

**City of Yuba City
Administrative Services Department
Staff Report**

Date: August 19, 2008
To: Honorable Mayor & Members of the City Council
From: City Treasurer
Presentation By: Steven C. Kroeger, Assistant City Manager/City Treasurer

Summary

Subject: Annual Investment Policy Adoption
Recommendation: Approve Investment Policy as amended
Fiscal Impact: None

Background:

In accordance with the City's Investment Policy, the Policy is submitted annually to the City Council for review and adoption.

Analysis:

Staff reviews the Policy annually in order to ensure that it continues to meet statutory requirements and reflects treasury best practices. As a result of this year's review, several minor changes are proposed. These changes represent the cumulative result of staff review, input from other treasury professionals, and consideration of the most recent investment policy guidelines set forth by the Association of Public Treasurers, United States & Canada (APT-US&C).

AB1745, which took effect January 1, 2008, added a new section to Government Code, section 53601(d), that allows local agencies to purchase debt issued by any of the other 49 states. Previously, the Government Code restricted purchases to debt issued by the State of California and local agencies within California.

As the City's Policy currently permits the purchase of debt obligations issued by the State of California and any local agency within California, it is recommended that the City incorporate the new Government Code provision to provide additional investment flexibility.

The following Policy updates are recommended:

Section VII. Suitable and Authorized Investments

State Obligations: Registered treasury notes or bonds of any of the 50 United States, 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 states. Such obligations must have a final maturity not exceeding five years from the date of purchase, and rate at least A-1, or the equivalent, short-term; or A, or the equivalent, long-term by a nationally recognized statistical rating organization (NRSRO) at the time of purchase.

Local Agency Obligations. Obligations 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 with a final maturity not exceeding five years from the date of purchase, and rated at least A or the equivalent by NRSRO at the time of purchase

Fiscal Impact:

None.

Alternatives:

1. Do not approve amendments. If this alternative is chosen, then the City will continue to invest funds using the Investment Policy as approved in August 2007.
2. Approve with modifications.

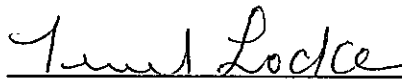
Recommendation:

Staff recommends approval of the Investment Policy as amended.

Attachments:

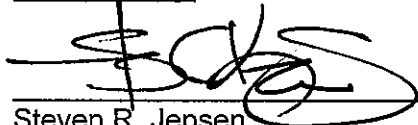
1. *Proposed Investment Policy (as amended)*
2. *Current Investment Policy with redlines showing proposed changes*

Prepared By:



Terrel Locke
Administrative Analyst I

Submitted By:



Steven R. Jepsen
City Manager

Reviewed By:

City Treasurer
Finance



A.B.

City of Yuba City

Investment Policy

August 19, 2008

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I. PURPOSE

It is the policy of the City of Yuba City to invest public funds in a prudent manner which will provide maximum security while meeting daily cash flow demands and conforming to all statutes governing the investment of public funds. Within these parameters, funds will be invested to optimize investment return.

II. SCOPE

This investment policy shall apply to all financial assets, other than proceeds of debt issues, of the City of Yuba City and the Yuba City Redevelopment Agency (collectively “the City”). These funds are accounted for in the City comprehensive annual financial report and include:

- General fund
- Special revenue funds
- Capital project funds
- Enterprise funds
- Internal service funds
- Trust and agency funds
- Any new fund created by the governing body, unless specifically exempted by the governing body

This investment policy applies to all transactions involving the financial assets and related activity of all the foregoing funds, with the exception of bond proceeds. Investment of bond proceeds will be governed by the permitted investment section of bond documents.

III. STANDARD OF CARE

Prudence. The standard of prudence to be used by investment officials shall be the “prudent investor standard” which states:

“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.”

Investment officers 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 fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this investment policy.

IV. OBJECTIVES

The primary objectives, in priority order, of investment activities shall be:

- Preservation of capital and protection of investment principal.
- Maintenance of sufficient liquidity to meet anticipated cash flows.
- Diversification to avoid incurring unreasonable market risks.
- Attainment of a market rate of return.
- Conformance with all applicable City ordinances, state statutes and federal regulations.

V. INVESTMENT AUTHORITY & RESPONSIBILITIES

Delegation of Authority. Authority to manage the investment program is granted to the Assistant City Manager/City Treasurer and derived from the California Government Code Section 53607. The Assistant City Manager/City Treasurer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials, and their procedures in the absence of the Assistant City Manager/City Treasurer.

The Assistant City Manager/City Treasurer may engage the services of registered external investment advisors in regard to the City's investment program. The Assistant City Manager/City Treasurer may, by written agreement with investment advisors, delegate the day-to-day placement of investments. Investment advisors shall make all investment decisions and transactions in strict accordance with State law and this investment policy.

Investment Procedures. The Assistant City Manager/City Treasurer shall establish written investment procedures for the operation of the investment program consistent with this investment policy. The procedures should include reference to:

- Safekeeping
- PSA repurchase agreements
- Wire transfer agreements
- Banking service contracts
- Collateral/depository agreements

Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this investment policy and the procedures established by the Assistant City Manager/City Treasurer.

Internal Controls. The Assistant City Manager/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. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits requires estimates and judgments by management.

Internal controls shall be subject to an annual independent review by an external auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

- Control of collusion
- Separation of transaction authority from accounting and record keeping
- Custodial safekeeping
- Avoidance of physical delivery securities
- Clear delegation of authority to subordinate staff members
- Written confirmation of transactions for investments and wire transfers
- Development of a wire transfer agreement with the lead bank and third-party custodian

Ethics and Conflicts of Interest. City employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees shall disclose to the City Manager any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio, and they shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the City.

