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MEMO

Date: March 25, 2020
To: Steve Schainker, City Manager
Cc: Deb Schildroth, Assistant City Manager
From: Duane Pitcher, Finance Director
Roger Wisecup, City Treasurer
Subject: Feasibility of Participating in Socially Responsible Investing

At the January 28, 2020 meeting, the City Council approved action directing staff to bring back a memo regarding the feasibility of participating in socially responsible investing.

Given the restrictions placed on Iowa local government investments that include limitations on investment vehicles eligible for inclusion in our investment portfolio and on time to maturity, participation in socially responsible investing is not feasible for the City of Ames.

Additional background information to support this conclusion is provided below.

Socially Responsible Investing

Socially responsible or sustainable investing is a growing investment field that uses environmental, social, and governance (ESG) criteria to evaluate investments. The use of ESG is primarily used in equity (stocks or direct ownership) investments. The City cannot participate in equity investments due to restrictions in the Iowa Code related to investment of public funds, nor would equity investments be appropriate for the City of Ames given the goals of our investment portfolio being primarily safety and liquidity. Though much less prevalent, there are some established fixed income ESG strategies that are based around corporate bonds and sovereign debt. The City cannot invest in corporate bonds and the only sovereign debt available is the U.S. government.

Local Government ESG Strategies

We reviewed a sample local government ESG strategies and it appears that most are very limited in impact or place significant restrictions on investments. Some examples include the California cities of Oakland and Santa Monica whose policies include a prohibition on investments with entities that engage in nuclear weapons work. This eliminates the option to invest in U.S. treasuries, although both invest in U.S. agency

securities. Others, such as the City of Chicago, include investments in local economic development, although these types of investments are not allowed under the Code of Iowa. The City of Boston's policy includes a provision that "encourages the adoption of ESG factors by organizations that offer the City Suitable and Authorized Investments". However, their list of authorized investments is much broader than allowed in Iowa and includes corporate notes, supranational securities (The World Bank, International Finance Corporations, etc.), and guaranteed investment contracts. These types of investments can vary significantly in underlying investment and are more actively involved in meeting ESG investment strategies.

Implementation of ESG strategies are much more common for local governments who manage pensions. Pension funds implement these strategies primarily through equity investments. Pension funds also have a much longer investment outlook than local government cash management portfolios. The City of Ames does not manage any pensions.

Code of Iowa Regulation of Public Funds Investments

Chapter 12B.10 of the Iowa Code sets forth requirements for the investment of local government public funds. Both the types of investments and maturity of investments are significantly limited. To maintain liquidity, the allowed investments are more like commodities and by design have little differentiation between investment options within a given class. This provides for active markets, strong liquidity, and narrow bid to offer spreads but no readily identifiable ESG differentiation. Iowa local government investments are limited to the following:

- Obligations of the U.S. government, its agencies, and instrumentalities

- Certificates of deposit at federally insured financial institutions meeting the public funds requirements included in Chapter 12C of the Iowa Code

- Prime bankers' acceptances with several restrictions

- Commercial paper with several restrictions

- Repurchase agreements with several restrictions

The availability of allowed investments that can be differentiated by some type of ESG factors is extremely limited. For example, Fannie Mae, a qualified U.S. government instrumentality, issues "green" bonds in the form of securitized loans for multifamily properties that meet certain energy efficiency standards. However, these securities are a very small part of the overall market and the original issue maturity far exceeds the allowed maturity for local government investments in Iowa.

Chapter 12 of the Code of Iowa also provides requirements for investments made by the statewide public pension systems and requires these pension funds to comply with a limited ESG investing strategy referred to as negative screening. The pension systems must establish and report on ESG investment strategies that screen out any sovereign investments as well as most companies investing in the countries

of Iran and Sudan and companies that boycott the country of Israel. These requirements do not apply to local governments.

Current City Investment Policy and Process

The City of Ames currently manages investments in accordance with a peer certified and City Council approved investment policy which complies with the requirements of the Code of Iowa. The City Treasurer provides a quarterly report to the Mayor and City Council on the status of the investment portfolio and provides certification of compliance with the Iowa Public Funds Investment Act and the City's investment policy. It is important in meeting fiduciary duties that investment policies be clear, concise, and measurable so that compliance can be demonstrated. Any inclusion of ESG factors as part of the investment policy should also meet these guidelines.

The City's investments are currently managed by the City Treasurer, who considers only qualified investments and screens investment options based on our investment policy objectives of safety, liquidity, and yield. The City Treasurer is able to screen and select investments quickly and efficiently since the selection parameters are objective, clear, and easy to determine. ESG factors are more subjective and not readily available and require additional time to research. By design, the administrative costs of managing an ESG portfolio are higher and more time consuming. It is not likely that we could effectively manage an ESG strategy given our current structure. Another option could be to attempt to find an outside investment manager to manage a portion of our portfolio with some ESG parameters. This would require a reconsideration of our investment priorities since it would likely cause a significant reduction in yield.

Conclusion

Based primarily on limited eligible investment options and very limited ability to differentiate eligible investments based on ESG factors, we do not think it is feasible to effectively implement an ESG strategy for the City of Ames investment portfolio.