of importance:

- Understanding the suitability of the investment to the financial requirements of the entity;
- Preservation and safety of principal;
- Liquidity;
- Marketability of the investment if the need arises to liquidate the investment before maturity ;
- Diversification of the investment portfolio; and
- Yield.

Each school district must customize its investment policy and strategies to meet board and administrative objectives as defined, as well as the unique conditions and resources of the district. School districts are required to review annually their investment policies and investment strategies, according to Section 2256.005(e) of the Government Code. Furthermore, the district must adopt a written instrument, such as a resolution, stating that it has reviewed the investment policy and investment strategies, and record any changes made to the policy or strategies.

A school district is also required to designate one or more of its employees (or other designee such as an investment adviser) as its investment officer to be responsible for the investment of funds, according to Section 2256.005(f) of the Government Code.

Training Required

Investment officers, treasurers and chief financial officers must attend two types of training: (1) at least one training session containing at least 10 hours of instruction relating to investment responsibilities within a year after taking office and (2) 10 hours of training every two years thereafter. The Public Funds Investment Act requires training to be provided by an independent source approved by the school district's board or a designated investment committee who advises the investment officer as provided for in the district's investment policy, according to Section 2256.008(a) of the Government Code. Training must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with the Public Funds Investment Act, according to Section 2256.008(c) of the Government Code.

Written Quarterly Report

Not less than quarterly, the investment officer of a school district must prepare and submit to the school board a written report of investment transactions made by the district, following generally accepted accounting principles (GAAP), according to Section 2256.023 (a) of the Government Code.

The report must include (1) a detailed description of the investment position of the school district on the date of the report and (2) a summary statement of each pooled fund group (portfolio), including:

- beginning market value for the reporting period;
- fully accrued interest during the period (accrued interest minus coupon payment: not cash basis);
- additions and changes to the market value during the period;
- ending market value for the period;
- statement of the book value and market value of each invested asset at the beginning and end of the reporting period;

- statement of the maturity date, if applicable, of each invested asset;
- statement of the account, fund, or pooled fund group for which each asset was acquired; and
- statement of the compliance of the investment portfolio with the school district's investment policy and investment strategies and with state law, according to Section 2256.023(b) of the Government Code.

In addition, the report must be prepared jointly by all investment officers of the district and be signed by each investment officer, according to Section 2256.023(b)(2) and (3) of the Government Code.

Considerations in Developing an Investment Policy

There are at least five variables that school boards must consider as they develop investment policies: the source of the funds, the amount of money available, the length of time that the money is available, the market rate that the board expects to achieve and the amount of risk the board is willing to take to achieve the desired income.

Investments can range from small dollar amounts that are only available for a matter of days or hours, to operating funds available for approximately a year, to millions of dollars that result when municipal bonds are sold for construction projects that may not be used for a year or more. And while municipal bonds are the single largest lump sum of cash that districts may have to work with, bonds are not the only source of funds for investment.

All school districts, even the smallest ones that are particularly strapped for cash, have money to invest. Funds sitting in low or no interest bank accounts or not yet deposited are funds that can earn interest. The structure of bank services can make districts money. Cash flow analysis can identify when funds are needed and funds that can be invested for longer periods.

With the exception of certain special districts and open enrollment charter schools, every school district in the state collects property taxes, and most of those taxes are collected from December through February of each school year. All of the money is not spent immediately; rather some is used incrementally throughout the year. There is money that may be available for longer-term investments.

Districts also receive some portion of their revenues from the state. On average, the state provides about 46.1 percent of district revenues, with property wealthy districts getting less, less frequently and property poor districts getting more, more frequently. State payments are sent to districts periodically over the year. A month or more may lapse between the time that state money is received and expenditures are made from those funds.

These monies may only be invested for a few weeks or days, but even these short-term investments can earn money.

On any given day of the week, districts have six to 100 active bank accounts, depending on the size of the district. Some of these accounts are interest bearing and some are not. Money moves in and out of those accounts daily. And, these are monies that can be invested for short periods of time, even invested overnight.

The strategies for investing for longer periods are significantly different from the strategies used for short-term investments. For some school districts, longer-term investments are defined as 90 days or longer. Only a district's own cash flow analysis will define cash use and appropriate strategies.

For example, when a district knows that it will not need a given amount money for a period of three months or more, the types of investment instruments considered appropriate might include certificates of deposit, agency notes and commercial paper that yield higher rates of interest. The downside is that these longer-term investment instruments may be subject to interest rate risk in the event that market interest rates increase. For example, if a district invests in a fixed rate instrument that pays 3 percent interest and the rate rises to 4 percent during that period, the district will have lost the opportunity for a higher rate of return. Therefore, board policy must be very clear about what dollars can and should be invested in instruments with early withdrawal penalties (such as Certificates of Deposits) or market price risk (such as securities). And the board must be prepared to consider the ramifications of spending decisions that might require early withdrawal of those funds.

Once the board fully understands what money it has available or anticipates having available in the future for investment purposes, it must then set the administration's investment parameters. Those parameters should be based upon the benchmark yield that the board has established, the amount of risk the board is willing to assume in order to achieve the desired income and the expertise and time available to manage the investments.

For example, a savings account in a bank or a certificate of deposit that is fully insured by the Federal Depository Insurance Corporation (FDIC) pays a lower interest rate because it has no market or volatility risk, but it does have collateral risk and risk of withdrawal penalties. Volatility risk is the risk that a specific security price will increase or decrease by greater increments than the general market. Collateral risk is the risk that the market value of collateral pledged to secure a deposit or an investment will not be sufficient to pay the principal of the investment.

The Public Funds Investment Act and the Texas Education Code contain a list of investment instruments that are prohibited by law because they are deemed to be too risky for governments or school districts. The school board's challenge is to examine all of the types of investments available to them and the capabilities of staff who will be administering the policy and set workable parameters for staff to follow.

While the Act lists all the types of investments, it is up to the board to tailor that list to its district. These parameters should authorize various types of investments for the many varieties of money. For example, in a smaller district with few staff resources to monitor the marketplace, a strong depository contract that allows funds held in the bank to earn a yield and one or more local government investment pools may be appropriate for both short and long-term investments.

In a moderate to large-sized district with the staff to conduct more extensive market analysis, some combination of investments in agency notes, commercial paper and local government investment pools may be possible and more appropriate. When a district has funds that it will not need for a period of three or more months, the district may want to consider investing in securities with higher interest rates and longer maturity dates. External sources of investment assistance or advice are available to help districts decide on the best approach for them.

Interest earnings can make it possible for even smaller districts to hire an extra teacher, buy needed technology or simply keep up with inflation between the time that bonds are issued and construction projects are complete. During 1998-99, for example, school districts in Texas reported interest earnings of $664 million. Once policies and strategies are in place, the administration should report quarterly to the school board and show board members how the policies are affecting the yield, positively or negatively.

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

Public Funds Investing in Texas
(University of North Texas) An overview of developing an investment policy, including the requirements of the Public Funds Investment Act and the necessary investment controls.

