City of Camarillo

CITY COUNCIL POLICY

Section: Finance

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Subject: **Investment Policy**

Number: 3.04

PURPOSE

To establish a policy for managing the City's monetary investments. This policy also applies to the funds for which the City provides financial management services.

POLICY

Authorized officials in positions of trust will act with care and prudence when making decisions regarding management and investment of public funds. Investments will be made in accordance with provisions of California Government Code, the Municipal Code, and this policy. The City's investment objectives are to safeguard principal, ensure liquidity to meet cash flow needs, and obtain an appropriate rate of return.

A. Internal Control

Internal control will be established and documented in writing. The controls will be designed to prevent loss of public funds arising from fraud, employee error, misrepresentation by third parties, and imprudent actions by employees and officers of the City. Controls deemed most important include:

1. Separation of duties.
2. Separation of transaction authority from accounting and recordkeeping.
3. Custodial safekeeping.
4. Clear delegation of authority.
5. Specific limitations regarding securities loss and remedial action.
6. Maintain control of wire transfers.
7. Minimize number of authorized investment officials.
8. Document transactions and strategies.
9. Maintain a code of ethics standard.

The City's investment procedures manual will establish and maintain an internal control structure designed to ensure the assets managed under the scope of this policy are protected from loss, theft, or misuse. The internal control structure will provide reasonable assurance these objectives are met.

B. 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.

The Treasurer 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 Treasurer 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.

C. Ethics and Conflicts of Interest

The City promotes a culture of honesty and ethical behavior. Officers and employees responsible for investing funds will refrain from personal business activity that conflicts with their ability to make impartial investment decisions.

D. Safety

The City will ensure the safety of its invested funds by limiting risk associated with credit and interest rates. Risks are mitigated through diversification of the portfolio and monitoring of investments, depositories, and security dealers.

E. Liquidity

The City's investment portfolio will be structured to meet anticipated cash flow needs.

F. Return

The objective of investment performance is to earn a total rate of return over a market cycle which approximates the return on a market index of Treasury and Federal Agency securities of commensurate risk and duration.

G. Maturity

The investment portfolio will be structured to provide sufficient funds to meet cash flow needs. A bond ladder strategy may be used for a portion of the City's funds where it is appropriate. The average maturity of the investment portfolio will not exceed three years, and no investment will have a maturity of more than five years from its date of purchase.

H. Authorized Investments

The City may invest funds through banks, savings and loans, authorized investment advisers, broker/dealers, as well as the State of California.

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. 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.

Authorized investments are:

1. State of California Local Agency Investment Fund (LAIF). The City may invest up to the maximum amount permitted by LAIF. LAIF's investments in instruments prohibited by or not specified in the City's policy do not exclude the investment in LAIF itself from the City's list of allowable investments, provided LAIF's reports allow the Treasurer to adequately judge the risk inherent in LAIF's portfolio.

2. United States Treasury notes, bonds, bills, or certificates of indebtedness, and 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.

3. Insured demand deposits, as defined by Section 5102 of the Financial Code, in national or state-chartered banks or state or federal associations.

4. Certificates of deposit, as defined by Section 5102 of the Financial Code, issued by a national or state-chartered bank or a state or federal association, provided the total will not exceed 15% of the total portfolio.

5. Federal agency or United States government sponsored enterprises, provided the total issues will not exceed 75%, nor will one issuer exceed 20%, of the total portfolio. Purchases are limited to the following senior issues:

a. Federal National Mortgage Association (FNMA) “Fannie Mae”.

b. Government National Mortgage Association (GNMA) “Ginnie Mae”.

c. Federal Home Loan Mortgage Corporation (FHLMC) “Freddie Mac”.

d. Federal Home Loan Bank (FHLB).

e. Federal Farm Credit Banks (FFCB).

f. Federal Agricultural Mortgage Corporation (FAMC) “Farmer Mac”.

g. Tennessee Valley Authority (TVA).

6. Government or U.S. Treasury money market funds rated “AAA” by two nationally recognized rating organizations. The total investment will not exceed 5% of the total portfolio.

7. Supranational Securities, provided they 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 must be rated in a rating category of “AAA” or its equivalent or better by at least one Nationally Recognized Statistical Rating Organization (NRSRO). No more than 10% of the total portfolio may be invested in these securities and no more than 5% of the portfolio may be invested in any single issuer.

8. Municipal Securities that are obligations of the City, the State of California, and any local agency within the State of California. Municipal securities must be rated in a rating category of “A” or its equivalent or better by at least one NRSRO. The exposure to these securities shall not exceed 20%, nor will any single issuer exceed 5% of the portfolio.

