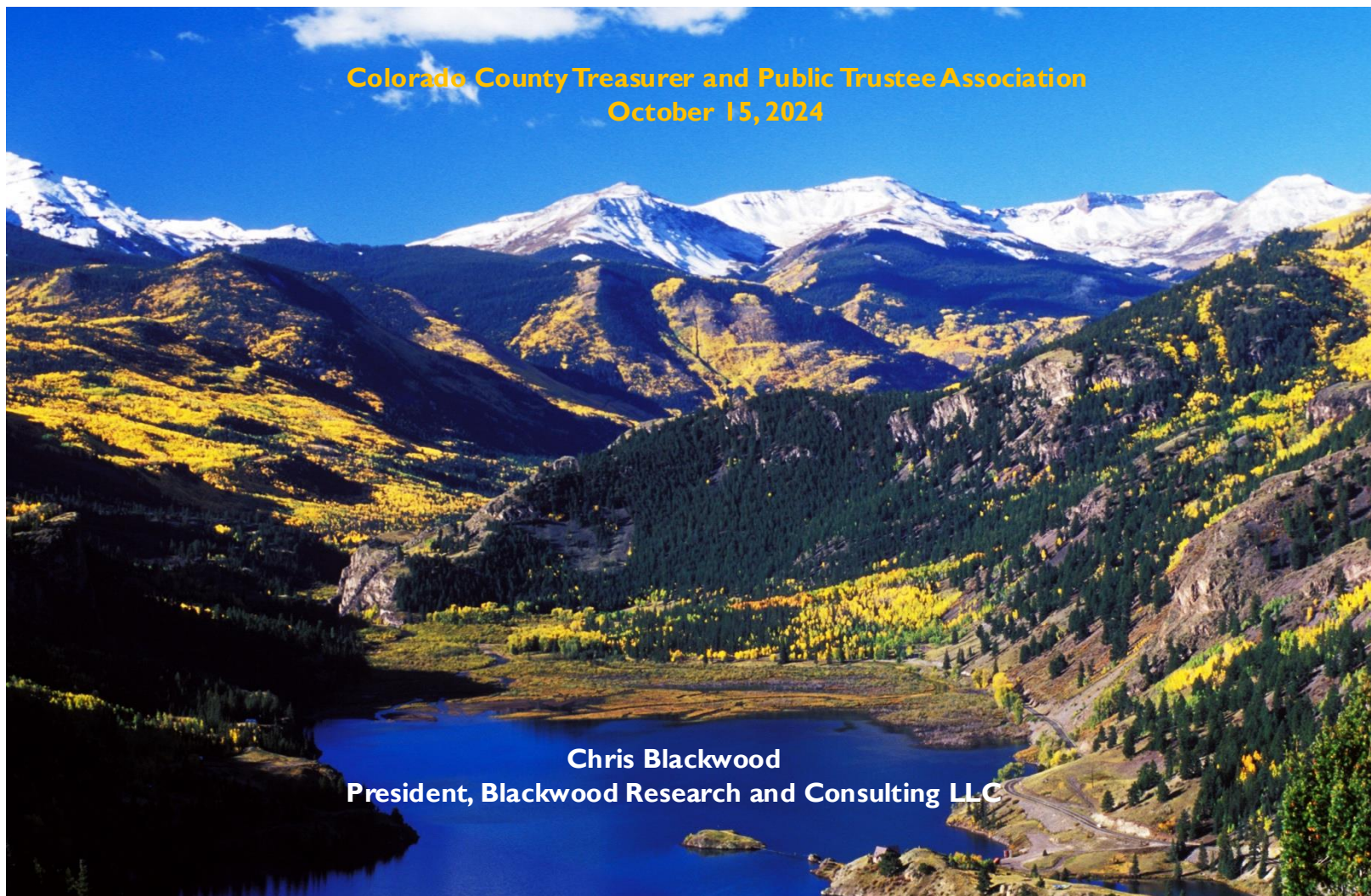


# INVESTING PUBLIC FUNDS IN COLORADO

Colorado County Treasurer and Public Trustee Association  
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# OVERVIEW

- ❖ The purpose of the book is to serve as an educational resource to Colorado public sector officials.
- ❖ The first section of the book (Basics) reviews the Colorado investment statutes (CRS 24-75-601 et seq.) and it provides contextual explanations of each section.
- ❖ The Basics section also discusses local government investment pools, bank deposits and PDPA, credit ratings, supranational securities, safekeeping and custody.
- ❖ Section two of the book (Strategies) first addresses a key concepts central to the efficient investing of public funds: cash flow analysis. Next, the book describes strategies for investing bond proceeds and arbitrage rebate.
- ❖ The last part of the Strategies section provides a detailed assessment of how local governments invest their money. In total, the book identifies trends in revenues, expenses, debt and investments for over 700 public entities (every school district, municipality, county and over 200 special districts).

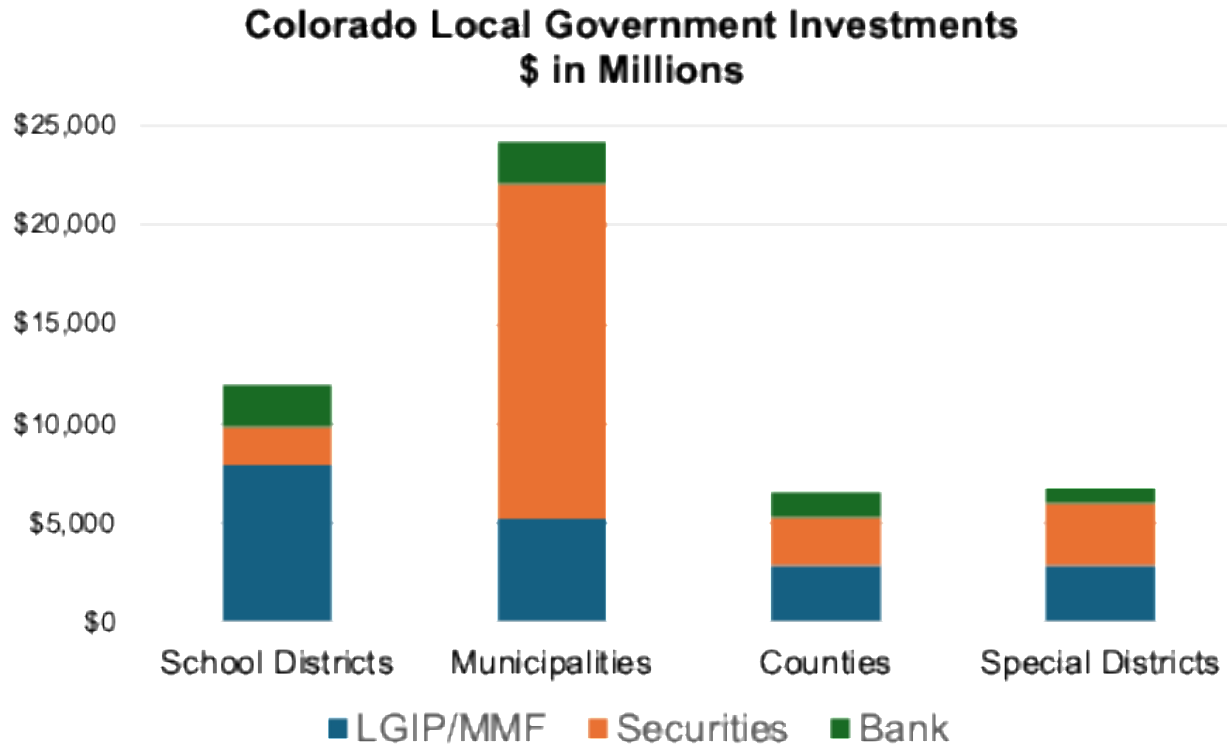


# QUESTIONS

- ❖ How much public funds do counties invest in Colorado?
- ❖ Where can I find the statutes for investing public funds?
- ❖ What is the difference between the three local government investment pools?
- ❖ What is PDPA and how does it protect public funds?
- ❖ What are the strategies to optimize a county's investment earnings?
- ❖ How can you steal money from a local government investment pool?

