



City of Woodland

REPORT TO MAYOR AND CITY COUNCIL

AGENDA ITEM

TO: THE HONORABLE MAYOR
AND CITY COUNCIL

DATE: May 19, 2009

SUBJECT: Approval of Annual Investment Policy

Report in Brief

California law requires the City Treasurer to submit to the City Council an annual statement of investment policy which the Council is required to consider at a public meeting. The City's Investment Policy is attached.

Staff recommends that the City Council approve the attached annual statement of Investment Policy which meets California law, reaffirms investment practices consistent with recognized standards and facilitates prudent investment strategies that consider safety, liquidity and yield.

Background

The attached City Investment Policy is presented to the City Council in order to meet the legislative requirements of S.B. 564 (CH 783) and S.B. 866 (CH 784). The City Treasurer is required to submit the following documents to the City Council:

1. An annual statement of investment policy which the Council is required to consider at a public meeting.
2. A Quarterly report considering the City's investments including investments and monies held by the City and Cash with Fiscal Agents.

In 2008, the City Council approved an Ordinance to amend Section 2-6-3 of the Municipal Code which modified the section of the Investment Policy regulating the periodic reporting of the City's investments, monies held by the City and Cash with Fiscal Agent. This action changed the periodic reporting from monthly to quarterly. The change is consistent with the legislative actions referenced above that have been incorporated into State law. In addition, quarterly investment reports have created efficiency within the City's Finance operation and for the City Council. Since the Investment Policy is focused on standards described herein, the monthly reports change slightly, if at all. The change to a quarterly schedule has provided more meaningful information without compromising the City Council's authority to oversee investment actions.

Discussion

In addition to meeting State law, the attached Investment Policy reaffirms investment practices that are based on guidelines endorsed by the California State Municipal Finance Officers Association (CSMFO), Government Finance Officers Association (GFOA) and the California Debt and Investment Advisory Commission (CDIAC). The attached Investment Policy also complies with the State of California's allowable investments (California Code No. 53601).

Surplus funds held by the City are invested in an effort to generate interest earnings. The responsibility of the City Treasurer, under City Code (Sec. 2-6-3.1) is to invest those surplus funds, which the Finance Officer has determined are not required to meet immediate necessities. The funds shall be invested, in accordance with Policy guidelines outlined by the City, under the authority granted by the State. The City Treasurer shall also, make those funds available for immediate necessities, under direction from the Finance Officer (Sec. 2-6-3.3).

As always, the City Treasurer and her staff are subject to the Prudent Investor Standard (California Government Code 52600.3) and shall always consider (in priority order) safety, liquidity and yield foremost when placing City surplus funds in any investment security.

Recommendation for Action

Staff recommends that the City Council approve the attached annual statement of Investment Policy which meets California law, reaffirms investment practices consistent with recognized standards and facilitates prudent investment strategies that consider safety, liquidity and yield.

Prepared by: Rex Greenbaum
Senior Accountant

Reviewed by: Amber D'Amato
Finance Officer

Mark G. Deven
City Manager

Attachments

CITY OF WOODLAND INVESTMENT POLICY

POLICY: It is the policy of the City of Woodland to maximize the productive use of assets entrusted to its care and to invest and manage those public funds wisely and circumspectly. The surplus funds shall be invested in accordance with the provisions of Article 1 and 2 of Chapter 4 of Part 1 of Division 2 of Title 5 of the California Government Code (53600-53997). Unless otherwise noted, all section references are to the California Government Code.

SCOPE: This investment policy applies to the City of Woodland's Surplus Funds, as defined by Section 536-1. Surplus Funds means those funds which are not required for the City of Woodland's immediate necessities as defined in Section 53601.

BACKGROUND & ANALYSIS:

1.0 **PURPOSE:** The Investment Policy is designed to provide guidelines for the prudent investment of the City's surplus funds.

2.0 **GOAL:** The goal of the Investment Policy is to enhance the economic status of the City while prudently protecting its pooled cash and also complying with this investment policy and California Government Code Sections 53600 through 53659, which governs investments for municipal governments. Although pursuit of interest earnings on investment is an appropriate City goal, the primary consideration is preservation of capital resources. Thus, the City's yield objective is to achieve a reasonable rate of return rather than the maximum generation of income that might expose the City to unacceptable levels of risk.

