



**City of Imperial Beach
Investment Policy**

Fiscal Year 2022/2023

CITY OF IMPERIAL BEACH, CALIFORNIA
INVESTMENT POLICY
Fiscal Year 2022/2023

I. INTRODUCTION

This Investment Policy is intended to identify various policies and procedures that will foster a prudent and systematic investment program designed to seek the City of Imperial Beach's objectives of safety, liquidity and yield through a diversified investment portfolio. This policy also serves to organize and formalize the City's investment-related activities, while complying with all applicable statutes governing the investment of public funds.

This Investment Policy was endorsed and adopted by the City's governing body and is effective as of September 21, 2022. This Investment Policy replaces any previous Investment Policy or Investment Procedures of the City.

II. SCOPE

This Investment Policy applies to all the City's financial assets and investment activities with the following exceptions:

- Proceeds of debt issuance shall be invested in accordance with the City's general investment philosophy as set forth in this policy; however, such proceeds are invested in accordance with permitted investment provisions of their specific bond indentures.

Pooling of Funds: Except for cash in certain restricted and special funds, the City will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

Specific Investment Accounts: From time to time, the City Council may authorize an investment in other specific investments, or the management of bond proceeds issued by the City of Imperial Beach. This may include deposits that are set aside for future needs of a long-term nature and may be invested in longer-term securities as allowed by the Government Code.

Inter-fund transfers are not covered by this policy.

III. PRUDENCE

Pursuant to California Government Code, Section 53600.3, all persons authorized to make investment decisions on behalf of the City are trustees and therefore fiduciaries subject to the *Prudent Investor Standard*:

“...all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the Agency, that a prudent person acting in a like capacity and familiar with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the Agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law.”

The Finance Director, Chief Administrative Officer and other authorized persons responsible for managing City funds acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes provided that the Finance Director, Chief Administrative Officer or other authorized persons acted in good faith. Deviations from expectations of a security's credit or market risk should be reported to the governing body in a timely fashion and appropriate action should be taken to control adverse developments.

IV. OBJECTIVES

The authority governing investments for municipal governments is set forth in Government Code sections 53600 et seq. The overriding objectives of the investment program are to preserve principal, provide sufficient liquidity, and manage investment risks.

1. *Safety*: Safety of principal is the foremost objective of the investment program. Investments will be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and interest rate risk.
2. *Liquidity*: The investment portfolio will remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated.

3. *Yield*: The investment portfolio will be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints for safety and liquidity needs.

V. ETHICS AND CONFLICTS OF INTEREST

All participants in the investment process shall act as fiduciaries of the public trust. As the employees assigned to implement the investment strategy, the Finance Director and Chief Administrative Officer, as identified by Resolution of the City Council, shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. The Finance Director and Chief Administrative Officer shall disclose any material financial interests in financial institutions that conduct business with the City, and they shall further disclose any personal financial/investment positions that could be affected by the performance of the City's operations and functions or by the management of the City's investment program.

Ethics and Conflicts of Interest: Officers and employees involved in the investment process shall refrain from personal business activity that conflicts with proper execution of the investment program or impair their ability to make impartial investment decisions. Additionally, the Finance Director, Chief Administrative Officer and other members of the management Investment Advisory Committee, as identified herein, are required to annually file applicable financial disclosures as required by the Fair Political Practices Commission (FPPC).

DELEGATION OF AUTHORITY

- A. Authority to manage the City's investment program is derived from California Government Code Sections 53600 *et seq.* The governing body is responsible for the City's cash management, including the administration of this Investment Policy. Management responsibility for the cash management of City funds is hereby delegated to the Finance Director and Chief Administrative Officer.

The Finance Director and Chief Administrative Officer will be responsible for all transactions undertaken and will establish a system of procedures and controls to regulate the activities of subordinate employees.

- B. The City may engage the services of one or more external investment managers to assist in the management of the City's investment portfolio in a manner consistent with the City's objectives. Such external managers may be granted discretion to purchase and sell investment securities in

accordance with this Investment Policy. Such managers must be registered under the Investment Advisers Act of 1940.