Investment Controls
(University of North Texas)
The elements of investment controls, the purpose of the school district investment policy, the role of ethics and disclosure in controlling risk, relationships with investment providers, and reporting requirements.

Sample Investment Policies
For illustration purposes only, the following school districts have granted permission for use of their investment policies as samples for other school districts to review. Once at the Web site, type "investment" in the search option.

Allen ISD
http://www.tasb.org/policy/pol/private/043901/

Eanes ISD
http://www.tasb.org/policy/pol/private/227909/

Mansfield ISD
http://www.tasb.org/policy/pol/private/220908/

North East ISD
http://www.tasb.org/policy/pol/private/015910/

Paris ISD
http://www.tasb.org/policy/pol/private/139909/

3. Adopt administrative procedures and controls.

In the investment process, the Board of Trustees and administrators of a school district are called upon to analyze the issues and make decisions on the direction the district will take. They are responsible for policies, strategies and reporting to the public. To support the board's policy and intent requires written procedures that will implement those directives and control risk. Administrative controls must be in place to ensure that all policies, rules and laws are being followed.

Many mistakenly believe that policy is procedure, but nothing could be further from the truth. Policy sets broad objectives and guidelines to define the board's intentions and procedures establish the steps necessary to fulfill those intentions. Procedures also create a system of internal controls to ensure that no one deviates from that plan of action. Given the large amounts of public money involved in investing, a district cannot allow the stipulated policy to go unheeded. Reports of misappropriated funds and financial problems in districts are usually accompanied by reports of someone who was allowed to circumvent the system. Even trusted individuals have been known to make bad mistakes in judgement when millions of dollars are at stake.

Sound procedures are explicitly tied back to board policy, and they give step-by-step instructions for employees to follow through each phase of the operation. Not only do these step-by-step instructions serve as a guide for current employees, but also in the event of employee turnover, the institutional knowledge of the person who may have done the job for years is passed on.

Written procedures also give board members, auditors and managers the ability to examine processes to identify control weaknesses and suggest changes to protect the district's assets. Administrative controls traditionally include protection against fraud and collusion and ensure separation of responsibilities, audits and disclosure.

Ensuring that controls are in place and that policy is carried out as intended will decrease the risk of loss, protect both the employee and the district from criticism, ensure that the district achieves the highest rate of return on invested dollars and enhance public trust in the district.

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

Investment Controls
(University of North Texas)
The elements of investment controls, the purpose of the school district investment policy, the role of ethics and disclosure in controlling risk, relationships with investment providers and reporting requirements.

Accounting for Investments
(Texas Education Agency)
The procedures for accounting for investments that are allowable under the Public Funds Investment Act.

Cash Budgeting and Investing Program
(North East ISD)
For illustration purposes only, North East ISD’s cash budgeting and investing procedures and controls.

4. Know how much you have to invest through cash flow forecasting.

Cash flow forecasting involves identifying the amount of money you have available each day, month and year and estimating the amount of revenue you expect to receive from each source and when you expect to receive it, as well as the expenditures you expect.

Revenues

The first step in cash flow forecasting is estimating major revenues, not only by year, but also by month, week or day where possible. State payments to the district are the easiest to estimate. The state sends a schedule of payments report to each district that outlines the amount the district will receive and the payment schedule for the year.

Districts should not include money related to debt service payments and bond proceeds when preparing a cash flow forecast since these funds and the associated expenses are subject to different laws and guidelines.

Federal dollars may come in the form of payments made directly to the district or through the Texas Education Agency (TEA) or the Regional Education Service Centers. Historic information and current program offerings will play a direct role in current estimates.

Local revenues from property taxes are the next to estimate. Annual historic information on tax collection rates by month and day as well as delinquent tax collection rates can be obtained from the tax collection offices and verified through deposits made in previous years. Adjustments are then made to the previous year numbers based on the current tax rate and appraisals.

Lastly, all other revenue sources can be grouped and estimated. These revenues might include such things as payments for meals, receipts from ticket sales at sporting events or any number of other sources. Again, historic information from the general ledger about the amount and frequency of revenues should be adjusted with assistance from the people who are administering the programs.

Expenditures

Next, the expenditures must be estimated, and again, those expenditures must be tracked by month or by shorter periods if they are to be useful.

Payroll will undoubtedly be the most significant expenditure to be tracked. Most districts have multiple pay periods; a monthly payroll for professional employees, a bi-weekly or bi-monthly payroll for auxiliary employees, and so forth. Some are fairly consistent from pay period to pay period, while others fluctuate. And, the amount paid to employees is not the only expenditure associated with payroll. There are also benefits, state and federal withholding amounts, and optional withholdings that must be included in an analysis.

Expenditures for goods and services also fluctuate throughout the year, depending on when orders are placed and received. Estimates will not be perfect, but careful analysis of the revenues versus the expected expenditures will allow the district to invest every possible dollar. And in the worst case scenario, cash flow forecasting will allow the district to know well in advance that borrowing will be necessary, and for how long the debt will be needed before revenues catch up with the expenditures.

Analysis

Some districts have approached cash flow forecasting with sophisticated software that will produce a wide variety of reports; others do their forecasting with a spreadsheet. All analysis is the result of building on historical data. Once the structure or spreadsheet is built, each year's new data can be added to give a better forecast and to eliminate single year aberrations.

TEA's *Financial Accountability System Resource Guide* (FASRG) contains a simple spreadsheet. The FASRG can be found on the Texas Education Agency Web site at http://www.tea.state.tx.us/school.finance/index.html#audit).

In either case, it is not the software that is critical to the process; it is the depth of information entered into the spreadsheet that is important. Initial forecasts may be crude, as the person who gathers the information becomes more experienced, the quality of the information will improve and its value to the district will increase.

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

Focus on Cash Flow Forecasting
(AJ Capital Corporation)
A short overview of cash flow forecasting: rates, length of investment and importance of conservatism in investing.

Cash Budgeting and Investing Program
(North East ISD)
For illustration purposes only, North East ISD’s cash budgeting and investing procedures and controls, including weekly cash flow forecasting.

5. Learn how to manage risk.

The old adage about the dangers of putting all of your eggs in one basket is of particular value in investments. All investments involve risk. There is a risk of losing money, but there is also a risk of not earning all that you could. A balance must be established between the high rate of return with riskier investments and the risk of earning less than is possible. This balance is basically seeking to achieve a market rate of return, a general term referring to the approximate interest rate that could be earned in a specific maturity range at any given point in time. Districts should work to achieve a market rate of return, and if the actual return exceeds the market rate of return, then be sure everyone understands the risks involved. Some of those risks are discussed below.

Diversification or investing in different types of instruments with different maturity dates spreads the maturity, liquidity, credit and market risk. Various investments react differently during changes in rates or different market conditions.

