

**LFN 2015-18**

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# Local Finance Notice

Chris Christie  
Governor

Kim Guadagno  
Lt. Governor

Charles A. Richman  
Commissioner

Timothy J. Cunningham  
Director

## Contact Information

### Director's Office

V. 609.292.6613  
F. 609.292.9073

### Local Government Research

V. 609.292.6110  
F. 609.292.9073

### Financial Regulation and Assistance

V. 609.292.4806  
F. 609.984.7388

### Local Finance Board

V. 609.292.0479  
F. 609.633.6243

### Local Management Services

V. 609.292.7842  
F. 609.633.6243

### Authority Regulation

V. 609.984.0132  
F. 609.984.7388

### Mail and Delivery

101 South Broad St.  
PO Box 803  
Trenton, New Jersey  
08625-0803

### Web:

[www.nj.gov/dca/divisions/dlgs](http://www.nj.gov/dca/divisions/dlgs)

E-mail: [dlgs@dca.nj.gov](mailto:dlgs@dca.nj.gov)

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## Approval Process for Local Unit Investment in Certain Municipal Debt Obligations

N.J.S.A. 40A:5-15.1(a)(5) has been amended to grant the Division of Local Government Services, rather than the Division of Investment, the role of approving local government investment in debt obligations having a maturity date of not more than 397 days from the date of purchase. For entities subject to the Local Fiscal Affairs Law (N.J.S.A. 40A:5-1 et seq.), this Notice discusses how to obtain Division approval to invest in such notes issued by municipalities, counties and fire districts (hereinafter referred to as "municipal notes").

Local units must obtain Division of Local Government Services approval before incorporating municipal notes into a cash management plan approved or amended pursuant to N.J.S.A. 40A:5-14. The Division set forth this process to ensure that municipal note investment can be responsibly incorporated into a local unit's cash management plan, as well as track local unit participation in the municipal note market and its competitive impact on interest rates.

The following information must be submitted to the Director:

- The proposed cash management plan incorporating municipal note purchases
- The amount of funds projected to be available for municipal note purchases
- A list of municipal notes purchased in the prior year, along with the amount, maturity date, interest rate and debt rating for each
- Whether the local unit consents to having their chief financial officer's business contact information forwarded to financial advisors to receive information on municipal note issuances

Requests for approval should be made via email to [dlgs@dca.nj.gov](mailto:dlgs@dca.nj.gov) with the subject heading "Request for Approval - Municipal Note Investment".

If the local unit seeks to incorporate municipal note purchases into its annual cash management plan approval (usually done at the governing body's reorganization meeting), the Division recommends submitting an approval request no later than two months prior expiration of the plan. This is to ensure the Division has sufficient time to make determinations prior to governing body reorganization meetings. However, a local unit is not barred from submitting an approval request at another time, such as for amending a cash management plan. The Division may issue an approval lasting up to one year.

Pursuant to N.J.S.A. 40A:5-14(a)(3), local units receiving Division approval to invest in municipal notes must specifically reference that approval in its cash management plan (if the governing body approves such investment as part of the plan). The local unit may then proceed without having to seek individual Division approval prior to each municipal note bid or purchase, unless the Division's approval states otherwise.

### **Important Notes on Cash Management Plans**

Investment in notes issued by municipalities, counties and fire districts must be authorized by a cash management plan adopted or amended by the governing body. Appendices "A" and "B" set forth the statutory text for N.J.S.A. 40A:5-14 and 40A:5-15.1, respectively. Local Finance Notice [CFO-1997-14](#) further discusses cash management plans and local government investment; however, since the issuance of that Notice, N.J.S.A. 40A:5-14 was amended by [P.L. 2007, c.241](#) to authorize local unit investment in certificates of deposit (subject to certain conditions).

When a cash management plan authorizes investment in bonds (including notes) maturing in more than one year, the maturity of those bonds must approximate the prospective use of the funds invested.

