CITY COUNCIL

Policy

CITY OF SAN MARCOS

SUBJECT: Investment Policy

ADOPTED: ~~December 12, 2023 by Resolution No. 2023-9249~~ November 26, 2024 by Resolution No. 2024-9382

REVISED: ~~November 26, 2024 by Resolution No. 2024-xxxx~~ December 9, 2025 by Resolution No. 2025-xxxx

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INTRODUCTION

The investment policies and practices of the City of San Marcos are based upon State law and prudent money management. The primary goals of these policies are:

1. To protect the principal monies entrusted to this office.
2. To provide sufficient liquidity to meet normal operating and unexpected expenditures.
3. To assure compliance with all Federal, State, and local laws governing the investment of monies under the control of the City Treasurer.
4. To generate a maximum amount of investment income within the parameters of prudent risk management and consistent with the above policies.

The monies entrusted to the City Treasurer (referred to as the “Fund” throughout the remainder of this document) will be invested, administered, and reported in a timely and prudent manner. The City Treasurer and staff will observe, review, and react to changing conditions that affect the fund. The authority to execute investment transactions that will affect the Fund will be limited to:

1. City Manager or Deputy City Manager; and
2. Director of Finance, acting together.

The Director of Finance will meet on a regular basis with the City Manager to discuss current market conditions, future trends, and to plan investment strategy to meet the City’s fiscal objectives.

The policy stated below will also address risk management because it is such an integral part of the investment policy. To concentrate only on maximizing return would be dangerous; therefore, policy issues will be directed to:

1. Limiting the Fund's exposure to each issue and issuer of debt; and
2. Determining minimum credit requirement that firms must have in order to hold City money.

I. SCOPE

In accordance with the investment resolutions of the City of San Marcos and as prescribed by Section 41000 through 41007 of the Government Code of the State of California, the City Treasurer is responsible for investing the unexpended cash in the City Treasury.

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

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 their permitted investment provisions.

II. OBJECTIVES

All investment management decisions and activities must assure ongoing compliance with all Federal, State, and local laws governing the investment of moneys under the control of the City Treasurer. The primary objectives, in priority order, of the City's investment activities shall be:

A. *Safety*: Safety of principal is the foremost objective of the investment program. Investments shall 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.

B. *Liquidity*: The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated.

C. *Return*: The investment portfolio shall 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.

III. PRUDENCE, INDEMNIFICATION, ETHICS AND CONFLICTS OF INTEREST

A. *Prudent Investor Standard*: Management of the City's investments is governed by the Prudent Investor Standard as set forth in the California Government Code 53600.3:

> " . . . 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 familiarity 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."

B. *Indemnification*: The Treasurer/Director of Finance and other authorized persons responsible for managing City funds, acting in accordance with written procedures and the investment policy and exercising due diligence, shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported within 30 days and appropriate action is taken to control adverse developments.

C. *Ethics*: All participants in the investment process shall act as custodians of the public trust. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. Thus employees and officials involved in the investment process shall refrain from personal business activity that could create a conflict of interest or the appearance of a conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions.

Employees and investment officials shall disclose to the City Treasurer any material interests in financial institutions with which they conduct business, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking any personal investment transactions with the same individual with whom business is conducted on behalf of the City.

IV. DELEGATION OF AUTHORITY

Authority to manage the City's investment program is derived from California Government Code, Sections 41006 and 53600 et seq.

The City Council is responsible for the management of the City's funds, including the administration of this investment policy. Management responsibility for the cash management of the City's funds is hereby delegated to the Treasurer.

The Treasurer will be responsible for all transactions undertaken and will establish a system of procedures and controls to regulate the activities of subordinate officials and employees. 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 Treasurer.

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.

The City's overall investment program shall be designed and managed with a degree of professionalism that is worthy of the public trust. The City recognizes that in a diversified portfolio, occasional measured losses may be inevitable and must be considered within the context of the overall portfolio's return and the cash flow requirements of the City.

