Date of Hearing: August 11, 2020

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Cecilia Aguiar-Curry, Chair
SB 998 (Moorlach) – As Amended May 22, 2020

SENATE VOTE: 39-0

SUBJECT: Local government: investments.

SUMMARY: Expands local agencies' investment options and makes other changes to their ability to invest surplus funds. Specifically, **this bill**:

1) Provides that a joint powers authority (JPA) that invests in securities and obligations, as specified, may establish the terms and conditions pursuant to which agencies may participate and invest in pool shares, and consistent with its status as a public agency by existing law, a federally recognized Indian tribe is eligible to participate in such a JPA or otherwise invest in pool shares consistent with the terms and conditions established by the JPA.

2) Specifies that local agencies, other than counties or a city and county, which have $100 million or more of investment assets under management may invest no more than 40% of their moneys in eligible commercial paper.

3) Provides that a local agency, other than a county or a city and county, may invest no more than 10% of its total investment assets in commercial paper and the medium-term notes of any single issuer.

4) Authorizes a local agency to invest in securities issued by, or backed by, the United States government that could result in zero- or negative-interest accrual if held to maturity, in the event of, and for the duration of, a period of negative market interest rates. Authorizes a local agency to hold these instruments until their maturity dates.

5) Specifies that the changes in 2) and 4) above shall remain in effect only until January 1, 2026, and as of that date is repealed.

FISCAL EFFECT: None

COMMENTS:

1) **Bill Summary.** This bill increases the commercial paper limit for cities and special districts that have more than $100 million in investment assets from 25% to 40% of their total surplus funds. This bill also allows local agencies to invest in securities backed or issued by the federal government that could result in zero- or negative-interest accrual if held to maturity during a period of negative market interest rates. These provisions contain a sunset date of January 1, 2026. Additionally, this bill prohibits cities and special districts from investing more than 10% of their commercial paper and medium-term investments in any single issuer. Lastly, this bill allows JPAs to determine the terms and conditions for public agencies to participate and invest in shares of beneficial interest consistent with existing law and clarifies that federally

recognized Indian tribes can participate in these investment pools. The California Municipal Treasurers Association is the sponsor of this bill.

2) **Author's Statement.** According to the author, "SB 998 provides improved investment modifications for municipal treasurers in this time of crisis. From raising commercial paper concentration limits to expanding access to JPA investment pools, the Legislature should be equipping local governments with more investment tools to safeguard their balance sheets."

3) **Investments.** Since 1913, state law has authorized local officials to invest a portion of local agencies' temporarily idle funds in a variety of financial instruments. Originally, state law limited the instruments to government bonds, but over time the laws governing local agency investments have been amended to keep pace with changing investment opportunities and current market offerings.

   California law allows local officials to deposit money in state or national banks, savings associations, federal associations, credit unions, or federally insured industrial loan companies in the State of California. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, state law outlines local agencies' investment objectives, also known as the prudent investor standard. The primary objective is to safeguard the principal of the funds under the local agency's control. The secondary objective is to meet the liquidity needs of the depositor. The final objective is to achieve a return on the funds under its control.

   State law limits the percentage that local agencies can invest in many types of investments. This encourages local agencies to diversify their investment portfolios, which limits the risk to the local agency if any investment does not have the expected return. Local agencies make investments with different maturity dates, which refer to the date when the borrower must make the final payment due on an investment.

4) **Commercial Paper and Medium-Term Notes.** Many local agencies seeking to invest funds, but also maximize liquidity, maintain commercial paper programs. Commercial paper programs offer notes of varying short-term maturities not to exceed 270 days. In addition to the maximum maturity of 270 days, state law includes additional safeguards to ensure that commercial paper programs operate effectively. Commercial paper must have the highest ranking or the highest letter and number rate as provided by a nationally recognized statistical rating organization. Entities issuing commercial paper must either be:

   a) General corporations with total assets in excess of $500 million and have debt, other than commercial paper, that is rated "A" or equivalent; or,

   b) Special purpose corporations, trusts, or limited liability companies that have program-wide credit enhancements, such as overcollateralization, letters of credit, or surety bonds, and have commercial paper rated "A-1" or higher.

