COUNCIL AGENDA: 06/05/07
ITEM: 3.7

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Nadine N. Nader

SUBJECT: **SEE BELOW**

DATE: May 25, 2007

Approved Kay Winer Date 5/25/07

SUBJECT: CITY FINANCIAL INVESTMENT PROGRAM AND INVESTMENT POLICY [Public Safety, Finance and Strategic Support Committee referral 5/17/07 – Item 4]

On May 17, 2007 staff presented a report on the City's Financial Investment Program and Investment Policy to the Public Safety, Finance and Strategic Support Committee. The Committee requested that the report be cross-referenced for full Council consideration. Attached please find the following documents:

- Macias Consulting Group – Investment Unit Evaluation Report, Response and Supplemental Information
- Proposed Changes to the City of San José Investment Policy
- Attachment: 05-24-07 draft changes to the City of San José Investment Policy

Michell [signature]
for NADINE N. NADER
Agenda Services Manager

Attachments

COUNCIL AGENDA: 06-05-07
ITEM: 3.7 (a)

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Scott P. Johnson

SUBJECT: **MACIAS CONSULTING GROUP – INVESTMENT UNIT EVALUATION REPORT, RESPONSE AND SUPPLEMENTAL INFORMATION**

DATE: May 25, 2007

Approved Kay Winer   Date 5/25/07

COUNCIL DISTRICT: Citywide

RECOMMENDATION

Review and acceptance of the "*City of San Jose Investment Unit Evaluation Report*" prepared by Macias Consulting Group as supplemented by the responses prepared by the Director of Finance and provide direction to staff subject to the review of the supplemental information requested by the Public Safety Finance & Strategic Support Committee regarding adding resources to the Investment Program as outlined in the Macias Report.

OUTCOME

Acceptance of the Investment Unit Evaluation prepared by Macias Consulting ("Macias Report"), as supplemented by the responses prepared by the Finance Department, will assist the Investment Unit of the Treasury Division to begin to move forward on evaluation of changes to processes, procedures and staffing levels which will enhance the City's Investment Program.

BACKGROUND

The attached report prepared by Macias Consulting and the responses prepared by the Finance Department were presented at the May 17, 2007 Public Safety, Finance & Strategic Support Committee (the "Committee") meeting. The Committee accepted the reports and recommendations as supplemented by the Finance Department's response. The Committee also directed the Department prepare a supplemental report to the City Council for the June 5, 2007 meeting regarding the timeline and benefits for enhancing the staffing levels in the Investment

Program. This supplemental report contains a "high-level" assessment on how additional resources (City personnel, non-personnel/equipment, consulting services, technology enhancements, and partial portfolio outsourcing) could positively impact the City's rate of return on the Investment Portfolio.

ANALYSIS

This section of the report contains a discussion of additional investment opportunities, potential yield benefit, and staffing/resource requirements to realize these additional opportunities. As noted in the response to the Macias Report, a disproportionate amount of staff time is spent on the *"day-to-day efforts of record-keeping and reporting"* rather than on investment and cash flow analytics. The City's Investment Policy allows for a diversity of investment vehicles, including such investment options as commercial paper, money market mutual funds, repurchase agreements and corporate notes. These investment options require more staff analytics and ongoing monitoring in order to purchase and ensure continued compliance with the Investment Policy.

Investment Opportunities

As part of the "high-level" analysis used to determine the potential benefits of adding additional resources to enhance portfolio performance with greater diversification, it is important to understand the dynamics of the day-to-day management of the City's portfolio. The City's goals when making investment decisions is to first safeguard its principal, second, to ensure liquidity to meet expenditures, and third, to earn a market rate of return on investments. Individual investment decisions are based on these three tenets and always in this order.