# OVERVIEW

- ❖ In total, Colorado local governments invest nearly \$50 billion of assets for their taxpayers. County governments invest approximately \$6.6 billion of public funds in Colorado. Of this amount, 44% is allocated to LGIPs, 37% to securities and 19% is held in bank accounts.



Source: Local government financial audits and reports for the year ended 12/31/22

# PERMITTED INVESTMENTS

- ❖ Colorado local governments are required to follow detailed rules and regulations as dictated by the investment laws of the state. The investment statutes are codified in Colorado Revised Statutes, Title 24, Article 75, Part 6, hereafter referred to as “CRS” In general, outside of retirement accounts, Colorado local governments can only invest in the following:

## Permitted Investments in Colorado

- 
- |                                     |                                    |
|-------------------------------------|------------------------------------|
| • U.S. Treasury securities          | • Securities lending agreements    |
| • Federal agency securities         | • Money market funds               |
| • Municipal securities              | • Guaranteed investment contracts  |
| • Local government investment pools | • Corporate and bank securities    |
| • Repurchase agreements             | • Commercial paper, negotiable CDs |
- 

- ❖ Understanding the meaning of each section of CRS can be quite challenging. Throughout the chapter I seek to provide context and clarification of CRS by adding a shaded box such as:

Key Points: Text appearing in a box like this is not part of CRS and simply seeks to provide context for Colorado public sector investors.

# LOCAL GOVERNMENT INVESTMENT POOLS

- ❖ A local government investment pool (LGIP) is a collective investment vehicle utilized by local government entities such as municipalities, counties, school districts, and special districts to pool their available funds for investment purposes. LGIPs are the most common investment product utilized by Colorado local governments. Within each sector, the percentage of local government assets that are invested in Colorado LGIPs is as follows: school districts (59.1%), municipalities (20.4%), counties (41.1%) and special districts (38.5%). At one time in the early 1990s there were 11 local government investment pools registered with the state of Colorado. Today, there are four (a new one was added in 2024).

## Colorado LGIPs registered in 1993

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- Colorado Surplus Asset Fund Trust
- Centennial State Surplus Funds Trust
- Colorado Diversified Trust
- Colorado Local Government Liquid Asset Trust
- Colorado Asset Management Trust
- Colorado Cooperative Liquid Asset Sec. System
- Government Asset Pool
- Local Government Asset Pool
- Colorado Public Funds Investment Trust
- Investment Trust of Colorado
- CASB Investment Plan Trust Fund

*Source: Colorado Division of Securities*



# BANK DEPOSITS AND PDPA

- ❖ In Colorado, public entities can only utilize banks that are certified to hold public deposits. Why is this important? As we learned during the 2008-09 financial crisis, banking institutions can fail putting depositors at risk. These risks were recently highlighted by the failure of Silicon Valley Bank in March 2023.
- ❖ The good news is that there are laws in Colorado that provide safeguards for the handling and deposit of public funds. The Colorado Public Deposit Protection Act (PDPA) establishes mechanisms to ensure that public funds held on deposit in eligible public depositories are protected in the event that an eligible public depository holding the public deposits becomes insolvent.

Key Points: According to CRS 24-75-601.1 (m) (IV) public entities must consider negotiable certificates of deposit as "bank securities as investments and not deposits subject to the protection of the "Public Deposit Protection Act", article 10.5 of title 11, or insured by the federal deposit insurance corporation".

# CREDIT RATINGS

- ❖ One way to assess the credit worthiness of an investment is to review the credit rating. CRS refers to the companies that provide credit rating services as Nationally Recognized Statistical Rating Organizations (NRSROs).
- ❖ NRSROs must be registered with the U.S. Securities and Exchange Commission's Office of Credit Ratings (OCR).
- ❖ CRS has credit rating requirements for debt instruments that carry credit risk such as corporate bonds, bank securities, commercial paper, municipal securities and negotiable CDs. In addition, many Colorado local governments have investment policies that add credit rating requirements for federal agency securities, money market funds and local government investment pools.
- ❖ Colorado law takes a more conservative approach to allowing securities with credit exposure. For corporate and bank securities CRS requires two ratings of at least AA-/Aa3 or the equivalent. There are minimum rating requirements for other securities including municipal bonds, commercial paper and negotiable CDs.



# CREDIT RATING COMPARISONS

## Long-Term Ratings

	<b>Fitch</b>	<b>Moody's</b>	<b>S&amp;P</b>
Investment Grade	AAA	Aaa	AAA
	AA	Aa	AA
	A	A	A
	BBB	Baa	BBB
	BB	Ba	BB
	B	B	B
	CCC	Caa	CCC
	CC	Ca	CC
	C	C	C
	RD	WR	D
SD	NR		

CRS Permitted

Source: Rating agency websites

# SUPRANATIONAL SECURITIES

- ❖ Supranational securities are financial instruments issued by organizations that are formed by multiple countries to pursue a common goal or objective that transcends national boundaries. They issue securities in the global financial markets to fund various projects and initiatives aimed at promoting economic development, stability, and cooperation among member states. The most well-known of these organizations is the International Bank for Reconstruction and Development (otherwise known as the World Bank).
- ❖ There are six supranational organizations that are rated in the highest category by multiple NRSROs. CRS allows local governments to invest in those supranational organizations in which the United States is a shareholder. Except for the European Investment Bank (the United States is not a shareholder), this would include:
  - The International Bank for Reconstruction and Development (World Bank)
  - International Finance Corporation
  - Inter-American Development Bank
  - African Development Bank
  - Asian Development Bank