3.0 **OBJECTIVE:** The City shall attempt to invest funds to the fullest extent possible and at the highest possible yield while satisfying the criteria for investment selection outlined below.

4.0 **INVESTMENT POLICY:**

The City has the fiduciary responsibility to maximize the productive use of assets entrusted to its care and to invest and manage those public funds wisely and circumspectly. In determining individual investment placements, the following factors shall be considered in priority order: safety, liquidity, and yield.

4.1 **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 is to mitigate credit risk and interest rate risk as summarized below.

4.1.1 **CREDIT RISK** – This is the risk of loss due to the failure of the security issuer or backer. Credit risk may be mitigated by:

4.1.1.1 Limiting investment to the safest types of securities;

4.1.1.2 Pre-qualifying the financial institutions, brokers/dealers, intermediaries, and advisers with which the City will do business;

4.1.1.3 Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

4.1.2 **INTEREST RATE RISK** – This is the risk that the market value of securities in the portfolio will fall due to changes in the general interest rates. Interest rate risk may be mitigated by:

4.1.2.1 Structuring the investment portfolio such that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity;

4.1.2.2 Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

4.2 **LIQUIDITY:**

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with the cash needs to meet anticipated demands. A portion of the portfolio should be placed in local government investment pools (such as LAIF), which offer same-day liquidity for short-term funds.

4.3 **YIELD:**

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout the budgetary and economic cycles, taking into account the investment risk of constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. Securities shall not be sold prior to maturity with the following exceptions:

4.3.1 A declining credit security, which could be sold early to minimize loss of principal;

4.3.2 A security swap, which would improve the quality, yield, or target duration of the portfolio;

4.3.3 A capital gain that would be realized to better position the overall portfolio to achieve investment policy goals.

5.0 **STANDARDS:**

5.1 **RESPONSIBILITY:**

The City Treasurer (as well as other City employees delegated by her) 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 deviations from expectations are reported in a timely basis and the liquidity and the purchase of securities are carried out in accordance with the terms of this policy. The City Treasurer and her staff shall recognize that the investment portfolio is subject to public review and evaluation.

5.1.1 Cash Review – the Treasurer or her delegate will review the cash balances and the investment portfolio daily, or as needed; items reviewed should include: bank account balances, maturing investments, debt service and other large periodic cash disbursements.

5.2 **PRUDENT INVESTOR STANDARD:** The City Treasurer and such employees as she may direct to make investments (see Section 5.4) are subject to the prudent investor standard set out under Section 53600.3. The City Treasurer or her delegate, 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 in a timely fashion and appropriate action is taken to control adverse developments, as defined in Section 53600.3.1.

5.3 **GOVERNMENT CODE:**

Government Code Sections 16481.2, 53601, 53635, and 53646 of the State of California regulate the investment policies of jurisdictions within the State. The City of Woodland will adhere to these provisions in developing and implementing the City's investment policies and practices.

5.4 **ETHICS AND CONFLICT OF INTEREST:**

Officers and employees involved in the investment process shall not engage in any activity that would conflict with the proper execution of this investment policy, create the appearance of such a conflict, or would impair the City Treasurer's ability to make impartial investment decisions.

5.5 **DELEGATION OF AUTHORITY:**

Authority to manage the investment program is granted to the City Treasurer. Under the oversight of the City Treasurer, responsibility of the operation of the investment program may be delegated to other staff who shall act in accordance with established written procedures and internal controls consistent with the investment policy.

5.6 **INTERNAL CONTROL:**

The City Treasurer 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 shall be designed to provide reasonable assurance that these objectives are met. Accordingly, the investment officer shall establish a process for an annual independent review by an external auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

- 5.6.1 Control of collusion
- 5.6.2 Separation of transaction authority from accounting and record keeping
- 5.6.3 Custodial safekeeping
- 5.6.4 Clear delegation of authority to subordinate staff members
- 5.6.5 Written confirmation of transactions for investments and wire transfers including settlement dates, amount of transaction, safekeeping account number and CUSIP number if applicable.
- 5.6.6 Development of a wire transfer agreement with the lead bank and third-party custodian.