VI. PROVIDERS OF FINANCIAL SERVICES

Authorized Broker/Dealers. The Assistant City Manager/City Treasurer shall maintain a list of broker/dealers from which the City purchases investments directly that are approved for investment purposes, and it shall be the policy of the City to purchase securities only from those authorized firms. To be eligible, a firm must have minimum capital of \$10,000,000 and at least five years of operation. These may include “primary” dealers, financial firms that have a primary dealer within their holding company structure or regional dealers. All must qualify under Securities and Exchange Commission (SEC) Rule 15c3-1 (Uniform Net Capital Rule).

All approved broker/dealers must supply the following annually:

- (1) Audited financial statements
- (2) Proof of National Association of Securities Dealers (NASD) certification
- (3) Proof of State registration
- (4) Completed broker/dealer questionnaire
- (5) Certification of having read and understood this investment policy

If the City has granted to an outside investment advisor authority to buy or sell securities, the investment advisor may place orders for the execution of such transactions with one or more broker/dealers of its choice, provided such broker/dealers meet the eligibility requirements set forth above. In such case, in lieu of the broker/dealer supplying (4) and (5) above, the investment advisor can fulfill this obligation by providing certification that its broker/dealers meet or exceed the requirements set forth in the City’s broker/dealer questionnaire and that the investment advisor agrees to comply with the investment policy.

An annual review of the minimum capital requirement and registration of qualified financial institutions and broker/dealers will be conducted by Assistant City Manager/City Treasurer.

From time to time, the Assistant City Manager/City Treasurer may choose to invest in instruments offered by minority and community financial institutions. In such situations, a waiver to the criteria above may be granted. All terms and relationships will be fully disclosed prior to purchase and will be reported to the appropriate entity on a consistent basis and should be consistent with State or local law. These types of investment purchases should be approved by the City Council in advance.

Safekeeping and Custody. The Assistant City Manager/City Treasurer shall select one or more banks to provide safekeeping and custodial services for the City.

The purchase and sale of securities and repurchase agreement transactions shall be settled on a delivery versus payment basis. All securities, except non-negotiable Certificates of Deposit, Mutual Funds, Money Market Funds, LAIF and CAMP will be delivered by book entry to be held by the City's custodian bank, its correspondent bank or its Depository Trust Company (DTC) participant account.

VII. SUITABLE AND AUTHORIZED INVESTMENTS

All investments and deposits of the City shall be made in accordance with California Government Code Sections 16429.1, 53600-53609 and 53630-53686. The City has further restricted authorized investments to the following:

Government Obligations.

1. United States Treasury bills, notes, bonds, or strips with a final maturity not exceeding five years from the date of purchase.
2. Federal Agency securities with a final maturity not exceeding five years from the date of purchase issued by the Government National Mortgage Association (GNMA) only. The aggregate investment in Federal Agency mortgage-backed securities shall not exceed 20% of the City's total portfolio.
3. Federal instrumentality (government sponsored enterprise) debentures, discount notes, callable securities and step-up securities with a final maturity not exceeding five years from the date of purchase.

State Obligations: Registered treasury notes or bonds of any of the 50 United States, 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 states. Such obligations must have a final maturity not exceeding five years from the date of purchase, and rate at least A-1, or the equivalent, short-term; or A, or the equivalent, long-term by a nationally recognized statistical rating organization (NRSRO) at the time of purchase.

Local Agency Obligations. Obligations 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 with a final maturity not exceeding five years from the date of purchase, and rated at least A or the equivalent by NRSRO at the time of purchase.

Special Assessment District Obligations. Limited Obligation Improvement Bonds issued by the City of Yuba City related to special assessment districts. Investment in such obligations requires the approval of the City Council and maturities may extend to thirty years.

Banker's Acceptances. Eligible Banker's Acceptances with a maturity not exceeding 180 days from the date of purchase, rated at least A-1 or the equivalent by a NRSRO, drawn on or accepted by a commercial bank with combined capital and surplus of at least \$250 million, whose deposits are insured by the FDIC, and whose senior long-term debt is rated at least A or the equivalent by a NRSRO at the time of purchase. No more than 30% of the City's total portfolio shall be invested in banker's acceptances of any one issuer, and the aggregate investment in banker's acceptances shall not exceed 40% of the City's total portfolio.

Commercial Paper. Prime Commercial Paper with a maturity not exceeding 270 days from the date of purchase with the highest ranking or of the highest letter and number rating as provided for by a NRSRO. The entity that issues the commercial paper shall meet all of the following conditions in either sub-paragraph A. or sub-paragraph B. below:

A. The entity shall (1) be organized and operating in the United States as a general corporation, (2) have total assets in excess of five hundred million dollars (\$500,000,000) and (3) Have debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.

B. The entity shall (1) be organized within the United States as a special purpose corporation, trust, or limited liability company, (2) have program wide credit enhancements, including, but not limited to, over collateralization, letters of credit or surety bond and (3) have commercial paper that is rated "A-1" or higher, or the equivalent, by a NRSRO.

No more than 10% of the City's total portfolio shall be invested in the commercial paper of any one issuer, and the aggregate investment in commercial paper shall not exceed 25% of the City's total portfolio.

Negotiable Certificates of Deposit. Negotiable Certificates of Deposit with a maturity not exceeding five years from the date of purchase, in FDIC insured State or nationally chartered banks or savings banks, subject to the limitations of California Government Code Section 53638. Purchases are limited to institutions which have long term debt rated in the "AA" category, or higher, or the equivalent, by a nationally recognized statistical rating organization. The aggregate investment in Negotiable Certificates of Deposit shall not exceed 30% of the City's total portfolio.