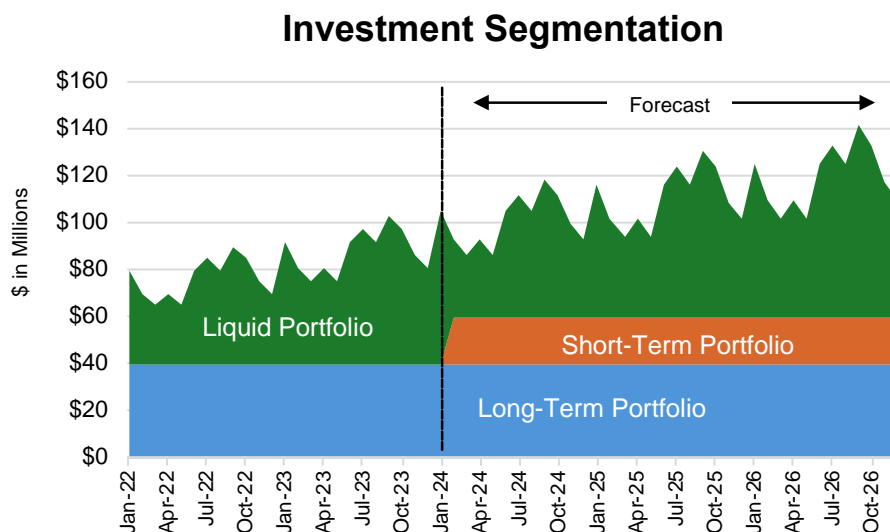
# SAFEKEEPING AND CUSTODY

- ❖ Anyone familiar with the investment industry, and many who follow the news, have heard about the historic fraud perpetrated by Bernie Madoff. Mr. Madoff created a giant Ponzi scheme over nearly two decades whereby he defrauded investors of \$17 billion. A key to his scheme was creating false trade tickets and producing fake statements. In short, he did not follow a basic best practice of public funds investing, namely third-party custody.
- ❖ Indeed, the Government Finance Office Association (GFOA) states:
  - “GFOA recommends that governments use an independent third-party custodial service for safekeeping of investments. Governments need to weigh the risks versus the costs of the services and understand exactly how the failure of a safekeeping provider would impact the government’s ability to access its investment assets.”

Source: GFOA Executive Board approval by the Committee on Treasury and Investments, February 2020

# CASH FLOW ANALYSIS: A KEY TO EFFECTIVE INVESTING

- ❖ Many elements of investing public funds in Colorado are out of the control of local government investors including the level and direction of interest rates, economic volatility, potential credit market issues or U.S. government shutdowns and their impact on the financial markets. However, with good planning public sectors can control how they invest their funds. The example above is typical of a large municipal or county government with significant investable assets and core reserves. The approach will differ for small counties that may not have large amounts of core reserves.



*For Illustrative Purposes Only*

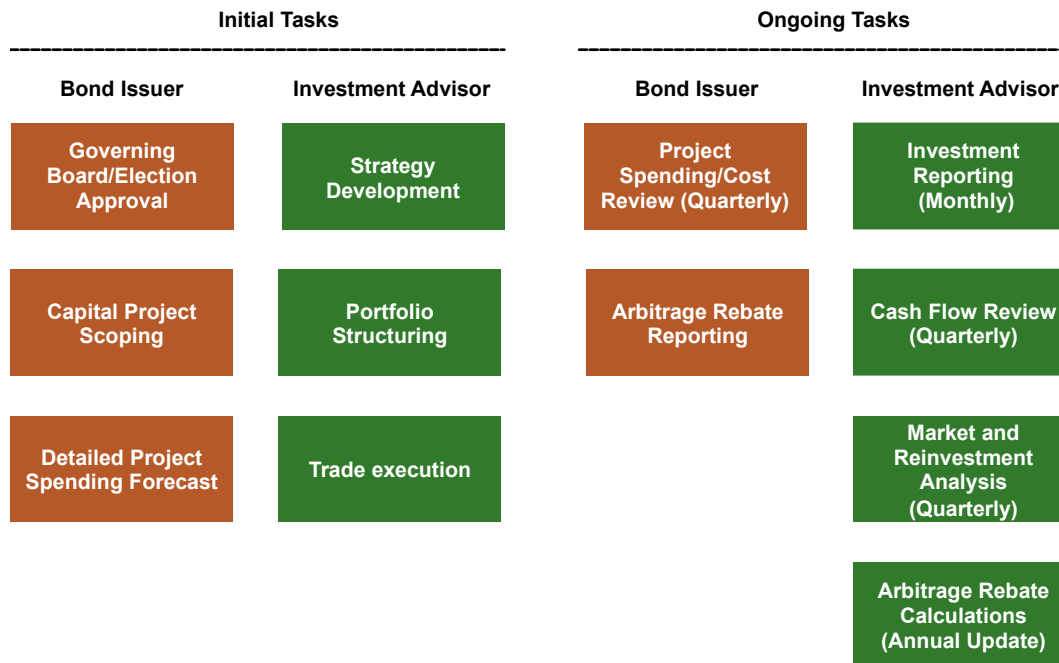
# INVESTING BOND PROCEEDS

- ❖ When a Colorado local government issues bonds, the proceeds from the bond issue are received on the closing date, but the project spending may stretch out over several years. In the current interest rate environment, investment earnings can materially add to the project/construction account and can reduce the amount of bonds issued. Thus, it is important that a government has a plan in place to invest the funds with strategies that seek to safely maximize interest earnings over the life of the project. Plus, unlike the investment of operating reserves, there are federal tax rules (arbitrage rebate) that may limit the amount of earnings that a government can keep.
- ❖ The specific investments utilized to invest bond proceeds are generally governed by the bond documents. In many cases, the bond documents reference the Colorado Revised Statutes (CRS) as the permitted investments. Referencing CRS is important because it allows an issuer wide latitude in the structuring of the investment portfolio.

# INVESTING BOND PROCEEDS

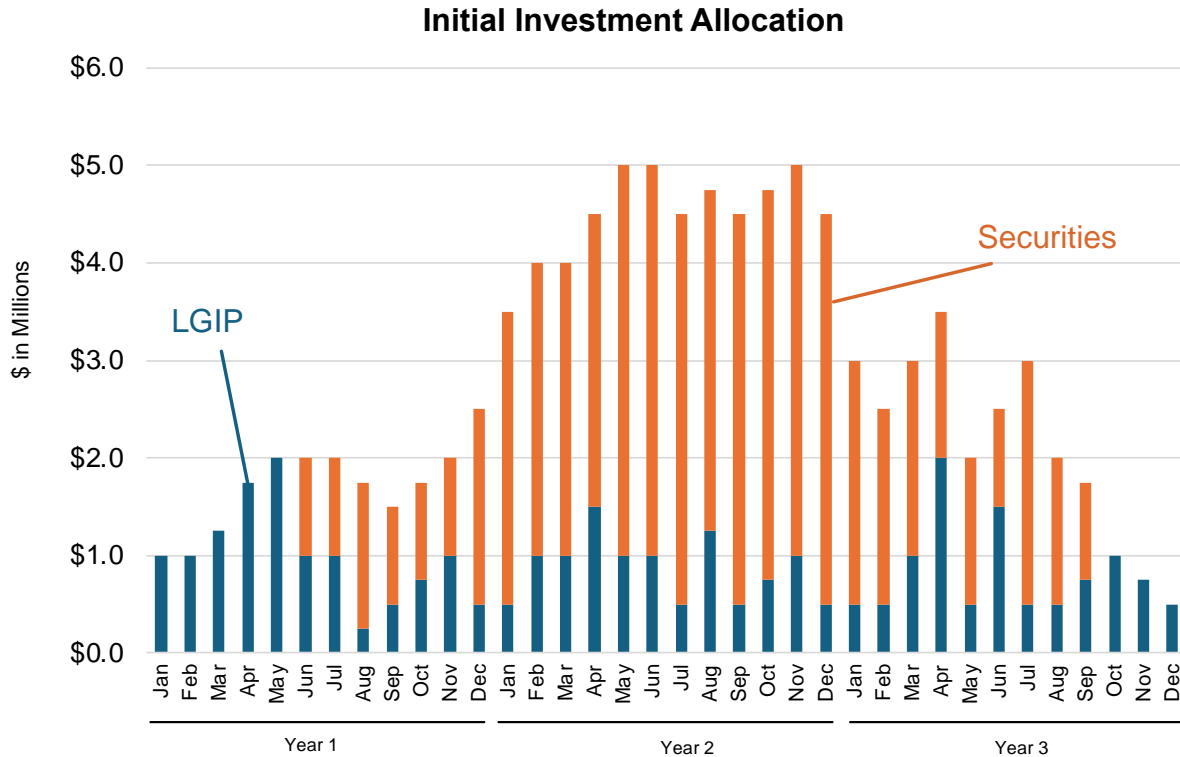
- ❖ As shown in the graphic below, there are initial and ongoing tasks for investing bond proceeds. In this example, the issuer retains the services of an investment adviser to guide and manage the process throughout the life of the project.