An Investment Committee consisting of the City Manager/Executive Director, Finance Director and Chief Administrative Officer shall be established to provide general oversight and direction concerning the policy related to management of the City's investment portfolio. Assigned Finance Department staff members may serve in a staff and advisory capacity, although are not members of the Committee.

VI. AUTHORIZED FINANCIAL INSTITUTIONS, DEPOSITORIES, AND BROKER/DEALERS

A list will be maintained of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by conducting a process of due diligence described in the investment procedures manual. These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

- A. The Finance Director or Chief Administrative Officer will determine which financial institutions are authorized to provide investment services to the City. Institutions eligible to transact investment business with the City include:
 - 1. Institutions licensed by the state as a broker-dealer.
 - 2. Institutions that are members of a federally regulated securities exchange.
 - 3. Primary government dealers as designated by the Federal Reserve Bank and non-primary government dealers;
 - 4. Nationally or state-chartered banks;
 - 5. The Federal Reserve Bank; and,
 - 6. Direct issuers of securities eligible for purchase.
- B. Selection of financial institutions and broker/dealers authorized to engage in transactions with the City will be at the sole discretion of the City.
- C. All financial institutions which desire to become qualified bidders for investment transactions (and which are not dealing only with the investment adviser) must supply the Finance Director or Chief Administrative Officer with a statement certifying that the institution has reviewed the California Government Code Section 53600 *et seq.* and the City's Investment Policy.

The Finance Director or Chief Administrative Officer will conduct an annual review of the financial condition and registrations of such qualified bidders.

- D. Selection of broker/dealers used by an external investment adviser retained by the City will be at the sole discretion of the investment adviser.
- E. Public deposits will be made only in qualified public depositories as established by State law. Deposits will be insured by the Federal Deposit Insurance Corporation, or, to the extent the amount exceeds the insured maximum, will be collateralized in accordance with State law.
- F. Collateralization:
 - 1. Certificates of Deposit: The City shall require any commercial bank or savings and loan association to deposit eligible securities with an agency of a depository approved by the State Banking Department to secure any uninsured portion of a non-negotiable Certificate of Deposit. The value of eligible securities as defined pursuant to Government Code Section 53651, pledged against a Certificate of Deposit shall be equal to 150% of the face value of the CD if the securities are classified as mortgages and 110% of the face value of the CD for all other classes of security.
 - 2. Repurchase Agreements: The City requires that repurchase agreements be collateralized only by securities authorized by Government Code:
 - The securities which collateralize the repurchase agreement shall be priced at Market Value, including any Accrued Interest plus a margin. The Market Value of the securities that underlie a repurchase agreement shall be valued at 102% or greater of the funds borrowed against those securities.
 - Financial Institutions shall mark the value of the collateral to market at least monthly and increase or decrease the collateral to satisfy the ratio requirement described above.
 - The City shall receive monthly statements of collateral.

VII. DELIVERY, SAFEKEEPING AND CUSTODY, AND COMPETITIVE TRANSACTIONS

- A. *Delivery-versus-payment*: Settlement of all investment transactions will be completed using standard delivery-vs.-payment procedures.
- B. *Third-party safekeeping*: To protect against potential losses by collapse of individual securities dealers, and to enhance access to securities, interest payments and maturity proceeds, all securities owned by the City will be held in safekeeping by a third-party bank custodian, acting

as agent for the City under the terms of a custody agreement executed by the bank and the City. All investment transactions will require a safekeeping receipt or acknowledgement generated from the trade. A monthly report will be received by the City from the custodian listing all securities held in safekeeping with current market data and other relevant information.

The only exceptions to the foregoing shall be depository accounts and securities purchases made with: (i) local government investment pools; (ii) time certificates of deposit, and (iii) mutual funds and money market mutual funds, since these securities are not deliverable.

