

MASSACHUSETTS SCHOOL BUILDING AUTHORITY

Investment Management Policy

Policies and Guidelines for Funds and Investments

The purpose of this document is to articulate the policy and guidelines of the Massachusetts School Building Authority (the “Authority”) for the investment of moneys held by the Authority.

Governing Law

Investment activity shall be conducted in conformance with federal, state, and other requirements of law.

Under section 3(s) of chapter 70B of the Massachusetts General Laws, the Authority may invest its funds in such investments as may be legal investments for the Commonwealth or any fiduciary in the Commonwealth. The Authority has been advised by counsel that this statutory provision essentially authorizes the Authority to invest its funds in accordance with the “prudent investor” rule articulated over the years by the Supreme Judicial Court and recently codified in the Massachusetts Prudent Investor Act (G.L. c. 203C).

Establishment of Funds

The Board of Directors of the Authority has approved a trust agreement to secure the Authority’s bonds, which agreement separately establishes funds to be held by the trustee under the trust agreement and prescribes permitted investments for such funds. The Board of Directors of the Authority has also authorized the Executive Director to take whatever actions necessary to establish an irrevocable trust for the purpose of holding moneys to provide for the Authority’s Other Post-Employment Benefits (OPEB) liability. The Authority has established an OPEB Trust, which separately establishes permitted investments for such funds. Additionally, the Executive Director of the Authority has been authorized to establish such other funds, as needed, for the investment and disbursement of the moneys which are clear of any trust, lien, or pledge or assignment securing bonds issued by the Authority, including: project fund proceeds from the issuance of Authority bonds; moneys received by the Authority from the School Modernization and Reconstruction Trust Fund (SMART fund); and other funds or revenues that the Authority may receive.

The Executive Director has deemed it appropriate to establish, including without limitation, funds for the following purposes:

Operating Fund — for the purpose of holding moneys to be used for the ongoing operating expenses of the Authority, including: vendor payments; payroll related expenses; and other operational, grant or loan payments to cities, towns, and regional school districts, or fund transfers.

Project Fund — for the purpose of holding bond proceeds or other borrowed moneys to be used for: school construction grants to cities, towns and regional school districts; vendor

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payments related to Cost of Issuance expenses; or vendor payments directly related to the construction of the project.

In connection with the above, the Authority holds funds in debt service and debt service reserve funds, sinking funds and escrows related to the defeasance and refunding of outstanding debt.

Delegation of Investment Authority

The Board authorized the Executive Director on June 20, 2005 to transact investments, to establish such policies and procedures for the investment and disbursal of the moneys in such funds, as deemed appropriate for the custody of the proceeds of the Authority's bonds, other moneys received by the Authority from the School Modernization and Reconstruction Trust Fund, and other funds or revenues that the Authority may receive. This authorization was included in the Authority's initial debt offering. The Executive Director may delegate investment authority to the Chief Financial Officer, Treasurer and other financial staff. All staff shall observe applicable restrictions imposed by federal and state law, and the provisions of this Investment Management Policy when making an investment decision.

Investment Objective

The primary objective in the investment of Authority funds in order of priority is the preservation of principal, while maintaining sufficient liquidity to meet financial obligations and providing a reasonable investment return.

Permitted Investments

Except for the investment of funds in escrow accounts related to the defeasance or refunding of the Authority's outstanding debt, the following investments shall be permitted for moneys in the foregoing Funds, with the stated objective of preserving the corpus of the fund while maintaining appropriate liquidity and earning a reasonable rate of return:

- (i) Government Obligations;
- (ii) Certificates or receipts representing direct ownership of future interest or principal payments on Government Obligations or any obligations of agencies or instrumentalities of the United States of America which are backed by the full faith and credit of the United States, which obligations are held by a custodian in safekeeping on behalf of the registered owners of such receipts;
- (iii) Agency Obligations;
- (iv) Obligations of, or obligations unconditionally guaranteed by, the World Bank (International Bank for Reconstruction and Development and International Finance Corporation), European Bank for Reconstruction and Development, European Investment Bank, Asian Development Bank, Inter-American Development Bank, African Development Bank and the Nordic Investment

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Bank, provided that such obligations are rated at the time of purchase hereunder in one of the two highest rating categories by each rating agency;