The primary risks for public entities are:

Credit Risk: The risk that the issuer of a security will not be able to pay interest or principal on a timely basis. Credit risk is minimized by buying high credit quality securities, as authorized by state law, and by making sure that all investments are collateralized, where collateral such as securities, evidence of deposits or other property, is pledged to a lender until a loan is repaid. If the borrower defaults, the lender has the legal right to seize the collateral and sell it to pay off the loan.

Liquidity Risk: The risk that the investment cannot be sold and that cash cannot be obtained when needed. There is a risk that school districts that are investing operating money will need the money before the investments' maturity date and will not have access to the money or will have to pay a penalty to get it.

Collateral Risk: The risk there will be insufficient collateral to fully compensate the district if the institution fails and cannot convert the investment to cash as agreed. There is also a risk that the ownership of the collateral is not perfected and the custody of the collateral may revert to an independent institution.

To minimize risk, a district should require a minimum of 102 percent collateral on the market value of the security and the expected interest earnings.

Market Risk: The risk that the price of the security could change and create an unrealized or realized loss. For example, if an investor purchases a security for $100, but the price of that security falls to $80, the investor would have suffered a $20 loss. The loss is realized if the investor sells the security for $80, however the loss is considered unrealized if the investor continues to hold the security in hopes that the price will come back up to the original price or higher.

Volatility Risk: The risk that a security or commodity will rise or fall sharply in price within a short-term period.

Opportunity Cost Risk: Opportunity cost is the difference between a current investment return and an alternative investment offering a higher return. For example, an investor might buy a safer U.S. Treasury security yielding 6.00 percent instead of commercial paper yielding 6.75 percent. The 0.75 percent difference in yield between these two options is referred to as the opportunity cost.

Risk, or the amount of risk a board is willing to take, directly affects what investments will be authorized and the potential for return on investments.

As mentioned earlier, diversification is the spreading of different types of risk over a large number of securities to reduce financial risk or the process of using different securities and maturities in a portfolio to reduce market and credit risk. The goal of diversification is to balance or spread risk and to minimize fluctuations in both the portfolio value and income. It is essential to understand investment risks and cash flow needs before one can properly balance those risks through diversification.

To create a diversified portfolio, investment officers must understand some basic principals and then use their judgment to apply those principals to their situation. To avoid keeping all of a district's eggs in one basket is a good rule of thumb, but just throwing eggs into different baskets without some thought can lead to disaster. Diversification requires thoughtful consideration.

Each school district has a portfolio that, while similar to other school districts in some ways, will be unique in others. For example, a diversified portfolio for a school district with a $100 million portfolio will look quite different from a diversified portfolio of $5 million. Two school districts with similar sized portfolios, but varying cash flows will look quite different as well, however they may both be sufficiently diverse.

There are basically three major categories of diversification: diversification by maturity, issuer and type.

Diversification by Maturity

When a portfolio is diversified by maturity, the investments mature at different times. There is no hard and fast rule to follow in diversifying by maturity, however the principle is that investments mature at different times, unless your cash flows absolutely require investments to mature at the same time.

A cash flow forecast is the most important tool one can use to determine where to place the maturity of investments in the portfolio. But, don't extend maturities just for the sake of "diversification"; it is essential that investments are not maturing after cash flow needs occur.

One reason for having different maturities is that as securities mature and are reinvested, all investments will not be reinvested at the same time. Because of the way ad valorem taxes are collected in Texas, we already have a built in system that requires us to break this rule by investing the bulk of our money during a short period of time. If markets are down (up) at the time those funds were invested, the bulk of the portfolio will be invested in a(n) down (up) market. But, by investing in securities with different maturity dates, the risk will be spread over the rest of the year.

A typical example in Texas of a portfolio that is not diversified by maturity is a school district with all its funds in overnight investments. If cash needs are immediate, this may be the ideal strategy. However, an overnight investment fluctuates daily with the market. If one's entire portfolio is in such investments and rates drop dramatically (or increase dramatically) then the entire portfolio will follow the direction of that change. Going back to the basic concept of diversification, a district may want to minimize potential income fluctuations by having some funds in fixed rate accounts that mature at later dates to stabilize earnings. You may not make as much in the short run if interest rates rise, but you have hedged your bets if interest rates drop.

Diversification by Issuer

When a district has diversified by issuer it has investments from various issuers making up its portfolio. An issuer is the entity that originates the debt and guarantees the final payment. Examples of issuers are the U.S. Treasury; banks; federal agencies such as Federal National Mortgage Association; or funds or pools, such as Lone Star, Logic, and TexPool.

The concept behind issuer diversification is to minimize credit risk, the risk that an issuer will default. If an issuer defaulted and all of a school districts portfolio was with that issuer, this would be a major catastrophe. Investments authorized under the Public Funds Investment Act are almost entirely high credit quality instruments, so the risk of default is generally low. However, it is still a good idea to diversify where possible, by issuer.

Diversification by Type

When a portfolio is diversified by type, this means it has a balance of various structures or types of investments. Some examples of investment types are: Local Government Investment Pools, Money Market Mutual Funds, U.S. Treasury Bills, U.S. Treasury Notes, Agency Discount Notes, Agency Coupon Notes, CDs and Commercial Paper.

To be diversified by type, not all investment types must be included in each portfolio. In fact, for smaller portfolios it would not be prudent to include all of them.

The idea behind investment diversification by type is to hedge your bets. Put some investments in investment categories that prosper during rising interest rates, while keeping some in investments that prosper when interest rates drop. The overall gain on investments is reduced, however the diversification of the portfolio has protected the district's assets.

For example, when interest rates are rising, investments in liquid assets, such as money market mutual funds and pools will generally perform better than others because as the market rates go up, the daily rate paid on these investments quickly follows. However, investments with longer maturities will lose value in the same market. Conversely, when interest rates are dropping, investments with longer maturities will hold their value. By having investments in both areas, you minimize the *overall* gain or loss in the portfolio.

Conclusion

Following the rules of diversification will not ensure a school district does not experience a loss. However, it does minimize the risk of fluctuating values and income. Diversification requires judgment and thought and should be a major consideration when purchasing investments.

The idea is to spread risk. Investing in two or three different securities, for example, does not necessarily equate to diversification. Everyone must look at the reports provided, read information statements and prospectuses and ask these questions:

- What risks are involved in this security?
- Will we have access to the money when we need it?
- How is this pool or fund different from other pools or funds?
- What kind of economic conditions would cause this investment to increase or decrease in value?
- Who can we turn to for sound advice?

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

Types of Investments
(Treasury Operations, Comptroller of Public Accounts)
The various types of allowed and disallowed investments, the advantages and disadvantages of different types of allowed investments and the risks associated with each.

Managing Risk in Investing School District Funds
(University of North Texas and Public Financial Management, Inc.)
How school district policies, strategies and procedures can help manage risk when investing funds.

Investment Strategies for Smaller Entities
(Patterson and Associates)
Investment strategies for smaller entities such as a school district with limited funds to invest. Different types of investments are described and discussed. Portfolio strategies are also outlined.