- C. *Competitive transactions*: All investment transactions will be conducted on a competitive basis which can be executed through a bidding process involving at least three separate brokers/financial institutions or through use of a nationally recognized trading platform where possible.

The only exceptions to the foregoing shall be depository accounts and securities purchases made with LAIF, LGIPs, time deposits, mutual funds, and money market mutual funds, since these securities are not deliverable.

VIII. AUTHORIZED AND SUITABLE INVESTMENTS

The City's investments are governed by Government Code, Sections 53600 et seq. Within the investments permitted by the Government Code, the City seeks to further restrict eligible investments to the guidelines listed below. In the event an apparent discrepancy is found between this Policy and the Government Code, the more restrictive parameters will take precedence. Percentage holding limits and credit rating minimums listed in this section apply at the time the security is purchased.

Any investment currently held at the time the Policy is adopted which does not meet the new Policy guidelines can be held until maturity and shall be exempt from the current Policy. At the time of the investment's maturity or liquidation such funds shall be reinvested only as provided in the most current Policy.

1. **U.S. Treasury** and other government obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest. There are no limits on the dollar amount or percentage that the City may invest in U.S. Treasuries.
 - The maximum maturity is five years.

2. Federal Agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. There are no limits on the dollar amount or percentage that the City may invest in government-sponsored enterprises.

- The maximum maturity is five years;
- No more than 20% of the total portfolio may be invested in callable federal agency securities.

3. Municipal Securities. These include obligations of the City, the State of California, any local agency within the state of California, and registered notes or bonds of any of the other 49 states in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 states, and, provided that:

- Long-term obligations are rated in the “A” category or higher by at least one nationally recognized statistical rating organization (NRSRO);
- The maximum maturity is five years;
- No more than 5% of the total portfolio may be invested in any single municipal securities issuer;
- No more than 30% of the portfolio may be invested in Municipal Securities.

4. Corporate Medium-Term Notes (MTNs) provided that:

- Such notes have a maximum maturity of five years;
- Are issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States;
- Are rated in the “A” category or better by at least one NRSRO;
- No more than 30% of the total portfolio may be invested in corporate medium-term notes; and,

- No more than 5% of the total portfolio may be invested in any single issuer of corporate medium-term notes.

5. Mortgage Pass-Through Securities, Collateralized Mortgage Obligations, and Asset-Backed Securities from issuers not defined in sections 1 and 2 of the Authorized and Suitable Investments Section of this policy, provided that:

- Such securities have a maximum stated final maturity of five years;
- Are rated in the category of “AA” or its equivalent or better by a NRSRO;
- Purchase of securities authorized by this subdivision may not exceed 20% of the portfolio; and,
- No more than 5% of the total portfolio is invested in any single issuer of Asset-Backed or Commercial Mortgage Securities.

6. Federally Insured Time Deposits (Non-Negotiable Certificates of Deposit) in state or federally chartered banks, savings and loans, or credit unions, provided that:

- The amount per institution is limited to the maximum covered under federal insurance;
- No more than 20% of the portfolio will be invested in a combination of federally insured and collateralized time deposits;
- The maturity of such deposits does not exceed 5 years; and,
- No more than 5% of the total portfolio may be invested in any single issuer of federally insured time deposits.

7. Time Deposits (Non-Negotiable Certificates of Deposit) in state or federally chartered banks, savings and loans, or credit unions in excess of insured amounts which are fully collateralized with securities in accordance with California law, provided that:

- No more than 20% of the portfolio will be invested in a combination of federally insured and collateralized time deposits;
- The maturity of such deposits does not exceed 5 years; and,
- No more than 5% of the total portfolio may be invested in any single issuer of time deposits.

8. Certificate of Deposit Placement Service (CDARS) provided that:

- No more than 30% of the total portfolio may be invested in a combination of certificates of deposit including CDARS; and,
- The maturity of CDARS deposits does not exceed five years.