Short-Term Investments Generally, different types of securities best fit different parts of the investment time horizon. Shorter more liquid investments are made with use of commercial paper ("CP"), Local Agency Investment Fund ("LAIF"), and money market mutual funds. The City's current practice is to utilize LAIF and a limited number of CP issuers, which have been reviewed and meet the City's credit requirements. During the course of the last year, the City invested approximately $1.7 billion in CP to meet cash flow needs.[1] If additional resources were available to conduct more analytics on money market mutual funds, repurchase agreements and other CP issuers, the City would have additional qualified investments options in order to make these short-term investments, allowing for greater portfolio diversification.

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[1] Note, while the City's total portfolio averages approximately $1.2 billion, investments and reinvestments are made during the course of the year in which the total investment volume exceeds the total portfolio size given both receipt of revenue and investment maturities both of which require reinvestment if funds are not needed on the day of receipt of revenue or maturity of the investment.

Longer-Term Investments The City's current practice with respect to investments of longer-term maturities (one to five years) is to invest in U.S. Government Agencies. U.S. Government Agencies represent approximately 93.2% of the City's current investment portfolio. During the course of the last year, the City invested approximately $705 million in this one to five year maturity range. Other additional investment vehicles, permitted by the Policy, include Corporate Notes and callable U.S. Government Agencies. The Investment Policy permits 15% of the portfolio to be invested in Medium-Term Corporate Notes ("Corporate Notes") with no more than 5% with any one issuer and no maturity can exceed three years. In today's market, Corporate Notes (with rating at least "A" or better by two of three rating agencies) yield 10 – 34 basis points[2] over U.S. Agencies with the same maturity. Additional staffing resources would provide the Investment Unit the opportunity to evaluate Corporate Notes as investment opportunities by having sufficient staff resources to analyze, research and monitor these investments.

Additionally, more time spent analyzing the City's cash flow needs would allow for greater use of callable securities[3]. As of March 31, 2007 (latest investment report available), 93.2% of the portfolio was invested in U.S. Agency Obligations, with 10.5% of these investments in callable securities. Callable U.S. Agency Obligations, in today's interest rate environment, are generally yielding 25 basis points above bullet maturities.[4] With additional staff analytical resources, investment decisions can be made with respect to liquidity needs at the call date(s) and the maturity date thereby reducing the reinvestment risk with the purchase of callable securities. Greater use of callable securities requires more quantitative analysis which is not currently possible with existing staff resources.

Potential Portfolio Yield Benefit

For every basis point increase in overall portfolio yield, the portfolio earns approximately $120,000 in additional interest earnings[5]. As noted in the discussion above there are several investment options that staff could research and add to the portfolio for increased diversification without moving away from the primary investment strategy of "buy and hold". Over time, with additional staff resources and consulting services, staff believes that portfolio yields could be increased by 5 to 7 basis points ($600,000 to $840,000 per year) over the yield obtained by maintaining our current portfolio mix. This additional yield could begin to be realized incrementally as staff is hired, trained and investment/reinvestment opportunities present themselves and after securing an investment advisor through a request for qualifications process. It is expected to take six to twelve months from placing the additional resources (staff, consulting

[2] Basis Point – one-hundredth of one percent (i.e. 0.01%).
[3] Callable Security – A security that can be redeemed by the issuer before the scheduled maturity date.
[4] Bullet Maturity -- A bond that is can not be redeemed by the issuer prior to maturity. Prior to the maturity or prepayment of the bond, interest payments are to be made in accordance with the payment schedule and principal is repaid in one lump sum at maturity.
[5] Assuming portfolio size of $1.2 billion.

services and technology enhancements) in service to start to realize the benefit of the investment in these additional resources.

Two-Year Phased Staffing and Resources Implementation

In implementing this enhanced Investment Program, staff recommends a two-year phased process. The Macias Report recommends the immediate hiring of an Investment Officer position. The Administrative Officer who previously held this position retired in March 2007. The Finance Department has commenced discussions with the Human Resources Department to create a more "finance specific series" for filling the highly technical (both in skills and educational level) positions required to operate and manage the City's Investment and Debt Programs, rather than continuing to utilize the City's generic administrative/analytical series. This need is juxtaposed over the immediate need to fill a critical high-level management position. With the addition of the recommended staffing shown in the table below, the total staff resources devoted to the Investment Program would be four management positions and two clerical positions responsible for the City's $1.2 billion investment portfolio. (The current staffing includes two management and two clerical positions).

