



Permitted Investments: A Roadmap

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WHERE TO START?



WHERE DO YOU LOOK FOR PERMITTED INVESTMENT REQUIREMENTS?

STATE LAW – Set forth in special bond acts, issuer enabling legislation or general laws.

CONTRACTS – (Bond documents). Revenue Bonds issued under trust indenture or bonds issued with bond insurance or liquidity facility (e.g. letter of credit)

FEDERAL TAX LAW – Limitations on the yield on investments; requirements for rebate of investment income to the IRS.

STATE LAW

GENERAL OBLIGATION BONDS AND MUNICIPAL MONIES

1. Look at Special Bond Act if you have one.
2. Look at RI General Laws applicable to general obligation bonds
3. Look at State Investment Commission “Additional Investment Powers” statute
4. Look at Ocean State Investment Pool statute
5. Look at Reserve Funds statute
6. Look at Collateralization of Public Deposits statute

Special Bond Acts

TYPICAL LANGUAGE

Any proceeds of bonds or notes issued hereunder or of any applicable federal or state assistance, pending their expenditure may be deposited or invested by the city treasurer, **in demand deposits, time deposits or savings deposits in banks which are members of the Federal Deposit Insurance Corporation or in obligations issued or guaranteed by the United States of America or by any agency or instrumentality thereof or as may be provided in any other applicable law of the state of Rhode Island or resolution of the city council or pursuant to an investment policy of the city.**

Rhode Island General Laws applicable to general obligation bonds

§ 45-12-28. Permitted temporary investments for bond proceeds.

Notwithstanding any contrary provision of general or special law, towns and cities may invest proceeds of any bond or note available during the period before those proceeds are needed for the purpose for which the bonds or notes were issued, in **investments described in § 35-10-11**. A city council or town council may adopt an ordinance or resolution limiting the permitted investments under § 35-10-11 to investments meeting specified standards of creditworthiness.

Rhode Island General Laws applicable to general obligation refunding bonds and notes

§ 45-12-5.2. Issuance of refunding bonds to pay outstanding bonds.

(e) The proceeds of refunding bonds, exclusive of costs of issuance any premium and accrued interest shall, upon their receipt, be paid immediately to the paying agent for the bonds which are to be refunded, and that paying agent shall hold those proceeds in trust until they are applied to refund bonds. While the proceeds are held in trust they may be invested for the benefit of the issuer in **obligations of the United States of America, the state of Rhode Island, or its political subdivisions.**

State Investment Commission “Additional Investment Powers”

§ 35-10-11. Additional investment powers.

The state, any state agency, any city or town, and any municipal agency which has, or has control of, any funds not immediately required for other purposes may, in addition to other investments in which it may be authorized to invest by law, and notwithstanding any provisions of any special law or municipal charter to the contrary, invest these funds, either individually or with each other, in:

(1) Deposits in banks, savings banks, national banks or trust companies, loan and investment companies, credit unions; and in shares of building-loan associations; the principal office of which institution or institutions is located in this state or which has a deposit-taking facility within this state; **provided, that the investments shall be made as would be done by prudent persons of discretion and intelligence in these matters who are seeking a reasonable income and preservation of their capital;**

State Investment Commission “Additional Investment Powers”

(2) Shares or units of beneficial interest of any open end investment company or association or investment trust which is registered under the federal Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq.; provided, that the company, association, or trust shall:

(i) Limit the issuance, distribution, and ownership of its shares or units solely to this state, state agencies, cities and towns of this state, and municipal agencies thereof, other than shares or units issued in connection with the initial capital required by the federal Investment Company Act of 1940;

(ii) Invest solely in securities and investments which are lawful for investments of savings deposits as set forth and defined in chapter 3 of title 19, without regard to the provisions of this chapter as to percentage of deposits which may be so invested, or are lawful for investment of reserve funds by cities and towns under § 45-11-1, but subject to the restrictions that:

State Investment Commission “Additional Investment Powers”

A) No investment shall be made in any security or investment authorized under chapter 3 of title 19, unless, after giving effect to the investment, no more than ten percent (10%) of the total assets of the company, association, or trust shall be invested in securities or investments of a class or type authorized solely under this chapter;

