City Investment Policy	Citywide Policy Manual
	Attachments: N/A
Effective Date: May 17, 2022~~May 18, 2021~~	**Responsible Department:** Administrative Services
Related Policies & Notes: Pension Investment Policy, OPEB Investment Policy	

POLICY

Under authority granted by the City Council, the City Treasurer and Deputy Treasurer are responsible for investing the surplus funds of the City.

The investment of the funds of the City of Cupertino is directed to the goals of safety, liquidity and yield. The authority governing investments for municipal governments is set forth in the California Government Code, Sections 53600 et seq.

The primary objective of the investment policy of the City of Cupertino is SAFETY OF PRINCIPAL. Investments shall be placed in those securities as outlined by type and maturity sector in this document. Effective cash flow management and resulting cash investment practices are recognized as essential to good fiscal management and control. The City's portfolio shall be designed and managed in a manner responsive to the public trust and consistent with state and local law. Portfolio management requires continual analysis and as a result the balance between the various investments and maturities may change in order to give the City of Cupertino the optimum combination of necessary liquidity and optimal yield based on cash flow projections.

SCOPE

The investment policy applies to all financial assets of the City of Cupertino as accounted for in the Annual Comprehensive ~~Annual~~ Financial Report (ACA~~A~~FR). Policy statements outlined in this document focus on the City of Cupertino's pooled, surplus funds, but will also apply to all other funds under the City Treasurer's span of control unless specifically exempted by statute or ordinance. This policy is applicable, but not limited to all funds listed below:

- General Fund
- Special Revenue Funds
- Capital Project Funds
- Enterprise Funds
- Internal Service Funds
- Trust and Agency Funds

- Any new fund unless specifically exempted

Investments of bond proceeds shall be governed by the provisions of the related bond indentures and/or cash flow requirements and therefore may extend beyond the maturity limitations as outlined in this document. Other post-employment benefit (OPEB) and Pension trust investments are governed by California Government Code Sections 53620 through 53622 and trust documents. The trusts are governed by separate investment policies entitled Investment Policy Statement City of Cupertino Investment Trust that were reviewed by the City of Cupertino Audit Committee on September 27, 2021 and October 25, 2021 and City Council on December 7, 2021~~October 27, 2020 and November 17, 2020, respectively~~.

PRUDENCE

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

> "…all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the Agency, that a prudent person acting in a like capacity and 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."

It is the City's intent, at the time of purchase, to hold all investments until maturity to ensure the return of all invested principal dollars. However, it is realized that market prices of securities will vary depending on economic and interest rate conditions at any point in time. It is further recognized that in a well-diversified investment portfolio, occasional measured losses are inevitable due to economic, bond market, or individual security valuation fluctuations. These occasional losses must be considered within the context of the overall investment program objectives and the resultant long-term rate of return. The City Treasurer and Deputy Treasurer, acting within the intent and scope of the investment policy and other written procedures and exercising due diligence, shall be relieved of personal responsibility and liability for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely manner and appropriate action is taken to control adverse developments.

OBJECTIVES

The primary objectives, in order of priority, of the City of Cupertino's investment activities shall be:

A. Safety of Principal

Safety of principal is the foremost objective of the City of Cupertino. Investments will be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, the City will diversify its investments by investing funds among a variety of securities with independent returns.

B. Liquidity

The City's investment portfolio will remain sufficiently liquid to meet all operating requirements which might be reasonably anticipated and provide the City with adequate cash flows to pay its obligations over the next six months. Additionally, the portfolio should consist largely of securities with active secondary resale markets.

C. Return

The City's investment portfolio shall be designed with the objective of attaining a rate of return throughout budgetary and economic cycles, commensurate with Cupertino's investment risk constraints and cash flow characteristics of the portfolio.