In order to begin to examine the feasibility of modifying the City's investment strategy of "buy-and-hold" and to provide market insight, adding funds for an investment advisory consultant services agreement would assist staff moving forward in this area.

Summary of Additional Investment Program Resources

Investment Manager*	$140,000
Financial Analyst*	120,000
Investment Advisor Consulting Services**	80,000
Non-Personnel Costs (computer equipment, online market services i.e. Bloomberg, ongoing training)	60,000
Treasury Technology Enhancements	70,000
Total Estimated Program Resource Costs	$470,000

**Staffing costs are estimated at full-year costs; given time involved in recruiting, first year costs can be assumed at 50 – 60% of first year costs.*
***First year costs assumed at 60% for investment advisor*

After achieving these first year objectives, staff would begin working with the investment advisor on options, parameters and performance measures to explore outsourcing a portion of the portfolio to an outside investment firm. These options and any Investment Policy changes would be brought forward to the Public Safety, Finance & Strategic Support Committee and subsequently to the City council for their review and approval.

ALTERNATIVES

Not applicable

PUBLIC OUTREACH/INTEREST

Not applicable

☐ **Criteria 1**: Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**

☐ **Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

☐ **Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

COORDINATION

The response to the Investment Unit's Evaluation has been prepared by the Finance Department in coordination with the City Manager's Office.

COST SUMMARY/IMPLICATIONS

During the course of the fiscal year, the City's General Fund represents 15% to 20% of the total portfolio. The costs of the Investment Program are spread proportionally across all of the funds included in the portfolio, and interest earnings are allocated proportionally as well.

SCOTT P. JOHNSON
Director, Finance

Attachments

For questions, please contact Scott P. Johnson, Director, at (408) 535-7000.

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Scott P. Johnson

SUBJECT: **PROPOSED CHANGES TO CITY OF SAN JOSE INVESTMENT POLICY**

DATE: May 24, 2007

Approved Kay Winer Date 5/25/07

COUNCIL DISTRICT: City-Wide

RECOMMENDATIONS

Adoption of a resolution approving the City of San Jose Investment Policy, including certain changes thereto.

OUTCOME

City Council's annual approval of the City's Investment Policy (the "Policy") meets the requirements contained in the City's Investment Policy, the guidelines set forth in the California Government Code and allows for approval of modifications to the investment guidelines as set forth by the Investment Policy.[1]

BACKGROUND

The City of San Jose Investment Policy (Policy) requires an annual review of the Policy by the Finance Department. The Finance Department submits any proposed changes to the Policy to the City Council for consideration and approval. The review of the Policy this year was undertaken with the following objectives:

- Examine the feasibility of disbanding the Investment Committee and replacing the oversight function with the appropriate Council committee

[1] Even though the provisions of California Government Code Sections 53600 et. seq., do not necessarily apply to San Jose as a charter city, San Jose has determined that it is prudent to conform its Investment Policy to State law.

- Incorporation of changes recommended by Macias Consulting as part of their review of the City's Investment Program

- Clarification of ambiguous language and conformance with current practices and procedures

- Clarification of means of reporting and information included in the Investment Reports

The proposed changes to the Investment Policy were presented to the Public Safety, Finance & Strategic Support ("PSF&SS") Committee on May 17. Based on the discussion and input from the Committee and the City Auditor's Office additional changes were made to the Investment Policy. This memorandum replaces the memorandum that was distributed with PSF&SS Committee packet.

ANALYSIS

In accordance with Section 17, (which is Section 16.0 of the Revised Policy); Finance Department staff has completed its annual review of the Policy. The proposed changes incorporated into the Policy with respect to disbanding the Investment Committee were reviewed with the Investment Committee on March 5, 2007. Committee members concurred with the proposed disbanding of the Investment Committee subject to provisions outlined to the Committee:

- Continue to provide the complete monthly and quarterly investment reports electronically on the City's web site for public access and have a hard copy available to the public in the City Clerk's Office.