The Ghost of Orange County
(First Southwest Asset Management)

6. Manage bond issuances to maximize interest earned and minimize interest paid.

The largest single sum of money that most districts will receive at one time will be the proceeds from a municipal bond issuance. Bonds are authorized by the voters and sold by the district for large projects to spread the cost over time to succeeding users of the facilities. Based upon a district's needs and the state's limitations on the amount of indebtedness a school district can carry (not to exceed 10 percent of assessed property valuation), the entire authorized amount does not have to be issued immediately. A district may issue in phases.

Most issues are tax exempt and in Texas are backed by the Permanent School Fund. Tens of millions of dollars are made available to pay for major construction projects when voters authorize bonds. When bonds are sold, the district is agreeing to pay interest to the buyers on a set schedule and soon after bonds are issued, the debt-service payments begin. Funds must be set aside to make payments on the debt. Depending on local ordinances and rates, districts often issue the authorized bonds as soon as the school board approves the sale of bonds, yet construction may not begin for months or years. In the meantime, the bond proceeds are invested.

Federal Income Tax Considerations

Provisions of Section 148 of the Internal Revenue Code of 1986 (from the Tax Reform Act, codified at 26 U.S.C. §148), as amended, (the "Code") states that the district's long-term debt obligations must meet certain minimum criteria to be considered and continue to be considered "tax exempt."

This "tax exempt" status means that interest income earned by purchasers of long-term debt instruments is not subject to federal income taxes. Related U.S. Treasury Regulations under Section 148 of the Code (26 C.F.R. §1.148-2) generally provide that the determination of tax exempt status is made on or before the date such obligations are issued based on reasonable expectations about the use of the bond proceeds.

Since these issues are sold in the tax-exempt market and reinvested in the taxable market, the rates for reinvestment will normally be higher because of the nature of the markets' relative risks.

Long-term debt that does not meet and continue to meet the minimum criteria of Section 148 of the Internal Revenue Code and the related Treasury Regulations described above are considered "arbitrage bonds" and are not considered "tax exempt." If bond proceeds are invested at a higher yield than the effective interest rate being paid on the bonds, they are said to produce arbitrage profits, and with only few exceptions, those profits must be paid back to the federal government. Under current tax laws, a district must make calculations periodically to determine any amounts that it might owe the federal government under these rules and must make actual payments of any amounts owed in five-year increments.

Obligations will become arbitrage bonds (as described above) if a district does not convey arbitrage profits to the federal government as rebate payments under Section 148(f) of the Code. The district's obligation to calculate and make rebate payments (if any) will continue as long as there are gross proceeds allocable to that outstanding debt issues. All debt issues are separate and stand alone. Failure to remit arbitrage profits to the IRS when due can result in a penalty equal to 50 percent of the rebate amount due, plus late filing interest.

That being said, the investment should be designed to earn as much interest as allowed. If too much interest is earned, it is simply rebated to the IRS. There is no penalty or stigma involved as long as the payment is timely.

The danger is not earning the allowed interest and consequently spending money on interest for borrowed money before the money is needed.

For example, if a tax-exempt bond issue is sold at a yield of 5.5 percent and the proceeds are invested in taxable securities of 6.75 percent, arbitrage of 1.25 percent (6.75 percent – 5.5 percent) is being earned.

On the other hand, selling a bond with a yield of 5.5 percent before it is needed for construction, for example, and investing the proceeds in a savings account that only earns 3 percent interest means that the a district is losing 2.5 percent interest (5.5 percent – 3 percent). In the long run, every dollar the district has to pay in interest is a dollar that is no longer available for construction.

Small bond issues are, in some cases, exempt from the payback provisions of the law, according to section 148 of the Code. As of January 1, 1998, a district that issues less than $10 million in bonds in a calendar year to finance construction of public school facilities, is a small issuer and receives the "small issuer exemption." In other words, if a district issues less than $10 million in bonds after January 1, 1998 in a calendar year, it is exempt from having to return excess interest to the federal government.

A school district is obliged to understand the laws and regulations under which they must operate and to comply with those laws. The results of non-compliance can be damaging monetarily and politically. Consult your attorney or tax advisor for additional information or clarification on tax status of income earned from investment of bond proceeds.

Impact of Drawdown Schedule

The timely investment of bond proceeds depends on the anticipated spending plan for the funds known as the drawdown schedule. A drawdown schedule is an estimate of the dates and amounts that expenditures on a project will be paid and is normally available from contractors or architects working on the project. Drawdown schedules represent the estimated cash flow requirements and are important in determining the amount of bonds to issue and the available funds to invest. Securities can be bought to match the estimated schedule.

The following are strategies for maximizing the interest earned on bond proceeds and could hold true for all investments:

1. Issue bonds when rates are low to reduce borrowing costs.
2. Try to create an accurate cash flow forecast to guide the investment of the proceeds.
3. Time the issue of bonds or portions of bonds authorized by the voters to coincide with when the money is needed and to use the small issuer exemption provisions of section 148 of the Internal Revenue Code .
4. Invest bond money so that it earns all the allowable interest, paying back arbitrage profits if necessary, but avoiding interest losses if at all possible.

The goal when investing bond proceeds is to safely maximize the interest rate spread differential between the bond yield and the proceeds reinvestment yield within the guidelines of investment policy and specific bond covenants. This means that simply keeping bond proceeds in a bank account, money market fund or investment pool may not be the wisest decision. Investment return is often an essential part of project funding and should be taken seriously. Earning even an extra quarter point of interest can translate into significant real dollars. To illustrate, a $5 million investment with a yield of 6.25 percent will earn $12,500 more than an investment yielding 6 percent. Alternately, it may not be wise to stretch for the highest yield available and assume a high degree of risk, if excess earnings will ultimately be rebated back to the government.

Before investing any proceeds, an investor should be prepared to consider the following:

- How much money will be invested? (Have some of the funds already been spent?)

- How quickly are proceeds likely to be spent? (An estimated draw schedule is essential!)
- How certain are these anticipated draws?
- Will any arbitrage spending exceptions be met, or will the district be required to rebate excess earnings to the government?
- What is the arbitrage yield? The arbitrage yield is a rate equal to the overall effective interest rate paid on a tax-exempt bond issue. (This will represent the benchmark rate that the district should seek to achieve.)
- Is it possible to achieve a positive spread? (Can funds currently be invested above the arbitrage yield?)
- What securities are authorized in the district's investment policy and specific bond covenants? (Be especially careful to avoid investing in securities that are unauthorized!)

It is important to note that drawdown schedules are inherently uncertain, so plan for adequate liquidity. If you purchase securities, plan on leaving 10 to 20 percent in a pool or money market fund so that an unexpected draw doesn't force a security sale at a loss.

In addition, when possible, try to gain enough yield to obtain a positive spread when you expect to be subject to IRS rebate. Positive spread is achieved when an investor earns a higher rate on securities purchased than the rate they have paid to borrow the money. For example, if a school district issues bonds at 6 percent and uses the bond proceeds to purchases securities that yield 6.50 percent, then the district has earned .50 percent positive spread.