MAXIMUM MATURITIES

Maturities of investments will be selected based on liquidity requirements to minimize interest rate risk and maximize earnings. Investment of surplus funds shall comply with the maturity limits as set forth in the California Government Code 53600, et seq. Where this section does not specify a limitation on the term or remaining maturity at the time of the investment, no investment shall be made in any security that at the time of the investment has a term remaining to maturity in excess of five years, unless the Council has granted express authority to make that investment either specifically or as a part of an investment program approved by the Council no less than three months prior to the investment. Reserve funds may be invested in securities exceeding five years if the maturity of such investments is made to coincide as nearly as practicable with the expected use of the funds.

PERFORMANCE EVALUATION

Investment performance is continually monitored and evaluated by the City Treasurer. Investment performance statistics and activity reports are generated on a quarterly basis for presentation to the oversight (audit) committee, City Manager and City Council. Yield on the City's investment portfolio is of secondary importance compared to the safety and liquidity objectives described above. The City's investment portfolio shall be designed to attain a market average rate of return through economic cycles. 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. Whenever possible, and consistent with risk limitations as defined herein and prudent investment principles, the Treasurer shall seek to augment return above the market average rate of return. The City may select alternative benchmarks for identified pools of City funds that have different objectives.

DELEGATION OF AUTHORITY

Authority to manage the City's investment program is derived from California Government Code, Sections 41006 and 53600 et seq. The Treasurer is responsible for investment management decisions and activities per City Council Resolution.

The Treasurer shall designate a staff person as a liaison/deputy in the event circumstances require timely action and the Treasurer is not present.

No officer or designee may engage in an investment transaction except as provided under terms of this policy and the procedures by the Treasurer and approved by the City Manager/Council. The Treasurer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

If an investment adviser is retained by the City, the investment adviser, registered under the Investment Advisers Act of 1940, must have at least five years' experience investing in the securities and obligations authorized by California Government Code 53601 subdivisions (a) to (k), inclusive, and subdivisions (m) to (q), inclusive, and with assets under management in excess of five hundred million dollars ($500,000,000). External investment advisers may be granted discretion to purchase and sell investment securities in accordance with this investment policy.

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.

OVERSIGHT COMMITTEE

An audit committee consisting of appropriate internal and external members, appointed by the City Council, shall be established to provide general oversight and direction concerning the policies related to management of the City's investment pool, OPEB trust, and Pension Rate Stabilization Program trust. The City Treasurer shall serve in a staff and advisory capacity. The committee shall meet at least quarterly to review policy changes, new legislation and portfolio status.

ETHICS AND CONFLICTS OF INTEREST

Officers and employees involved in the investment process shall refrain from personal business activity that conflicts with proper execution of the investment program, or impairs their ability to make impartial investment decisions. Additionally the City Treasurer and the Deputy Treasurer are required to annually file applicable financial disclosures as required by the Fair Political Practices Commission (FPPC).

SAFEKEEPING OF SECURITIES

To protect against fraud or embezzlement or losses caused by collapse of an individual securities dealer, all securities owned by the City shall be held in safekeeping by a third party custodian acting as agent for the City under the terms of a custody agreement. All trades executed by a dealer will settle delivery versus payment (DVP) through the City's safekeeping agent. In order to verify investment holdings, an external auditor, on an annual basis, shall independently verify securities held in custody for the City. Additionally, the City Treasurer shall include a listing of holdings provided by the City's custodian to the quarterly investment report as verification between annual reviews by the external auditor.

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) money mutual funds, since the purchased securities are not deliverable. All other exceptions to this safekeeping policy must be approved by the City Treasurer in written form and included in the quarterly report to City Council.

INTERNAL CONTROL

Separation of duties between the Treasurer's function and Finance is designed to provide proper internal controls to prevent the potential for converting assets or concealing transactions. Dual transaction controls, separate and independent notifications, and reports provided by financial institutions shall be used to help implement these controls.