- Continue to provide quarterly investment reports to the Council Committee responsible for finance related matters and change the responsibilities of this Council committee, (currently Public Safety, Finance & Strategic Support Committee (PSF&SSC)); to include a full presentation from staff of the Quarterly Investment Reports for quarters ending December 31 and June 30.

- Request that the City Auditor add to his workplan a review of the City's investment program for compliance and internal controls, no less than semi-annually.

This proposal was also conceptually presented to the PSF&SS Committee at the February 15, 2007 meeting with direction to staff to return to the Committee with the revised changes to the Policy to disband the Investment Committee. On May 17, 2007, the Finance Department presented the proposed Policy changes to the PSF&SS Committee for their consideration and approval.

At the PSF&SS Committee Meeting, the City Auditor's Office distributed a memo indicating disagreement with the Finance Department's recommended Policy change which would have included semi-annual compliance reviews of the Investment Program by the City Auditor. An alternative recommendation was made and accepted by the Committee in which the Director of Finance would cause semi-annual compliance audits of the Investment Program. These changes are described in more detail below.

Recommended Changes – Please refer to the Policy attached with this memorandum for recommended changes (the proposed new wording is in double underlined font, while the deleted wording is indicated by strikeouts and changed language following the Committee presentation is highlighted. A color version of the proposed changes has been posted electronically to the City's website). The summary below provides a description of the proposed change and rationale for the change. Small word edits and clarifications are not specifically discussed in the staff report.

Section 3.0 -- Prudent Investor Standard – This language has been revised to more closely mirror the language in the California Government Code. The Prudent Investor standard is a commonly used concept for both public and private investors and provides guidance to professional staff in conducting their day-to-day work in investing and managing the City's investment portfolio.

Section 5.0 – Delegation of Authority – There is a significant amendment to the Policy recommended in this section connected to the recommendation to eliminate the Investment Committee and designate new oversight responsibilities to the City Council.

The Investment Committee's responsibility as described in the Current Investment Policy (Section 5.0(F)) is to provide external review of investment activity, investment strategy, investment and banking procedures, significant investment-related work projects being undertaken in the Finance Department, and new types of debt financings being contemplated by the City. The Investment Committee currently meets quarterly and its meetings are summarized in minutes which are distributed to the City Council. Per the City's Investment Policy, the Investment Committee shall consist of the City Manager (or his/her designee), the Director of Finance, three Deputy Directors of Finance, as appointed by the Director of Finance and three private sector investment experts. Private sector members of the Committee must be professionals who operate in the San Jose area and have a background in finance, investments, economics, accounting, banking, or are educators in a related area.

Due to the difficulty in recruiting public members (only one public member currently resides on the Committee), staff's recommendation for the elimination of the Investment Committee will be with the following safeguards being added or maintained:

- Continue to provide the complete monthly and quarterly investment reports electronically on the City's web site for public access and have a hard copy available to the public in the City Clerk's Office. (Section 15.0 of the Revised Policy)

- Continue to provide quarterly investment reports to the Council Committee responsible for finance related matters and change the responsibilities of this Council committee, (currently Public Safety, Finance & Strategic Support Committee (PSF&SS)), by adding the requirement to include a full presentation from staff of the Quarterly Investment Reports no less than semi-annually for quarters ending December 31 and June 30. (Section 5.0(E) of the Revised Policy).

- Add a new section to the Policy (section 15.4) titled, Semi-Annual Compliance Audits. This new section addresses the requirement to have no less than semi-annual compliance audits to determine whether the City's investments within the City's pooled portfolio are in compliance with the City's Investment Policy. The new proposed language with respect to semi-annual compliance audits is as follows:

  No less than semi-annually each year, a compliance audit shall be conducted of the City's investment program to determine whether the City's investments within the City's pooled portfolio are in compliance with the City's Investment Policy, internal controls, and department procedures. If the City Council does not direct that the compliance audits be included in the City Internal Auditor's annual workplan, then the Director of Finance shall cause such compliance audits to be conducted by an external auditor.