(B) No investment shall be made in any security or investment authorized under chapter 3 of title 19, unless, after giving effect to the investments, no more than five percent (5%) of the total assets shall be invested in the securities or investments authorized solely under this chapter of any one issuer or obligor; and

(C) If the lawful investments constitute collateral for any repurchase agreement, the company, association, or trust shall take delivery of the collateral either directly or through an authorized custodian; and

(iii) Invest solely in such of the investments as would be done by prudent persons of discretion and intelligence in these matters who are seeking a reasonable income and preservation of their capital; and

State Investment Commission “Additional Investment Powers”

(3) Notwithstanding the provisions of paragraphs (1), (2)(ii)(A), and (2)(ii)(B), in:

(i) **Obligations issued or guaranteed by the United States government or any agency or instrumentality thereof and repurchase agreements fully collateralized thereby, or in securities of any open end investment company or association or investment trust, custodial arrangement, or pool which is registered under or exempt from the federal Investment Company Act of 1940, provided, that the portfolio of the company, association, trust, custodial arrangement, or pool is limited to obligations issued or guaranteed by the United States government or any agency or instrumentality thereof and repurchase agreements fully collateralized thereby and that the company, association, trust, custodial arrangement, or pool takes delivery of the collateral either directly or through an authorized custodian, agent, or depository; and**

(ii) **Any security of a state or political subdivision thereof, or in securities of any open end investment company or association or investment trust, custodial arrangement, or pool which is registered under or exempt from the federal Investment Company Act of 1940, provided, that**

State Investment Commission “Additional Investment Powers”

(A) The portfolio of the company, association, trust, custodial arrangement, or pool is limited to state or political subdivision securities and repurchase agreements fully collateralized thereby;

(B) The company, association, trust, custodial arrangement, or pool takes delivery of the collateral either directly or through an authorized custodian or depository;

(C) The interest on the securities is exempt from federal income taxation;

(D) At the time of the investment, the security (in the case of a security issued by or on behalf of a state or political subdivision thereof) has a rating as determined by a national rating agency of municipal obligations equal or superior to the last rating by the agency applicable to general obligations of the state or (in the case of a fund) the fund invests solely in securities having these ratings;

(E) In connection with the investments, the state, state agency, city, town, or municipal agency may enter into contracts to purchase and resell the investments at specified or determinable prices.

State Investment Commission “Additional Investment Powers”

(4) **Notwithstanding the provisions of subdivision (1), in certificates of deposit** obtained in accordance with the following conditions:

- (i) The funds are initially invested through a financial institution as defined in subdivision 19-1-1(7) or chapter 19-1, selected by the investing governmental entity;
- (ii) The selected financial institution arranges for the deposit of the funds in certificates of deposit in one or more federally insured banks or savings and loan associations, for the account of the governmental entity;
- (iii) **The full amount of the principal and accrued interest of each certificate of deposit is insured by the Federal Deposit Insurance Corporation;**
- (iv) The selected financial institution acts as custodian for the governmental entity with respect to the certificates of deposit issued for the governmental entity's account; and
- (v) At the same time that the governmental entity's funds are deposited and the certificates of deposit are issued, the selected financial institution receives an amount of deposits from customers of other banks and savings and loan associations, wherever located, equal to the amount of funds initially invested by the governmental entity through the selected financial institution.

(5) **Public deposits placed in accordance with the conditions prescribed in this subsection shall not be required to be secured by eligible collateral as set forth in chapter 35-10.1.**

Ocean State Investment Pool Statute

§ 35-10.2-8. Participation units.

The general treasurer is authorized to sell to all agencies, authorities, commissions, boards, municipalities, political subdivisions, and other public units of the state, participation units in any such combined investment trust fund. Such participation units **are made legal investments** for all the funds under the custody of such agencies, authorities, commissions, boards, municipalities, political subdivisions, and other public units of the state.

Reserve Fund Statute

§ 45-11-1. Establishment and use of funds.