9. Negotiable Certificates of Deposit (NCDs) provided that:

- They are issued by institutions which have long-term obligations which are rated in the “A” category or higher by at least one nationally recognized statistical rating organization; or have short term debt obligations rated “A-1” or higher, or the equivalent, by at least one NRSRO;
- The maturity does not exceed five years;
- No more than 30% of the total portfolio may be invested in NCDs; and,
- No more than 5% of the total portfolio may be invested in any single issuer of NCDs.

10. Banker’s Acceptances provided that:

- They are issued by institutions with short term debt obligations rated “A-1” or higher, or the equivalent, by at least one NRSRO; and have long-term debt obligations which are rated in the “A” category or higher by at least one NRSRO;
- The maturity does not exceed 180 days;
- No more than 40% of the total portfolio may be invested in banker’s acceptances; and,
- No more than 5% of the total portfolio may be invested in any single issuer of banker’s acceptances.

11. Commercial Paper provided that the securities are issued by an entity that meets all of the following conditions in either paragraph a or b and other requirements specified below:

a. **SECURITIES** issued by corporations:

- (i) A corporation organized and operating in the United States with assets more than \$500 million.

- (ii) The securities are rated “A-1” or its equivalent or better by at least one NRSRO.
- (iii) If the issuer has other debt obligations, they must be rated in a rating category of “A” or its equivalent or better by at least one NRSRO.

b. **SECURITIES** issued by other entities:

- (i) The issuer is organized within the United States as a special purpose corporation, trust, or limited liability company.
- (ii) The securities must have program-wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or a surety bond.
- (iii) The securities are rated “A-1” or its equivalent or better by at least one NRSRO.

- No more than 10% of the outstanding commercial paper of any single issuer.
- No more than 25% of the total portfolio is invested in commercial paper.
- No more than 5% of the total portfolio is invested in any single commercial paper issuer.
- The maturity does not exceed 270 days from the date of purchase.

12. Repurchase Agreements collateralized with securities authorized pursuant to Government Code that are maintained at a level of at least 102% of the market value of the repurchase agreements, provided that:

- The maximum maturity of repurchase agreements will be 1 year;
- There is no limit to the amount to be invested in repurchase agreements;
- Securities used as collateral for repurchase agreements will be delivered to the City’s custodian bank; and,
- The repurchase agreements are the subject of a master repurchase agreement between the City and the provider of the repurchase agreement. The master repurchase agreement will be substantially in the form developed by the Securities Industry and Financial Markets Association (SIFMA).

13. State of California Local City Investment Fund (LAIF), provided that:

- The City may invest up to the maximum permitted amount in LAIF; and,
- LAIF's investments in instruments prohibited by or not specified in the City's policy do not exclude it from the City's list of allowable investments, provided that the fund's reports allow the Finance Director or Chief Administrative Officer to adequately judge the risk inherent in LAIF's portfolio.

14. Local Government Investment Pools

- No more than 10% per issuer limitation for Local Government Investment Pools other than LAIF.

15. Mutual Funds and Money Market Mutual Funds that are registered with the Securities and Exchange Commission under the Investment Company Act of 1940, provided that:

- Mutual Funds that invest in the securities and obligations as authorized under California Government Code Section 53601 (a) to (k) and (m) to (q) inclusive and that meet either of the following criteria:
 1. Attained the highest ranking or the highest letter and numerical rating provided by not less than two NRSROs; or,
 2. Have retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by California Government Code Section 53601 and with assets under management in excess of \$500 million;

No more than 10% of the total portfolio may be invested in shares of any one mutual fund.

- Money Market Mutual Funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and issued by diversified management companies and meet either of the following criteria:
 1. Have attained the highest ranking or the highest letter and numerical rating provided by not less than two NRSROs.

2. Have retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience managing money market mutual funds with assets under management in excess of \$500 million.

No more than 20% per fund of the total portfolio may be invested in the shares of any one money market mutual fund.

- No more than 20% of the total portfolio may be invested in these securities.