9. Negotiable Certificates of Deposit (NCDs), issued by a nationally or state-chartered bank, a savings association or a federal association, a state or federal credit union, or a federally-licensed or state-licensed branch of a foreign bank. The amount of the NCD insured up to the FDIC limit does not require any credit ratings. Any amount above the FDIC insured limit must be issued by institutions which have short-term obligations rated “A-1” or its equivalent or better by at least one NRSRO; or long-term obligations rated in a rating category of “A” or its equivalent or better by at least one NRSRO. The exposure to these securities shall not exceed 20%, nor will any single issuer exceed 5% of the portfolio.

10. 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 $1 billion.

   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.

The City may purchase no more than 10% of the outstanding Commercial Paper of any single issuer. No more than 10% of the portfolio may be invested in Commercial Paper. No more than 5% of the portfolio may be invested in any single issuer. The maximum maturity does not exceed 270 days.

11. Corporate Medium Term Notes (MTNS) issued by a corporation 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. The securities shall be rated in a rating category of “AA” or its equivalent or better by at least one NRSRO. No more than 10% of the total portfolio may be invested in MTNs and no more than 5% of the portfolio shall be invested in any single issuer.

12. Asset-backed Securities, Agency mortgage-backed mortgage pass-through securities and Agency collateralized mortgage obligations from issuers not defined in section 2 and 5 of the authorized investment section of this policy. The securities shall be rated in a rating category of “AA” or its equivalent or better by a NRSRO. No more than 10% of the total portfolio may be invested in these securities and no more than 5% of the portfolio shall be invested in any single Asset-Backed or Commercial Mortgage security issuer.

I. Prohibited Investments and Activities

1. Investments not specifically identified by this policy without the prior approval of the City Council are prohibited.

2. Trading securities for the sole purpose of speculating or taking an unhedged position on the future direction of interest rates is prohibited.

3. In accordance with Government Code, Section 53601.6 investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.

4. Investment in any security that could result in a zero interest accrual if held to maturity 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.

8. The purchase of futures and options is prohibited.

J. Collateralization Requirements

Uninsured time deposits with banks and savings and loans will be collateralized in the manner prescribed by law for depositories accepting municipal investment funds. The collateral for certificates of deposits will be an amount equal to a minimum of 150% of the face value of the deposited funds in the securities that are classified as a mortgage and 110% of the face value of the deposited funds for all other classes of security (California Government Code Sections 53651 and 53652).

K. Safekeeping of Securities and Certificates of Deposit (CD)

1. Securities. The City will contract with a bank or trust company for the safekeeping of securities. The third party custodian must provide written safekeeping documentation.

2. Certificates of Deposit. The City will hold its own CDs.

L. Risk Management and Diversification

1. Mitigating Credit Risk in the Portfolio is addressing 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:

a. The diversification requirements included in the "Authorized Investments" section of this policy are designed to mitigate credit risk in the portfolio.

b. No more than 5% of the total portfolio may be deposited with or invested in securities issued by any single issuer unless otherwise specified in this policy.

c. The City may elect to sell a security prior to its maturity and record a capital gain or loss in order to manage the quality, liquidity or yield of the portfolio in response to market conditions or City's risk preferences.

d. If securities owned by the City are downgraded by an NRSRO to a level below the quality required by this investment policy, it will be the City's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.

   i. If a security is downgraded, the Treasurer will use discretion in determining whether to sell or hold the security based on its current maturity, the economic outlook for the issuer, and other relevant factors.

   ii. If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported monthly to the Council.

2. Mitigating Market Risk in the Portfolio is addressing 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 purchasing longer-term investments only with funds that are not needed for current cash flow purposes.

   a. 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:

      i. The City will maintain a minimum of six months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements.

ii. The maximum percent of callable securities (does not include "make whole call" securities as defined in the Glossary) in the portfolio will be 20%.

iii. The maximum stated final maturity of individual securities in the portfolio will be five (5) years, except as otherwise stated in this policy.

iv. The duration of the portfolio will generally be approximately equal to the duration (typically, plus or minus 20%) of a Benchmark, an index selected by the City based on the City's investment objectives, constraints, and risk tolerances.

M. LAIF, Investment Pools and 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 to determine whether the City shall invest in this option. The questionnaire will address the following general questions:

a. A description of eligible investment securities, and a written statement of investment policy and objectives.

b. A description of interest calculations and how it is distributed, and how gains and losses are treated.

c. A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.

d. A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.

e. A schedule for receiving statements and portfolio listings.

f. Are reserves, retained earnings, etc. utilized by the pool/fund?

g. A fee schedule, and when and how is it assessed.

h. Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

N. Investment Transactions

1. To the extent practicable, the Treasurer shall endeavor to complete investment transactions using a competitive bid process whenever possible. The City Council 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.