**Bond Proceeds Investment Process**



# INVESTING BOND PROCEEDS

- ❖ The chart below shows how an investment adviser might structure a portfolio with securities (orange bars) with maturities aligned with the project spending plan. The portfolio would have an allocation to a local government investment pool (blue bars) to meet liquidity needs



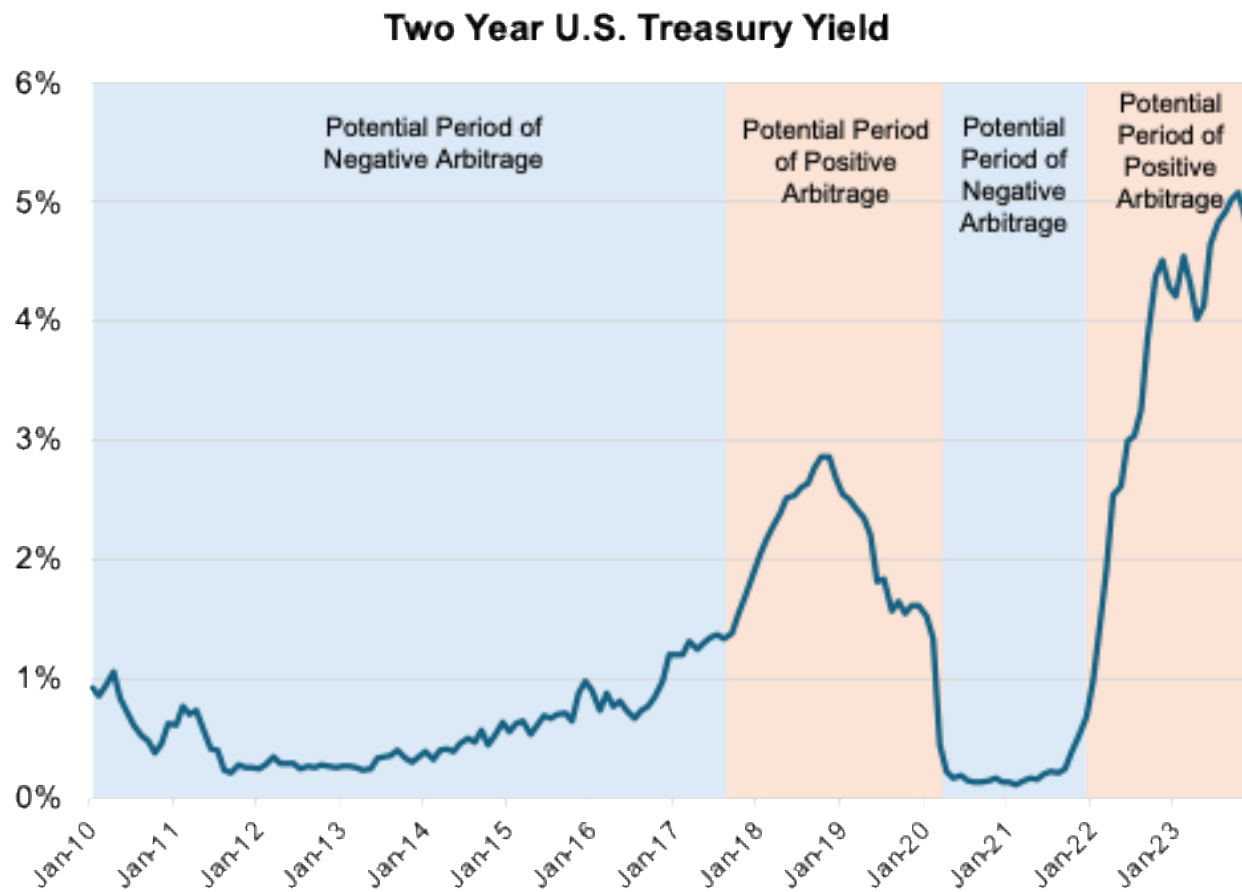
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# ARBITRAGE REBATE

- ❖ General federal tax rules prohibit the investment of bond proceeds at a yield materially higher than the yield on the bonds. To implement this general rule, there are two separate arbitrage requirements included in the Internal Revenue Code – arbitrage rebate and yield restriction.
- ❖ Arbitrage rebate refers to the positive arbitrage earnings that are required to be “rebated” to the federal government.
- ❖ Yield restriction rules provide specifically defined temporary periods during which bond proceeds are permitted to be invested at a yield materially higher than the bond yield. For example, bond proceeds earmarked for capital costs have a 3-year temporary period (but can be longer in certain circumstances).
- ❖ For many issuers, the topic of arbitrage rebate was not in the forefront especially when investment yields were under 1% from 2010 to 2017 and again after the pandemic from mid-2020 to the end of 2021 (see the chart on the next page). The increase in yields over the past two years has not only accelerated interest earnings but also raised the specter of issues related to arbitrage rebate.

# INTEREST RATES AND ARBITRAGE REBATE



Source: Two Year Treasury Yield: Federal Reserve Bank of St. Louis

# SPENDING EXCEPTIONS

❖ The IRS regulations require that arbitrage be calculated at least every five years. Unless the bond issue meets the exceptions described below, any positive arbitrage earned must be rebated to the federal government within 60 days after the end of the period. However, if an issuer can satisfy any of the four rebate exceptions described below, the issuer is permitted to keep any positive arbitrage.

- ❖ Small Issuer Exception
- ❖ 6-month Spending Exception
- ❖ 18-month Spending Exception
- ❖ 24-month Spending Exception.

