



Massachusetts School Building Authority

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To: Administration, Operations and Finance Subcommittee
Massachusetts School Building Authority

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Subject: Investment Management Policy

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The Commonwealth's Finance Advisory Board has recently adopted regulations concerning investment management of public funds. The MSBA is one of the entities covered by the new regulation. The regulation requires the MSBA's governing body (MSBA Board of Directors) to adopt a formal written policy on investment management. The MSBA must file the Board approved Investment Management Policy with the Finance Advisory Board on or before March 31, 2011.

Staff has prepared a draft of an Investment Management Policy for the Board's review. As you may know, at the time of the MSBA's inaugural bond offering in 2005, an Investment Management Policy was drafted that mirrored the investment restrictions contained in the MSBA's enabling statute and trust agreement. The Investment Management Policy has been updated from time to time mainly to conform with any new provisions in subsequent trust agreements or bond issues.

The primary objectives in the investment of MSBA funds, in order of priority, are the preservation of principal, maintaining sufficient liquidity to meet financial obligations and providing a reasonable investment return.

These restrictions require funds to be invested solely in high credit quality financial instruments. Attached please find the current draft of the Investment Management Policy for the MSBA.

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Investment Management Policy

Policies and Guidelines for Funds and Investments

The purpose of this document is to articulate guidelines and policies of the Massachusetts School Building Authority (the “Authority”) for the investment of moneys held by the Authority.

Governing Law

Investment activity shall be conducted in conformance with federal, state, and other requirements of law.

Under section 3(s) of chapter 70B of the Massachusetts General Laws, the Authority may invest its funds in such investments as may be legal investments for the Commonwealth or any fiduciary in the Commonwealth. The Authority has been advised by counsel that this statutory provision essentially authorizes the Authority to invest its funds in accordance with the “prudent investor” rule articulated over the years by the Supreme Judicial Court and recently codified in the Massachusetts Prudent Investor Act (G.L. c. 203C).

The Board of Directors of the Authority has approved a trust agreement to secure the Authority’s bonds, which agreement establishes funds to be held by the trustee under the trust agreement and prescribes permitted investments for such funds, and has authorized the Executive Director of the Authority to establish such other funds to be held by the Authority, and such policies and procedures for the investment and disbursement of the moneys in such funds, as she may deem appropriate for the custody of the proceeds of the Authority’s bonds and other moneys received by the Authority from the School Modernization and Reconstruction Trust Fund, including without limitation an Operating Fund, a Project Fund, a Community Assistance Fund and a Rebate Fund.

The Executive Director has determined to establish the following funds for the following purposes:

Operating Fund — for the purpose of holding funds required to cover the ongoing operating expenses to be paid over to vendors, cover payroll and other expenses.

Project Fund — for the purpose of holding borrowed funds to be paid over to cities, towns and regional schools as school construction grants.

Community Assistance Fund — for the purpose of holding non-borrowed funds to be paid over to cities, towns and regional schools as school construction grants or loans.

Rebate Fund — for the purpose of accumulating moneys required to be paid over to the Internal Revenue Service as rebate or yield reduction payments relating to tax exempt bonds issued by the Authority.

Delegation of Authority

The Board authorized the Executive Director on June 20, 2005 to transact investments, to establish such policies and procedures for the investment and disbursement of the moneys in such funds, as she may deem appropriate for the custody of the proceeds of the Authority's bonds, other moneys received by the Authority from the School Modernization and Reconstruction Trust Fund, and other funds or revenues that the Authority may receive. This authorization was included in the Authority's initial debt offering. The Executive Director may delegate her investment authority to the Chief Financial Officer, Treasurer and other financial staff. All staff shall observe applicable restrictions imposed by federal and state law, the Authority's Trust Agreement and the provisions of this Investment Management Policy when making an investment decision.

Objective

The primary objective in the investment of Authority funds in order of priority is the preservation of principal, while maintaining sufficient liquidity to meet financial obligations and providing a reasonable investment return.

