

City of Los Alamitos

Statement of Investment Policy for Fiscal Year 2009-10

Adopted September 21, 2009

1. Purpose: The purpose of this policy is to comply with the requirements of California Government Code Section 53600 et. seq. and to provide clear guidance for the investment of all monies of the City of Los Alamitos.

2. Application: This regulation applies to all financial assets of the City of Los Alamitos.

3. Regulation:

A. Investment Objectives

The investment of all funds of the City of Los Alamitos is structured to achieve, in priority order, the goals of safety, liquidity, and yield within the parameters established by law.

The primary objective of the investment policy of the City of Los Alamitos is safety. Most investments will be highly liquid. Maturities will be selected to anticipate cash needs, thereby, avoiding the need for forced liquidation. Within the constraints of safety and liquidity, the highest and best yield will be sought.

B. Legal and Policy Constraints

The authority governing investments for municipal government agencies is set forth in the California Government Code Section 53600, et. seq. In all instances, the City of Los Alamitos shall comply with the requirements of state law and as it is amended from time to time.

In addition to the requirements of state law, the City of Los Alamitos:

- ◆ shall not purchase or sell securities on margin.
- ◆ shall not borrow funds for the sole purpose of arbitrage.
- ◆ shall not use third party placement (brokers - C.D. securities) for investment of funds. When placing an inactive deposit with a financial institution, the deposit will be placed directly with the management of the institution. (See criteria in Appendix B for full requirements for placement of investment deposits with financial institutions.)

For Repurchase Agreements, the acceptable collateral is U. S. Treasury Issues or Federal Agency Issues (i.e., FNMA, FHLB, FFCB, and GNMA). A statement showing the type of collateral being utilized must be forwarded.

Investments shall be made with judgement and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

C. Safekeeping of Securities

All purchased securities shall be physically delivered versus payment (DVP basis) to a safekeeping account as designated by the City. It is recognized that this contractual agreement with the designated institution will serve as an independent third party custodian.

D. Maturity and Term

California Government Code Section 53601 states that except as otherwise allowed:

No investment shall be made in any security, other than a security underlying a repurchase or reverse repurchase agreement authorized by this section, which at the time of the investment has a term remaining to maturity in excess of five years, unless the legislative body has granted express authority to make that investment either specifically or as a part of an investment program approved by the legislative body no less than three months prior to the investment.

The City of Los Alamitos administers funds according to cash flow requirements. As a result, there is a core of funds that are not necessary for the daily operational needs of the City for paying expenses. From time to time market conditions of fixed income markets present opportunities for higher interest rates on high grade securities with a low risk exposure. It is in the best interest of the City of Los Alamitos to practice a fully diversified investment plan that will ensure safety, liquidity, and

the increase of acceptable yield from these situations.

To the extent possible, the City of Los Alamitos will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City of Los Alamitos shall not directly invest in securities maturing more than two years from the date of purchase.

At no time will more than 50 percent (50%) of the City of Los Alamitos' funds be invested longer than one year. Purchases greater than two years will meet the following requirements and restrictions:

1. The security must be a U. S. Treasury Note or Bond, a Federal National Mortgage Association (FNMA) debenture, or a Federal Home Loan Bank (FHLB) debenture.
2. A maximum of twenty-five percent (25%) of the City of Los Alamitos' invested funds can be invested in securities over two years.
3. No securities can be purchased by the City of Los Alamitos with a maturity greater than five years unless matched to a specific cash flow or asset acquisition.

E. Investment Authority

The Director of Administrative Services/City Treasurer is authorized to make investments on behalf of the City of Los Alamitos. Such investments shall only be limited to the instruments authorized under California Government

Code Sections 53601 and 53635 and further described in Appendix A.

All investments of the City of Los Alamitos shall be approved by the Director of Administrative Services/City Treasurer.

No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Director of Administrative Services/City Treasurer.

Officers and employees of the City of Los Alamitos involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the Director of Administrative Services/City Treasurer any material financial interests in financial institutions that conduct business with the City of Los Alamitos, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City of Los Alamitos, particularly with regard to the time of purchases and sales. The Director of Administrative Services/City Treasurer shall make similar disclosures to the City Council. Under no circumstances shall investment officers or employees accept gifts, trips, or any type of gratuity from individuals or institutions engaged in investment practices with the City of Los Alamitos.