6.0. **SCOPE:**

This investment policy shall apply to all financial assets of the City of Woodland, including, but not limited to:

- 6.1 General Fund
- 6.2 Special Revenue Funds
- 6.3 Capital Projects Funds
- 6.4 Debt Service Funds
- 6.5 Enterprise Funds
- 6.6 Internal Service Funds
- 6.7 Trust and Agency Funds
- 6.8 Redevelopment Funds
- 6.9 Public Financing Authority Funds

7.0 **SAFEKEEPING AND CUSTODY:**

7.1 **SELECTION OF ELIGIBLE FINANCIAL INSTITUTIONS:**

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:

- 7.1.1 Audited financial statement (annually)
- 7.1.2 Proof of National Association of Securities Dealers (NASD) certification
- 7.1.3 Proof of state registration
- 7.1.4 Certification of having read, understood and agreed to comply with the City's investment policy. These documents shall be provided annually as appropriate. In selecting financial institutions for deposit or investment of funds, the authorized Investment Officers shall consider the credit-worthiness of the institution.

7.2 **BROKER/DEALERS:**

- 7.2.1 Investments must be purchased directly from the issuer, from an institution licensed by the State as a broker/dealer, from a member of a federally regulated securities exchange, or from a brokerage firm designed as a primary government dealer by the Federal Reserve Bank.
- 7.2.2 The City Treasurer will maintain a file of broker/dealers with which the City is currently doing business, which will include (at minimum) the firm name, contact person, telephone number, fax number, e-mail address, and annual audited financial statements (as applicable).

7.3 **DELIVERY VS. PAYMENT:**

All trades, where applicable, will be executed by delivery vs. payment to ensure that securities are deposited prior to the release of funds. To protect against potential losses by collapse of individual securities dealers, all securities owned by the City shall be held in safekeeping by a third party bank trust department acting as agent for the City under terms of a custody agreement executed between the bank and the City.

7.4 **COLLATERALIZATION:**

Collateral is required for investments in non-negotiable certificates of deposit. In order to reduce market risk, the collateral level shall be at least 110% of market value of principal and interest and marked to market weekly. Securities acceptable as collateral shall be the direct obligations of, or are fully guaranteed as to principal and interest, by the United States or any agency of the United States.

8.0 **AUTHORIZED INVESTMENTS:**

Investment of City funds is governed by the California Government Code Sections 53600 et seq. Within the context of such limitations, the following investments are authorized:

8.1 **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.

8.2 **STATE OF CALIFORNIA OBLIGATIONS**-including bonds payable solely out of the revenues from a revenue-producing property operated by the State of California or by a department, board, agency, or authority of the state.

8.3 **FEDERAL AGENCY OBLIGATIONS** – enterprise obligations, participations or other instruments including those issued or fully guaranteed as to principal and interest by the Federal Government agencies; (e.g. Government National Mortgage Association (GNMA), the Federal Farm Credit Bank (FFCB), the Federal Home Loan Bank (FHLB), the Federal National Mortgage Association (FNMA), and the Federal Home Loan Mortgage Corporation (FHLMC)).

8.4 **NEGOTIABLE CERTIFICATES OF DEPOSIT** –issued by nationally or state chartered banks, state or federal savings institutions (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a state-licensed branch of a foreign bank. Purchases of negotiable certificates of deposit may not exceed 30% of the cost value of the portfolio.

8.5 **LOCAL AGENCY INVESTMENT FUND (LAIF)** – As authorized in Government Code Section 16429.1, local agencies may invest in the Local Agency Investment Fund, a money market fund, which allows local agencies to pool their investment resources. Current policies of LAIF set minimum and maximum amounts of monies that may be invested as well as maximum numbers of transactions that are allowed per month.

8.6 **CA LOCAL AGENCY OBLIGATIONS** – bonds, notes, warrants or other evidences of indebtedness of any local agency within California, 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.

8.7 **CERTIFICATE OF DEPOSIT (CD)** - Purchased through a bank or savings and loan association for a specified period of time at a specified rate of interest. The first \$100,000 of a certificate of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC). CD's with a face value in excess of \$100,000 will be collateralized by U.S. Treasury Department securities, which must be at least 110% of the face value of the CD. No other collateralization will be accepted.

8.8 **MEDIUM TERM CORPORATE NOTES** with a maximum maturity of five years may be purchased. Securities eligible for investment shall be rated AA or better by Moody's and Standard & Poor's volatility risk rating services.

