Chapter 1

Maximizing Opportunities with a Public Budget

In This Chapter

- Dealing with the red tape
- Being a good steward
- Taking advantage of marketplace opportunities

You come to work every morning thinking about investing your funds, right? Not likely. Sure, that's one of the things on your job description, but sometimes there's just not enough time in the day to get everything done. You have reports to run, new accounting standards to implement, budgets to plan, audits to complete, and the list goes on and on.

Face it — finding better ways to invest your funds might not be at the top of your to-do list. What's more, you may have settled into what could be called your investment comfort zone. Then there's that little barrier of fear: fear of the unknown, fear of making a mistake, fear of criticism.

Does this feeling sound familiar? *"Why take any risk? I should be risk-averse, because safety is spelled out in the investment policy. No need to stick my neck out — why not just put it all in CDs and let it ride?"*

Okay, so you're not that cynical. That's good — you don't want to adopt that attitude. But when it comes to public fund investing, there's a very good chance you could do better than you are now. And that's precisely what I cover in this chapter.

The Challenges Facing Government Financial Officers

Here are some of the things that might be holding you back from finding better ways to invest your funds:

- You don't have time.
- You don't have investment education or background.
- You know what investments to pick and why to pick them, but explaining the investments to your administrator or board is just too difficult.
- You're stuck in a rut, always doing what you've always done.
- You're too comfortable with your investments.
- Someone else handles "that."
- Poor habits (yes, we all have them).
- You wear too many hats.
- You procrastinate.
- You have the responsibility but not the authority.
- You're making the wrong assumptions.
- Your investment policy is out-of-date.
- You have no written investment plan.

What's your investment IQ? A little quiz

This quiz can be a great tool for finding out what you know (and don't know).

1. In a falling interest rate market, I want my portfolio duration to be

   (a) High

   (b) Low

2. I can have two different investments with the same yield and same maturity date but with different duration.

   (a) True

   (b) False

3. When market interest rates fall, the value of bonds

   (a) Goes up

   (b) Goes down

4. Investing in only short-term and long-term maturities is known as what investment strategy?

   (a) Barbell

   (b) Matching

   (c) Ladder

5. Callable securities have a higher coupon rate.

   (a) True

   (b) False

6. The higher the bond coupon rate, the higher the bond yield.

   (a) True

   (b) False

(See answers at the end of this chapter.)

The Importance of Good Stewardship

Stewardship (meaning the management or administration of the finances and property of others) can affect the lives of the people you work with. As a good steward, you have to have the ability to find more money for pensions and retirement plans, more efficient technology, better computers, more ergonomic work spaces, new police cars, and better work facilities to name a few. Through good stewardship, you can have more money for emergencies and community development. Being able to manage such affairs well makes a big difference.

Looking after someone else's money is no easy task though. Your responsibility is not only to look after their money and make sure it's properly accounted for, but also to make sure it's safe and working for them by earning the maximum yield within the guidelines set by their investment policy. For that, you need a strategy.

An investment plan is not the same thing as the investment policy that your organization has adopted. The *investment policy* sets boundaries and puts limits on what you can invest in. The *investment plan* is your strategy. A good investment strategy is stated in writing and is communicated to all who need to know it.

Manage your public funds without an investment plan and you're just "winging it" — flying by the seat of your pants, investing whichever way the wind blows, always just aiming for the highest interest rate. You need a *contingency* (backup) plan for all possible situations.

For example, what's your plan for when interest rates fall (and they always do, after they rise)? What's your plan for rising interest rates (and they always rise, after they fall)? Is your plan great for rising market interest rates but poor for falling rates, or is it the opposite? Or, do you have all the bases covered?

Having a plan makes good business sense, but it also prepares you to explain your investment decisions. You should always be ready to give a defense of how you steward the investments.

Liquidity — having money when you need it

This information may seem basic, but you can't make a good investment decision until you know how much money you have to invest. A portion of the money you're overseeing has to be *liquid,* meaning ready for use at all times.

So how much liquidity do you need, and how do you figure this out? You have to do a cash-flow analysis.

The simplest way to determine liquidity is to learn from history by examining a portfolio over a two- to three-year period. You're looking for the "perfect storm" in your general fund, trying to spot how much money was left over for investing when times were the toughest.

Here's how: Look at the lowest balance over the last two years, add the smallest amount of monthly revenue, and subtract the highest monthly expense that shows up in the past two years of cash flow.

For example, imagine that the lowest balance of the period was $6 million, the lowest total deposits for any given month were $300,000, and the highest monthly expenses were $1.2 million. Now just do the math:

$6 million – $1.2 million + $300,000 = $5.1 million