F. Transfer of Investment Funds

The transferring of investment funds will be carried out exclusively by use of telephonic or electronic wire transfers. Each entity with which the City does business shall receive, in writing from the Director of Administrative Services/City Treasurer, a listing which limits transfers of funds to preauthorized bank accounts only. The listing will also contain the names of City staff authorized to request such transfers and will be updated, in writing, for all changes of authorized staff and bank accounts, as necessary.

G. Deposits

Money must be deposited in state or national banks, state or federal savings associations, or state or federal credit unions in the State of California. It may be in inactive deposits, active deposits or interest-bearing active deposits. The deposits cannot exceed the amount of the bank's, savings and loan's or credit union's paid up capital surplus.

The bank or savings and loan must secure the active and inactive deposits with eligible securities having a market value of 110% of the total amount of the deposits. State law also allows, as an eligible security, first trust deeds having a value of 150% of the total amount of the deposits. A third class of collateral is letters of credit drawn on the Federal Home Loan Bank (FHLB). The investment officer may, at his/her discretion, waive security for that portion of a deposit which is insured pursuant to federal law. Currently, the first \$100,000 of a deposit is federally insured. It is the City's policy to waive this collateral requirement for the first \$100,000 because it is possible to receive a higher rate.

From time to time certain institutions ask to reduce the existing certificate of deposit from \$100,000 to \$99,000 or \$98,000. This is so the accrued interest on the deposit will also be insured. It is to the City's advantage to reduce the principal deposit to the lower level for full insurance coverage of principal and accrued interest if the financial institution requests the reduction and if there is no penalty assessed for the reduction. If funds are to be collateralized, the acceptable collateral is 110% of the deposit in government securities.

H. Investments

The following is a list of investments authorized by the California Government Code:

- U. S. Treasury Issues
- Federal Agency Issues
- Certificates of Deposit
- Bankers Acceptances
- Commercial Paper
- Medium Term Corporate Notes
- Negotiable Certificates of Deposit
- Mutual Funds
- Repurchase Agreements
- Reverse Repurchase Agreements
- Local Agency Investment Fund (LAIF)
- County Pooled Funds
- Passbook Savings/Money Market
- Financial Futures/Options

A description of these investments is listed in Appendix A.

The following types of investments can be used by the City of Los Alamitos:

- U. S. Treasury Issues
- Federal Agency Issues
- Bankers Acceptances (Bank rated C or better or A-1 or better)
- Commercial Paper
- Certificates of Deposit (Bank rated C or better or A-1 or better)
- Medium Term Corporate Notes
- Negotiable Certificates of Deposit (Bank rated C or better or A-1 or better)
- Local Agency Investment Fund (LAIF)
- Passbook Savings Account
- Money Market Account (AAA rated)
- Repurchase Agreements (Master Repurchase Agreement: 102% collateralized)

I. Diversification

The City of Los Alamitos shall diversify its investments by security type and institution. With the exception of U. S. Treasury securities and authorized investment pools, no more than 50 percent (50%) of the City of Los Alamitos' investment portfolio shall be invested in a single security type or with a single financial institution.

J. Performance Standards

The investment portfolio shall be designed with the objective of obtaining a rate of return, throughout budgetary and economic cycles, commensurate with investment risk constraints and cash flow needs.

The basis used by the Director of Administrative Services/City Treasurer to determine whether market yields are being achieved shall be the U. S. Treasury Bill and Local Agency Investment Fund (LAIF).

K. Reporting

In accordance with California Government Code Sections 53607 and 53646, the Director of Administrative Services/City Treasurer and the City Manager shall render monthly reports to the City Council showing: (a) type of investment; (b) institution; (c) date of maturity; (d) amount of deposit; (e) current market value for all securities with a maturity of more than twelve (12) months; (f) rate of interest on each security; and (g) such other data as the City Council may, from time to time, specify.

The Director of Administrative Services/City Treasurer shall establish an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures.

L. Policy Review

1. Annual Statement of Investment Policy

The Director of Administrative Services/City Treasurer and the City Manager shall annually render to the City Council a Statement of Investment Policy which Statement shall be adopted by the City Council.

2. Periodic Review

To ensure a statement which is consistent with any new relevant legislation and financial trends, the Director of Administrative Services/City Treasurer shall periodically report to the City Council proposed changes and amendments to this document for

review and approval. In any event, all changes in state law affecting this policy shall be considered incorporated immediately upon their effective date unless otherwise adopted earlier by action of the City Council.