- 8.9 **MONEY MARKET MUTUAL FUNDS** - Mutual funds invested in U.S. Government securities are permitted under this policy and under the California Government Code Section 53601. In order to be eligible for investment under this section, an investment objective of such a fund must be the maintenance of a price per share of \$1.00. The following criteria must also be met:
- 8.7.1 The fund shall have a minimum of \$500 million in total portfolio value.
 - 8.7.2 The fund shall be registered with the Securities and Exchange Commission, and shall have achieved a rating of AAA by Moody's and AAA by S&P.
 - 8.7.3 The fund shall have retained an advisor which is registered with the SEC, or which is exempt from such registration, and has at least 5 years experience managing money market funds, including those in excess of \$500 million.

9.0 **INVESTMENT PARAMETERS:**

9.1 **DIVERSIFICATION:**

The City of Woodland will diversify its Investments by security type and institution and the City will select maturities to provide for stability of income and liquidity. Diversification strategies shall be determined and revised periodically. In establishing specific diversification strategies, the following policies and constraints shall apply:

- 9.1.1 Portfolio maturities shall be matched against liabilities to avoid undue concentration in a specific maturity sector.
- 9.1.2 Maturities selected shall provide for stability of income and liquidity.
- 9.1.3 Disbursement and payroll dates shall be covered through LAIF, marketable U.S. Treasury bills or other cash equivalent instruments such as money market mutual funds which will ensure that appropriate liquidity is maintained.

9.2 **MAXIMUM MATURITIES:**

In order to minimize the impact of market risk, it is intended that all investments will be held to maturity. Investments may be sold prior to maturity for cash flow, appreciation purposes or in order to limit losses, however, no investment shall be made based solely on earnings anticipated from capital gains. To the extent possible, the City shall attempt to match its investments to anticipated cash flow requirements. The City will not invest in securities maturing more than 5 years from the date of purchase. The City may adopt weighted average maturity limitations (2 years) consistent with investment objectives.

9.3 **PROHIBITED INVESTMENTS AND DIVESTMENT:**

The City Treasurer shall not make any investment prohibited under Article 1 or 2 of Chapter 4 of the California Government Code (see e.g. Section 53601.6 and 53631.5). Investments authorized when made, but no longer permitted by applicable law, may be divested from the City of Woodland's portfolio in accordance with the investment statement, investment objectives and prudent investor standard.

9.4 **TAX and REVENUE ANTICIPATION NOTES (TRANS):**

Government Code Section 53821.5 prohibits the investment of TRAN proceeds in securities that have terms exceeding those of the TRAN itself. The TRAN proceeds can be invested in items that have no specific term to maturity as long as the proceeds can be removed within the period of the TRAN without a penalty.

10.0 **REPORTING:**

10.1 **METHODS:**

The City Treasurer shall prepare monthly investment reports to the City Manager and City Council which shall include the:

- 10.1.1 par amount of the investment,
- 10.1.2 classification of the investment,
- 10.1.3 percentage of the total portfolio, which each type of investment represents, name of the institution or entity,
- 10.1.4 rate of interest,
- 10.1.5 maturity date,
- 10.1.6 current market value,
- 10.1.7 reports shall also include a statement that the projected cash flow is adequate to meet expected obligations over the next six months, and that the portfolio is in compliance with this policy. The report shall be due approximately 45 days from the end of the month being reported.

10.2 **PERFORMANCE STANDARDS:**

The investment portfolio will be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow need. The portfolio shall be managed in accordance with the parameters specified within this policy; a market average rate of return will be obtained during a market/economic environment of stable interest rates. An appropriate benchmark of the 90-day U.S. Treasury bill shall be established against which portfolio performance shall be compared.

10.3 **MARKING TO MARKET:**

The market value of the portfolio shall be calculated at least yearly and a statement of the market value of the portfolio shall be issued at least quarterly with the investment report.

11.0 **INVESTMENT POLICY ADOPTION:**

The Investment Policy shall be adopted by minute action of the City Council of the City of Woodland. Moreover, the Policy shall be reviewed on an annual basis, and modifications must be approved by the City Council.