Section 6.0 – Ethics and Conflicts of Interest – This proposed change adds the reference to Government Code Section 1090 as an area which needs to be examined with respect to potential conflicts of interest in addition to the California Political Reform Act.

Section 7.0 – Authorized Financial Dealers and Institutions – The proposed amendments in this section accomplish several objectives:

- Clarification of the City's ability to file copies of audited financial statements of the financial institutions electronically or in paper and clarification that the gathering of financial statements is completed annually as part of the annual review process and not part of an ongoing updating review process. The ability to store the financial statements electronically reduces physical filing requirements, creates ease of access by multiple staff and reduces the time involved in compiling the documentation.

- Clarification that the City will enter into Agreements with Financial Institutions (including broker/dealer firms) to the extent they are providing services other than broker/dealer services to the City. The City will conduct business only with the broker/dealers meeting the Standards for Financial Institutions as described in this section for the purpose of buying and selling securities. All other work must be evaluated by the Director of Finance for the determination of whether a written Agreement is necessary to conduct other investment related activities, such as investment advisory services and investment custodial services.

- Clarification on the timing of distribution of the Investment Policy to Financial Institutions and broker/dealers. The distribution will occur after City Council's approval of any revisions to the Policy or subsequent to the annual approval process.

Section 8.0 – Authorized Investments – There are several changes in the authorized investment section which are recommended to bring our Policy more in alignment with the Government Code. These proposed changes are summarized below:

- Commercial Paper (Section 8.0 (5)), increasing the allowable maturity from 180 days to 270 days. This change conforms to the Government Code and matches the maximum maturity date in which commercial paper can be issued.

- Local Agency Investment Fund ("LAIF") (Section 8.0 (9)), adding the requirement to conduct an annual review of LAIF's Pooled Money Investment Board's ("PMIB") Annual Report. Adding this requirement here, allows for the elimination of Section 9.0 of the Policy, which is duplicative of other sections.

- Money Market Mutual Fund (Section 8.0 (10)), recommended change allows for the credit criteria to be one of two standards (rating or investment advisor management) rather than requiring both. This change is consistent with the Government Code provisions.

Section 9.0 – Investment Pools/Mutual Funds – These requirements are included in Section 7.0 (B), Section 8.0 (9) and Section 8.0 (10) of the Revised Policy. Deleting this section of the Policy ensures that the Policy remains internally consistent and eliminates any duplication.

Section 11.0 – Diversification – The recommended change clarifies that portfolio diversification will be undertaken only to the extent that it is consistent with the primary objectives of safety, liquidity and yield.

Section 14.1 – Market Yield (Benchmark) – The Macias Audit includes two recommendations regarding benchmarking of the portfolio yields. Recommendation #1 suggests elimination of the 6-month rolling average of the one-year T-Bill since the City's portfolio historically has an average days to maturity greater than 180 days. Recommendation #2 suggests selecting specific targets to meet or exceed as benchmarks for yield performance.

Based on these recommendations, staff is revising this section of the policy to eliminate the specific benchmark targets and adding that the Director of Finance determines whether market yields are being achieved by identifying benchmark(s) comparable to the weighted average maturity of the investment portfolio. The recommended change reiterates the primary objective in the design of the City's Investment Portfolio of attaining a market rate of return throughout budgetary and economic cycles, taking into consideration the investment risk tolerance and liquidity needs of the City. Yield on the City's investment portfolio is of secondary importance to the safety and liquidity objectives.

Section 15.0 – Reporting and Distribution – The proposed changes in this section of the policy clarify the electronic means of distribution of the monthly and quarterly investment reports.