V. INTERNAL CONTROLS

The Treasurer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the entity are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Periodically, as deemed appropriate by the City and/or the City Council, an independent analysis by an external auditor shall be conducted to review internal controls, account activity and compliance with policies and procedures.

VI. DELIVERY, SAFEKEEPING, CUSTODY, AND COMPETITIVE TRANSACTIONS

All investment transactions shall be conducted on a delivery-versus-payment basis.

To protect against potential losses by collapse of individual securities dealers, all securities owned by the City, including collateral on repurchase agreements, shall be held in safekeeping by a third party bank trust department, acting as agent for the City under the terms of a custody agreement executed by the bank and by the City. All securities will be received and delivered using standard delivery versus payment procedures (i.e., the City's safekeeping agent will only release payment for security after the security has been properly delivered). This section is intended to comply with Government Code 53635.

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.

VII. AUTHORIZED FINANCIAL INSTITUTIONS, DEPOSITORIES, AND BROKER DEALERS

To the extent practicable, the Treasurer shall endeavor to complete investment transactions using a competitive bid process whenever possible. The City's Treasurer will determine which financial institutions are authorized to provide investment services to the City. It shall be the City's policy to purchase securities only from authorized institutions and firms.

The Treasurer shall maintain procedures for establishing a list of authorized broker/dealers and financial institutions which are approved for investment purposes that are selected through a process of due diligence as determined by the City. Due inquiry shall determine whether such authorized broker/dealers, and the individuals covering the City are reputable and trustworthy, knowledgeable and experienced in Public Agency investing and able to meet all of their financial obligations. These institutions may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15c3-1 (uniform net capital rule).

The City shall transact investments in accordance with Government Code Section 53601.5 institutions eligible to transact investment business with the City include:

- Institutions licensed by the state as a broker-dealer.
- Institutions that are members of a federally regulated securities exchange.
- Primary government dealers as designated by the Federal Reserve Bank and non-primary government dealers.
- Nationally or state-chartered banks.
- The Federal Reserve Bank.
- Direct issuers of securities eligible for purchase.

Selection of financial institutions and broker/dealers authorized to engage in transactions will be at the sole discretion of the City, except where the City utilizes an external investment adviser in which case the City may rely on the adviser for selection.

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 Treasurer with audited financials and a statement certifying that the institution has reviewed the California Government Code, Section 53600 et seq. and the City's investment policy. The Treasurer will conduct an annual review of the financial condition and registrations of such qualified bidders.

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.

Selection of broker/dealers used by an external investment adviser retained by the City will be at the sole discretion of the adviser. Where possible, transactions with broker/dealers shall be selected on a competitive basis and their bid or offering prices shall be recorded. If there is no other readily available competitive offering, best efforts will be made to document quotations for comparable or alternative securities. When purchasing original issue instrumentality securities, no competitive offerings will be required as all dealers in the selling group offer those securities at the same original issue price.

The City shall, at least annually, send a copy of the current investment policy to all dealers approved to do business with the City. Confirmation of receipt of this policy shall be considered as evidence that the dealer understands the City's investment policies, and intends to show the City only appropriate investments.

VIII. AUTHORIZED INVESTMENTS

The City's investments are governed by California Government Code, Sections 53600 et seq. Within the investments permitted by the Code, the City seeks to further restrict eligible investments to the guidelines listed below. In the event a discrepancy is found between this policy and the Code, the more restrictive parameters will take precedence. Credit rating minimums and percentage holding limits 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 current policy.

An appropriate risk level shall be maintained by primarily purchasing securities that are of high quality, liquid, and marketable. The portfolio shall be diversified by security type and institution to avoid incurring unreasonable and avoidable risks regarding specific security types or individual issuers.

A. United States Treasury Bills, Bonds, and Notes, or those for which the full faith and credit of the United States are pledged for payment of principal and interest. There is no limitation as to the percentage of the portfolio which can be invested in this category. Maturity is not to exceed the projected dates of the City's cash needs or five years, whichever is less.