Finally, school districts should carefully document their trade process. Keep in mind that bond counsel and financial advisors can provide a district the necessary expertise to negotiate this minefield and protect the assets of the district. Investment advisors can assist the district with the effective and efficient investment of the proceeds.

Investment of Debt Service Funds

General fund and debt service derive their revenues from taxes, however the cash outflows are very different from each other.

Debt service payments to pay off the bonds are established the day the bonds are sold. Principal and interest payments are determined for each financial year for the entire length of time till the bonds are paid off.

The district can invest its tax money that it has set aside for debt service payments to meet the principal and interest payments. For example, the district gets tax money in January of 200X. The principal and interest on bonds is due on August 15, 200X. This money can be invested to mature on the date of debt service payment in an investment for seven months (January to August) and earn interest.

Controlling Interest Cost

Controls targeting debt-related costs are very beneficial and are practical to implement. The primary objectives of debt management controls are to minimize debt-related costs and to avoid unnecessary debt-related costs. Without effective debt-management controls, the district may incur excessive interest costs and loan fees. Any degree of unnecessary or avoidable interest costs represents waste. A lower debt component of the tax rate is the primary benefit of effective debt management controls.

Interest costs may be controlled through several effective debt management techniques, which are listed below.

- Implement a board policy to establish a debt ceiling that is related to the district's ratio of long-term debt to the amount of taxable property and/or the debt rate cap.
- Build projections of the district's budgetary and cash flow requirements for a three to five-year period to understand the district's total debt requirements. These projections will facilitate study of all debt options and also help avoid excessive borrowing fees as a result of repetitive debt borrowing that could have been consolidated under a single loan.
- Build and maintain a rainy day fund to avoid short-term borrowing.
- Compare debt financing options and costs under all options available in the marketplace, especially when considering lease-purchase financing, which is generally viewed as an expensive option in most instances.
- Actively monitor the economic advantages of advance refunding of long-term debt.
- Use formal competitive procurement methods to obtain the best competitive bids or competitive proposals for financing costs.

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

The Basics of Arbitrage Compliance

(First Southwest Asset Management)
Overview of compliance with arbitrage requirements.

The Investment of Bond Proceeds
(First Southwest Asset Management)
Considerations, strategies and bidding agents when investing bond proceeds.

State and Local Government Series Securities:
http://www.publicdebt.treas.gov/spe/spe.htm

Internal Revenue Service:
http://www.irs.gov

Bond Review Board:
http://www.brb.state.tx.us

7. Develop a strategy for earning the best rates.

The Texas Education Agency's *Financial Accountability System Resource Guide* (FASRG) defines investments as all securities and other assets acquired primarily for the purpose of obtaining income. All cash and cash equivalents have the ability to earn interest. Switching to an interest-earning account, or using a sweep account to move any excess cash into an interest-bearing account can help obtain income. Checking accounts should be reviewed to determine if there is an opportunity to earn interest. If the account earns no interest, it is recorded in the accounting records as a deposit, rather than an investment.

When a district is developing its investment strategy, all assets should be considered and placed in interest-earning vehicles if possible. It is the job of the investment officer to earn the best rate available on the assets given different situations and their intended uses.

To determine the intended use of the funds, the district needs a cash flow analysis. The analysis tells the investor when given amounts of cash will be needed and, therefore, the length of time that the funds can be invested. After a cash flow analysis directs the maturity of the investment, a policy prescribes the authorized investments that can be used.

The amount to invest and the length of time that it can be invested will put certain limitations on the district's market choices. If policy prescribes a weighted average maturity and/or maximum maturity, this will be another condition of the investment strategy. With these conditions in mind, the school district can competitively bid the time and type of investment and choose the best rate available meeting those conditions.

The Public Funds Investment Act requires each district to write a strategy statement for each type of fund invested. The strategy statement must address:

- the suitability of the investments;
- the preservation and safety of principal;
- liquidity;
- marketability of the investment;
- diversification; and
- yield.

The school district should address these same issues every time that money is invested.

In a simplified example, let's say that a district needs funds in 200 days for payroll. The policy allows the use of a pool, CDs and T-Bills. The investment officer or broker that the district employs checks the rates for all three types of investments and chooses the one offering the highest rate of interest being paid for investments that mature before the end of the 200 days. However, it is not simply a rate comparison.

If the investor thinks that rates are rising, the best investment might be the pool that will reflect the rise. If rates are generally falling, the investor will want to lock in today's higher rate for the 200-day period. And in the event that it appears that rates are rising, but suddenly the rates begin to drop, the district may move the dollars from a variable-rate investment instrument to a fixed-rate investment instrument. Good brokers search for the securities that best meet the investor's needs and can often advise the investing district about its options.

As investments are made to match liabilities, most districts end up with a *laddered* portfolio. Each liability identified by the cash flow is matched to a specific investment or security and the resulting portfolio has these securities maturing regularly to pay the bills. It is called a ladder because a graph of the portfolio maturities would appear regular and almost equal to reflect the liabilities that are also normally regularly timed and relatively equal in size. Some larger districts will have funds available for longer-term investments, but even those will have a large portion of the portfolio in a laddered structure.

An important part of every portfolio is liquidity, which measures the ease with which an investment instrument can be converted to cash. And every portfolio must have a portion that is liquid, which is in cash or a cash equivalent. Unexpected liabilities that may occur. A high school boiler may need to be replaced or the district may need emergency funds to pay for extra teachers because of an unexpected enrollment surge.

Components of an Investment Portfolio

Most investment portfolios, regardless of size, will have three components:

- liquid assets that can be tapped immediately;
- short-term investments that will be available within a shorter time frame; and
- longer-term investments that typically earn higher rates of interest but are more difficult or costly to liquidate should cash suddenly be needed.

Larger districts also may have even longer-term investments because they typically have larger sums of cash available for investment at any given time. Each district defines the length of these investments in accordance with its own needs and cash flows. To most small districts, short term is 1-6 months and longer term is 6-12 months.

Traditionally, districts have used only time deposits (CDs) bought from their local banks as their investments. Since all CDs are collateralized in Texas, there is little risk of loss on bank defaults. But that translates into lower interest rates, because investors are rewarded for taking risk.

Currently however, under the law and its standard of care, the district's cash should be used for maximum investment benefit. It is the responsibility of the district to thoroughly research its options and choose an appropriate strategy that safeguards funds but also earns a reasonable market yield. Since every investment has some risk, the investor must research those risks and follow some set strategy to minimize unacceptable risks.