Permitted Investments

The following investments shall be permitted for moneys in the foregoing Funds, with the stated objective of preserving the corpus of the fund while maintaining appropriate liquidity and earning a reasonable rate of return:

- (i) Government Obligations;
- (ii) Certificates or receipts representing direct ownership of future interest or principal payments on Government Obligations or any obligations of agencies or instrumentalities of the United States of America which are backed by the full faith and credit of the United States, which obligations are held by a custodian in safekeeping on behalf of the registered owners of such receipts;
- (iii) Agency Obligations;
- (iv) Obligations of, or obligations unconditionally guaranteed by, the World Bank (International Bank for Reconstruction and Development and International Finance Corporation), European Bank for Reconstruction and Development, European Investment Bank, Asian Development Bank, Inter-American Development Bank, African Development Bank and the Nordic Investment Bank, provided that such obligations are rated at the time of purchase hereunder in one of the two highest rating categories by each Rating Agency;

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- (v) Interest-bearing time or demand deposits, certificates of deposit, or other similar banking arrangements with any government securities dealer, bank, trust company, savings and loan association, national banking association or other savings institution (including the Trustee or any affiliate of the Trustee), provided that such deposits, certificates, and other arrangements are fully insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation or (b) interest-bearing time or demand deposits or certificates of deposit with any bank, trust company, national banking association or other savings institution (including the Trustee or any affiliate of the Trustee), provided such deposits and certificates are in or with a bank, trust company, national banking association or other savings institution whose long-term unsecured debt is rated in one of the two highest long-term Rating Categories by each Rating Agency then maintaining a rating on any Bonds;
- (vi) Repurchase agreements collateralized by securities described in subparagraphs (i), (ii) or (iii) above with any registered broker/dealer or with any commercial bank, provided that (a) a specific written repurchase agreement governs the transaction, (b) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (1) a Federal Reserve Bank, or (2) a bank which is a member of the Federal Deposit Insurance Corporation and which has combined capital, surplus and undivided profits of not less than \$25 million, and the Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (c) the repurchase agreement has a term of thirty days or less, or the Trustee or the third-party custodian will value the collateral securities no less frequently than weekly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five Business Days of such valuation, and (d) the fair market value of the collateral securities in relation to the amount of the repurchase obligation, including principal and interest, is equal to at least 102%;
- (vii) Forward purchase agreements providing for delivery of securities described in subparagraphs (i), (ii) or (iii) above or subparagraph (ix) below with banks or other financial institutions (including the Trustee or any affiliate of the Trustee) whose long-term unsecured debt or claims-paying ability is rated in one of the two highest Rating Categories by each Rating Agency then maintaining a rating on any of the Bonds Outstanding, provided that any such agreement must be accompanied by an opinion of counsel to the effect that the securities delivered will not be considered a part of the estate of such bank or other financial institution in the event of a declaration of bankruptcy or insolvency by such bank or institution;

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- (viii) Money market funds rated in the highest short term Rating Category by each Rating Agency then maintaining a rating on any Bonds, including, without limitation, the JPMorgan Money Market Mutual Funds, or any other mutual fund rated in the highest short term Rating Category by each Rating Agency then maintaining a rating on any Bonds, for which the Trustee or an affiliate of the Trustee serves as investment manager, administrator, shareholder servicing agent, and/or custodian or sub custodian, notwithstanding that (A) the Trustee or an affiliate of the Trustee receives fees from such funds for services rendered, (B) the Trustee charges and collects fees for services rendered pursuant to this Trust Agreement, which fees are separate from the fees received from such funds, and (C) services performed for such funds and pursuant to this Trust Agreement may at times duplicate those provided to such funds by the Trustee or its affiliates.
- (ix) Commercial paper rated in the highest short term Rating Category by each Rating Agency then maintaining a rating on any Bonds;
- (x) Advanced-Refunded Municipal Bonds;
- (xi) Short-term or long-term obligations, whether tax exempt or taxable, of any state or local government or authority or instrumentality thereof or any other entity that has the ability to issue obligations the interest on which is excludable from gross income for federal income tax purposes, provided that any such obligations are rated at the time of purchase in one of the two highest rating categories by each Rating Agency then maintaining a rating on any Bonds Outstanding;
- (xii) Investment contracts with banks or other financial institutions (including the Trustee or any affiliate of the Trustee) whose long-term unsecured debt or claims-paying ability is rated in one of the two highest Rating Categories by each Rating Agency then maintaining a rating on any of the Bonds Outstanding; and
- (xiii) Any other investment in which moneys of the Authority may be legally invested, provided that the Authority receives a Rating Confirmation in connection with such investment from each Rating Agency then maintaining a rating on any Bonds Outstanding.

Due Diligence on Investment Providers

Prior to making an investment, the Authority shall review the qualifications, financial strength, experience and expertise of the investment provider. The review is intended to avoid doing business with a firm that is financially weak, has limited experience in providing the investment instrument being purchased lacks general financial expertise or is otherwise unsuitable for the

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investment of Authority funds. This review may include, but shall not be limited to, the following: information on the financial condition of the provider, recent financial statement, credit rating reports, a summary of the volume of securities (by investment instrument) traded or sold by the firm, the experience of the account officer(s) handling Authority's investments and any other information deemed appropriate.