Non-Negotiable Certificates of Deposit. Non-negotiable Certificates of Deposit with a maturity not exceeding five years from the date of purchase, in FDIC insured State or nationally chartered banks or savings banks, subject to the limitations of California Government Code Section 53638. Amounts in excess of FDIC insurance coverage shall be secured in accordance with California Government Code Section 53652.

Selected Depository Institutions. The City may invest in Certificates of Deposit with a “Selected Depository Institution” in accordance with California Government Code Section 53601.8 providing the bank is an authorized participant if the CDARS (Certificate of Deposit Account Registry Service).

Repurchase Agreements. Repurchase Agreements with a final termination date not exceeding 30 days collateralized by U.S. Treasury obligations, Federal Agency securities, or Federal Instrumentality securities listed above with the maturity of the collateral not exceeding five years. For the purpose of this section, the term collateral shall mean purchased securities under the terms of the City’s Master Repurchase Agreement. The purchased securities shall have a minimum market value including accrued interest of 102% of the dollar value of the funds borrowed. Collateral shall be held in the City’s custodian bank, as safekeeping agent, and the market value of the collateral securities shall be marked-to-the-market daily.

Repurchase Agreements shall be entered into only with broker/dealers who are recognized as Primary Dealers with the Federal Reserve Bank of New York, or with financial firms that have a primary dealer within their holding company structure. Approved Repurchase Agreement counterparties shall have a short-term credit rating of at least A-1 or the equivalent and a long-term credit rating of at least A or the equivalent. Repurchase agreement counterparties shall execute a City approved Master Repurchase Agreement with the City. The Assistant City Manager/Treasurer shall maintain a copy of the City’s Master Repurchase Agreement along with a list of the broker/dealers who have executed same.

Medium Term Notes. Medium Term Notes (“Corporate Notes”) issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States, with a final maturity not exceeding five years from the date of purchase, and rated at least A or the equivalent by a NRSRO at the time of purchase. No more than 10% of the City’s total portfolio shall be invested in medium term notes of any one issuer, and the aggregate investment in medium term notes shall not exceed 30% of the City’s total portfolio.

Asset Backed Obligations. Any asset backed obligation with a final maturity not exceeding five years from the date of purchase, rated at least AA or the equivalent by a NRSRO. The aggregate investment in Asset backed obligations shall not exceed 20% of the City’s total portfolio.

Money Market Funds. Money Market Funds registered under the Investment Company Act of 1940 that (1) are “no-load” (meaning no commission or fee shall be charged on purchases or sales of shares); (2) have a constant daily net asset value per share of \$1.00; (3) invest only in the securities and obligations authorized in this investment policy and (4) have a rating of Aaa or the equivalent by at least two NRSROs. The combined investment in money market funds and mutual funds shall not exceed 20% of the City’s total portfolio.

Local Government Investment Pools. State of California’s Local Agency Investment Fund (LAIF) and shares of beneficial interest issued by a joint powers authority such as the California Asset Management Program (CAMP), as authorized respectively in Government Code Sections 16429.1 and 53601 (o), up to the maximum allowed by the pools.

Due Diligence Requirement. A thorough investigation of an investment pool is required prior to investing and on a continual basis. At a minimum, the following information shall be on file for each pool:

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

Legislative Changes. Any State of California legislative action that further restricts allowable maturities, investment types or percentage allocations will be incorporated into this investment policy and supersede any and all previous applicable language. If the City is holding an investment that is subsequently prohibited by a legislative change, the City may hold that investment until the maturity date to avoid an unnecessary loss.

VIII. INVESTMENT PARAMETERS

Diversification. The City shall diversify the investments within the portfolio to avoid incurring unreasonable risks inherent in over investing in specific instruments, individual financial institutions or maturities. The asset allocation in the portfolio should, however, be flexible depending upon the outlook for the economy, the securities markets, and the City's anticipated cash flow needs.

Maximum Maturities. To the extent possible, the City shall attempt to match its investments with anticipated cash flow requirements and known future liabilities. With the exception of Special Assessment District obligations, the City will not invest in securities maturing more than five (5) years from the date of purchase, unless the City Council has by resolution granted authority to make such an investment at least three months prior to the date of investment.

Sale of Investments Prior to Maturity. The City recognizes that investments occasionally may be sold prior to maturity and measured losses may be desirable in a diversified portfolio as long as such sales are consistent with the overall objectives of the City and the guidelines established by this Policy. Such sales shall be considered within the context of the overall portfolio's return, provided that the sale of a security is in the best long term interest of the City.

IX. EVALUATION OF INVESTMENT PERFORMANCE

The investment portfolio shall be designed to attain a market rate of return throughout budgetary and economic cycles, taking into account prevailing market conditions, risk constraints for eligible securities, and cash flow requirements. The performance of the City's investments shall be compared to the average yield on the U.S. Treasury security that most closely corresponds to the portfolio's weighted average effective maturity. When comparing the performance of the City's portfolio, its rate of return will be computed net of all fees and expenses.

X. REPORTING

The Assistant City Manager/City Treasurer shall prepare and present a quarterly investment report to the City Council. This report will include the following elements relative to the investments held at quarter-end.