16. Supranational Securities, provided that:

- a. Issues are US dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank.
- b. The securities are rated in a rating category of "AA" or its equivalent or better by a NRSRO.
- c. No more than 30% of the total portfolio may be invested in these securities.
- d. No more than 10% of the portfolio may be invested in a single Supranational issuer.
- e. The maximum maturity does not exceed five years.

Any State of California legislative action that further restricts allowable maturities, investment type or percentage allocations, shall be incorporated into this Investment Policy and supersede any and all previous applicable provisions inconsistent with such legislative action.

IX. MAXIMUM MATURITIES

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities. No investment will be made in any security with a remaining maturity in excess of five years from the date of trade settlement, unless the City Council has by resolution granted express authority to make such an investment.

X. PORTFOLIO RISK MANAGEMENT

A. Prohibited Investment Vehicles and Practices

1. State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to futures and options.

2. In accordance with Government Code Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.
3. Investment in any security that could result in a zero-interest accrual if held to maturity is prohibited. However, under a provision sunsetting on January 1, 2026, securities backed by the U.S. Government that could result in a zero- or negative interest accrual if held to maturity are permitted.
4. Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.
5. Purchasing or selling securities on margin is prohibited.
6. The use of reverse repurchases agreements, securities lending or any other form of borrowing or leverage is prohibited.
7. The purchase of foreign currency denominated securities is prohibited.

B. *Mitigating Credit Risk in the Portfolio*

Credit risk is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt. The City will mitigate credit risk by adopting the following strategies:

1. The diversification requirements included in Section VIII are designed to mitigate credit risk in the portfolio;
2. No more than 5% of the total portfolio may be invested in securities of any single issuer, other than the US Government, its agencies and enterprises, supranationals, money market funds, local government investment pools or unless otherwise specified in this investment policy;
3. The City may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or City's risk preferences; and,
4. If securities owned by the City are downgraded to a level below the quality required by this Investment Policy, making the security ineligible for additional purchases, the following steps will be taken:

- a. Any actions taken related to the downgrade by the investment manager will be communicated to the Finance Director or Chief Administrative Officer in a timely manner.
- b. If a decision is made to retain a downgraded security in the portfolio, the credit situation will be monitored and reported monthly to the governing board.

C. Mitigating Market Risk in the Portfolio

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The City recognizes that, over time, longer-term portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The City will mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cashflow purposes.

The City further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The City, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

1. The City will maintain a minimum of six months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements;
2. The stated final maturity of individual securities in the portfolio will be five years, except as otherwise stated in this policy;
3. The maximum weighted average stated final maturity of the total portfolio shall not exceed three years; and,
4. The duration of the portfolio will at all times be approximately equal to the duration (typically plus or minus 20%) of a Market Benchmark Index selected by the City based on the City's investment objectives, constraints and risk tolerances. The City's current Benchmark will be documented by the City.

XI. FOSSIL FUELS RESTRICTION

The purchase of securities issued by fossil fuel companies that directly source the majority of their revenue from oil, gas and/or coal production is prohibited.

XII. INVESTMENT POOLS/MUTUAL FUNDS

The City shall conduct a thorough investigation of any pool or mutual fund prior to making an investment, and on a continual basis thereafter. The Finance Director or Chief Administrative Officer shall develop a questionnaire which will answer the following general questions:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how it is distributed, and how gains and losses are treated.
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.
- A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings.
- Are reserves, retained earnings, etc. utilized by the pool/fund?
- A fee schedule, and when and how is it assessed.
- Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

XIII. INVESTMENT OBJECTIVES (PERFORMANCE STANDARDS AND EVALUATION)

- A. *Overall Objective:* The investment portfolio will be designed with the overall objective of obtaining a total rate of return throughout economic cycles, commensurate with investment risk constraints and cash flow needs.
- B. *Specific Objective:* The investment performance objective for the portfolio will be to earn a total rate of return over a market cycle which is approximately equal to the return on the Market Benchmark Index selected by the City.

XIV. PROCEDURES AND INTERNAL CONTROLS

A. Procedures

The Finance Director or Chief Administrative Officer will establish investment policy procedures to assist investment staff with day-to-day operations of the investment program consistent with this policy. Such procedures will include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the City Treasurer.