Investment Process

The Authority recognizes that the appropriate investment process varies depending upon the characteristics of the specific instrument. Listed below is the process to be followed for the significant investment of funds in the following types of instruments.

Marketable Securities — A competitive bid process shall be the Authority's preferred method of purchasing marketable security¹ investments. The bid process shall consist of at least three firms being requested to provide quotes by a specified time in the specified manner². The request to bid should list the specific instrument, investment amount and maturity date of the investment.

Money Markets — Investments in Money Markets, Demand Deposits and Auction Rates may be done after a comparative review. For money markets the review may include, but shall not be limited to, the following: a comparison for the past year of the fund being considered to the performance to other funds with similar credit standards, average maturity of investments and other comparative information deemed appropriate. Only funds ranked in the top quartile may be invested in by the Authority.

Demand Deposits — For demand deposits the review may include, but shall not be limited to, the following: a comparison for the past year of each bank yield on demand deposits, the method used by each bank to establish demand deposits rates, restrictions on the investment, administrative procedures and other comparisons deemed appropriate. The bank showing the highest past rate should receive the investment. If in the judgment of the Authority's Treasurer the bank offering the highest rate will not provide the highest rate going forward because of the method of setting its interest rate, the bank may be passed over to the next bank. The Treasurer may also pass over a bank because of the restrictions or administrative procedure deemed problematic. Whenever a bank offering the highest rate is not selected, the Treasurer shall prepare and forward to the Authority's Chief Financial Officer his basis for passing over the bank.

Auction Rates — For auction rates instruments the review shall consist of a comparison for the past year of the auction rate yield of the specific issuer to a nationally recognized index for auction rate instrument. Only instruments with an average yield greater than the index are eligible for initial investment. Once an investment is made the Authority may continue to invest in the security at each reset date. Periodically the Treasurer shall review the performance to determine if the specific security continues to yield greater than the national index.

¹ A marketable security for the purpose of this paragraph shall include treasuries, agencies, commercial paper, certificate of deposits and similar financial instruments. Money markets, demand deposits, auction rates and guaranteed investment contracts are not to be considered marketable securities.

² The manner to receive bids are fax, email, telephone and via the Bloomberg Information Network.

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Guaranteed Investment Contracts — For Guaranteed Investment Contracts (GICs) investments shall be made after the receipt of at least three bids. The request for bids may specify differing amounts of collateral depending upon the bidder's credit rating.

Rebate

The Authority recognizes that under certain circumstances investment earnings in excess the "Arbitrage yield" will need to be rebated to the Federal Government. Therefore, the Authority shall be diligent in complying with all regulations concerning the investment of bond proceeds. Prior to investing bond proceeds, the Treasurer shall consult with bond counsel to ensure that the bidding and other investment procedures conform to current IRS regulations.

The Treasurer shall maintain records to record the expenditure of bond proceeds, investment earnings and determination of any rebate liability. All investment providers must be required to provide appropriate reports and certifications. The Treasurer shall determine that an investment will comply with IRS regulations and provide sufficient data to perform rebate calculations.

Reporting

The Treasurer may from time to time prepare a report on the composition and results of the investment portfolio. The report shall list by type of investment instrument the following: issuer, par amount, purchase price, market value, coupon or yield of each investment and maturity.

Internal Controls

The Chief Financial Officer shall establish a system of internal controls, which shall be documented in writing. Internal controls shall address the following: clear delegation of authority to staff members, separation of transaction authority from financial reporting, prohibition on a unilateral wire transfer authority, timely reconciliation of transactions and other controls deemed appropriate. The Chief Financial Officer may from time to time test the internal control system.

Conflict/Ethics

All participants in the investment process shall act responsibly and professionally. The Treasurer and other employees involved in the investment process shall refrain from personal business activity that could conflict with the operation of the investment program or impair their ability to make impartial decisions. All employees shall disclose any relationship that may give an appearance of impropriety. All employees involved in investment decisions shall file a Statement of Financial Interests with the State Ethics Commission annually.

Consultants/Advisors

The Authority may engage the services of an Consultant/Advisor to assist and advise on investments. For guaranteed investment contracts a Consultant/Advisor may provide information on firms currently bidding on such agreements, standard industry provisions, current market conditions, timing suggestions and receipt of bids. If an Advisor/Consultant is engaged, the role shall be to advise and assist, not to make the final investment decision.