- Type of Investment
- Issuer of Investment
- Maturity date
- Coupon rate
- Yield to maturity
- Face value
- Market value
- A description of investments that are under the management of contracted parties
- A statement of compliance of the City's portfolio with this investment policy
- A statement of the City's ability to meet expenditure requirements for the following six months, or an explanation of why sufficient funds may not be available
- Other information regarding the City's portfolio as appropriate

XI. POLICY REVIEW AND ADOPTION

This investment policy shall be submitted annually to the City Council for adoption. The policy shall be reviewed at least annually to ensure its consistency with the overall objectives of the City and its relevance to current law and financial and economic trends. Any modifications made thereto must be approved by the City Council.

GLOSSARY OF SELECTED TERMS*

Benchmark

A passive index used to compare the performance, relative to risk and return, of an investor's portfolio.

Cash Flow

A comparison of cash receipts (revenues) to required payments (debt service, operating expenses, etc.).

Credit Risk

The chance that an issuer will be unable to make scheduled payments of interest and principal on an outstanding obligation. Another concern for investors is that the market's perception of a corporation's credit will cause the market value of a security to fall, even if default is not expected.

Credit Rating

Various alphabetical and numerical designations used by institutional investors, Wall Street underwriters, and commercial rating companies to give relative indications of bond and note creditworthiness. Standard & Poor's and Fitch Ratings use the same system, starting with their highest rating, of AAA, AA, A, BBB, BB, B, CCC, CC, C, and D for default. Moody's Investors Service uses Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C, and D. Each of the services use pluses (+), minuses (-), or numerical modifiers to indicate steps within each category. The top four letter categories are considered investment grade ratings.

Duration

A measure of the timing of cash flows to be received from a security that provides the foundation for a measure of the interest rate sensitivity of a bond. Duration is an elasticity measure and represents the percentage change in price divided by the percentage change in interest rates. A high duration measure indicates that for a given level of movement in interest rates, prices of securities will vary considerably.

Fiduciary

An individual who holds something in trust for another and bears liability for its safekeeping.

Liquidity

The ease with which an investment may be converted to cash, either by selling it in the secondary market or by demanding its repurchase pursuant to a put or other prearranged agreement with the issuer or another party.

Liquidity Risk

The chance that a security, sold prior to maturity, will be sold at a loss of value. For a local agency, the liquidity risk of an individual investment may not be as critical as how the overall liquidity of the portfolio allows the agency to meet its cash needs.

Market Risk

The chance that the value of a security will decline as interest rates rise. In general, as interest rates fall, prices of fixed income securities rise. Similarly, as interest rates rise, prices fall. Market risk also is referred to as systematic risk or risk that affects all securities within an asset class similarly.

Maturity

The stated date on which all or a stated portion of the principal amount of a security becomes due and payable.

Net Present Value

An amount that equates future cash flows with their value in present terms.

Par Amount or Par Value

The principal amount of a note or bond which must be paid at maturity. Par, also referred to as the “face amount” of a security, is the principal value stated on the face of the security. A par bond is one sold at a price of 100 percent of its principal amount.

Pooled Investment

A market institution authorized under various sections of state law that represents the combined deposits of more than one local agency and pays returns based upon each local agency’s share of investment in the pool.

Portfolio

The combined holdings of all investment assets held by an investor.

Principal Amount

The face amount or par amount of a bond or issue of bonds payable on stated dates of maturity.

Put

The ability of a holder of an investment security to sell at a specified time and for a specified price the security back to the issuer or prior holder.

Return

The principal plus interest on an investment or portfolio of investments. In certain unfavorable market environments or due to risk factors, income derived from principal and interest may be less than the original amount invested.

Risk

The uncertainty of maintaining the principal or interest associated with an investment due to a variety of factors.

Yield

For the purposes of this publication, return and yield are synonymous.

*Excerpted from Understanding Public Investment Reporting - A Handbook For Local Elected Officials, California Debt and Investment Advisory Commission, 2003.

GLOSSARY OF INVESTMENT INSTRUMENTS*

Asset-Backed Securities

Securities that are supported by pools of assets, such as installment loans or leases, or by pools of revolving lines of credits. Asset-backed securities are structured as trusts in order to perfect a security interest in the underlying assets.

Bank Note

A senior, unsecured, direct obligation of a bank or U. S. branch of a foreign bank.

Banker's Acceptance

Normally, a short-term bill of exchange that is accepted as payment by banks engaged in financing trade of physical assets or merchandise.

Bond

A debt obligation of a firm or public entity. A bond represents the agreement to repay the debt in principal and, typically, in interest on the principal.

Callable Security

An investment security that contains an option allowing the issuer to retire the security prior to its final maturity date.

Certificate of Deposit

A short-term, secured deposit in a financial institution that usually returns principal and interest to the lender at the end of the loan period. Certificates of Deposit (CDs) differ in terms of collateralization and marketability. Those appropriate to public agency investing include:

Negotiable Certificates of Deposit

Generally, short term debt instruments that usually pay interest and are issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. The majority of negotiable CDs mature within six months while the average maturity is two weeks. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

Non-Negotiable Certificates of Deposit

CDs that carry a penalty if redeemed prior to maturity. A secondary market does exist for these non-negotiable CDs, but include a transaction cost that reduces returns to the investor. Non-negotiable CDs issued by banks and savings and loans are insured by the Federal Deposit Insurance Corporation up to the amount of \$100,000, including principal and interest. Amounts deposited above this amount may be secured with other forms of collateral through an agreement between the investor and the issuer. Collateral may include other securities including Treasuries or agency securities such as those issued by the Federal National Mortgage Association.

Commercial Paper

A short-term, unsecured promissory note issued by a large corporation.

Corporate Notes and Bonds

Debt instruments, typically unsecured, issued by corporations, with original maturities in most cases greater than one year and less than ten years.

Federal Agency and Instrumentality Obligations

Obligations issued by a government-sponsored entity or a federally regulated institution.