The Chief Financial Officer must also provide the governing body a monthly report summarizing

- all investments made or redeemed over the past month
- each organization holding local unit funds
- the amount of securities purchased or sold, class or type of securities purchased, book value, earned income, fees incurred and market value of all investments as of the report date
- such other information as may be required by the governing body

When an individual serves as Chief Finance Officer for multiple local units, and more than one of those local units authorizes investment in bonds or notes issued by local government entities,

the potential for conflict of interest exists. Examples of situations where potential conflicts could arise include:

- The same individual is CFO of Municipality X and Municipality Y. Municipality X issues a note, and Municipality Y's cash management plan permits investment in municipal notes.
- The same individual is CFO of Municipality X and Municipality Y. The cash management plans of both Municipality X and Municipality Y permit investment in municipal notes.

Where such potential conflicts arise, it is recommended that the Chief Finance Officer seek advice from legal counsel on resolving the potential conflict in a manner compliant with the Local Government Ethics Law and other laws that may be applicable. An advisory opinion from the Local Finance Board (or a municipal or county ethics board if one exists) regarding compliance with the Local Government Ethics Law may also be requested in writing. Please note that the Local Finance Board's substantial ethics caseload requires local government officers and employees to allow for considerable lead time when requesting an advisory ethics opinion from the Board.

### Conclusion

Section 16 of [P.L. 2015, c. 95](#) amended [N.J.S.A. 40A:5-15.1\(a\)\(5\)](#) as part of the "Division of Local Government Services Modernization and Local Mandate Relief Act of 2015," enacted on August 10, 2015. The law makes a series of changes that streamline certain Division and Local Finance Board functions, along with relieving local governments of certain mandates and allowing greater flexibility in select areas. This Notice is one of a series of guidance documents to be issued by the Division discussing changes made by the new law.

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Approved: Timothy J. Cunningham, Director

Document	Internet Address
P.L. 2015, c.95	<a href="http://www.njleg.state.nj.us/2014/Bills/PL15/95_.PDF">http://www.njleg.state.nj.us/2014/Bills/PL15/95_.PDF</a>
LFN CFO-1997-14	<a href="http://www.nj.gov/dca/divisions/dlgs/lfns/pre_98/cfo-1997-14.pdf">http://www.nj.gov/dca/divisions/dlgs/lfns/pre_98/cfo-1997-14.pdf</a>
P.L. 2007, c.241	<a href="http://www.njleg.state.nj.us/2006/Bills/AL07/241_.PDF">http://www.njleg.state.nj.us/2006/Bills/AL07/241_.PDF</a>

## Appendix A

### 40A:5-14 Adoption of cash management plan.

40A:5-14. a. Each local unit shall adopt a cash management plan and shall deposit, or invest, or both deposit and invest, its funds pursuant to that plan. The cash management plan shall include:

- (1) the designation of a public depository or depositories as defined in section 1 of P.L.1970, c.236 (C.17:9-41) and may permit deposits in such public depository or depositories as permitted in section 4 of P.L.1970, c.236 (C.17:9-44) or in subsection i. of this section;
- (2) the designation of any fund that meets the requirements established pursuant to section 8 of P.L.1977, c.396 (C.40A:5-15.1);
- (3) the authorization for investments as permitted pursuant to section 8 of P.L.1977, c.396 (C.40A:5-15.1); or
- (4) any combination of the designations or authorizations permitted pursuant to this subsection a.

b. The cash management plan shall be approved annually by majority vote of the governing body of the local unit and may be modified from time to time in order to reflect changes in federal or State law or regulations, or in the designations of depositories, funds or investment instruments or the authorization for investments. The chief financial officer of the local unit shall be charged with administering the plan.

c. The cash management plan shall be designed to assure to the extent practicable the investment of local funds in interest bearing accounts and other permitted investments. The cash management plan shall be subject to the annual audit conducted pursuant to N.J.S.40A:5-4. When an investment in bonds maturing in more than one year is authorized, the maturity of those bonds shall approximate the prospective use of the funds invested.