Wire transfers shall be approved prior to being submitted to the financial institution. Wire transfers initiated by Treasury staff must be reconfirmed by the appropriate financial institution to Finance staff**.** Proper documentation is required for each investment transaction and must include a broker trade confirmation and a cash disbursement wire transfer confirmation. Timely bank reconciliation is conducted to ensure proper handling of all transactions. The investment portfolio and all related transactions are reviewed and balanced to appropriate general ledger accounts by Finance staff on a monthly basis.

An annual agreed-upon procedures engagement in accordance with the attestation standards established by the American Institute of Certified Public Accountants shall be conducted by an auditor solely to assist management in determining the City's compliance with this investment policy. At the conclusion of such engagement, the agreed-upon procedures report detailing all procedures performed and findings noted (if applicable) shall be provided to the Audit Committee of the City.

REPORTING

Monthly transaction reports will be submitted by the Treasurer to the City Council within 30 days of the end of the reporting period in accordance with California Government Code Section 53607.

The City Treasurer shall also prepare a quarterly investment report, including a succinct management summary that provides a clear picture of the status of the current investment portfolio. The report will be prepared in a manner that will report all information required under this policy and as recommended by California Government Code. The Treasurer will submit the report to Council no later than the second regular council meeting, or approximately 45 days following the end of the quarter covered by the report.

AUTHORIZED FINANCIAL INSTITUTIONS, DEPOSITORIES, AND QUALIFIED 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).

In accordance with Section 53601.5, institutions eligible to transact investment business with the City include:

- 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.

COLLATERAL REQUIREMENTS

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.

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.

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

- The securities which collateralize the repurchase agreement shall be priced at Market Value, including any Accrued Interest plus a margin. The Market Value of the securities that underlie a repurchase agreement shall be valued at 102% or greater of the funds borrowed against those securities.
- Financial institutions shall mark the value of the collateral to market at least monthly and increase or decrease the collateral to satisfy the ratio requirement described above.
- The City shall receive monthly statements of collateral.

AUTHORIZED INVESTMENTS

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

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. There is no percentage limitation of the portfolio that can be invested in this category, although a five-year maturity limitation is applicable.

2. Obligations issued by Federal agencies or United States Government-Sponsored Enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. There are no limits on the dollar amount or percentage that the City may invest in Federal Agency or Government-Sponsored Enterprises (GSEs), provided that:
    - No more than 25% of the portfolio may be invested in any single Agency/GSE issuer.
    - The maximum maturity does not exceed five (5) years.
    - The maximum percent of agency callable securities in the portfolio will be 20%.

3. Banker's Acceptances (bills of exchange or time drafts drawn on and accepted by commercial banks) may not exceed 180 days to maturity or 40% of the portfolio.

    - They are issued by institutions which have short-term debt obligations rated "A-1" or its equivalent or better by at least one NRSRO; or long-term debt obligations which are rated in a rating category of "A" or its equivalent or better by at least one NRSRO.
    - No more than 5% of the portfolio may be invested in any single issuer.

4. Local Agency Investment Fund (LAIF), which is a State of California managed investment pool, may be used up to the maximum permitted by California state law. 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..

5. Commercial paper issued by corporations organized and operating in the United States having assets in excess of $500,000,000, ranked "A-1" or its equivalent or better by at least one Nationally Ranked Statistical Rating Organization (NRSRO), issued by corporations which have long-term obligations rated in a rating category of "A" or its equivalent or better by one NRSRO. Purchases of eligible commercial paper may not exceed 270 days to maturity nor

represent more than 10% of the outstanding paper of the issuing corporation. Purchases of commercial paper may not exceed 25% of the portfolio. Under a provision sunsetting on January 1, 2026, no more than 40% of the City's portfolio may be invested in Commercial Paper if the City's investment assets under management are greater than $100,000,000. No more than 10% of the total investments may be invested the in commercial paper and medium term notes of any single issuer.