Mortgage Pass-Through Obligations

Securities that are created when residential mortgages (or other mortgages) are pooled together and undivided interests or participations in the stream of revenues associated with the mortgages are sold.

Municipal Notes, Bonds, and Other Obligations

Obligations issued by state and local governments to finance capital and operating expenses.

Notes

Debt obligations of a firm or public entity, usually maturing in less than ten years.

Repurchase Agreements

From the perspective of a local agency, the short term, often overnight, purchase of securities with an agreement to resell the securities at an agreed upon price.

Reverse Repurchase Agreements

Differs from a repurchase agreement in the sense that a reverse repurchase agreement is an agreement to sell securities in return for cash with an agreement to repurchase the securities at an agreed upon price.

State and Local Investment Pools

The combined deposits of state and local agencies organized and operated by a state treasurer or a local official. These pools operate much like a mutual fund, with local agencies investing money together in order to increase efficiency and reduce costs.

State Notes, Bonds, and Warrants

Obligations of the State of California or another state government with different maturity lengths.

Zero-Interest Bond

A bond on which interest is not payable until maturity (or earlier redemption), but compounds periodically to accumulate to a stated maturity amount. Zero-interest bonds are typically issued at a discount and repaid at par upon maturity.

*Excerpted from Understanding Public Investment Reporting - A Handbook For Local Elected Officials, California Debt and Investment Advisory Commission, 2003.

City of Yuba City

Investment Policy

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I. PURPOSE

It is the policy of the City of Yuba City to invest public funds in a prudent manner which will provide maximum security while meeting daily cash flow demands and conforming to all statutes governing the investment of public funds. Within these parameters, funds will be invested to optimize investment return.

II. SCOPE

This investment policy shall apply to all financial assets, other than proceeds of debt issues, of the City of Yuba City and the Yuba City Redevelopment Agency (collectively “the City”). These funds are accounted for in the City comprehensive annual financial report and include:

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This investment policy applies to all transactions involving the financial assets and related activity of all the foregoing funds, with the exception of bond proceeds. Investment of bond proceeds will be governed by the permitted investment section of bond documents.

III. STANDARD OF CARE

Prudence. The standard of prudence to be used by investment officials shall be the “prudent investor standard” which states:

“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.”

Investment officers 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 fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this investment policy.

IV. OBJECTIVES

The primary objectives, in priority order, of investment activities shall be:

- Preservation of capital and protection of investment principal.
- Maintenance of sufficient liquidity to meet anticipated cash flows.
- Diversification to avoid incurring unreasonable market risks.
- Attainment of a market rate of return.
- Conformance with all applicable City ordinances, state statutes and federal regulations.

V. INVESTMENT AUTHORITY & RESPONSIBILITIES

Delegation of Authority. Authority to manage the investment program is granted to the Assistant City Manager/City Treasurer and derived from the California Government Code Section 53607. The Assistant City Manager/City Treasurer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials, and their procedures in the absence of the Assistant City Manager/City Treasurer.

The Assistant City Manager/City Treasurer may engage the services of registered **external** investment advisors in regard to the City's investment program. The Assistant City Manager/City Treasurer may, by written agreement with investment advisors, delegate the day-to-day placement of investments. Investment advisors shall make all investment decisions and transactions in strict accordance with State law and this investment policy.

Investment Procedures. The Assistant City Manager/City Treasurer shall establish written investment procedures for the operation of the investment program consistent with this investment policy. The procedures should include reference to:

- Safekeeping
- PSA repurchase agreements
- Wire transfer agreements
- Banking service contracts
- Collateral/depository agreements

Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this investment policy and the procedures established by the Assistant City Manager/City Treasurer.

Internal Controls. The Assistant City Manager/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. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits requires estimates and judgments by management.

Internal controls shall be subject to an annual independent review by an external auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

- Control of collusion
- Separation of transaction authority from accounting and record keeping
- Custodial safekeeping
- Avoidance of physical delivery securities
- Clear delegation of authority to subordinate staff members
- Written confirmation of transactions for investments and wire transfers
- Development of a wire transfer agreement with the lead bank and third-party custodian

Ethics and Conflicts of Interest. City employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees shall disclose to the City Manager any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio, and they shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the City.

VI. PROVIDERS OF FINANCIAL SERVICES

Authorized Broker/Dealers. The Assistant City Manager/City Treasurer shall maintain a list of broker/dealers from which the City purchases investments directly that are approved for investment purposes, and it shall be the policy of the City to purchase securities only from those authorized firms. To be eligible, a firm must have minimum capital of \$10,000,000 and at least five years of operation. These may include “primary” dealers, financial firms that have a primary dealer within their holding company structure or regional dealers. All must qualify under Securities and Exchange Commission (SEC) Rule 15c3-1 (Uniform Net Capital Rule).

All approved broker/dealers must supply the following annually:

- (1) Audited financial statements
- (2) Proof of National Association of Securities Dealers (NASD) certification
- (3) Proof of State registration
- (4) Completed broker/dealer questionnaire
- (5) Certification of having read and understood this investment policy

If the City has granted to an outside investment advisor authority to buy or sell securities, the investment advisor may place orders for the execution of such transactions with one or more broker/dealers of its choice, provided such broker/dealers meet the eligibility requirements set forth above. In such case, in lieu of the broker/dealer supplying (4) and (5) above, the investment advisor can fulfill this obligation by providing certification that its broker/dealers meet or exceed the requirements set forth in the City’s broker/dealer questionnaire and that the investment advisor agrees to comply with the investment policy.