B. 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 (i.e. Government National Mortgage Association (GNMA), the Federal Farm Credit Bank System (FFCB), the Federal Home Mortgage Association (GNMA), the Federal Home Loan Bank Board (FHLBB), and the Federal National Mortgage Association (FNMA)). Although there is no percentage limitation on the dollar amount that can be invested in these issues, the "prudent investor" rule shall apply for a single agency name. Maturity is not to exceed the projected dates of the City's cash needs or five years, whichever is less.

C. Municipal Obligations: Registered State warrants or treasury notes or bonds of this State, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the State or by a department, board, agency, or authority of the State. Registered treasury notes or bonds of any of the other 49 United 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 United States, in addition to California. Bonds, notes, warrants, or other evidences of indebtedness of any local agency within this State, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.

   Municipal Obligations under this subdivision shall be rated "A" or better by a nationally recognized statistical rating organization (NRSRO) with a maximum maturity of five years, and shall be limited to 30% of the market value of the portfolio.

D. Bills of exchange or time draft drawn on and accepted by a commercial bank, otherwise known as bankers' acceptances. Bankers' acceptances purchased may not exceed 180 days to maturity or 40% of the market value of the portfolio. No more than 5% of the market value of the portfolio may be invested in bankers' acceptances issued by any one bank.

E. Commercial paper, provided that the entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or paragraph (2):

   1. The entity is organized and operating in the United States as a general corporation, has total assets in excess of $500 Million, the securities are rated "A-1" or the equivalent or higher by a NRSRO, and has debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.

   2. The entity is organized within the United States as a special purpose corporation, trust, or limited liability company, has program-wide credit enhancements including, but not limited to, over collateralization, letters of credit, or surety bond, and has commercial paper that is rated "A-1" or higher, or the equivalent, by a NRSRO.

   Purchases of eligible commercial paper:

   - May not exceed 25% of the market value of the portfolio if its investment assets are less than $100 million. If the City's investment assets are greater than $100 million then the purchases of eligible commercial paper may not exceed 40% of the market value of the portfolio. The increase in the portfolio's maximum exposure to commercial paper expires on January 1, 2031~~2026~~ unless additional legislative action is taken.

- Be no more than 5% of the market value of the portfolio may be invested in a commercial paper issued by any one corporation.
- Have a maximum maturity is not to exceed 270 days. Effective January 1, 2026, the maximum maturity is extended to not exceed 397 days.

F. Negotiable certificates of deposit issued by a nationally or state-chartered bank, a savings association, or a federal association, a state or federal credit union, or a state-licensed branch of a foreign bank. Negotiable certificates of deposit (NCD) differ from other certificates of deposit by their deposit liquidity. They are issued against funds deposited for specified periods of time and earn specified or variable rates of interest. NCD are traded actively in secondary markets. When feasible, an independent credit rating service will be used as part of the evaluation process. Any amount above the FDIC insured limit must be issued by institutions which are rated "A-1" for deposits by Standard & Poor's, or "P-1" for deposits by Moody's or comparably rated by a NRSRO.

   Transactions in NCD shall not collectively exceed 30% of the total portfolio in effect immediately after any such investment is made. No more than 5% of the market value of the portfolio may be invested in NCD issued by any one corporation. The maturity is not to exceed 5 years.

G. Repurchase Agreements. The City may invest in repurchase agreements with banks and dealers with which the City has entered into a master repurchase agreement which specifies terms and conditions of repurchase agreements.

   1. Transactions shall be limited to the primary dealers and the top banking institutions according to a NRSRO based on liquidity, profitability, and financial strength. The maturity of repurchase agreements shall not exceed 30 days. The market value of securities used as collateral for repurchase agreements shall be monitored daily by the investment staff and will not be allowed to fall below 102% of the value of the repurchase agreement plus the value of collateral in excess of the value of the repurchase agreement. In order to conform with provisions of the Federal Bankruptcy Code which provides for the liquidation of securities held as collateral for repurchase agreements, the only securities acceptable as collateral shall be certificates of deposit, eligible bankers' acceptances, or securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States.

