



## 5.1 Investing Public Funds

Municipal Officials Handbook, pages 141-142

### 5.101 Investment of Public Funds – Legal Requirements

Similar to private businesses, local governments must manage their cash. Cash management responsibilities include both cash for which there may be an immediate need as well as cash that may be invested for extended periods of time. State law provides for limits, controls and guidance concerning the local government's cash management responsibilities.

Section 7-6-201, MCA requires local governments to "...deposit all public money...in solvent banks, building and loan associations, savings and loan associations, or credit unions..." Money not necessary for immediate use may be placed in savings or time deposit (CD's) or in repurchase agreements. Section 7-6-202, MCA allows for the investment of public funds in direct obligations of the U.S. government including U.S. treasury bills and bonds, as well as a laundry list of other allowable investments. Investment in money market funds is permitted only in limited circumstances. Finally, the law specifies the security necessary to ensure the safety and prompt payment of all deposits (7-6-207, MCA).

### 5.102 Investment Process – a Loser's Game

Investment of public funds can be a highly complex area of responsibility for municipal officials with little or no formal investment training or experience and it is not always clear which investments are permissible under the law. Two Attorney General's Opinions, 42 Op. Attorney Gen. No. 25 (1987) and 44 Op. Attorney Gen. No. 22 (1981), have answered some of the questions. However, while the Attorney General's Opinions are meant to interpret the law and add clarity, the information is still decidedly technical and difficult to understand for most officials.

It is quite common for local officials to receive phone calls from investment firm representatives promising attractive rates of return on their investments. The representative may or may not understand the investments they are trying to sell or their inherent risks. Even more likely, the investment representative will not know which types of investments are permissible for Montana local governments.

Unfortunately, some finance officials have fallen victim to illusions of earning high rates of return for their taxpayers and invested public funds in risky investments that have resulted in substantial losses to their local government.

One unnamed author wrote:

Imagine the following two scenarios:

1. The city clerk-treasurer, through his/her diligent cash management efforts, increased the city's investment earnings from \$30,000 per year to \$40,000 per year; or
2. The city clerk-treasurer, in an attempt to increase the city's investment income, invested the city's funds in an illegal investment instrument. The investment is in default and it is likely the city will lose the original principal amount of \$10,000.

Which of the two preceding events would result in a headline in the local newspaper? Quite obviously, the prospect of a city or town losing money by investing in an illegal investment instrument would attract a great deal of attention in most Montana communities. Conversely, local government officials rarely receive recognition for their efforts, even when their efforts are exemplary. While we do not suggest that elected officials should base their investment decisions on reactions of the local media, the point is that the consequences of trying to maximize the return on investments may not be worth the associated risks.

### **5.103 Investment Options**

Local government officials can fulfill their cash management responsibilities without attempting to maximize the return on their investments. Simple investment options such as purchasing certificates of deposits (adequately secured) from local banks can provide safe and satisfactory rates of return. Montana local governments also have at their disposal the expertise of highly trained and experienced investment professionals at the state level. The Board of Investments administers the Short-Term Investment Pool (STIP) for state government. State law (17-6-204, MCA) allows, but does not require, Montana local governments to use the pool. STIP has several advantages for local governments including access to competitive rates of return provided by trained investment professionals, assurance the city's funds are adequately secured, and total liquidity provided by such a large investment pool. Unlike a certificate of deposit, which must be invested for a definite period of time, a local government's funds (regardless of the amount) can be deposited in STIP one day and taken out the next while earning competitive rates of return for the period the funds are on deposit.

Elected officials should take an active role in determining where the city's funds should be invested, who may make investment decisions, diversification, what investments are permissible, and the decision latitude of those responsible for investments. These decisions of the elected body can best be implemented

through a formalized investment policy.

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