An annual review of the minimum capital requirement and registration of qualified financial institutions and broker/dealers will be conducted by Assistant City Manager/City Treasurer.

From time to time, the Assistant City Manager/City Treasurer may choose to invest in instruments offered by minority and community financial institutions. In such situations, a waiver to the criteria above may be granted. All terms and relationships will be fully disclosed prior to purchase and will be reported to the appropriate entity on a consistent basis and should be consistent with State or local law. These types of investment purchases should be approved by the City Council in advance.

Safekeeping and Custody. The Assistant City Manager/City Treasurer shall select one or more banks to provide safekeeping and custodial services for the City.

The purchase and sale of securities and repurchase agreement transactions shall be settled on a delivery versus payment basis. All securities, except non-negotiable Certificates of Deposit, Mutual Funds, Money Market Funds, LAIF and CAMP will be delivered by book entry to be held by the City's custodian bank, its correspondent bank or its Depository Trust Company (DTC) participant account.

VII. SUITABLE AND AUTHORIZED INVESTMENTS

All investments and deposits of the City shall be made in accordance with California Government Code Sections 16429.1, 53600-53609 and 53630-53686. The City has further restricted authorized investments to the following:

Government Obligations.

1. United States Treasury bills, notes, bonds, or strips with a final maturity not exceeding five years from the date of purchase.
2. Federal Agency securities with a final maturity not exceeding five years from the date of purchase issued by the Government National Mortgage Association (GNMA) only. The aggregate investment in Federal Agency mortgage-backed securities shall not exceed 20% of the City's total portfolio.
3. Federal instrumentality (government sponsored enterprise) debentures, discount notes, callable securities and step-up securities with a final maturity not exceeding five years from the date of purchase.

State Obligations: Registered treasury notes or bonds of any of the 50 United States, 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 states. Such obligations must have a final maturity not exceeding five years from the date of purchase, and rate at least A-1, or the equivalent, short-term; or A, or the equivalent, long-term by a nationally recognized statistical rating organization (NRSRO) at the time of purchase.

~~***State of California and Local Agency Obligations.***~~ Obligations of the State of California and 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 with a final maturity not exceeding five years from the date of purchase, and rated at least A or the equivalent by a nationally recognized statistical rating organization (NRSRO) at the time of purchase.

Special Assessment District Obligations. Limited Obligation Improvement Bonds issued by the City of Yuba City related to special assessment districts. Investment in such obligations requires the approval of the City Council and maturities may extend to thirty years.

Banker's Acceptances. Eligible Banker's Acceptances with a maturity not exceeding 180 days from the date of purchase, rated at least A-1 or the equivalent by a NRSRO, drawn on or accepted by a commercial bank with combined capital and surplus of at least \$250 million, whose deposits are insured by the FDIC, and whose senior long-term debt is rated at least A or the equivalent by a NRSRO at the time of purchase. No more than 30% of the City's total portfolio shall be invested in banker's acceptances of any one issuer, and the aggregate investment in banker's acceptances shall not exceed 40% of the City's total portfolio.

Commercial Paper. Prime Commercial Paper with a maturity not exceeding 270 days from the date of purchase with the highest ranking or of the highest letter and number rating as provided for by a NRSRO. The entity that issues the commercial paper shall meet all of the following conditions in either sub-paragraph A. or sub-paragraph B. below:

A. The entity shall (1) be organized and operating in the United States as a general corporation, (2) have total assets in excess of five hundred million dollars (\$500,000,000) and (3) Have debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.

B. The entity shall (1) be organized within the United States as a special purpose corporation, trust, or limited liability company, (2) have program wide credit enhancements, including, but not limited to, over collateralization, letters of credit or surety bond and (3) have commercial paper that is rated "A-1" or higher, or the equivalent, by a NRSRO.

No more than 10% of the City's total portfolio shall be invested in the commercial paper of any one issuer, and the aggregate investment in commercial paper shall not exceed 25% of the City's total portfolio.

Negotiable Certificates of Deposit. Negotiable Certificates of Deposit with a maturity not exceeding five years from the date of purchase, in FDIC insured State or nationally chartered banks or savings banks, subject to the limitations of California Government Code Section 53638. Purchases are limited to institutions which have long term debt rated in the "AA" category, or higher, or the equivalent, by a nationally recognized statistical rating organization. The aggregate investment in Negotiable Certificates of Deposit shall not exceed 30% of the City's total portfolio.

Non-Negotiable Certificates of Deposit. Non-negotiable Certificates of Deposit with a maturity not exceeding five years from the date of purchase, in FDIC insured State or nationally chartered banks or savings banks, subject to the limitations of California Government Code Section 53638. Amounts in excess of FDIC insurance coverage shall be secured in accordance with California Government Code Section 53652.

Selected Depository Institutions. The City may invest in Certificates of Deposit with a “Selected Depository Institution” in accordance with California Government Code Section 53601.8 providing the bank is an authorized participant if the CDARS (Certificate of Deposit Account Registry Service).

Repurchase Agreements. Repurchase Agreements with a final termination date not exceeding 30 days collateralized by U.S. Treasury obligations, Federal Agency securities, or Federal Instrumentality securities listed above with the maturity of the collateral not exceeding five years. For the purpose of this section, the term collateral shall mean purchased securities under the terms of the City’s Master Repurchase Agreement. The purchased securities shall have a minimum market value including accrued interest of 102% of the dollar value of the funds borrowed. Collateral shall be held in the City’s custodian bank, as safekeeping agent, and the market value of the collateral securities shall be marked-to-the-market daily.