   2. No more than 50% of the portfolio may be invested in repurchase agreements, and a perfected security interest shall always be maintained in the securities subject to a repurchase agreement.

H. Medium-term notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, 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. Notes eligible for investment under this subdivision shall be rated "A" or better by a NRSRO. Purchases of medium-term notes shall be limited to 30% of the market value of the portfolio. No more than 5% of the market value of the portfolio may be invested in medium-term notes issued by any one corporation. The maturity is not to exceed 5 years.

I. Local Agency Investment Fund. The City may invest in the Local Agency Investment Fund (LAIF) established by the State Treasurer for the benefit of local agencies up to the maximum permitted by State law.

J. Time Deposits. The City may invest in non-negotiable time deposits collateralized in accordance with the California Government Code, in those banks and savings and loan associations which meet the requirements for investment in negotiable certificates of deposit. Since time deposits are not liquid, no more than 15% of the portfolio may be invested in this category. The issuer firm should have been in existence for at least five years. The City may waive the first $250,000 of collateral security for such deposits if the institution is insured pursuant to federal law. In order to secure the uninsured portions of such deposits, an institution shall maintain at least 10% in excess of the total amount deposited. Real estate mortgages may not be accepted as collateral. The maximum term for deposits shall be one year.

K. Money Market Funds. The City may invest in money market funds which invest solely in U.S. Treasuries, obligations of the U.S. Treasury, and repurchase agreements relating to such treasury obligations. To be eligible:

1. The fund must have attained the highest ranking or the highest letter and numerical rating provided by not less than two (2) 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 managing money market mutual funds with assets under management in excess of $500 million.
3. No more than 20% of the total portfolio may be invested in these securities.

L. Local Government Investment Pools. The City may invest in Local Government Investment Pools (LGIPs), which may be authorized under state statutes and sponsored by the state or local governments, or may be set up through intergovernmental agreements known as "joint powers" agreements. These pools typically combine the cash of participating jurisdictions and invest the cash in securities allowed under the state's laws regarding government investments. By pooling funds, participating governments benefit from economies of scale, full-time portfolio management, diversification, and liquidity. These funds are not subject to the same SEC rules applicable to money market mutual funds. One such LGIP is the

California Asset Management Program (CAMP), a California common law trust established pursuant to and in accordance with the Joint Exercise of Powers Act, by a Declaration of Trust, made as of December 15, 1989, and as subsequently amended (the "Declaration of Trust"), as a vehicle for public agencies to jointly exercise their common power to invest bond proceeds and other funds.

M. Mortgage pass-through securities, collateralized mortgage obligations, and asset-backed securities from issuers not defined in sections "A" and "B" of the Authorized Investment Section of this policy. The City may invest in these securities provided that such securities have a maximum stated final maturity of five years and; are rated in a rating category of "AA" or its equivalent or better by a nationally recognized statistical rating organization. Purchase of securities authorized by this subdivision may not exceed 20% of the portfolio.

N. Internal Revenue Code Section 115 Pension Trust. The City may invest in an Internal Revenue Code Section 115 Pension Trust (Section 115 Trust). The Trust permits the City, under federal and state law, to invest in a more diversified array of appropriate investments to maximize returns, as a vehicle for public agencies to exercise their power to invest in equities, bonds and other long-term investments. Investments authorized by this subdivision shall be governed by a separate Investment Policy Statement with prior approval of the City Council. There is no limitation as to the percentage of the portfolio which can be invested in this category.

O. SUPRANATIONALS, provided that the 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. The securities are rated in a rating category of "AA" or its equivalent or better by a NRSRO. No more than 30% of the total portfolio may be invested in these securities. No more than 10% of the portfolio may be invested in any single issuer. The maximum maturity does not exceed five (5) years.

P. Other investments that are, or may become, legal investments through the State of California Government Code and with prior approval of the City Council.