- Section 15.1 – Quarterly Investment Reports – the list of items to be included in the Quarterly Investment Report has been rearranged to group the information into the following major categories of reporting: Portfolio Statistics, Portfolio Performance, Compliance Reporting Requirements, Investment Trading Activity, and Investment Strategy. This grouping assists in preparing the quarterly reports.

- Section 15.2 – Monthly Investment Reports – the list of items has also been rearranged to group the information into the following major categories of reporting: Portfolio Statistics, Portfolio Performance, Compliance Reporting Requirements, and adding a section on Investment Strategy.

Section 16.0 – Investment Policy Review/Adoption – The proposed change recommends that the Council Committee responsible for reviewing the quarterly reports also reviews any recommended changes to the Investment Policy prior to submission to the entire City Council for consideration and approval.

Exhibit A -- Primary Dealer Name Changes – Primary government securities dealers report weekly to the Government Securities Dealers Statistics Unit of the Federal Reserve Bank of New York. The proposed revisions to Exhibit A in the attached Investment Policy reflect the most recent changes to the Federal Reserve Bank's Primary Dealer List which was last updated February 8, 2007. Two dealers have been removed from the list, ABN AMRO Bank N.V., New York Branch and CIBC World Markets Corp. and one firm has been added to the list Cantor Fitzgerald & Co.

PUBLIC OUTREACH

The proposed changes regarding disbandment of the Investment Committee were discussed at the March 5, 2007 Investment Committee meeting. The proposed revisions were also discussed and approved by the Public Safety, Finance & Strategic Support Committee on May 17, 2007.

COORDINATION

This memorandum was coordinated with the offices of the City Manager and City Attorney.

COST SUMMARY/IMPLICATIONS

Not applicable.

CEQA

Not a project.

Scott Johnson
SCOTT P. JOHNSON
Director, Finance Department

Attachment

For questions, please contact Julia H. Cooper, Deputy Director, Treasury at (408) 535-7011.

C I T Y O F S A N J O S E

I N V E S T M E N T P O L I C Y

1.0 POLICY

The purpose of this Investment Policy ("Policy") is to establish overall guidelines for the management and investment of the City of San Jose's ("City") public funds.

It is the policy of the City to invest public funds in a manner to meet the City objectives, in order of priority, safety of invested funds, maintenance of sufficient liquidity to meet cash flow needs; and attainment of maximum yield possible consistent with the first two objectives, while conforming to the provisions of California Government Code Sections 53600 et seq.[2], the Charter of the City of San Jose, the City of San Jose Municipal Code, and this Policy.

2.0 SCOPE

This Policy applies to all funds, entities and investment activities under the Director of Finance's control as accounted for in the Comprehensive Annual Financial Report, including but not limited to the following unless specifically exempted by statute or ordinance:

- General Fund
- Special Revenue Funds
- Debt Service Funds
- Capital Projects Funds
- Enterprise Funds
- Trust and Agency Funds
- Any new fund created by the City Council unless specifically exempted.

1) The City's Deferred Compensation Plan is excluded because it is managed by a third party administrator under the authority of the City's Deferred Compensation Advisory Committee and invested by individual plan participants. Additionally, the City's Retirement Funds are generally excluded because they are managed by the Retirement Administration under the authority of the Retirement Boards.

2) Proceeds of debt issuances shall be invested in accordance with the investment objectives of this Policy and in accordance with the permitted investment provisions of their specific bond indentures. The reporting requirements in Section 15~~6~~ shall not apply to bond proceeds held by trustees. If in the opinion of the Director of Finance the matching of bond reserve fund with the maturity schedule of an individual bond issue is prudent, the Director of Finance is authorized to cause the bond reserve fund to be invested in an

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[2] Even though the provisions of California Government Code Sections 53600 et. seq. do not necessarily apply to the City as a charter city the City has determined that it is prudent to conform this Investment Policy to State law.

investment vehicle that is authorized by this Policy but that has a maturity that exceeds the five year limitation specified in Section 12~~3~~ of this Policy.