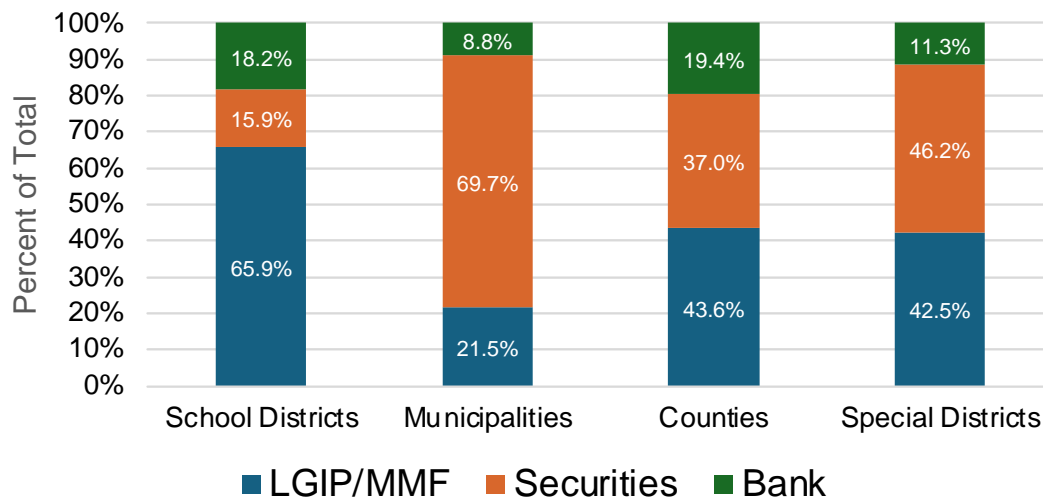


Source: The National Association of Bond Lawyers, The Workshop: Hybrid 2022

# HOW DO LOCAL GOVERNMENTS INVEST THEIR MONEY?

- ❖ While most Colorado local governments can invest with the full array of investments permitted by CRS, the investment strategies and products utilized vary widely based on the type of government. In the pages that follow I discuss my research findings from the financial audits for every municipality (272), school district (178), county (64) and a sample of 200 special districts.

## Colorado Local Government Investment Profiles



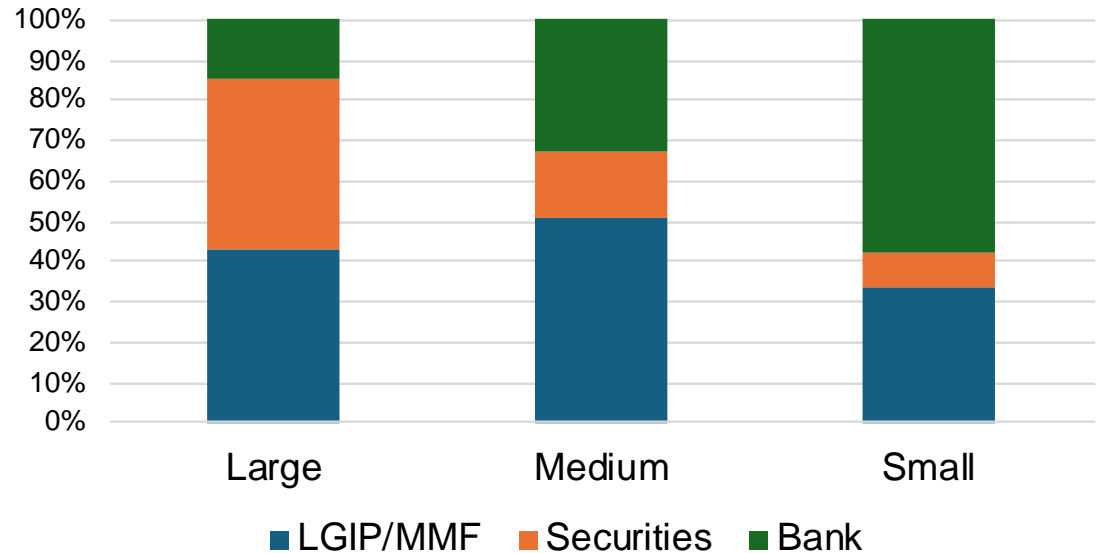
Source: Local government financial audits and reports

# COUNTY INVESTMENT TRENDS

❖ There are 64 counties in Colorado with combined revenues of \$6.0 billion, expenditures of \$5.7 billion and total investments of \$6.6 billion (these figures exclude Denver and Broomfield). The location and economic structure of a county has a material impact on population, revenues, expenditures and the amount of funds available for investment.

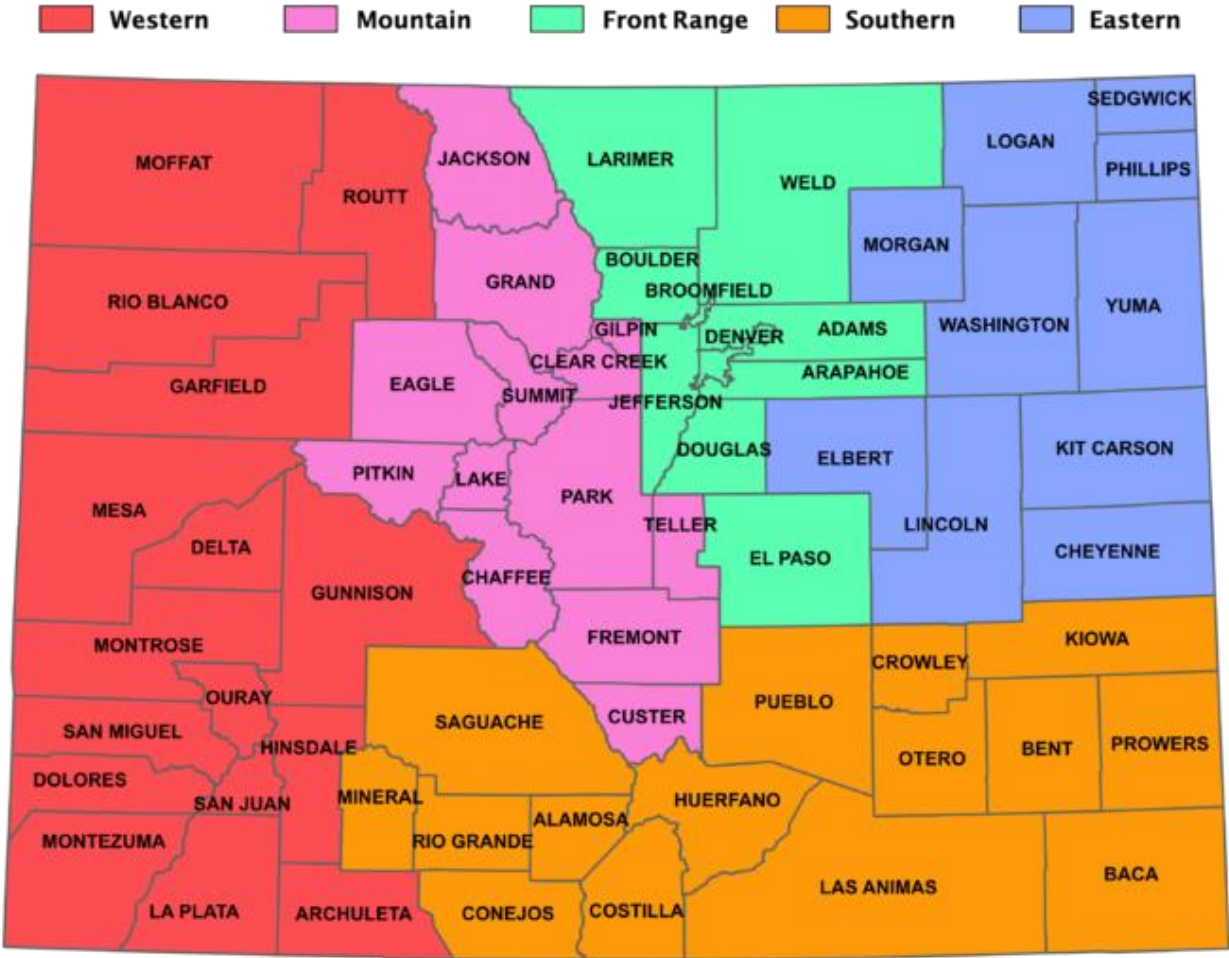
The unique service mandates of county governments impact the way they invest their funds. During the property tax collection season (March to June) this creates large monthly inflows and outflows. This is probably why county treasurers keep a larger amount of funds liquid (LGIP/MMF/Bank) compared to a similarly sized municipality.