d. The cash management plan may include authorization to invest in any of the investments authorized pursuant to section 8 of P.L.1977, c.396 (C.40A:5-15.1) and shall set policies for selecting and evaluating investment instruments accordingly. Such policies shall consider preservation of capital, liquidity, current and historical investment returns, diversification, maturity requirements, costs and fees, and when appropriate, policies of investment instrument administrators. Policies shall be based on a cash flow analysis prepared by the chief financial officer and be commensurate with the nature and size of the funds held by the local unit. All investments shall be made on a competitive basis insofar as practicable.

e. The cash management plan shall require a monthly report to the governing body summarizing all investments made or redeemed since the last meeting. The report shall set forth each organization holding local unit funds, the amount of securities purchased or sold, class or type of securities purchased, book value, earned income, fees incurred, and market value of all investments as of the report date and other information that may be required by the governing body.

f. The official charged with the custody of moneys of a local unit shall deposit or invest them as designated or authorized by the cash management plan pursuant to subsection a. of this section and shall thereafter be relieved of any liability for loss of such moneys due to the insolvency or closing of any depository designated by, or the decrease in value of any investment authorized by, the cash management plan pursuant to subsection a. of this section.

g. Any official involved in the designation of depositories or in the authorization for investments as permitted pursuant to section 8 of P.L.1977, c.396 (C.40A:5-15.1), or any combination of the preceding, or the selection of an entity seeking to sell an investment to the local unit who has a material business or personal relationship with that organization shall disclose that relationship to the governing body of the local unit and to

the Local Finance Board or a county or municipal ethics board, as appropriate.

h. The registered principal of any security brokerage firm selling securities to the local unit shall be provided with, and sign an acknowledgment that the principal has seen and reviewed the local unit's cash management plan, except that with respect to the sale of a government money market mutual fund, the registered principal need only be provided with and sign an acknowledgment that the government money market mutual fund whose securities are being sold to the local unit meets the criteria of a government money market mutual fund as set forth in paragraph (1) of subsection e. of section 8 of P.L.1977, c.396 (C.40A:5-15.1).

i. The cash management plan may provide for the purchase of certificates of deposit in accordance with the following conditions:

(1) the funds are initially invested through a public depository as defined in section 1 of P.L.1970, c.236 (C.17:9-41) designated by the local unit;

(2) the designated public depository arranges for the deposit of the funds in certificates of deposit in one or more federally insured banks or savings and loans associations, for the account of the local unit;

(3) 100 percent of the principal and accrued interest of each certificate of deposit is insured by the Federal Deposit Insurance Corporation;

(4) the designated public depository acts as custodian for the local unit with respect to the certificates of deposit issued for the local unit's account; and

(5) at the same time that the local unit's funds are deposited and the certificates of deposit are issued, the designated public depository 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 local unit through the designated public depository.

Amended 1977, c.281, s.4; 1979, c.315, s.1; 1981, c.196, s.1; 1983, c.8, s.2; 1997, c.148, s.2; 2007, c.241.

## Appendix B

### 40A:5-15.1. Securities which may be purchased by local units

8. Securities which may be purchased by local units.

a. When authorized by a cash management plan approved pursuant to N.J.S.40A:5-14, any local unit may use moneys which may be in hand for the purchase of the following types of securities which, if suitable for registry, may be registered in the name of the local unit:

(1) Bonds or other obligations of the United States of America or obligations guaranteed by the United States of America;

(2) Government money market mutual funds;

(3) Any obligation that a federal agency or a federal instrumentality has issued in accordance with an act of Congress, which security has a maturity date not greater than 397 days from the date of purchase, provided that such obligation bears a fixed rate of interest not dependent on any index or other external factor;

(4) Bonds or other obligations of the local unit or bonds or other obligations of school districts of which the local unit is a part or within which the school district is located;

(5) Bonds or other obligations, having a maturity date not more than 397 days from the date of purchase, approved by the Division of Local Government Services of the Department of Community Affairs for investment by local units;

(6) Local government investment pools;

(7) Deposits with the State of New Jersey Cash Management Fund established pursuant to section 1 of P.L.1977, c.281 (C.52:18A-90.4); or

(8) Agreements for the repurchase of fully collateralized securities, if:

(a) the underlying securities are permitted investments pursuant to paragraphs (1) and (3) of this subsection a.;