The city council of any city and voters of any town in this state in a financial town meeting, or any other municipal body legally empowered to appropriate funds of a city or town, if they see fit to do so, may vote:

(1) To establish a fund to be designated as a reserve fund, this fund to be available to the city or town as necessary for temporary borrowings in anticipation of taxes, but otherwise available only for capital expenditures;

* * *

(3) To permit the investment by the city or town treasurer, with the advice and consent of the city or town council, as the case may be, of the fund in **savings accounts or certificates of deposit of commercial or savings banks or trust companies, or in obligations of the United States or its agencies, or in any other short term investment, as would be made by prudent persons of discretion and intelligence;**

Collateralization of Public Deposits statute

§ 35-10.1-3. Securing of deposits.

(a) Every qualified public depository shall, at a minimum insure or pledge eligible collateral equal to one hundred percent (100%) of public deposits which are **time deposits with maturities greater than sixty (60) days**, and which were maintained with that depository institution as of October 1, 1991; provided, that any qualified depository institution which does not meet its minimum capital standard as prescribed by its federal regulator shall insure or pledge eligible collateral equal to one hundred percent (100%) of all public deposits maintained with that depository institution as of October 1, 1991. The amount of eligible collateral required shall be determined when funds are deposited for time deposits, and at the end of each month for demand deposits. The amount of required insurance shall be determined in accordance with § 35-10.1-8.

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LOOK AT CONTRACTS

Bond Indentures and Escrows

RI Health and Educational Building Corporation
Public School Indenture

RI Infrastructure Bank Water and Wastewater
System Borrower Revenue Bond Indentures

RI Health and Educational Building Corporation Public School Indenture

"Permitted Investments" with respect to the Series 2018 B Bonds means any of the following:

- (i) **Government Obligations;**
- (ii) **Federal Agency Obligations;**
- (iii) **Exempt Obligations;**
- (iv) **Uncollateralized certificates of deposit that are fully insured** by the Federal Deposit Insurance Corporation and issued by a banking organization authorized to do business in the State and having its principal office or a deposit-taking facility in the State.
- (v) **Collateralized certificates of deposit** that are (a) issued by a banking organization authorized to do business in the State that has an equity capital of not less than \$125,000,000, whose unsecured senior debt, or debt obligations fully secured by a letter or credit, contract, agreement or surety bond issued by it, are rated by at least one nationally recognized Rating Agency in at least the second highest rating category, and (b) are fully collateralized by Permitted Collateral;
- (vi) **Investment Agreements that are fully collateralized by Permitted Collateral;** and
- (vii) **Ocean State Investment Pool** created pursuant to Sections 35-10.2-1 through 35-10.2-11 of the Rhode Island General Laws.

RI Infrastructure Bank Water and Wastewater System Borrower Revenue Bond Indentures

"Permitted Investments" shall mean and include any of the following securities, **if and to the extent the same are at the time legal for investment** of the funds held pursuant to this Indenture:

(i) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are unconditionally guaranteed by, the United States of America, including obligations of any Federal agency or corporation which has been or may hereafter be created pursuant to an act of Congress as an agency or instrumentality of the United States of America to the extent unconditionally guaranteed by the United States of America, and any certificates or receipts representing direct ownership of future interest or principal payments in such bonds or other obligations;

(ii) public housing bonds issued by public agencies or municipalities and fully guaranteed as to the payment of both principal and interest by the United States of America; temporary notes, preliminary loan notes or project notes issued by public agencies or municipalities, in each case fully secured as to the timely payment of both principal and interest by a requisition or payment agreement with the United States of America, or obligations issued by any state or any public agencies or municipalities which at the time of purchase are rated in either of the two highest rating categories by each Rating Agency then maintaining a rating on such obligations;

RI Infrastructure Bank Water and Wastewater System Borrower Revenue Bond Indentures

(iii) direct and general obligations of any state of the United States to the payment of the principal of and interest on which the full faith and credit of such state is pledged, and direct and general obligations of any political subdivision of any such state to the payment of which the full faith and credit and unlimited ad valorem taxing power of such political subdivision is pledged, provided that at the time of their purchase under the Indenture such obligations are rated in either of the two highest rating categories by a nationally recognized bond rating agency;

(iv) commercial paper rated in the highest category by each Rating Agency then maintaining a rating on such commercial paper;

(v) investments in a money market fund or other fund the investments of which consist exclusively of obligations described in clause (i) above;