IX. COLLATERALIZATION

A. **Certificates of Deposit (CDs).** 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 California 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.

B. **Collateralization of Bank Deposits.** This is the process by which a bank or financial institution pledges securities, or other deposits for the purpose of securing repayment of deposited funds. The City shall require any bank or financial institution to comply with the collateralization criteria defined in California Government Code, Section 53651.

C. **Repurchase Agreements.** The City requires that Repurchase Agreements be collateralized only by securities authorized in accordance with California Government Code:

1. 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.
2. 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.
3. The City shall receive monthly statements of collateral.

X. 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 Treasurer 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?

XI. PORTFOLIO RISK MANAGEMENT AND DIVERSIFICATION

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.
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 repurchase 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 shall mitigate credit risk by adopting the following strategies:

1. The diversification requirements included in Section VI are designed to mitigate credit risk in the portfolio;
2. Unless otherwise specified in this policy, 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, LGIPs, money market mutual funds, and supranationals;
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 by to a level below the requirements of this 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 Treasurer in a timely manner.
    b. If a decision is made by the Treasurer to retain the downgraded security in the portfolio, its presence in the portfolio will be monitored and reported monthly to the City Council.

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 shall 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 cash flow purposes. The City further recognizes that certain types of securities, including variable rate securities, securities with principal pay downs 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 shall maintain a minimum of six months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements.
2. The maximum percent of callable securities (does not include "make whole call" securities) in the portfolio shall be 20%.
3. The maximum stated final maturity of individual securities in the portfolio shall be five years, except as otherwise stated in this policy.
4. The duration of the portfolio will approximate 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.

XII. MAXIMUM MATURITY

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities.

The City will not invest in securities maturing more than five (5) years from the date of trade settlement, unless the City Council has by resolution granted authority to make such an investment.

XIII. INVESTMENT POLICY REVIEW

This investment policy shall be reviewed at least annually 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. The City Council shall be responsible for maintaining guidance over this investment policy to ensure that the City can adapt readily to changing market conditions, and shall approve any modification to the investment policy prior to implementation.

XIV. REVIEW OF THE INVESTMENT PORTFOLIO

The Treasurer shall periodically, but no less than quarterly, review the portfolio to identify investments that do not comply with this investment policy and establish protocols for reporting major and critical incidences of noncompliance to the City Council.

XV. PERFORMANCE EVALUATION

The investment portfolio shall be designed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the City's risk constraints, the cash flow characteristics of the portfolio, and state and local laws, ordinances or resolutions that restrict investments.

The Treasurer shall monitor and evaluate the portfolio's performance relative to the chosen market benchmark(s), which will be included in the Treasurer's quarterly report. The Treasurer shall select an appropriate, readily available index to use as a market benchmark.

XVI. REPORTING

Monthly transaction reports will be submitted by the Finance Director to the City Council in accordance with California Government Code Section 53607. The monthly report will include the following items:

1. An asset listing showing par value, cost and independent third-party fair market value of each security as of the date of the report, the source of the valuation, type of investment, issuer, maturity date and interest rate.
2. Transactions for the period.
3. A description of the funds, investments and programs (including lending programs) managed by contracted parties (i.e. LAIF; investment pools, outside money managers and securities lending agents)
4. 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. Percentage of the portfolio represented by each investment category;
    d. Average portfolio credit quality; and,
    e. Time-weighted total rate of return for the portfolio for the prior one month, three months, twelve months and since inception compared to the City's market benchmark returns for the same periods;
5. 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.
6. A statement that the City has adequate funds to meet its cash flow requirements for the next six months.

The City's investment reporting policy meets or exceeds the requirements of California Government Code Section 53646.

The Treasurer shall annually submit a recommended updated Investment Policy to be reviewed and approved by City Council.

XVII. STATE LAW

The legislated authority of the Fund is covered in Sections 53601, 53635, and 53646 of the Government Code. It is the policy of the City Treasurer to comply with the State laws governing the Fund.

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 "FreddieMac" issues discount notes, bonds and mortgage pass-through securities.