### County Investment Allocation



Source: County financial audits

# COLORADO COUNTIES REGIONAL MAP



# INVESTMENTS BY COUNTY

<u>County</u>	<u>Region</u>	<u>Investment Category</u>	<u>Investments (\$ Mil)</u>
Morgan County	Eastern	Medium	\$77.6
Elbert County	Eastern	Medium	\$49.4
Logan County	Eastern	Medium	\$40.6
Washington County	Eastern	Medium	\$26.7
Yuma County	Eastern	Small	\$24.5
Kit Carson County	Eastern	Small	\$10.7
Lincoln County	Eastern	Small	\$17.9
Phillips County	Eastern	Small	\$5.5
Sedgwick County	Eastern	Small	\$20.1
Cheyenne County	Eastern	Small	\$14.3
<b>Total</b>			<b>\$287.3</b>

El Paso County	Front Range	Large	\$377.5
Arapahoe County	Front Range	Large	\$485.6
Jefferson County	Front Range	Large	\$436.8
Adams County	Front Range	Large	\$526.9
Douglas County	Front Range	Large	\$449.8
Larimer County	Front Range	Large	\$493.5
Weld County	Front Range	Large	\$835.4
Boulder County	Front Range	Large	\$391.9
<b>Total</b>			<b>\$3,997.4</b>

Eagle County	Mountain	Large	\$276.9
Summit County	Mountain	Large	\$149.7
Pitkin County	Mountain	Large	\$156.9
Fremont County	Mountain	Medium	\$31.1
Teller County	Mountain	Medium	\$33.7
Chaffee County	Mountain	Medium	\$41.2
Park County	Mountain	Medium	\$28.1
Grand County	Mountain	Medium	\$62.8
Clear Creek County	Mountain	Medium	\$35.6
Gilpin County	Mountain	Medium	\$28.0
Lake County	Mountain	Small	\$15.1
Custer County	Mountain	Small	\$7.7
Jackson County	Mountain	Small	\$11.2
<b>Total</b>			<b>\$878.0</b>

<u>County</u>	<u>Region</u>	<u>Investment Category</u>	<u>Investments (\$ Mil)</u>
Pueblo County	Southern	Large	\$244.4
Otero County	Southern	Medium	\$41.4
Alamosa County	Southern	Medium	\$28.9
Las Animas County	Southern	Medium	\$28.8
Prowers County	Southern	Small	\$22.5
Rio Grande County	Southern	Small	\$13.9
Conejos County	Southern	Small	\$10.6
Huerfano County	Southern	Small	\$6.8
Saguache County	Southern	Small	\$17.2
Crowley County	Southern	Small	\$15.9
Bent County	Southern	Small	\$2.6
Costilla County	Southern	Small	\$9.4
Baca County	Southern	Small	\$11.9
Kiowa County	Southern	Small	\$7.5
Mineral County	Southern	Small	\$5.9
<b>Total</b>			<b>\$467.7</b>

Mesa County	Western	Large	\$131.9
Garfield County	Western	Large	\$108.6
La Plata County	Western	Large	\$101.6
Moffat County	Western	Large	\$119.6
Montrose County	Western	Medium	\$87.9
Delta County	Western	Medium	\$35.0
Montezuma County	Western	Medium	\$36.5
Routt County	Western	Medium	\$79.6
Gunnison County	Western	Medium	\$52.6
Archuleta County	Western	Medium	\$34.5
San Miguel County	Western	Medium	\$38.4
Rio Blanco County	Western	Medium	\$72.9
Ouray County	Western	Small	\$10.5
Dolores County	Western	Small	\$17.2
San Juan County	Western	Small	\$4.7
Hinsdale County	Western	Small	\$4.4
<b>Total</b>			<b>\$804.0</b>

Key: Small \$0-\$25 million Medium \$25-\$100 million Large \$100million +



# COUNTY SUMMARY STATISTICS

## County Financial Summary

\$ in Millions

<u>Region</u>	<u>Population</u>	<u>Revenues</u>	<u>Expenditures</u>	<u>Investments</u>
Western	472,554	\$830	\$784	\$936
Mountain	260,345	\$724	\$640	\$878
Front Range	3,920,503	\$3,774	\$3,581	\$3,997
Southern	283,632	\$468	\$475	\$468
Eastern	113,519	<u>\$210</u>	<u>\$205</u>	<u>\$287</u>
Total	5,050,553	\$6,006	\$5,684	\$6,566