GLOSSARY

Agency - A debt security issued by a federal or federally sponsored agency. Federal agencies are backed by the full faith and credit of the U.S. Government. Federally sponsored agencies (FSA's) are backed by each particular agency with a market perception that there is an implicit government guarantee. An example of federal agency is the Government National Mortgage Association (GNMA). An example of a FSA is the Federal National Mortgage Association (FNMA).

Cash Sale/Purchase - A transaction which calls for delivery and payment of securities on the same day that the transaction is initiated.

CALIFORNIA POOLED INVESTMENT AUTHORITY (CPIA) –this investment pool is managed by MBIA-Municipal Investors Service Corporation, an investment subsidiary of MBIA, Inc

Certificate of Deposit - A document written by a bank or other financial institution that is evidence of a deposit, with the issuer's promise to return the deposit plus earnings at a specified interest rate within a specified time period.

Collateralization - Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

Coupon Rate - The annual rate of interest received by an investor from the issuer of certain types of fixed-income securities. Also known as the "interest rate."

Credit Quality - The measurement of the financial strength of a bond issuer. Generally, the higher the credit quality of a bond issuer, the lower the interest rate paid by the issuer because the risk of default is lower. Credit quality ratings are provided by nationally recognized rating agencies.

Credit Risk - The risk to an investor that an issuer will default in the payment of interest and/or principal on a security.

Delivery Versus Payment (DVP) - A type of securities transaction in which the purchaser pays for the securities when they are delivered either to the purchaser or his/her custodian.

Diversification - A process of investing assets among a range of security types by sector, maturity, and quality rating.

Duration - A measure of the timing of the cash flows, such as the interest payments and the principal repayment, to be received from a given fixed-income security. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity.

Fair Value - The amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Federal Funds (Fed Funds) - Funds placed in Federal Reserve banks by depository institutions in excess of current reserve requirements. Fed funds are considered to be immediately available funds.

Government Securities - An obligation of the U.S. government, backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market. See "Treasury Bills, Notes, and Bonds."

Interest Rate - See "Coupon Rate."

Internal Controls - An internal control structure designed to ensure that the assets of the entity are protected from loss, theft, or misuse.

Investment Policy - A concise and clear statement of the objectives and parameters formulated by an investor or investment manager for a portfolio of investment securities.

Liquidity - An asset that can be converted easily and quickly into cash.

Local Agency Investment Fund (LAIF) - An investment pool for local governments in which their money pooled and managed by the California State Controller's Office.

Mark-to-market - The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

Market Risk - The risk that the value of a security will rise or decline as a result of changes in market conditions.

Market Value - Current market price of a security.

Maturity - The date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder. See "Weighted Average Maturity."

Money Market Fund - Mutual funds that invest solely in money market instruments (short-term debt instruments, such as Treasury bills, commercial paper, bankers' acceptances, and federal funds).

Mutual Fund - An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments.

Mutual Fund Statistical Services - Companies that track and rate mutual funds, e.g., IBC/Donoghue, Lipper Analytical Services, and Morningstar.

Par - Face value or principal value of a bond, typically \$1,000 per bond.

Principal - The face value or par value of a debt instrument. Also may refer to the amount of capital invested in a given security.

Prudent Investor Standard - An investment standard outlining the fiduciary responsibilities of public funds

Safekeeping - Holding of assets (e.g., securities) by a financial institution.

Swap - Trading one asset for another.

Term Bond - Bonds comprising a large part or all of a particular issue which come due in a single maturity. The issuer usually agrees to make periodic payments into a sinking fund for mandatory redemption of term bonds before maturity.

Treasury Bills - Short-term U.S. government non-interest bearing debt securities with maturities of no longer than one year and issued in minimum denominations of \$10,000

Treasury Notes - Intermediate U.S. government debt securities with maturities of one to 10 years and issued in denominations ranging from \$1,000 to \$1 million or more.

Treasury Bonds - Long-term U.S. government debt securities with maturities of ten years or longer and issued in minimum denominations of \$1,000.

"Volatility Risk" Rating - A rating system to clearly indicate the level of volatility and other non-credit risks associated with securities and certain bond funds.

Weighted Average Maturity (WAM) - The average maturity of all the securities that comprise a portfolio.

Yield - The current rate of return on an investment security generally expressed as a percentage of the security's current price.