Some of the basic points to consider in making investment decisions are:

- Matching, to the extent possible, the investment maturity to the most distant liability date. For example, the district needs $10,000 to pay for building repairs in January, and another $20,000 for repairs in March. Provided there is sufficient cash on hand to pay both bills, invest $20,000 of excess cash so that it will mature in March and $10,000 to mature in January rather than investing $30,000 to mature in January. This course of action allows the district to match liabilities but also to attain the normally longer and higher rates.
- Compare all the various investment types available to the district. No investment is always going to be the best. Do your comparison shopping on all the types authorized for each investment decision.
- Competitively bid each investment. No one broker or bank is always going to have the best rate. At least three bids/offers should be taken to ensure that the best rate is received. It is also important to remember to compare apples to apples. Ask if CDs are all quoted on a 360 or 365 days basis and if you are comparing yield and not other rates.
- Document each purchase with a trade ticket of some type, which records all the information and that can be used to compare to supporting documents like safekeeping receipts and confirmations later.
- Consider all the costs of a transaction. Buying a security may not be better than a pool for example when clearing and safekeeping costs are included.
- Reconcile regularly to broker and bank confirmations.

- Report each security and interest-bearing investment on your monthly report.

A new service available, which helps small and large districts, is Treasury Direct from the U.S. Treasury. Districts wanting to buy T-Bills or T-Notes can do so online (or otherwise) directly from the Treasury and have them safekept at the Federal Reserve.

Local Government Investment Pools

Many small districts use local government investment pools for all their investment needs. These commingled investment vehicles address all the strategy requirements required by law and offer current market rates through an economy of scale and professional management. Larger districts use the pools for the liquidity portion of their portfolios for the same reason. The biggest advantage of pools is having a full-time professional making the "big" decisions while the district reaps the benefits.

There are several pools available in Texas to help districts. There are different types of pools, however, and the investor should understand the pool’s objectives and structure. Small districts normally need pools that strive to maintain $1 net asset value (constant dollar pools). A constant dollar pool is a type of money market fund that offers safety of principal and liquidity. The fund maintains a stated objective of a $1 share value for all participants, which means that the dollar value of the original deposit is expected to be maintained through conservative management practices. Even though these are extremely conservative, their size and active management create rates normally above both CDs and Treasury Bills.

Brokers

When buying securities, a district will most likely use a broker to search the marketplace for the best rates available—within the limitations set for that decision by the district (for example, time limits and authorized investment types.) But no broker will always have the best investment idea. Seeking suggestions from a minimum of three broker/dealers is advisable.

Investment Advisors

Some larger districts use investment advisors to manage its portfolios. An advisor does not sell securities but instead manages or provides advice on a portfolio in accordance with the district’s unique policy and cash flow. As with brokers, districts are required to give a written copy of the district’s investment policy to any investment management firm that is under contract with the district to invest or manage the district’s investment portfolio. And the investment management firm is required to certify in writing that the firm has reviewed the district’s policy and acknowledges its responsibility to implement reasonable controls to comply with the policy.

The Public Funds Investment Act requires monitoring and reporting on the portfolio quarterly, and this reporting is an important part of the investment strategy. Reporting will show whether the goals and objectives set by the board are being met and whether the risks to necessary liquidity and credit quality set in policy are being controlled.

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

Purpose of Investments
(Treasury Operations, Texas Comptroller of Public Accounts)
The three basic purposes of investments: safety, liquidity and yield.

Types of Investments
(Treasury Operations, Texas Comptroller of Public Accounts)
The various types of allowed and disallowed investments, the advantages and disadvantages of different types of allowed investments and their risks.

Investment Decision Making Information: From Wall Street to the Web
(Patterson and Associates)
Information available for school districts making investment decisions.

State and Local Government Series Securities:
http://www.publicdebt.treas.gov/spe/spe.htm

8. Monitor your investments and deposits.

Monitoring investments means regularly checking to see if the district's money is safely earning a competitive market rate and that purchases comply with statute. By law, districts must report on a quarterly basis. However, one of the primary purposes of monitoring is to give the investment officer warning about potential problems with the portfolio. Some districts have found it useful to require monthly reports on the performance of their portfolios. Monitoring book values, market values per instrument invested and their changes can be accomplished using a spreadsheet. Districts also can also use free tracking by outside brokers or pay investment consultants for monitoring services.

Investments are defined in TEA's Financial Accountability System Resource Guide as securities and other assets acquired primarily for the purpose of obtaining income or profit. The primary purpose of a checking account, however, is not to make a profit and checking accounts are therefore accounted for as a deposit rather than an investment in the district's accounting records. But cash or cash equivalent assets all have the potential to earn interest.

On any given day, interest rates can change. Most interest rates move up and down as the Federal Reserve raises or lowers prevailing interest rates for short-term borrowing. Often, districts will earn a higher yield by investing for a longer period of time or investing in different security types. By carefully monitoring pool rates and comparing them to agency and commercial paper yields, it is possible to determine their relative value.

One basis point, a measure used to quote yields on bills, notes and bonds, is equal to .01 percent of yield. One percentage point (1 percent) is equal to 100 basis points. When investments total hundreds of thousands and even millions of dollars, the difference between 6 percent interest and 6.5 percent interest, or 50 basis points, can translate into a significant sum of money. For example, the effect of 50 basis points on a $1 million investment is $5,000 in additional annual income.

Therefore, if the money manager has the flexibility to move money between investment instruments at little or no cost to the district, the district can earn a higher yield, or rate, on its investments. The ability to adjust investment allocations frequently, however, depends on the district's having qualified staff with the time to monitor the market and move money when appropriate.

Consequently, some districts with considerable sums to invest may hire investment managers to manage the district's investment portfolio within the policies established by the board. Others simply opt to leave all money in their local banks in a lower yielding instrument or account. Still others have chosen investment pools, or a group of investors that have joined together and used their combined resources to invest in higher-yielding instruments that would not otherwise be available to smaller investors.

Another key to monitoring investments is understanding what type of investment instruments work best for the district. A fixed-interest rate is good for investors when interest rates are falling because the investors are guaranteed the rate on the day the instrument was purchased, no matter how low the rate drops before the instrument matures. But during times when interest rates are rising, an investor would lose money with a fixed-rate instrument that remained at the lower rate. However, even the experts can not predict the direction rates will move with any regularity, so a district is best served by diversifying its investments.

Certificates of Deposit (CDs) and certain bonds have fixed-interest rates. With CDs, there is little risk that the bank will default on its obligation to the investor, therefore, the interest rates are typically very low. Also, CDs are considered illiquid, meaning there is no secondary market or opportunity to sell the investment should the district need money before the CD's maturity date. If the district chooses to withdraw its funds early, it must pay a sizable penalty. Therefore, the purchase of investments should be made with the intent and ability to hold the investment to maturity.

For many districts, investment pools represent a desirable option. The biggest advantage is that the pool employs experts to make the "big" decisions, and the school district benefits from the pool's ability to invest in instruments to which smaller investors would not have access. There are several major investment pools available to districts in Texas. Each of them offers daily liquidity, which means that districts can deposit and withdraw funds daily without penalty. Because of the size of these pools, interest rates exceed the interest paid on CDs and U. S. Treasury bills and short-term securities issued by the U.S. Treasury.

The major challenge in deciding which pool is most desirable is the yield or rate of return on investments. The good news is that joining multiple pools allows a district to pick and choose the pool that is paying the highest rate of interest.