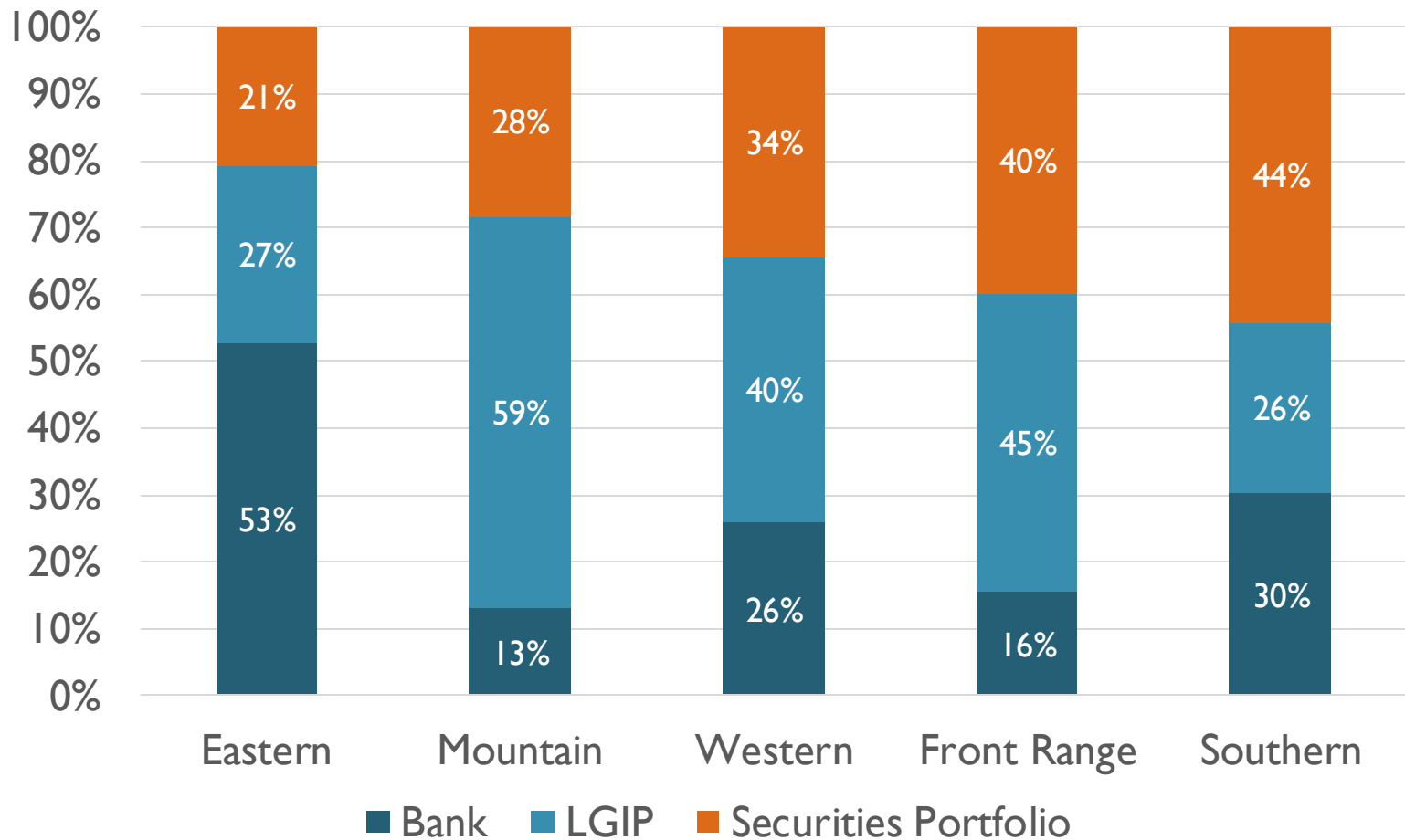
## County Per Capita Summary

<u>Region</u>	<u>Revenues</u>	<u>Expenditures</u>	<u>Investments</u>
Western	\$1,757	\$1,660	\$1,981
Mountain	\$2,779	\$2,456	\$3,372
Front Range	\$963	\$913	\$1,020
Southern	\$1,649	\$1,673	\$1,649
Eastern	<u>\$1,853</u>	<u>\$1,803</u>	<u>\$2,531</u>
Total	\$1,189	\$1,125	\$1,300

Source: County financial audits

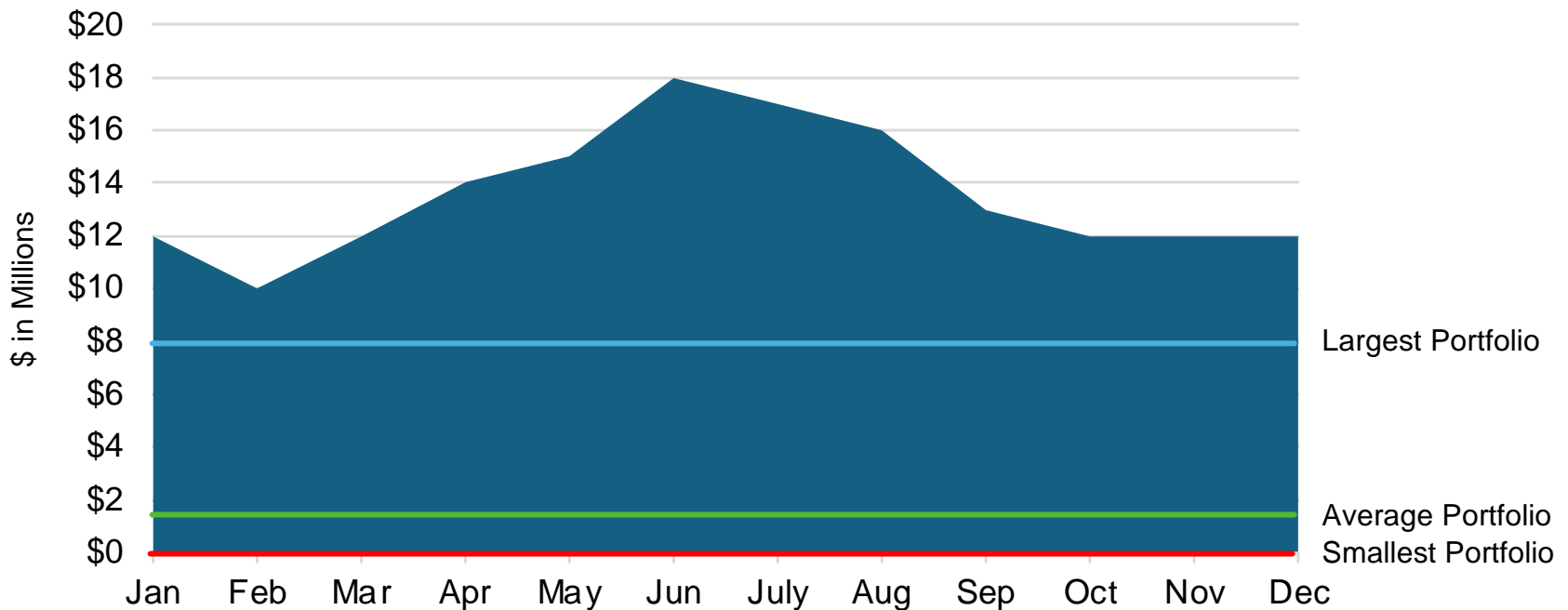
Note: Financial information for the City and County of Denver and the City and County of Broomfield are NOT included in the table above.