APPENDIX A

DEPOSITORY SERVICES

Active deposits are demand or checking accounts which receive revenues and pay disbursements.

Interest-bearing active deposits are money market accounts at a financial institution (i.e., bank, savings and loan, credit union). These accounts are demand accounts (i.e., checking accounts) with restricted transaction activity.

Inactive deposits are Certificates of Deposit issued in any amount for periods of time as short as fourteen days and as long as several years. Interest must be calculated on a 360 day basis, actual number of days. The criteria for investments in Certificates of Deposit are described in Appendix B.

Passbook savings account is similar to an inactive deposit except not for a fixed term. The interest rate is much lower than Certificates of Deposit, but the savings account allows for flexibility. Funds can be deposited and withdrawn according to daily operational needs.

INVESTMENT SECURITIES

U.S. Treasury Issues are direct obligations of the United States Government. These issues are called bills, notes, and bonds. The maturity range of new issues is from 13 weeks (T-Bills) to 30 years (T-Bonds). These are highly liquid and are considered the safest investment security.

Federal Agency Issues are issued by direct U. S. Government agencies or quasi-government agencies. These issues are guaranteed directly or indirectly by the United States Government. Examples of these securities are Federal Home Loan Bank (FHLB) notes, Federal National Mortgage Association (FNMA) notes, Federal Farm Credit Bank (FFCB) notes, Federal Intermediate Credit Bank (FIC) debentures, Small Business Administration (SBA) notes, Government National Mortgage Association (GNMA) notes, and Student Loan Association (SALLMAE) notes.

Certificates of Deposit are investments for inactive funds issued by banks, savings and loans, and credit unions. Investments of \$100,000 are insured respectively by Federal Deposit Insurance Corporation (FDIC), Federal Savings and Loan Insurance Corporation (FSLIC), and the National Credit Union Share Insurance Fund (NCUSIF). Certificates of Deposit can be issued from 14 days to several years in maturity allowing the City investment of funds to be matched to cash flow needs. For deposits exceeding \$100,000, the financial institution is required to collateralize the investment with 110% government securities. The City does not accept 150% collateral (First Trust Deeds) or 105% Letters of Credit (L.C.).

Negotiable Certificates of Deposit (NCD) are unsecured obligations of the financial institution. These securities

are generally issued in bearer form and pay interest at maturity. Although negotiable, a strong secondary market exists only in the NCD's issued by the largest United States banks. Examples of large banks include Bank of America, Citibank, Chase Manhattan, Manufacturers Hanover, etc. These securities generally trade with minimum amounts of \$1 million per trade with the average trade in the secondary market of \$5 million.

Bankers Acceptances are short term credit arrangements to enable businesses to obtain funds to finance commercial transactions. They are time drafts drawn on a bank by an exporter or importer to obtain funds to pay for specific merchandise. By its acceptance, the bank becomes primarily liable for the payment of the draft at maturity. An acceptance is a high grade negotiable instrument. Acceptances are purchased in various denominations for 30 to 180 days but no longer than 180 days. The interest is calculated on a 360 day discount basis similar to Treasury Bills. Local Agencies cannot invest more than forty percent (40%) of their surplus money in Bankers Acceptances.

Commercial Paper is a short term unsecured promissory note issued by a corporation to raise working capital. These negotiable instruments may be purchased at a discount to par value or interest bearing. Commercial paper is issued by corporations such as General Motors Acceptance Corporation (GMAC), Shearson-American Express, Bank of America, Wells Fargo Bank, etc.

Local agencies are permitted by state law to invest in commercial paper of "prime" quality to the highest ranking or of the highest letter and numerical rating as provided by Moody's Investor's Service, Inc. or Standard and Poor's Corporation. Purchases of eligible commercial paper may not exceed 180 days maturity nor exceed fifteen percent of the local agency's surplus funds. An additional fifteen percent (15%) (for a total of 30%) can be invested in Commercial Paper provided the average maturity of invested funds in Commercial Paper does not exceed 30 days.

Medium Term Corporate Notes are unsecured promissory notes issued by a corporation organized and operating in the United States. These are negotiable instruments and are traded in the secondary market. Medium Term Corporate Notes (MTN) can be defined as extended maturity commercial paper. Corporations use these MTN's to raise capital. Examples of MTN issuers are General Electric, GMAC, Citibank, Wells Fargo Bank, etc.