Repurchase Agreements shall be entered into only with broker/dealers who are recognized as Primary Dealers with the Federal Reserve Bank of New York, or with financial firms that have a primary dealer within their holding company structure. Approved Repurchase Agreement counterparties shall have a short-term credit rating of at least A-1 or the equivalent and a long-term credit rating of at least A or the equivalent. Repurchase agreement counterparties shall execute a City approved Master Repurchase Agreement with the City. The Assistant City Manager/Treasurer shall maintain a copy of the City’s Master Repurchase Agreement along with a list of the broker/dealers who have executed same.

Medium Term Notes. Medium Term Notes (“Corporate Notes”) issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States, with a final maturity not exceeding five years from the date of purchase, and rated at least A or the equivalent by a NRSRO at the time of purchase. No more than 10% of the City’s total portfolio shall be invested in medium term notes of any one issuer, and the aggregate investment in medium term notes shall not exceed 30% of the City’s total portfolio.

Asset Backed Obligations. Any asset backed obligation with a final maturity not exceeding five years from the date of purchase, rated at least AA or the equivalent by a NRSRO. The aggregate investment in Asset backed obligations shall not exceed 20% of the City’s total portfolio.

Money Market Funds. Money Market Funds registered under the Investment Company Act of 1940 that (1) are “no-load” (meaning no commission or fee shall be charged on purchases or sales of shares); (2) have a constant daily net asset value per share of \$1.00; (3) invest only in the securities and obligations authorized in this investment policy and (4) have a rating of Aaa or the equivalent by at least two NRSROs. The combined investment in money market funds and mutual funds shall not exceed 20% of the City’s total portfolio.

Local Government Investment Pools. State of California’s Local Agency Investment Fund (LAIF) and shares of beneficial interest issued by a joint powers authority such as the California Asset Management Program (CAMP), as authorized respectively in Government Code Sections 16429.1 and 53601 (o), up to the maximum allowed by the pools.

Due Diligence Requirement. A thorough investigation of an investment pool is required prior to investing and on a continual basis. At a minimum, the following information shall be on file for each pool:

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

Legislative Changes. Any State of California legislative action that further restricts allowable maturities, investment types or percentage allocations will be incorporated into this investment policy and supersede any and all previous applicable language. If the City is holding an investment that is subsequently prohibited by a legislative change, the City may hold that investment until the maturity date to avoid an unnecessary loss.

VIII. INVESTMENT PARAMETERS

Diversification. The City shall diversify the investments within the portfolio to avoid incurring unreasonable risks inherent in over investing in specific instruments, individual financial institutions or maturities. The asset allocation in the portfolio should, however, be flexible depending upon the outlook for the economy, the securities markets, and the City's anticipated cash flow needs.

Maximum Maturities. To the extent possible, the City shall attempt to match its investments with anticipated cash flow requirements and known future liabilities. With the exception of Special Assessment District obligations, the City will not invest in securities maturing more than five (5) years from the date of purchase, unless the City Council has by resolution granted authority to make such an investment at least three months prior to the date of investment.

Sale of Investments Prior to Maturity. The City recognizes that investments occasionally may be sold prior to maturity and measured losses may be desirable in a diversified portfolio as long as such sales are consistent with the overall objectives of the City and the guidelines established by this Policy. Such sales shall be considered within the context of the overall portfolio's return, provided that the sale of a security is in the best long term interest of the City.

IX. EVALUATION OF INVESTMENT PERFORMANCE

The investment portfolio shall be designed to attain a market rate of return throughout budgetary and economic cycles, taking into account prevailing market conditions, risk constraints for eligible securities, and cash flow requirements. The performance of the City's investments shall be compared to the average yield on the U.S. Treasury security that most closely corresponds to the portfolio's weighted average effective maturity. When comparing the performance of the City's portfolio, its rate of return will be computed net of all fees and expenses.

X. REPORTING

The Assistant City Manager/City Treasurer shall prepare and present a quarterly investment report to the City Council. This report will include the following elements relative to the investments held at quarter-end.

- Type of Investment
- Issuer of Investment
- Maturity date
- Coupon rate
- Yield to maturity
- Face value
- Market value
- A description of investments that are under the management of contracted parties
- A statement of compliance of the City's portfolio with this investment policy
- A statement of the City's ability to meet expenditure requirements for the following six months, or an explanation of why sufficient funds may not be available
- Other information regarding the City's portfolio as appropriate

XI. POLICY REVIEW AND ADOPTION

This investment policy shall be submitted annually to the City Council for adoption. The policy shall be reviewed at least annually to ensure its consistency with the overall objectives of the City and its relevance to current law and financial and economic trends. Any modifications made thereto must be approved by the City Council.

GLOSSARY OF SELECTED TERMS*

Benchmark

A passive index used to compare the performance, relative to risk and return, of an investor's portfolio.

Cash Flow

A comparison of cash receipts (revenues) to required payments (debt service, operating expenses, etc.).

Credit Risk

The chance that an issuer will be unable to make scheduled payments of interest and principal on an outstanding obligation. Another concern for investors is that the market's perception of a corporation's credit will cause the market value of a security to fall, even if default is not expected.

Credit Rating

Various alphabetical and numerical designations used by institutional investors, Wall Street underwriters, and commercial rating companies to give relative indications of bond and note creditworthiness. Standard & Poor's and Fitch Ratings use the same system, starting with their highest rating, of AAA, AA, A, BBB, BB, B, CCC, CC, C, and D for default. Moody's Investors Service uses Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C, and D. Each of the services use pluses (+), minuses (-), or numerical modifiers to indicate steps within each category. The top four letter categories are considered investment grade ratings.

