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Weighing the Risks and Rewards of a New Investment Policy

By Cathy Tyson

"What's a prudent amount of risk we are willing to take?" asked Council Member Amy Worth at a recent City Council meeting. A good question for the City of Orinda, as well as residents.

Because of a loss taken from the sale of a couple of CIT Bonds in November of 2009, the City Council asked the Finance Advisory Committee to review the city's investment policy and come up with suggestions for guidelines that would lessen the city's exposure to risk.

At that time Orinda's investment priorities were: safety, liquidity and yield - in that order. It seemed a good idea when the CIT Bonds were purchased; they had "A" ratings by both Moody's and S & P rating services and met Orinda's conservative investment policy criteria. They were sold at a net loss of $166,000 - a painful lesson for all.

The new policy developed by the Finance Advisory Committee and newly appointed Treasurer Jim Hudak recommends restructuring managed city funds into two pools - the Liquidity Pool and the Reserve Pool. "The Liquidity Pool will consist of those funds which will reasonably be assumed to be needed by the City during the ensuing year given the expected revenues and expenses," noted the June 15th Staff Report.

The Reserve Pool can contain medium term notes rated at least Aa or AA by at least two ratings agencies - Moody's, Standard and Poors or Fitch. Any corporate security downgraded below the acceptable ratings must be sold within a reasonable amount of time - usually a month. No one corporate issuer may be more than five percent of the Reserve Pool's assets at the time of purchase. Finally, no one industry's concentration will be more than twenty percent of the Reserve Pool's assets at the time of purchase.

While council members liked the new policy, initially they wrestled with how to handle an existing investment that would not meet the new policy if adopted. At issue was the $1.2 million dollars worth of GE bonds that are earning a very respectable 5%, are rated AAA and will mature in 2013.

"We're trying to identify our level of risk," said Council Member Steve Glazer. "I'm bewildered that the Council would adopt a policy and at the same time create an exception. To not implement the policy seems a little crazy."

Explaining that Orinda is always going to need the money, he suggested the City Council, "Adopt the policy and live with the consequences."

In the end, the Council agreed to implement the new policy recommended by the Finance Advisory Committee, and will liquidate the GE bonds.

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