Local agencies are restricted by the California Government Code to investments in corporations rated in the top three note categories by a single nationally recognized rating service. Further restrictions are a maximum term of five years to maturity and total investments in Medium Term Corporate Notes may not exceed thirty percent (30%) of the local agency's surplus money.

Repurchase Agreements and Reverse Repurchase Agreements are short term investment transactions.

Banks buy temporarily idle funds from customers by selling them U. S. Government or other securities with a contractual agreement to repurchase the same securities on a future date. Repurchase Agreements are typically for one to ten days in maturity. The customer receives interest from the bank. The interest rate reflects both the prevailing demand for Federal Funds and the maturity of the repo. Some banks will execute Repurchase Agreements for a minimum of \$100,000, but most banks have a minimum of \$500,000. A Reverse Repurchase Agreement (Reverse repo) is exactly what the name implies. The City of Los Alamitos may invest periodically in Repurchase Agreements, but as a matter of policy the City of Los Alamitos does not invest in Reverse Repurchase Agreements.

Local Agency Investment Fund (LAIF) is a special fund in the State Treasury which local agencies may use to deposit funds for investment. There is no minimum investment period and the minimum transaction is \$5,000, in multiples of \$1,000 above that, with a maximum of \$20 million for any agency. It offers high liquidity because deposits can be converted to cash in twenty-four hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate share determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly by electronic deposit to a designated bank account.

The State keeps an amount for reasonable costs of making the

investments, not to exceed one-quarter of a percent of the earnings.

County Pooled Funds are similar to the State of California Local Agency Investment Fund (LAIF), but administered by the County of Orange.

Mutual Funds are referred to in California Government Code Section 53601(k) as “shares of beneficial interest issued by diversified management companies.” The Mutual Fund must be restricted by its by-laws to the same investments as the local agency by the California Government Code. These investments are Treasury Issues, Federal Agency Issues, State of California and City (within California) debt obligation, Bankers Acceptances, Commercial Paper, Certificates of Deposit, Negotiable Certificates of Deposit, Repurchase Agreements, Reverse Repurchase Agreements, Financial Futures and Financial Options and Medium Term Corporate Notes. The quality rating and percentage restrictions in each investment category applicable to the local agency also apply to the Mutual Fund.

A further restriction is that the purchase price of share or mutual funds shall not include any sales commission. Investments in mutual funds shall not exceed fifteen percent of the local agency’s surplus money.

Financial Futures and Financial Options are forward contracts for securities. The California Government Code states that a local agency may incur future contracts/options for any of the investment securities enumerated in Section 53601. Due to the volatility of

trading in financial futures, the City of Los Alamitos does not invest in financial futures or financial options.

APPENDIX B

INVESTMENT CRITERIA FOR FINANCIAL INSTITUTIONS

The City of Los Alamitos requires that each financial institution submit current financial statements which are evaluated by staff prior to the investment of funds. The following criteria are used:

The institution must have been in business at least three years.

The institution must submit audited financial statements.

The institution must have assets of at least \$50 million and a net worth to liability ratio of 3.5% to 1.

Investments of less than 180 days to maturity can use a net worth asset ratio of 3.0% to 1.

Investments in Credit Unions require Equity (net worth) to Asset Value of 5.0%. The loan balance to share draft ratio is compared to industry standards, but should not exceed 90%. The City may invest funds for a period up to 120 days in institutions with a Regular Reserve to Loan Balance ratio of a least 3.25%. For longer periods of time, the ratio must be at least 4.0%.

In addition, examination is made of the Reserve for Loan Losses category to evaluate the financial trend of the institution's asset base. When available, data is evaluated regarding the level of non-performing assets (i.e., loans no longer paying interest and/or principal in the amount called for in the original contract agreement). Comparison is made of institution ratio values to the industry averages.

Under deposits, if data is available, we track the ratio of \$100,000 certificates of deposit (brokered money) to the total deposit base. A percent greater than 50% is an area of concern.

Whenever possible, the use of several years' financial data is evaluated to present a trend of activity in the institution.

It is also required that interest be paid on a monthly basis; current law only requires quarterly payments. No more than \$100,000 is placed in any savings and loan, small bank, or credit union.