Duration

A measure of the timing of cash flows to be received from a security that provides the foundation for a measure of the interest rate sensitivity of a bond. Duration is an elasticity measure and represents the percentage change in price divided by the percentage change in interest rates. A high duration measure indicates that for a given level of movement in interest rates, prices of securities will vary considerably.

Fiduciary

An individual who holds something in trust for another and bears liability for its safekeeping.

Liquidity

The ease with which an investment may be converted to cash, either by selling it in the secondary market or by demanding its repurchase pursuant to a put or other prearranged agreement with the issuer or another party.

Liquidity Risk

The chance that a security, sold prior to maturity, will be sold at a loss of value. For a local agency, the liquidity risk of an individual investment may not be as critical as how the overall liquidity of the portfolio allows the agency to meet its cash needs.

Market Risk

The chance that the value of a security will decline as interest rates rise. In general, as interest rates fall, prices of fixed income securities rise. Similarly, as interest rates rise, prices fall. Market risk also is referred to as systematic risk or risk that affects all securities within an asset class similarly.

Maturity

The stated date on which all or a stated portion of the principal amount of a security becomes due and payable.

Net Present Value

An amount that equates future cash flows with their value in present terms.

Par Amount or Par Value

The principal amount of a note or bond which must be paid at maturity. Par, also referred to as the “face amount” of a security, is the principal value stated on the face of the security. A par bond is one sold at a price of 100 percent of its principal amount.

Pooled Investment

A market institution authorized under various sections of state law that represents the combined deposits of more than one local agency and pays returns based upon each local agency’s share of investment in the pool.

Portfolio

The combined holdings of all investment assets held by an investor.

Principal Amount

The face amount or par amount of a bond or issue of bonds payable on stated dates of maturity.

Put

The ability of a holder of an investment security to sell at a specified time and for a specified price the security back to the issuer or prior holder.

Return

The principal plus interest on an investment or portfolio of investments. In certain unfavorable market environments or due to risk factors, income derived from principal and interest may be less than the original amount invested.

Risk

The uncertainty of maintaining the principal or interest associated with an investment due to a variety of factors.

Yield

For the purposes of this publication, return and yield are synonymous.

*Excerpted from Understanding Public Investment Reporting - A Handbook For Local Elected Officials, California Debt and Investment Advisory Commission, 2003.

GLOSSARY OF INVESTMENT INSTRUMENTS*

Asset-Backed Securities

Securities that are supported by pools of assets, such as installment loans or leases, or by pools of revolving lines of credits. Asset-backed securities are structured as trusts in order to perfect a security interest in the underlying assets.

Bank Note

A senior, unsecured, direct obligation of a bank or U. S. branch of a foreign bank.

Banker's Acceptance

Normally, a short-term bill of exchange that is accepted as payment by banks engaged in financing trade of physical assets or merchandise.

Bond

A debt obligation of a firm or public entity. A bond represents the agreement to repay the debt in principal and, typically, in interest on the principal.

Callable Security

An investment security that contains an option allowing the issuer to retire the security prior to its final maturity date.

Certificate of Deposit

A short-term, secured deposit in a financial institution that usually returns principal and interest to the lender at the end of the loan period. Certificates of Deposit (CDs) differ in terms of collateralization and marketability. Those appropriate to public agency investing include:

Negotiable Certificates of Deposit

Generally, short term debt instruments that usually pay interest and are issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. The majority of negotiable CDs mature within six months while the average maturity is two weeks. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

Non-Negotiable Certificates of Deposit

CDs that carry a penalty if redeemed prior to maturity. A secondary market does exist for these non-negotiable CDs, but include a transaction cost that reduces returns to the investor. Non-negotiable CDs issued by banks and savings and loans are insured by the Federal Deposit Insurance Corporation up to the amount of \$100,000, including principal and interest. Amounts deposited above this amount may be secured with other forms of collateral through an agreement between the investor and the issuer. Collateral may include other securities including Treasuries or agency securities such as those issued by the Federal National Mortgage Association.

Commercial Paper

A short-term, unsecured promissory note issued by a large corporation.

Corporate Notes and Bonds

Debt instruments, typically unsecured, issued by corporations, with original maturities in most cases greater than one year and less than ten years.

Federal Agency and Instrumentality Obligations

Obligations issued by a government-sponsored entity or a federally regulated institution.

Mortgage Pass-Through Obligations

Securities that are created when residential mortgages (or other mortgages) are pooled together and undivided interests or participations in the stream of revenues associated with the mortgages are sold.

Municipal Notes, Bonds, and Other Obligations

Obligations issued by state and local governments to finance capital and operating expenses.

Notes

Debt obligations of a firm or public entity, usually maturing in less than ten years.

Repurchase Agreements

From the perspective of a local agency, the short term, often overnight, purchase of securities with an agreement to resell the securities at an agreed upon price.

Reverse Repurchase Agreements

Differs from a repurchase agreement in the sense that a reverse repurchase agreement is an agreement to sell securities in return for cash with an agreement to repurchase the securities at an agreed upon price.

State and Local Investment Pools

The combined deposits of state and local agencies organized and operated by a state treasurer or a local official. These pools operate much like a mutual fund, with local agencies investing money together in order to increase efficiency and reduce costs.

State Notes, Bonds, and Warrants

Obligations of the State of California or another state government with different maturity lengths.

Zero-Interest Bond

A bond on which interest is not payable until maturity (or earlier redemption), but compounds periodically to accumulate to a stated maturity amount. Zero-interest bonds are typically issued at a discount and repaid at par upon maturity.

*Excerpted from Understanding Public Investment Reporting - A Handbook For Local Elected Officials, California Debt and Investment Advisory Commission, 2003.