6. Negotiable Certificates of Deposits issued by nationally or state-chartered banks, state or federal savings associations, or state or federal credit unions, or by a federally licensed or state-licensed branch of a foreign bank. Purchases of Negotiable Certificates of Deposit may not exceed 30% of the portfolio. No more than 5% of the portfolio may be invested in any single issuer. A maturity limitation of five years is applicable. 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 debt 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.

7. Repurchase agreements that specify terms and conditions may be transacted with banks and broker dealers. The maturity of the repurchase agreements shall not exceed one year. The market value of the securities used as collateral for the repurchase agreements shall be monitored by the investment staff and shall not be allowed to fall below 102% of the value of the repurchase agreement. A PSA Master Repurchase Agreement is required between the City of Cupertino and the broker/dealer or financial institution for all repurchase agreements transacted.

8. Reverse repurchase agreements are not authorized.

9. Certificates of Deposit (time deposits), non-negotiable and collateralized in accordance with the California Government Code, may be purchased through banks, savings and loan associations, or credit unions. Within a limit of 30% of the portfolio, these institutions may use a private sector entity to assist in the placement of the time deposits under the conditions specified by the Government Code.

10. Medium Term Corporate Notes issued by corporations organized and operating in the United States or by depository institutions licensed by the United States or any state and operating within the United States, with a maximum maturity of five years may be purchased. Securities eligible for investment shall be rated in the rating category of "A" or better by at least one NRSRO. Purchase of medium term note s may not exceed 30% of the portfolio. No more than 10% of the total investments may be invested in the commercial paper and medium term notes of any single issuer.

11. Municipal securities, including obligations of the City, the State of California, and any

local agency within the State of California, provided that:

- The securities are rated in a rating category of "A" or its equivalent or better by at least one NRSRO.
- No more than 5% of the portfolio may be invested in any single issuer.
- No more than 30% of the portfolio may be in Municipal Securities.
- The maximum maturity does not exceed five (5) years.

12. Municipal securities (Registered Treasury Notes or Bonds) of any of the other 49 states in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 states, in addition to California.
    - The securities are rated in a rating category of "A" or its equivalent or better by at least one nationally recognized statistical rating organization ("NRSRO").
    - No more than 5% of the portfolio may be invested in any single issuer.
    - No more than 30% of the portfolio may be in Municipal Securities.
    - The maximum maturity does not exceed five (5) years.

13. Asset-backed, mortgage-backed, mortgage pass-through securities, and collateralized mortgage obligations, provided that:
    - The securities are rated in a rating category of "AA" or its equivalent or better by a NRSRO.
    - No more than 20% of the total portfolio may be invested in these securities.
    - No more than 5% of the portfolio may be invested in any single Asset-Backed or Commercial Mortgage security issuer. There is no issuer limitation on any Mortgage security where the issuer is the US Treasury or a Federal Agency/GSE.
    - The maximum legal final maturity does not exceed five (5) years.

14. Supranationals, provided that:
    - 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.

15. Various daily money market funds administered for or by trustees, paying agents and custodian banks contracted by the City of Cupertino may be purchased as allowed under State of California Government Code. Only funds holding U.S. Treasury obligations, Government agency obligations, or repurchase agreements collateralized by U.S. Treasury or Government agency obligations can be utilized and may not exceed 20% of the cost value of the portfolio.

16. Ineligible investments are those that are not described herein, including but not limited to, common stocks and long-term (over five years in maturity) notes and bonds are prohibited from use in this portfolio. It is noted that special circumstances arise that necessitate the purchase of securities beyond the five-year limitation. On such occasions, requests must be approved by City Council prior to purchase. Additionally:

    - State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to futures and options.
    - In accordance with Government Code, Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.
    - Investment in any security that could result in a zero-interest accrual if held to maturity is prohibited. Under a provision sunsetting on January 1, 2026, securities backed by the U.S. Government that could result zero- or negative-interest accrual if held to maturity are permitted.
    - Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.
    - Purchasing or selling securities on margin is prohibited.
    - The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited.
    - The purchase of foreign currency denominated securities is prohibited.