FNMA. Like FHLB and FreddieMac, the Federal National Mortgage Association was established to provide credit and liquidity in the housing market. FNMA, also known as "FannieMae," issues discount notes, bonds and mortgage pass-through securities.

GNMA. The Government National Mortgage Association, known as "GinnieMae," 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.

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.

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, the issuer will likely call its current securities and reissue them at a lower rate of interest.

CERTIFICATE OF DEPOSIT (CD). A time deposit with a specific maturity evidenced by a certificate.

CERTIFICATE OF DEPOSIT ACCOUNT REGISTRY SERVICE (CDARS). A private placement service that allows local agencies to purchase more than $250,000 in CDs from a single financial institution (must be a participating institution of CDARS) while still maintaining FDIC insurance coverage. CDARS is currently the only entity providing this service. CDARS facilitates the trading of deposits between the California institution and other participating institutions in amounts that are less than $250,000 each, so that FDIC coverage is maintained.

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 BANK DEPOSIT. A bank deposit that is collateralized at least 100% (principal plus interest to maturity). The deposit is collateralized using assets set aside by the issuer such as Treasury securities or other qualified collateral to secure the deposit in excess of the limit covered by the Federal Deposit Insurance Corporation.

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.

COLLATERALIZED TIME DEPOSIT. Time deposits that are collateralized at least 100% (principal plus interest to maturity). These instruments are collateralized using assets set aside by the issuer such as Treasury securities or other qualified collateral to secure the deposit in excess of the limit covered by the Federal Deposit Insurance Corporation.

COMMERCIAL PAPER. The short-term unsecured debt of corporations.

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.

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 security to changes interest rates.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC). The Federal Deposit Insurance Corporation (FDIC) is an independent federal agency insuring deposits in U.S. banks and thrifts in the event of bank failures. The FDIC was created in 1933 to maintain public confidence and encourage stability in the financial system through the promotion of sound banking practices.

FEDERALLY INSURED TIME DEPOSIT. A time deposit is an interest-bearing bank deposit account that has a specified date of maturity, such as a certificate of deposit (CD). These deposits are limited to funds insured in accordance with FDIC insurance deposit limits.

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.

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 the State Treasurer's Office Local Agency Investment Fund (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.

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.

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 (T-bills, discount notes, commercial paper, and banker's acceptances) are issued and traded.

MONEY MARKET MUTUAL FUND. A mutual fund that invests exclusively in short-term securities. Examples of investments in money market funds are certificates of deposit and U.S. Treasury securities. Money market funds attempt to keep their net asset values at $1 per share.

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).

A credit rating agency that the Securities and Exchange Commission in the United States uses for regulatory purposes. 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 Fitch, S&P, and Moody's.

NEGOTIABLE CERTIFICATE OF DEPOSIT (NCD). 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. Negotiable CDs are traded in a secondary market.

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."

REPURCHASE AGREEMENT. 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.

SECURITIES AND EXCHANGE COMMISSION (SEC). The U.S. Securities and Exchange Commission (SEC) is an independent federal government agency responsible for protecting investors, maintaining fair and orderly functioning of securities markets and facilitating capital formation. It was created by Congress in 1934 as the first federal regulator of securities markets. The SEC promotes full public disclosure, protects investors against fraudulent and manipulative practices in the market, and monitors corporate takeover actions in the United States.

SECURITIES AND EXCHANGE COMMISSION (SEC) RULE 15c3-1. An SEC rule setting capital requirements for brokers and dealers. Under Rule 15c3-1, a broker or dealer must have sufficient liquidity in order to cover the most pressing obligations. This is defined as having a certain amount of liquidity as a percentage of the broker/dealer's total obligations. If the percentage falls below a certain point, the broker or dealer may not be allowed to take on new clients and may have restrictions placed on dealings with current client.

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 Supranational is a multi-national organization whereby member states transcend national boundaries or interests to share in the decision making to promote economic development in the 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 T-bills 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.