B. *Internal Controls*

The Finance Director or Chief Administrative Officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. The internal control structure will be designed to provide reasonable assurance that these objectives are met. Internal controls will be described in the City's investment procedures manual.

XV. **REPORTING, DISCLOSURE AND PROGRAM EVALUATION**

A. *Monthly Reports*

Monthly investment reports will be submitted by the Finance Director or Chief Administrative Officer to the governing board. These reports will disclose, at a minimum, the following information about the risk characteristics of the City's portfolio:

1. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate;
2. Monthly transactions for the period;
3. A one-page summary report that shows:
 - a. Average maturity of the portfolio and modified duration of the portfolio;
 - b. Maturity distribution of the portfolio;
 - c. Average portfolio credit quality; and,
 - d. Time-weighted total rate of return for the portfolio for the prior one month, three months, twelve months, year to date, and since inception compared to the Benchmark Index returns for the same periods.
4. A statement of compliance with investment policy, including a schedule of any transactions or holdings which do not comply with this policy or with the California Government Code, including a justification for their presence in the portfolio and a timetable for resolution; and,
5. A statement that the City has adequate funds to meet its cash flow requirements for the next six months.

B. *Annual Reports*

1. The investment policy will be reviewed and updated at least annually at the beginning of the calendar year to ensure its consistency with

the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.

2. A comprehensive annual report will be presented in conjunction with the investment policy review. This report will include comparisons of the City's return to the Benchmark Index return, suggest policies and improvements that might enhance the investment program, and will include an investment plan for the coming year.

C. Periodic Audit

The City Treasurer may establish a process of periodic independent review by an external expert to assure compliance with internal controls.

XIII. REVIEW OF INVESTMENT POLICY

This policy shall be subject to review by the City Council/Board on an annual basis. Any recommended modifications or amendments shall be presented by Staff to the City Council/Board for their consideration and adoption.

Prepared by:

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Approved as to content:

Erika Cortez
Chief Administrative Officer

Date:

Appendix II

GLOSSARY OF INVESTMENT TERMS

Agencies. Shorthand market terminology for any obligation issued by a *government-sponsored entity (GSE)*, or a *federally related institution*. Most obligations of GSEs are not guaranteed by the full faith and credit of the US government. Examples are:

FFCB. The Federal Farm Credit Bank System provides credit and liquidity in the agricultural industry. FFCB issues discount notes and bonds.

FHLB. The Federal Home Loan Bank provides credit and liquidity in the housing market. FHLB issues discount notes and bonds.

FHLMC. Like FHLB, the Federal Home Loan Mortgage Corporation provides credit and liquidity in the housing market. FHLMC, also called “Freddie Mac” issues discount notes, bonds and mortgage pass-through securities.

FNMA. Like FHLB and Freddie Mac, the Federal National Mortgage Association was established to provide credit and liquidity in the housing market. FNMA, also known as “Fannie Mae,” issues discount notes, bonds and mortgage pass-through securities.

GNMA. The Government National Mortgage Association, known as “Ginnie Mae,” issues mortgage pass-through securities, which are guaranteed by the full faith and credit of the US Government.

PEFCO. The Private Export Funding Corporation assists exporters. Obligations of PEFCO are not guaranteed by the full faith and credit of the US government.

TVA. The Tennessee Valley Authority provides flood control and power and promotes development in portions of the Tennessee, Ohio, and Mississippi River valleys. TVA currently issues discount notes and bonds.

Asked. The price at which a seller offers to sell a security.

Asset Backed Securities. Securities supported by pools of installment loans or leases or by pools of revolving lines of credit.

Average Life. In mortgage-related investments, including CMOs, the average time to expected receipt of principal payments, weighted by the amount of principal expected.

Banker’s Acceptance. A money market instrument created to facilitate international trade transactions. It is highly liquid and safe because the risk of the trade transaction is transferred to the bank which “accepts” the obligation to pay the investor.