Safekeeping Investment Securities and Collateral

All investments in treasuries, agencies and commercial paper should be held in the district's name and safekept by the trust department of the bank. The bank issues safekeeping receipts to the district, listing par amount, maturity date, discount/coupon rate and the CUSIP (Committee on Uniform Securities Identification Procedures) number. These receipts should be checked when received from the bank and filed in a secure place.

CUSIP numbers track individual securities. This is a unique identification number attached to each security that allows dealers, brokers, bankers and others to track and keep up with securities and their movements. CUSIP is a standard alphanumeric system of identification of security issues that is used throughout the financial community. It is a nine-digit code assigned to each issue. The CUSIP is like a social security number for each issue. There is only one for each issue, which can very specifically identify the security. For example, a CUSIP number could be 313396ME9.

In the process of investing, it is important that securities a school district purchases are kept safe. Typicaly a school district buys securities electronically, and securities are delivered before payment is made, which secures the assets for the buyer. Once purchased, they must be kept in a safe place with the school districts' names attached to them. This task is typically performed in a bank's safekeeping department. However,in selecting a bank for safekeeping, be warned of potential problems with independence.

For example, the district's depository bank is Bank A. The collateral may be safekept at any Bank (B through Z), however not by Bank A. Bank B through Z could be in the same town or out of town. This third-party bank (B through Z) will issue a receipt that lists the collateral pledged by Bank A to the district. This collateral cannot be released by Bank B without the approval of the district.

A surety bond or securities collateralize all of a district's deposits in its depository. The securities for collateral should be held at either a third-party bank or the Federal Reserve Bank or Federal Home Loan Bank.

After securities have been received by the bank, ask for an accounting to show what has been received. The district should carefully check the par amount because discrepancies can occur from what was transferred and what the receiving bank shows it has received.

While this process seems fairly simple, care should be taken to ensure that what the district owns has been transferred and received in like fashion. Human error in keying in amounts transferred could be disastrous and a nightmare for the district to correct.

In the cash management process, it is also important that cash in the bank is fully collateralized. This means that the funds a school district's depository bank has on deposit should be secured by securities of equal value plus 2 percent. This collateral should be monitored daily to ensure the safety of the school district's money. The amount and cost of a bank's charge for over collateralizing can be negotiated with the depository bank.

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

Purpose of Investments
(Treasury Operations, Texas Comptroller of Public Accounts)
Three basic purposes of investments: safety, liquidity and yield.

Choosing and Using Benchmarks
(Patterson and Associates)
How to use benchmarks to create a sound investment portfolio.

9. Negotiate depository contracts that maximize returns.

The Texas Education Code, section 45.203, requires that a school district depository must be a bank located in Texas. The bank selected as a school depository and the school district must enter into a depository contract in a form approved by the State Board of Education. School districts must bid depository contracts every two years. A school district and the district's depository bank may agree to extend a depository contract for one additional two-year term. An extension of this type is not subject to the two-year bid requirement.

For a school district, the idea is to maximize safety and yield by minimizing balances in low-interest accounts, eliminating low-interest or no-interest accounts and minimizing fees or service charges. The school district's goal is to ensure all assets are earning at a reasonable market rate.

Banks invest money deposited in the institution and earn interest, and pay out interest to the depositors for the use of their money. The bank's goal is to make a profit, and that profit is the difference between the interest earned and the interest paid. Because school districts are often the largest investor in town, they should have the negotiating power to achieve favorable terms. The investor's job is to know from the financial or other sources what is a reasonable rate for its targeted maturity range.

Many districts pay for banking services by leaving money in the bank. These are called compensating balances. The bank pays little or no interest and the school district pays little or no fees. Be warned: there is no such thing as free banking.Depository contracts that require compensating balances use an earnings credit rate (ECR) to generate the money to pay banking fees. Other depository contracts are paid on a fee basis in which the direct fees are paid monthly for services received. To compare these different approaches, the district must calculate the amount of interest that is paid through the ECR versus what might be earned in another investment. The ECR rate is almost always less than comparable rates in pools or money market funds so the district could earn the higher rate, pay the fees and keep the increased earnings.

Depository contracts should also address how excess funds will be handled. The idea is to let the banking structure work for you. The amount of interest the bank pays on account balances is critical. What kinds of accounts can be used to keep balances low so that every possible dollar can be invested in higher yield instruments? An account structure that uses sweep accounts can keep assets earning at market rates daily and minimizes the amount of collateral required by the bank. For example, districts can earn interest even on dollars held overnight by investing remaining balances at the end of a day in an overnight sweep account. Sweep accounts may allow several investment options including repurchase agreements, an agreement whereby the seller agrees to repurchase the securities at an agreed upon price and time.

The FDIC insures bank accounts up to $100,000 by each tax identification number, not by account. This protects the district should the bank become insolvent. But school districts typically have a great deal more cash in the bank, so how will they protect the taxpayer's assets in excess of $100,000?

In a depository contract, the district should make certain that all time and demand balances are fully collateralized, meaning that the bank has pledged certain authorized securities as collateral for the amount of principal and current interest earned on deposit. As discussed earlier, these balances should be collateralized to 102 percent, and the collateral should be held in a separate institution outside the bank's holding company. Administrators must monitor this function to ensure that the district's assets are fully protected in the event of default. The Texas Education Code, section 45.208, requires that depository banks provide a bond and/or pledge approved securities in an aggregate amount sufficient to adequately protect the funds of the school district deposited with the bank. If a bank provides a bond, the board of trustees of the school district must approve the bond and the surety on the bond. A copy of the depository contract and bond must be filed with the TEA.

It is important to negotiate interest-bearing checking accounts, banking account structure, sweep accounts and other services to achieve the most favorable terms for all bank services and fees.

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

Texas Education Code: http://tlo2.tlc.state.tx.us/statutes/edtoc.html

Types of Investments
(Treasury Operations, Comptroller of Public Accounts)
The various types of allowed and disallowed investments, the advantages

and disadvantages of different types of allowed investments and their risks.

Choosing and Using Benchmarks
(Patterson and Associates)
Use of benchmarks in investing.

Flexible Repurchase Agreements
(First Southwest Asset Management)
Flexible repurchase agreements.

10. Use the experts when you need them.

Most Texas districts lack the technical expertise or the time to monitor investments each day, and smaller portfolios do not usually warrant constant attention to investments. Some investment decisions require specialized expertise. There are various types of experts with whom a district can consult for assistance. Some districts are reluctant to spend money for these services. In many cases, however, the expenditure of funds for these services can and will result in decreased risk and increased revenues for the district.

Who are these experts? Moreover, what sort of services can they provide? It pays to know what resources are available and how to obtain and manage those resources should the district decide to use them.

Banks offer depository services that basically include the traditional banking services such as deposits and withdrawals. They can also offer debt issuance and investment advice particularly to small districts. In Texas, each bank must certify that it has reviewed the district's investment policy and acknowledge that the bank has implemented reasonable procedures to ensure compliance with the district's policy.