# ALLOCATION OF INVESTMENTS



# SMALL COUNTIES: CASH FLOW/PORTFOLIOS

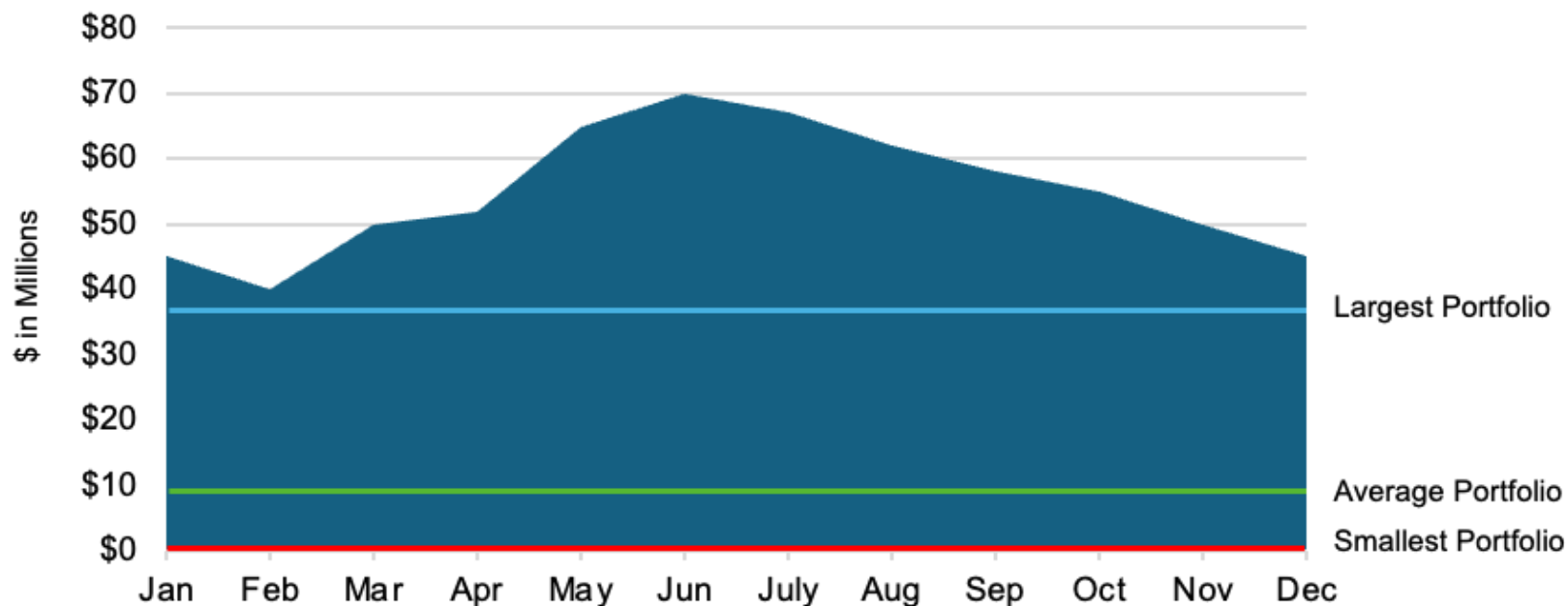
- ❖ This category includes 24 counties with investable assets of less than \$25 million.
- ❖ The amount of investable assets averaged \$12 million.
- ❖ Of the 24 counties, only five had securities portfolios, ranging from a high of 58% of total assets, to a low of 0% of assets and an average of 9% of assets.



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## MEDIUM COUNTIES: CASH FLOW/PORTFOLIOS

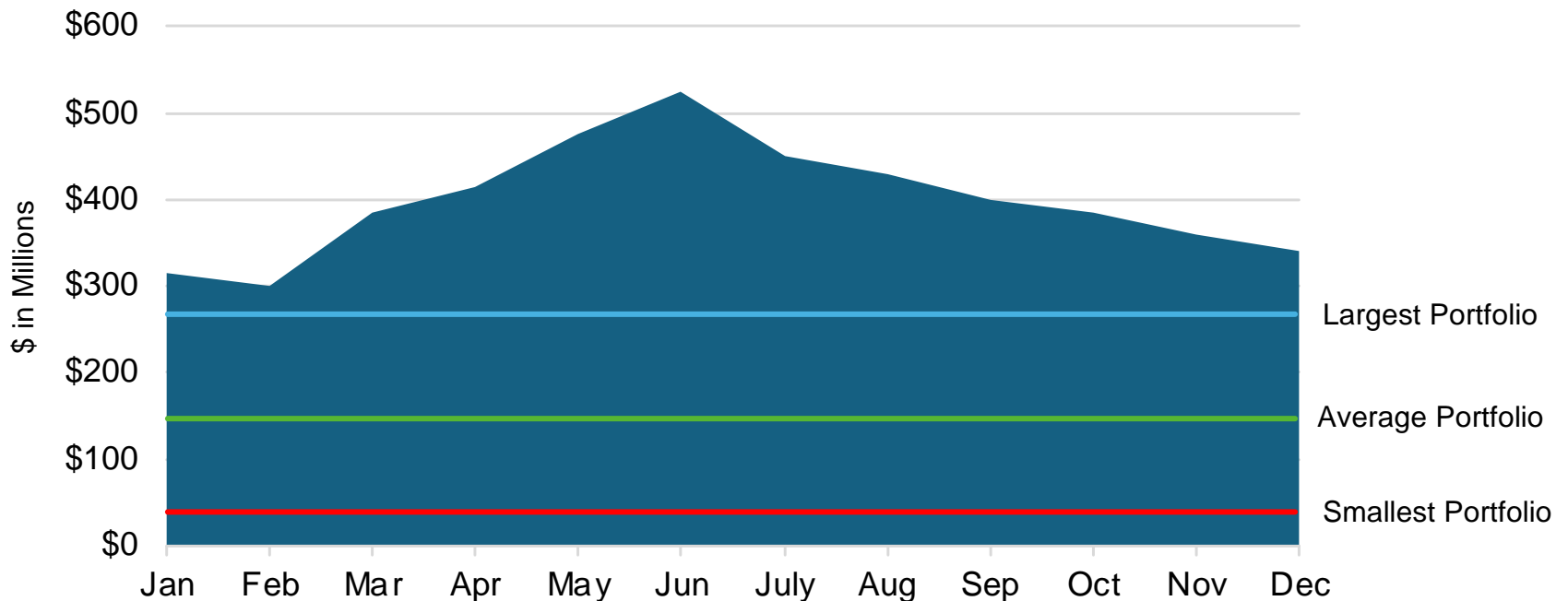
- ❖ This category includes 22 counties with investable assets ranging between \$25 million and \$100 million.
- ❖ The amount of investable assets averaged \$45 million.
- ❖ Of the 22 counties, 14 had securities portfolios ranging from a high of 80% of total assets, to a low of 0% of assets and an average of 17% of assets.



*For Illustrative Purposes Only*

# LARGE COUNTIES: CASH FLOW/PORTFOLIOS

- ❖ As of December 31, 2022, there were 16 counties with investment portfolios greater than \$100 million.
- ❖ The amount of investable assets averaged \$340 million.
- ❖ Each of these 16 counties had Securities portfolios, ranging from a high of 82% of total assets, to a low of 8% of assets and an average of 42% of assets.



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# CONCLUSION

- ❖ Each local government is subjected to things that it can't control, such as fluctuations in the economy, tax revenues, citizen initiatives or state budgetary decisions. While many events are of out their control, governments can decide how to invest funds. Here are some steps each local government can take to safely maximize interest earnings:
  - **Develop an Investment Policy.** While state law provides the guidelines on permitted investments, it does not address several key issues like investment objectives, segregation of duties, investment diversification, custody, internal controls and reporting standards.
  - **Conduct a Cash Flow Analysis.** Over 50% of Colorado's local government investable funds are held in liquid accounts. Over the long run, there is an opportunity cost to holding this much in liquid accounts. Many governments could benefit from conducting a cash flow analysis and segmenting a portion of their funds into longer term investments. Chapter 8 provides detailed strategies for each type of government.
  - **Understand and Utilize Colorado LGIPs.** In particular, Small governments (defined in Chapter 10) generally keep too much money in bank accounts. Depending on interest rates, they could potentially benefit from investing in a local government investment pool.

# ANSWERS

- ❖ How much public funds do counties invest in Colorado?
  - About \$6.6 billion
- ❖ Where can I find the statutes for investing public funds?
  - <https://cctpta.org/treasurers-manual/title-24/article-75/>
- ❖ What is the difference between the three local government investment pools?
  - GASB 79 compliance and secondary portfolios
- ❖ What is PDPA and how does it protect public funds?
  - PDPA requires banks to collateralize public fund deposits
- ❖ What are the strategies to optimize a county's investment earnings?
  - It depends on the size of a County's investment portfolio
- ❖ How can you steal money from a local government investment pool?
  - Changing the standard bank instructions on file without authorization



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