3.0 PRUDENCE

"City Investment Officials" means the Director of Finance, Deputy Director of Finance-Treasury, Administrative Officer-Investment/Cash Management, Financial Analyst/Treasury Analyst and any other Finance staff that the Director of Finance authorizes in writing. The overall investment program shall be designed and managed with a degree of professionalism worthy of the public trust. City Investment Officials performing duties in furtherance of the investment program, shall act as fiduciaries subject to the Prudent Investor Standard which shall be applied in the context of managing an overall portfolio.

~~The overall investment program shall be designed and managed with a degree of professionalism worthy of the public trust.~~

Prudent Investor Standard: Acting with care, prudence and diligence under ~~Investments shall be made with judgment and care – under~~ circumstances then prevailing, that a prudent ~~which p~~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 of the agency. ~~s of~~ Individuals charged with responsibility of investing public funds improve their chance of meeting the prudent investor standard by following a strict professional discipline which involves prudence, discretion and intelligence as exercised 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.

City Investment Officials, acting in accordance with this Policy and written procedures governing the City's investment program and exercising due diligence, shall be relieved of personal responsibility and liability for an individual security's credit risk or market price changes, provided that deviation from expectations are reported in a timely fashion as required by this Policy and the City's investment program procedures and appropriate action is taken to control adverse developments.

4.0 OBJECTIVES

The primary objectives, in order of priority, of the City's investment program are:

A. Safety: Safety of principal is the foremost objective of the investment program. Investments of the City shall 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 financial institutions and securities offering independent returns~~ and financial institutions~~. In particular, the City shall seek to preserve principal by mitigating credit risk and market or interest rate risk by doing each of the following:

- Credit risk, defined as the risk of loss due to the failure of the security issuer or backer, will be mitigated by:

  - ~~1)~~o Limiting investments to the safest types of securities;
  - ~~2)~~o Prequalifying the financial institutions with which the City will do business;
  - ~~3)~~o Diversifying the investment portfolio so that the failure of any one issuer or backer will not place an undue financial burden on the City; and
  - ~~4)~~o Monitoring the investment portfolio on a daily basis to anticipate and respond appropriately to a significant reduction of credit worthiness of any of the depositories.

- Market or interest rate risk, defined as the risk that the market value of portfolio securities will fall due to an increase in general interest rates, will be mitigated by:

  1) Structuring the City's portfolio so that securities mature to meet the City's cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to their maturation to meet those specific needs; and

  2) Occasionally restructuring the portfolio to minimize the loss of market value and/or maximize cash flows subject to the constraints described in Section 14~~5~~.2 of this Policy.

B. Liquidity: The City's investment portfolio will be structured in a manner which will provide that securities mature at the same time as cash is needed to meet anticipated demands (static liquidity). Additionally, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity). The specific percentage mix of different investment instruments and maturities is described in Section 8.0 of this Policy.

It is the full intent of the City to hold all investments until maturity to ensure the return of all invested principal. However, securities may be sold prior to maturity as needed to comply with the intent of this Policy. While it may occasionally be necessary or strategically prudent for the City to sell a security prior to maturity to either meet unanticipated cash needs, to minimize loss of principal of a security with declining credit, or to restructure the portfolio, this Policy specifically prohibits trading securities for the sole purpose of speculating or taking an unhedged position on the future direction of interest rates. Specifically, "When, as, and if issued" trading and open-ended portfolio restructuring transactions are prohibited.

C. Yield: The City's investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into consideration the investment risk constraints and liquidity needs. Yield on the City's investment portfolio is of secondary importance compared to the safety and liquidity objectives described above. Investments are limited to relatively low-risk securities in anticipation of earning a fair return relative to the risk being assumed. Nevertheless, investment performance shall be continually monitored and evaluated by the Director of Finance by comparison with other ~~investment portfolio~~ benchmark yields.

5.0 DELEGATION OF AUTHORITY

Authority to manage the City's investment program is derived as follows:

A. Responsibilities of the Finance Department

The Finance Department is charged by the City Charter with responsibility for maintaining custody of all public funds and securities belonging to or under the control of the City, and for the deposit and investment of those funds in accordance with principles of sound treasury management and in accordance with applicable laws and ordinances.