Broker/Dealers are registered with the Securities and Exchange Commission to sell securities to entities. Brokers simply broker the trades between two institutions (the district and the seller of the security), while a dealer actually has an inventory of securities to sell to the entity. In either case, a broker/dealer can provide current market information to the district and can canvass the markets for the best rates. To ensure the district is receiving fair market prices, it is imperative to do competitive bidding on all securities and ensure that all securities are delivered to the district's depository or safekeeping bank (custodian) to perfect the district's ownership. In fact, Texas law mandates that all securities are settled delivery versus payment. There are two methods for delivery of investment securities, one of which is delivery versus payment, the other is delivery versus receipt. Delivery versus payment occurs when securities are delivered before payment is made, which secures the assets for the buyer. Delivery versus receipt occurs when securities are delivered via the exchange of a signed receipt for the securities. This is considered to be less secure than delivery versus payment. This is considered a secure method of delivery. This means that no broker/dealer should ever hold the district's securities. In Texas, each broker must certify that he has reviewed the district's investment policy and acknowledge that the broker has implemented reasonable procedures to ensure compliance with the district's policy.

In choosing a broker to work with the district, you should have some basic information about the brokers and their firms. The district can develop a short questionnaire that gathers information about the firm, its address and contacts, its credit and in which markets it specializes. Other important requirements for brokers might be their National Association of Security Dealers (NASD) registration, their Texas registration with the State Securities Commission and references from other districts or trusted advisors. According to the Public Funds Investment Act, brokers should be provided a copy of the district's investment policy and certify that they will comply with the policy. The district is also required to annually review, revise, and adopt a list of qualified brokers who are authorized to engage in investment transactions with the district.

Financial Advisers offer financial counsel on debt issuance and sometimes about reinvesting bond proceeds. Some charge a fee and earn commissions on the products they recommend. Other advisors only charge fees and do not sell any product or accept commissions. Some are generalists, while others specialize in specific areas such as investing, insurance, taxes or other areas.

Investment Advisers must be registered with the Securities and Exchange Commission and must abide by the rules of the Investment Advisers Act. An investment adviser acts as a district's adviser and agent in the marketplace. They advise on particular securities or manage the portfolio of a district. Some also provide consulting on cash management. Investment advisory services usually specialize in a particular kind of investment (fixed income or stocks) or type of funds (public funds or private individual investor's funds). They charge a fee for their services, which can be a flat fee or a fee based on the assets under management.

Investment Advisers are often called ***Investment Counsel*** or ***Investment Managers*** or ***Portfolio Managers*** or ***Money Managers or Pool Managers*** when they have the fiduciary responsibility for managing pools, treasuries, agencies, commercial paper or other security types. Their responsibility is the optimization of the portfolio. The district can grant them that responsibility partially or fully. Regardless, the adviser must manage the funds within the parameters and restrictions of the district's investment policy and be fully accountable to the district. In Texas, each adviser must certify that the district's investment policy has been received and reviewed and acknowledge that the adviser's firm has implemented reasonable procedures to ensure the policy is followed.

Bond counsel is an attorney or law firm that prepares the legal opinion for a municipal bond issue. Their "opinion" is part of the official statement (OS) that is the municipal equivalent of a prospectus for the buyer of the bonds. These individuals or firms specialize in public borrowings and charge a fee for services rendered. These fees are accounted for and charged against bonds as a cost of debt issuance.

Selecting an Expert

Most of these services are considered professional services, and therefore competitive bidding is not required, however the district may be well served by issuing a formal request for proposals so that services and fee structures may be compared. Price comparisons, credentials, registrations and reference checks are highly recommended.

Expectations for these experts should be clearly defined and agreed to before entering into any sort of written agreement for services. Before even contacting one of these experts for a proposal, the district should know what it wants and needs. Some questions that district officials should ask themselves are:

- What services is the district looking for?
- Will the district participate in decisions?
- How will the board ensure district policies are followed?
- Are there confidentiality or other agreements needed to protect the district's interests and ensure compliance with board policy?
- What results is the board expecting?
- When does the board expect to see results?
- Will the service pay for itself?
- How will performance be assessed?
- How, when and under what circumstances will services be terminated by both parties?
- What type of bonding, liability insurance or other assurances can be provided to the district to ensure that assets will be protected?
- Will there be monthly or quarterly reports on progress?
- Will there be regular reports to the board?

A contract with an investment management firm may not be for a term longer than two years. The board of trustees of the district must make a renewal or extension of the contract by order or resolution.

Contract Monitoring

Regular monitoring of the contract is critical. Designate someone to be responsible for monitoring the contract. Establish regular contact with the expert. The Public Funds Investment Act requires quarterly progress reports to the board. In addition, the Act requires that the district, in conjunction with its annual financial audit, perform a compliance audit of management controls on investments and adherence to the district's investment policy. Provide for termination of the contract in cases of non-compliance or poor results.

No matter what services are acquired, a district should never relinquish total control over its investments or debt issues. And the use of an expert to assist the district does not relieve the district of the responsibility for monitoring its investments to ensure they are in compliance with the investment policy. In the long run, it will be the district that is held accountable by the public.

Additional Resources:

Below is a list of additional resources you may find helpful. Information in the documents and URLs listed below are not endorsed by this agency, but only provided as resource material. For more information on these resources, consult the bibliography.

The Benefits of Using an Investment Advisor
(First Southwest Asset Management)
Benefits of using an investment advisor when investing school district funds.

Choosing an Investment Advisor
(Laura Fowler, Henslee, Fowler, Hepworth and Schwartz)
Strategies for choosing an investment advisor, including the types of certification different financial planners may obtain and the regulatory agencies that review the activities of investment advisors.

Conclusion

The primary goal of any school district's investment strategy is to obtain a reasonable market rate of interest on all investments, without putting the district's assets at risk. Accomplishing this goal requires a great deal of planning and expertise—expertise that many smaller and some larger districts may not possess.

While managing funds presents a risk of losing money, albeit very small in some cases, there is also a risk of not earning as much as possible. A balance must be established between the risk of avoiding a low return and the risk of earning less than you could. TSPR has found that the most successful districts have a plan that recognizes the district's unique needs and builds a foundation for safety, liquidity and yield through a combination of investment strategies.

The Texas School Performance Review won a 1999 Innovations in American Government award for its efforts to improve education. The John F. Kennedy School of Government of Harvard University administers the awards in partnership with the Council for Excellence in Government. They are funded by the Ford Foundation, which gave TSPR and nine other award winners $100,000 grants to replicate their cutting-edge programs across the nation. Learn more about the Innovations in American Government and this year's other winners at our web site www.window.state.tx.us/txinnovator/ti9911/special.html.

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The information in this document does not serve as legal advice nor replace the independent judgment of a district's governing body concerning its investments. A district should consult its attorney or other appropriate counsel such as its investment adviser to resolve questions about its investment transactions. Internet links have been provided in "Banks to Bonds: A Practical Path for Investing" for resources provided by government agencies. state institutions, or public school districts. Readers should contact non-governmental or private organizations directly for copies of resource materials.

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