2. All transactions must be approved in writing by two authorized signatories and will be conducted on a delivery-versus-payment basis.
3. A preformatted form will be used for all wire transfers.

4. Wire transfers between brokers and/or security dealers are prohibited.

5. Wire transfers directly between the State of California (LAIF) and the City's safekeeping bank are permitted.

O. Investment Services

All providers of Investment Services must be approved by Council and must have an office in the State of California.

1. Investment Advisers. External investment advisers must be registered under the Investment Advisers Act of 1940.

2. Broker/Dealers. Broker/dealers must qualify under the Securities and Exchange Commission Rule 15C3-1, and annually provide the City Treasurer with an audited financial statement and documents verifying compliance with Rule 15C3-1.

P. Notice of Policy

The City will include a copy of this investment policy and the resolution when opening an account and annually provide a copy to all current investment advisers and broker/dealers. Receipt of the policy and confirmation that the policy has been reviewed by persons approved to advise the City, will be acknowledged in writing.

Q. Reporting

The Director of Finance will prepare a monthly Investment Report, including a management summary of the status of the investment portfolio and all security transactions made during the past month. Investments will be reported at fair market value as of the closing business day of each month. This report will be approved and signed by the City Manager and submitted to the Investment Committee and City Council within thirty (30) days following the end of the month.

For financial reporting purposes, the City values its investments annually in accordance within the fair value hierarchy established by Generally Accepted Accounting Principles and is stated in the cash and investment footnote of the Annual Comprehensive Financial Report (ACFR). The hierarchy categorizes inputs to valuation techniques into three levels based on the relative availability of market pricing information. The hierarchy gives the highest priority to unadjusted quotes in active market for identical assets and the lowest priority to unobservable input.

R. Annual Review

This Investment Policy will be reviewed annually by the Investment Committee and the City Council. The review will take place no later than September 30 of each fiscal year.

S. Glossary of Investment Terms

1. 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:

   a. FAMC. The Federal Agricultural Mortgage Corporation, also known as “Farmer Mac”, is a stockholder-owned, publicly traded company that was chartered by the United States federal government in 1988 to serve as a secondary market in agricultural loans such as mortgages for agricultural real estate and rural housing.

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

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

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

   e. 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.

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

   g. 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.

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

3. Authorized Institution. A bank, broker dealer or registered investor advisor that has been approved by the City to conduct business with.

4. 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.

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

6. 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.

7. 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 securities, 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.

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

9. 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.

10. 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.

11. Commercial Paper. An unsecured, short-term debt instrument issued by corporations, typically used for the financing of payroll, accounts payable, inventories, and meeting other short-term liabilities.

12. Corporate 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.

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

14. 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.

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

16. 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.

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

18. 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).

19. Fair Value Measurement and Application (GASB 72). This accounting statement addresses the accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset between market participants at the measurement date. The fair value hierarchy prioritizes the inputs used to measure fair value into three broad Levels (Levels 1, 2 and 3), moving from quoted prices in active markets in Level 1 to unobservable inputs in Level 3. The City's investments are typically categorized using level 2 fair value inputs.

    a. Level 1 inputs are observable, quoted prices for identical assets or liabilities in active markets.

    b. Level 2 inputs are quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets in markets that are not active; and inputs other than quoted prices e.g. interest rates and yield curves.

    c. Level 3 inputs are unobservable inputs for the asset or liability. These should be based on the best information available at the time of valuation. The reporting entity's own data should be adjusted if information is reasonably available without undue cost and effort. (These investments are typically not held by the City and would be a rare occurrence in the City's investment portfolio).

20. Laddering. This is an investment strategy whereby an investor staggers the maturity of the bonds in their portfolio so they mature at regular intervals and the income or proceeds can be used by the investor for projects, expenses, or reinvestment.

21. 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.

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

23. 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.

24. 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.

25. Local Agency. Any city or county, including a charter city or county, or special district.

26. 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."

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

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

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

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

31. 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.

32. Money Market. The market in which short-term debt instruments (T-bills and discount notes) are issued and traded.

33. 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.

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

35. Mutual Fund. An entity which pools the funds of investors and invests those funds in a set of securities 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.

36. 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.

37. 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. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

38. 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. The standard states "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 City, 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 City. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law."

39. 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.

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

41. 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.

42. Total Portfolio. A measure of total investible assets of the City including currency, deposits, and securities.

43. 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.

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

45. Volatility. The rate at which security prices change with changes in general economic conditions or the general level of interest rates.