Benchmark. A comparison security or portfolio. A performance benchmark is a partial market index, which reflects the mix of securities allowed under a specific investment policy.

Bid. The price at which a buyer offers to buy a security.

Broker. A broker brings buyers and sellers together for a transaction for which the broker receives a commission. A broker does not sell securities from his own position.

Callable. A callable security gives the issuer the option to call it from the investor prior to its maturity. The main cause of a call is a decline in interest rates. If interest rates decline since an issuer issues security, it will likely call its current securities and reissue them at a lower rate of interest. Callable securities have reinvestment risk as the investor may receive its principal back when interest rates are lower than when the investment was initially made.

Certificate of Deposit (CD). A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs may be marketable.

Collateral. Securities or cash pledged by a borrower to secure repayment of a loan or repurchase agreement. Also, securities pledged by a financial institution to secure deposits of public monies.

Collateralized Mortgage Obligations (CMO). Classes of bonds that redistribute the cash flows of mortgage securities (and whole loans) to create securities that have different levels of prepayment risk, as compared to the underlying mortgage securities.

Commercial Paper. The short-term unsecured debt of corporations.

Cost Yield. The annual income from an investment divided by the purchase cost. Because it does not give effect to premiums and discounts which may have been included in the purchase cost, it is an incomplete measure of return.

Coupon. The rate of return at which interest is paid on a bond.

Credit Risk. The risk that principal and/or interest on an investment will not be paid in a timely manner due to changes in the condition of the issuer.

Current Yield. The annual income from an investment divided by the current market value. Since the mathematical calculation relies on the current market value rather than the investor's cost, current yield is unrelated to the actual return the investor will earn if the security is held to maturity.

Dealer. A dealer acts as a principal in security transactions, selling securities from and buying securities for his own position.

Debenture. A bond secured only by the general credit of the issuer.

Delivery vs. Payment (DVP). A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser's agent.

Derivative. Any security that has principal and/or interest payments which are subject to uncertainty (but not for reasons of default or credit risk) as to timing and/or amount, or any security which represents a component of another security which has been separated from other components ("Stripped" coupons and principal). A derivative is also defined as a financial instrument the value of which is totally or partially derived from the value of another instrument, interest rate, or index.

Discount. The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as T-bills and banker's acceptances, are known as **discount securities**. They

sell at a discount from par and return the par value to the investor at maturity without additional interest. Other securities, which have fixed coupons, trade at a discount when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

Diversification. Dividing investment funds among a variety of investments to avoid excessive exposure to any one source of risk.

Duration. The weighted average time to maturity of a bond where the weights are the present values of the future cash flows. Duration measures the price sensitivity of a bond to changes in interest rates. (See modified duration).

Federal Funds Rate. The rate of interest charged by banks for short-term loans to other banks. The Federal Reserve Bank through open-market operations establishes it.

Federal Open Market Committee: A committee of the Federal Reserve Board that establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

Local Agency Investment Fund (LAIF): A voluntary investment fund open to government entities and certain non-profit organizations in California that is managed by the State Treasurer's Office.

Local Government Investment Pool: Investment pools that range from LAIF to county pools, to Joint Powers Authorities (JPAs). These funds are not subject to the same SEC rules applicable to money market mutual funds.

Leverage. Borrowing funds in order to invest in securities that have the potential to pay earnings at a rate higher than the cost of borrowing.

Liquidity: The speed and ease with which an asset can be converted to cash.

Make Whole Call. A type of call provision on a bond that allows the issuer to pay off the remaining debt early. Unlike a call option, with a make whole call provision, the issuer makes a lump sum payment that equals the net present value (NPV) of future coupon payments that will not be paid because of the call. With this type of call, an investor is compensated, or "made whole."

Margin: The difference between the market value of a security and the loan a broker makes using that security as collateral.

Market Risk. The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates.

Market Value. The price at which a security can be traded.

Marking to Market. The process of posting current market values for securities in a portfolio.

Maturity. The final date upon which the principal of a security becomes due and payable.