(vi) bank time deposits evidenced by certificates of deposit issued by banks or savings and loan institutions (which may include any Fiduciary) having at the time of purchase a combined capital and surplus of not less than \$50,000,000 which are members of the Federal Deposit Insurance Corporation; provided that any such time deposits in excess of applicable federally insured limits are fully secured by obligations described in clause (i) above, which such obligations at all times have a market value (exclusive of accrued interest) at least equal to such bank time deposits so secured, including interest;

RI Infrastructure Bank Water and Wastewater System Borrower Revenue Bond Indentures

(vii) repurchase agreements relating to securities of the type specified in clause (i) above with banks or trust companies having a combined capital and surplus of not less than \$50,000,000 or with government bond dealers reporting to, trading with, and recognized as a primary dealer by, the Federal Reserve Bank of New York; provided that the market value of such securities is at the time of entering into such agreement at least one hundred three percent (103%) of the repurchase price specified in the agreement; and provided further that such securities are delivered to or held by the Trustee or a depository satisfactory to the Trustee in such manner as may be required to provide a perfected security interest in such securities;

(viii) investment contracts with, or guaranteed by, banks or other financial institutions whose long-term unsecured debt or claims-paying ability at the time of purchase is rated in one of the three highest rating categories for such debt or claims-paying ability by each Rating Agency then maintaining a rating on such banks or other financial institutions;

(ix) bonds, notes or other evidences of indebtedness issued or guaranteed by the Federal Banks for Cooperatives, Federal Intermediate Credit Bank, Federal Home Loan Mortgage Corporation, Federal Home Loan Bank System, Federal Land Banks, Export-Import Bank of the United States, Federal National Mortgage Association, Government National Mortgage Association or any agency or Instrumentality of or corporation wholly owned by the United States of America; and (x) Advance-Refunded Municipal Bonds.

Indentures

Indentures often have special investment requirements for defeasance escrows—typically government securities

FEDERAL TAX LAW

Two questions for investment income on tax-exempt bond proceeds:

1. Can you earn it?
2. Can you keep it?

FEDERAL TAX LAW

Can you earn it?

You can qualify under the arbitrage rules to invest at an unrestricted yield (but potentially subject to rebate) for 3 years for “new money” issues if you reasonably expect to spend at least 85% of “spendable proceeds” within 3 years and invest not more than 50% of the proceeds in investments having a guaranteed yield for 4 years or more.

FEDERAL TAX LAW

Yield Restriction

The yield restriction requirements provide that bond proceeds may not be invested in investments earning a yield higher than the yield of the bond issue, except for investments (i) during one of the temporary periods permitted under the regulations (including the initial three year temporary period described above), (ii) in a reasonably required reserve or replacement fund (e.g., a Debt Service Reserve Fund) or (iii) in an amount not in excess of the lesser of 5% of the sale proceeds of the issue or \$100,000 (the “minor portion”).

FEDERAL TAX LAW

Can you keep it?

If bond proceeds are permitted to be invested at a yield in excess of the yield on the bonds (under one of the exceptions to yield restriction referred to above), rebate payments may be required to be made to the U. S. Treasury.

- First installment due no later than 60 days after the end of the fifth anniversary of each bond issuance;
- Succeeding installments at least every five years;
- Final installment no later than 60 days after retirement of last bond in the issue.

FEDERAL TAX LAW

Exceptions to Rebate

Six month Exception – spent within 6 months

Qualified Small Issuer Exception – issuer will issue less than \$5,000,000 in the calendar year

FEDERAL TAX LAW

Eighteen-Month Expenditure Exception –

if at least 15% of expected bond proceeds actually are spent within six months at least 60% are spent within twelve months and 100% of actually are spent within eighteen months

FEDERAL TAX LAW

Two-Year Construction Expenditures Exception

Construction expenditures include costs of reconstruction and rehabilitation, but do not include costs of acquiring any interest in land or other existing real or personal property.

Exemption from rebate if proceeds in fact are spent at least as quickly as follows:

- 10% within six months
- 45% within twelve months
- 75% within eighteen months
- 100% within twenty-four months

QUESTIONS AND ANSWERS

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