(b) the custody of collateral is transferred to a third party;

(c) the maturity of the agreement is not more than 30 days;

(d) the underlying securities are purchased through a public depository as defined in section 1 of P.L.1970, c.236 (C.17:9-41); and

(e) a master repurchase agreement providing for the custody and security of collateral is executed.

b. Any investment instruments in which the security is not physically held by the local unit shall be covered by a third party custodial agreement which shall provide for the designation of such investments in the name of the local unit and prevent unauthorized use of such investments.

c. Purchase of investment securities shall be executed by the "delivery versus payment" method to ensure that securities are either received by the local unit or a third party custodian prior to or upon the release of the local unit's funds.

d. Any investments not purchased and redeemed directly from the issuer, government money market mutual fund, local government investment pool, or the State of New Jersey Cash Management Fund, shall be

purchased and redeemed through the use of a national or State bank located within this State or through a broker-dealer which, at the time of purchase or redemption, has been registered continuously for a period of at least two years pursuant to section 9 of P.L.1967, c.93 (C.49:3-56) and has at least \$25 million in capital stock (or equivalent capitalization if not a corporation), surplus reserves for contingencies and undivided profits, or through a securities dealer who makes primary markets in U.S. Government securities and reports daily to the Federal Reserve Bank of New York its position in and borrowing on such U.S. Government securities .

e. For the purposes of this section:

(1) a "government money market mutual fund" means an investment company or investment trust:

(a) which is registered with the Securities and Exchange Commission under the "Investment Company Act of 1940," 15 U.S.C. s.80a-1 et seq., and operated in accordance with 17 C.F.R. s.270.2a-7;

(b) the portfolio of which is limited to U.S. Government securities that meet the definition of an eligible security pursuant to 17 C.F.R. s.270.2a-7 and repurchase agreements that are collateralized by such U.S. Government securities in which direct investment may be made pursuant to paragraphs (1) and (3) of subsection a. of this section; and

(c) which is rated by a nationally recognized statistical rating organization.

(2) a "local government investment pool" means an investment pool:

(a) which is managed in accordance with 17 C.F.R. s.270.2a-7;

(b) which is rated in the highest category by a nationally recognized statistical rating organization;

(c) which is limited to U.S. Government securities that meet the definition of an eligible security pursuant to 17 C.F.R. 270.2a-7 and repurchase agreements that are collateralized by such U.S. Government securities in which direct investment may be made pursuant to paragraphs (1) and (3) of subsection a. of this section;

(d) which is in compliance with rules adopted pursuant to the "Administrative Procedure Act," P.L.1968, c.410 (C.52:14B-1 et seq.) by the Local Finance Board of the Division of Local Government Services in the Department of Community Affairs, which rules shall provide for disclosure and reporting requirements, and other provisions deemed necessary by the board to provide for the safety, liquidity and yield of the investments;

(e) which does not permit investments in instruments that: are subject to high price volatility with changing market conditions; cannot reasonably be expected, at the time of interest rate adjustment, to have a market value that approximates their par value; or utilize an index that does not support a stable net asset value ; and

(f) which purchases and redeems investments directly from the issuer, government money market mutual fund, or the State of New Jersey Cash Management Fund, or through the use of a national or State bank located within this State, or through a broker-dealer which, at the time of purchase or redemption, has been registered continuously for a period of at least two years pursuant to section 9 of P.L.1967, c.93 (C.49:3-56) and has at least \$25 million in capital stock (or equivalent capitalization if not a corporation), surplus reserves for contingencies and undivided profits, or through a securities dealer who makes primary markets in U.S. Government securities and reports daily to the Federal Reserve Bank of New York its position in and borrowing on such U.S. Government securities .

f. Investments in, or deposits or purchases of financial instruments made pursuant to this section shall not be subject to the requirements of the "Local Public Contracts Law," P.L.1971, c.198 (C.40A:11-1 et seq.).

L.1977,c.396, s.8; amended 1991, c.458, s.2; 1997, c.148, s.3; 2015, c.95, s. 16.