Medium Term Notes. Unsecured, investment-grade senior debt securities of major corporations which are sold in relatively small amounts on either a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

Modified Duration. The percent change in price for a 100-basis point change in yields. Modified duration is the best single measure of a portfolio's or security's exposure to market risk.

Money Market. The market in which short-term debt instruments (Tbills, discount notes, commercial paper, and banker's acceptances) are issued and traded.

Mortgage Pass-Through Securities. A securitized participation in the interest and principal cash flows from a specified pool of mortgages. Principal and interest payments made on the mortgages are passed through to the holder of the security.

Municipal Securities. Securities issued by state and local agencies to finance capital and operating expenses.

Mutual Fund. An entity which pools the funds of investors and invests those funds in a set of securities which is specifically defined in the fund's prospectus. Mutual funds can be invested in various types of domestic and/or international stocks, bonds, and money market instruments, as set forth in the individual fund's prospectus. For most large, institutional investors, the costs associated with investing in mutual funds are higher than the investor can obtain through an individually managed portfolio.

Nationally Recognized Statistical Rating Organization (NRSRO): Credit rating agencies provide assessments of an investment's risk. The issuers of investments, especially debt securities, pay credit rating agencies to provide them with ratings. The three most prominent NRSROs are Moody's, S&P and Fitch.

Negotiable CD: A short-term debt instrument that pays interest and is issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank.

Premium. The difference between the par value of a bond and the cost of the bond, when the cost is above par.

Prepayment Speed. A measure of how quickly principal is repaid to investors in mortgage securities.

Prepayment Window. The time period over which principal repayments will be received on mortgage securities at a specified prepayment speed.

Primary Dealer. A financial institution (1) that is a trading counterparty with the Federal Reserve in its execution of market operations to carry out U.S. monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the U.S. Government securities market.

Prudent Person (Prudent Investor) Rule. A standard of responsibility which applies to fiduciaries. In California, the rule is stated as "Investments shall be managed with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of like character and with like aims to accomplish similar purposes."

Realized Yield. The change in value of the portfolio due to interest received and interest earned and realized gains and losses. It does not give effect to changes in market value on securities, which have not been sold from the portfolio.

Repurchase Agreement (RP, Repo). Short-term purchases of securities with a simultaneous agreement to sell the securities back at a higher price. From the seller's point of view, the same transaction is a reverse repurchase agreement.

Safekeeping. A service to bank customers whereby securities are held by the bank in the customer's name.

Structured Note. A complex, fixed income instrument, which pays interest, based on a formula tied to other interest rates, commodities or indices. Examples include inverse floating rate notes which have coupons that increase when other interest rates are falling, and which fall when other interest rates are rising, and "dual index floaters," which pay interest based on the relationship between two other interest rates - for example, the yield on the ten-year Treasury note minus the Libor rate. Issuers of such notes lock in a reduced cost of borrowing by purchasing interest rate swap agreements.

Supranational: A multi-national organization whereby member states transcend national boundaries or interests to share in the decision making to promote economic development in member countries.

Total Rate of Return. A measure of a portfolio's performance over time. It is the internal rate of return, which equates the beginning value of the portfolio with the ending value; it includes interest earnings, realized and unrealized gains, and losses in the portfolio.

U.S. Treasury Obligations. Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are considered to have no credit risk and are the benchmark for interest rates on all other securities in the US and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

Treasury Bills. All securities issued with initial maturities of one year or less are issued as discounted instruments and are called Treasury bills. The Treasury currently issues three- and six-month Tbills at regular weekly auctions. It also issues "cash management" bills as needed to smooth out cash flows.

Treasury Notes. All securities issued with initial maturities of two to ten years are called Treasury notes and pay interest semi-annually.

Treasury Bonds. All securities issued with initial maturities greater than ten years are called Treasury bonds. Like Treasury notes, they pay interest semi-annually.

Yield to Maturity. The annualized internal rate of return on an investment which equates the expected cash flows from the investment to its cost.