RISK MANAGEMENT AND DIVERSIFICATION

Mitigating Credit Risk in the Portfolio

Credit risk is the risk that a security or a portfolio will lose some or all 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:

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

- 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.
- 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.

- If the credit ratings of any security owned by the City are downgraded 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.
- 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.
- 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 City Council.

Mitigating Market Risk in the Portfolio

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

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

- The City will maintain a minimum of six months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements.
- The maximum stated final maturity of individual securities in the portfolio will be five (5) years, except as otherwise stated in this policy.
- The duration of the portfolio will generally be approximately equal to the duration (typically, plus or minus 20%) of a Market Benchmark, an index selected by the City based on the City's investment objectives, constraints and risk tolerances.

DEPOSITS

To be eligible to receive local agency money, a bank, savings association, federal association, or federally insured industrial loan company shall have received an overall rating of not less than "satisfactory" in its most recent evaluation by the appropriate federal financial supervisorial agency of its record of meeting the credit needs of California's communities.

INTEREST EARNINGS

All moneys earned and collected from investments authorized in this policy shall be allocated monthly to various fund accounts based on the cash balance in each fund as a percentage of the entire pooled portfolio.

REVIEW OF 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.

POLICY REVIEW

The City of Cupertino's investment policy shall be adopted by resolution of the City Council on an annual basis. This investment policy shall be reviewed at least annually to ensure its consistency with the overall objectives of preservation of principal, liquidity, and yield, and its relevance to current law and financial and economic trends.

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

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

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

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

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

ASSET BACKED SECURITIES. Securities supported by pools of installment loans or leases or by pools of revolving lines of credit.

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

BANKER'S ACCEPTANCE. A money market instrument created to facilitate international trade transactions. It is highly liquid and safe because the risk of the trade transaction is transferred to the bank which "accepts" the obligation to pay the investor.

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

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

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

CALLABLE. A callable security gives the issuer the option to call it from the investor prior to its maturity. The main cause of a call is a decline in interest rates. If interest rates decline since an issuer issues 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.

CERTIFICATE OF DEPOSIT (CD). A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs may be marketable.

CERTIFICATE OF DEPOSIT ACCOUNT REGISTRY SYSTEM (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 MORTGAGE OBLIGATIONS (CMO). Classes of bonds that redistribute the cash flows of mortgage securities (and whole loans) to create securities that have different levels of prepayment risk, as compared to the underlying mortgage securities.

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

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

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

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

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

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

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

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

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

DISCOUNT. The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as T-bills and banker's acceptances, are known as discount securities. They sell at a discount from par, and return the par value to the investor at maturity without additional interest. Other securities, which have fixed coupons, trade at a discount when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

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

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

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

FEDERAL OPEN MARKET COMMITTEE. A committee of the Federal Reserve Board that establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

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.

MARKING TO MARKET. The process of posting current market values for securities in a portfolio.

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

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

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

MONEY MARKET. The market in which short-term debt instruments (T-bills, discount notes, commercial paper, and banker's acceptances) are issued and traded.

MORTGAGE PASS-THROUGH SECURITIES. A securitized participation in the interest and principal cash flows from a specified pool of mortgages. Principal and interest payments made on the mortgages are passed through to the holder of the security.

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

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

NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO).

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 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).

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

PREPAYMENT SPEED. A measure of how quickly principal is repaid to investors in mortgage securities.

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

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

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

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

REGIONAL DEALER. A financial intermediary that buys and sells securities for the benefit of its customers without maintaining substantial inventories of securities and that is not a primary dealer.

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.

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.

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

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

City Manager's signature: _____

Date: _____

Director of Administrative Services' signature: _____

Date: _____

Revisions:

City Manager's signature: _____

Date: _____

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