   Cities and special districts, other than the City and County of San Francisco and the City of Los Angeles, may invest no more than 25% of their surplus funds in commercial paper and no more than 10% of the commercial paper of any single issuer. Counties, or local agencies that pool investments, may invest no more than 40% of their surplus funds in commercial paper and no more than 10% of surplus funds in any one issuer's commercial paper.

Some local agencies may be interested in longer-term investments than commercial paper. Medium-term notes are securities with a maximum remaining maturity of five years or less. Local agencies may invest up to 30% of their surplus funds in medium-term notes, which must be issued by corporations or depository institutions licensed in the United States, with at least an "A" rating. Medium-term investments provide greater liquidity compared to long-term investments, which may not mature for decades.

5) **JPA Law and Investments.** The Joint Exercise of Powers Act allows two or more public agencies to use their powers in common if they sign a joint powers agreement. Sometimes an agreement creates a new, separate government called a joint powers agency or JPA. Agencies that can exercise joint powers include federal agencies, state departments, counties, cities, special districts, school districts, federally recognized Indian tribes, and even other joint powers authorities.

   Some local agencies pool investment resources and form JPAs to jointly exercise their power to make specified investments. These JPAs can issue shares of beneficial interest to participating public agencies. Each share represents an equal and proportionate interest in the underlying pool of securities and investments owned by the JPA. JPAs wanting to issue shares of beneficial interest must retain an investment advisor that meets all of the following criteria:

   a) The advisor is registered with, or exempt from registering with, the United States Securities and Exchange Commission;

   b) The advisor has at least five years of experience investing in specified securities and obligations; and,

   c) The advisor has assets under management in excess of $500 million.

6) **Zero- or Negative-Interest Rates.** Existing law generally prohibits local agencies from investing surplus funds in securities that could realize zero- or negative-interest. This essentially bars local agencies from investing in securities that would, if held until the maturity date, receive a final payment equal to, or less than, what was initially invested. This prohibition was enacted by the Legislature following Orange County's bankruptcy in 1994.

   However, in recent years, central banks in Europe, Scandinavia, and Japan have implemented a negative interest rate policy on excess bank reserves in the financial system. This unorthodox monetary policy tool is designed to spur economic growth through spending and investment, as depositors would be incentivized to spend cash rather than store it at the bank and incur a guaranteed loss. Negative interest rates are not only an unconventional monetary policy tool, but they are also a recent one. The European Central Bank instituted negative-interest rates in June 2014 when it lowered its deposit rate to -0.1%. Other European countries and Japan have since opted to offer zero- or negative-interest rates.

   While the United States has yet to adopt a negative interest rate policy, there is growing thought that it could if the economy continues its recent downturn. This bill allows local agencies to invest in zero- or negative-interest rate securities if they are backed or issued by the United States Government, and only "in the event of, and for the duration of, a period of negative market interest rates."

7) **Arguments in Support.** The California Municipal Treasures Association argues that, "Cities and special districts with large investment portfolios should have the same 40% commercial paper portfolio concentration limit that counties have. Currently, counties and the cities of San Francisco and Los Angeles have a 40% commercial concentration limit, while other cities and special districts with large portfolios do not. Raising the latter to 40% would reflect more consistent and equitable public policy.

   "Cities and special districts should have a 10% single issuer corporate debt concentration limit that is based upon a local agency's total investment assets. Currently, cities and special districts have a 10% single issuer commercial paper concentration limit that is based upon an issuer's total annual commercial paper issuance. Including medium-term notes in the debt calculation and basing the limit upon a local agency's total investment assets would more effectively limit losses.

   "Local agencies should be able to buy zero- or negative-interest accrual securities during a period of negative interest rates, if they would result in less loss of principal. Zero interest accrual interests are banned. An exception should be made so that local agencies have an alternative to sitting on cash at financial institutions.

   "Indian Tribes, as public agencies, should be able to invest in public agency investment pools. Currently Indian Tribes can enter into JPAs, with the exception of JPA investment pool agreements. As public agencies, they should have access to a stable public sector investment alternative."

8) Arguments in Opposition. None on file.

REGISTERED SUPPORT / OPPOSITION:

Support

California Municipal Treasurers Association [SPONSOR]
California Asset Management Program
California Special Districts Association
City of San Diego

Opposition

None on file

Analysis Prepared by: Jimmy MacDonald / L. GOV. / (916) 319-3958