- (v) Interest-bearing time or demand deposits, certificates of deposit, or other similar banking arrangements with any government securities dealer, bank, trust company, savings and loan association, national banking association or other savings institution provided that such deposits, certificates, and other arrangements are (a) fully insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, or (b) if the institution enters into a collateral agreement with the MSBA which maintains collateral in U.S. government securities, agencies of the U.S. government, or corporate and municipal securities with an AA or higher rating by at least two of the three rating agencies then maintaining a rating on any of the bonds outstanding of the Authority, equal to 102% of the MSBA's deposits with the institution, or (c) if deposits are placed with the Massachusetts Municipal Depository Trust, or (d) if deposits are placed with an Issuing and Paying Agent;
- (vi) Repurchase agreements collateralized by securities described in subparagraphs (i), (ii) or (iii) above with any registered broker/dealer or with any commercial bank, provided that (a) a specific written repurchase agreement governs the transaction, (b) the securities are held, free and clear of any lien, by an independent third party acting solely as agent for the Authority, and such third party is (1) a Federal Reserve Bank, or (2) a bank which is a member of the Federal Deposit Insurance Corporation and which has combined capital, surplus and undivided profits of not less than \$25 million, and the Authority shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, (c) the repurchase agreement has a term of thirty days or less, or the third-party custodian will value the collateral securities no less frequently than weekly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five business days of such valuation, and (d) the fair market value of the collateral securities in relation to the amount of the repurchase obligation, including principal and interest, is equal to at least 102%;
- (vii) Forward purchase agreements providing for delivery of securities described in subparagraphs (i), (ii) or (iii) above or subparagraph (ix) below with banks or other financial institutions whose long-term unsecured debt or claims-paying ability is rated in one of the two highest rating categories by each rating agency then maintaining a rating on any of the bonds of the Authority outstanding, provided that any such agreement must be accompanied by an opinion of counsel to the effect that the securities delivered will not be considered a part of the estate of such bank or other financial institution in the event of a declaration of bankruptcy or insolvency by such bank or institution;

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- (viii) Money market funds rated in the highest short term rating category by each rating agency then maintaining a rating on any bonds outstanding of the Authority, or any other mutual fund rated in the highest short term rating category by each rating agency then maintaining a rating on any bonds of the Authority outstanding.
- (ix) Commercial paper rated in the highest short term rating category by each rating agency then maintaining a rating on any bonds of the Authority outstanding;
- (x) Advanced-Refunded Municipal Bonds which shall mean any bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state (i) which are not callable at the option of the obligor or otherwise prior to maturity or as to which irrevocable notice has been given by the obligor to call such bonds or obligations on the date specified in the notice, (ii) which are fully secured as to principal and interest and redemption premium, if any, by a fund consisting only of cash, Government Obligations or Agency Obligations which fund may be applied only to the payment of interest when due, and the principal of and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable notice, as appropriate, and (iii) as to which the principal of and interest on the Government Obligations or Agency Obligations which have been deposited in such fund along with any cash on deposit in such fund is sufficient to pay all interest when due, and all principal of and redemption premium, if any, on the bonds or other obligations described in this definition on the maturity date or dates thereof or on the redemption date or dates specified in the irrevocable notice referred to in subclause (i) above, as appropriate;
- (xi) Short-term or long-term obligations, whether tax exempt or taxable, of any state or local government or authority or instrumentality thereof or any other entity that has the ability to issue obligations the interest on which is excludable from gross income for federal income tax purposes, provided that any such obligations are rated at the time of purchase in one of the two highest rating categories by each rating agency then maintaining a rating on any bonds of the Authority outstanding; and
- (xii) Investment contracts with banks or other financial institutions whose long-term unsecured debt or claims-paying ability is rated in one of the two highest rating categories by each rating agency then maintaining a rating on any of the bonds of the Authority outstanding.

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Investment of funds in escrow accounts established for the purpose of the defeasance or refunding of outstanding debt are to be in compliance with the requirements as set out in GASB 86, with the express purpose of permitting the Authority to account for the reduction of outstanding debt for defeased. As of the date of this Investment Policy, GASB 86 defines such permitted investments as:

- Direct obligations of the U.S. government
- Obligations guaranteed by the U.S. government
- Securities backed by U.S. government obligations as collateral and for which interest and principal payments on the collateral generally flow immediately through to the security holder.

In addition, the monetary assets held in the trust are required to provide cash flows that approximately coincide, as to timing and amount, with the scheduled interest and principal payments on the defeased debt.

Due Diligence on Investment Providers

Prior to making an investment, the Authority shall review the qualifications, financial strength, experience and expertise of the investment provider. The review is intended to avoid doing business with a firm that is financially weak, has limited experience in providing the investment instrument being purchased, lacks general financial expertise or is otherwise unsuitable for the investment of Authority funds. This review may include, but shall not be limited to, the following: information on the financial condition of the provider, recent financial statement, credit rating reports, a summary of the volume of securities (by investment instrument) traded or sold by the firm, the experience of the account officer(s) handling Authority's investments and any other information deemed appropriate.

Investment Process

The Authority recognizes that the appropriate investment process varies depending upon the characteristics of the specific instrument. Listed below is the process to be followed for the significant investment of funds in the following types of instruments.

Marketable Securities — A competitive bid process shall be the Authority's preferred method of purchasing marketable security¹ investments. The bid process shall consist of at least three firms being requested to provide quotes by a specified time in the specified manner². The request to bid should list the specific instrument, investment amount and maturity date of the investment.

Money Markets — Investments in Money Markets may be done after a comparative review. For money markets the review may include, but shall not be limited to, the following: a comparison for the past year of the fund being considered to the performance to other funds

¹ A marketable security for the purpose of this paragraph shall include treasuries, agencies, commercial paper, certificate of deposits and similar financial instruments. Money markets, demand deposits, auction rates and guaranteed investment contracts are not to be considered marketable securities.

² The manner to receive bids are fax, email, telephone and via the Bloomberg Information Network.

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with similar credit standards, average maturity of investments and other comparative information deemed appropriate. Only funds ranked in the top quartile may be invested in by the Authority.

Demand Deposits — For demand deposits the review may include, but shall not be limited to, the following: a comparison for the past year of each bank yield on demand deposits, the method used by each bank to establish demand deposits rates, restrictions on the investment, financial and rating reports on the bank, administrative procedures, diversification, and other comparisons deemed appropriate. The bank offering the highest interest rate should receive the investment. If, however, in the judgment of the Authority’s Chief Financial Officer the bank offering the highest rate will not provide the highest rate going forward because of the method of setting its interest rate, or as a result of any of the factors considered as part of the review including those listed above, the bank may be passed over to the next bank. The Chief Financial Officer may also pass over a bank because of the restrictions or administrative procedure deemed problematic. Whenever a bank offering the highest rate is not selected, the Treasurer shall prepare a written statement which indicates the reason for not selecting the bank.

Guaranteed Investment Contracts — For Guaranteed Investment Contracts (GICs), investments shall be made after the receipt of at least three bids. The request for bids may specify differing amounts of collateral depending upon the bidder’s credit rating.

Rebate

The Authority recognizes that under certain circumstances investment earnings in excess of the “Arbitrage yield” will need to be rebated to the Federal Government. Therefore, the Authority shall be diligent in complying with all regulations concerning the investment of bond proceeds. Prior to investing bond proceeds, the Treasurer shall consult with bond counsel to ensure that the bidding and other investment procedures conform to current IRS regulations.

The Treasurer shall maintain records to record the expenditure of bond proceeds, investment earnings and determination of any rebate liability. All investment providers must be required to provide appropriate reports and certifications. The Treasurer shall determine that an investment will comply with IRS regulations and provide sufficient data to perform rebate calculations.

Reporting

The Treasurer may from time to time prepare a report on the composition and results of the investment portfolio. The report shall list by type of investment instrument the following: issuer, par amount, purchase price, market value, coupon or yield of each investment and maturity.

Internal Controls

The Chief Financial Officer shall establish a system of internal controls, which shall be documented in writing. Internal controls shall address the following: clear delegation of authority to staff members, separation of transaction authority from financial reporting, prohibition on a unilateral wire transfer authority, timely reconciliation of transactions and other controls deemed appropriate. The Chief Financial Officer may from time to time test the internal control system.

Conflict/Ethics

All participants in the investment process shall act responsibly and professionally. Authority employees involved in the investment process shall refrain from personal business activity that could conflict with the operation of the investment program or impair their ability to make impartial decisions and shall disclose any relationship that may give an appearance of impropriety. Authority employees involved in final investment decisions shall file a Statement of Financial Interests with the State Ethics Commission annually.

Consultants/Advisors

The Authority may engage the services of a Consultant/Advisor to assist and advise in the development of an investment portfolio or with the procurement of any of the investment instruments. For guaranteed investment contracts a Consultant/Advisor may provide information on firms currently bidding on such agreements, standard industry provisions, current market conditions, timing suggestions and receipt of bids. If an Advisor/Consultant is engaged, the role shall be to assist and advise, not to make the final investment decision.