B. Responsibilities of the Director of Finance

The Director of Finance is appointed by the City Manager and is subject to his or her direction and supervision. In accordance with the City Charter, Article VIII, Section 806, the Director of Finance is charged with responsibility for the conduct of all Finance Department functions, including the custody and investment of City funds, and the development of procedures to implement this Policy. The Director of Finance is further responsible for the duties and powers imposed by the general laws of the State of California upon City Treasurers, City Assessors and City Tax Collectors.

Subject to the limitations and requirements specified in this Policy, the Director of Finance and his/her authorized designee(s) can execute agreements and other forms of documentation in order to make investments in Permitted Investments (as defined in Section 8, below). Under the oversight of the Director of Finance, responsibility for the operation of the investment program may be delegated to the Finance staff, who shall act in accordance with established written procedures and internal controls consistent with the Policy. The Director of Finance shall be responsible for all transactions undertaken and shall establish a system of controls in accordance with Section 1~~3~~4.0 of this Policy.

C. Responsibilities of the City Manager

The City Manager is responsible for directing and supervising the Director of Finance. He or she is responsible further to keep the City Council fully advised as to the financial condition of the City.

D. Responsibilities of the City Auditor

The City Auditor is charged by the City Charter with conducting performance audits as assigned by the City Council. A review of the City's investment program could be a part of the responsibility described above. ~~A review of the City's investment program could be part of the responsibility described above. Accordingly, Nno less than semi-annually each year, the City~~

~~Auditor's Office shall conduct or cause to be conducted a compliance audit of the investment program which is to be limited to compliance with the Investment Policy, internal controls, and departmental procedures with respect to the investment of funds. . A review of the City's investment program could be part of the responsibility described above.~~

~~A performance review of the City's investment program could be part of the performance audit function responsibility described in the City Charter, but is not contemplated as part of the semi-annual compliance review.~~

E. Responsibilities of the City Council

The City Council shall annually review and shall adopt by resolution the ~~consider and adopt a written~~ Investment Policy as described in Section 16.0. As provided in that Policy, the Council shall receive and review monthly and quarterly investment reports. The distribution of these monthly and quarterly reports shall be by electronic means as described in Section 15~~6~~.0 of the Policy. No less than semi-annually, with the Second Quarterly Report (July – December) and the Fourth Quarterly Report (January – June) the City Council Committee assigned the responsibility for review of Finance Department reports shall have agendized a presentation and overview of the City's Investment Program.

~~F. Responsibilities of the Investment Committee~~

~~There shall be an Investment Committee consisting of the City Manager (or his/her designee), the Director of Finance, three Deputy Directors of Finance, as appointed by the Director of Finance and three private sector investment experts. A fourth Deputy Director of Finance will serve as an alternate member to provide a quorum as needed. Private sector members of the Committee must be professionals who operate in the San Jose area and have a background in finance, investments, economics, accounting, banking, or are educators in a related area.~~

~~Nominations of potential candidates to fill the private sector Committee vacancies may be made to the Finance Department by the Mayor, Councilpersons and the Administration. After collecting the nominations, the Finance Department will forward all nominations to the Mayor who will then appoint the new member from the list of nominations. The private sector Committee members will serve staggered 4-year terms.~~

~~The Committee shall meet at least quarterly to discuss investment activity, investment strategy, investment and banking procedures, significant investment-related work projects being undertaken in the Finance Department, and new types of debt financings being contemplated by the City, as requested by Council, by Council Committees, or by the Administration. The Committee's meetings will be summarized in minutes which are distributed to the City Council.~~

5.1 INVESTMENT PROCEDURES

The Director of Finance shall establish written investment policy procedures for the operation of the investment program consistent with this Policy. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No City Investment Official may engage in an investment transaction on behalf of the City except as provided under the terms of this Policy and the written procedures established by the Director of Finance.

6.0 ETHICS AND CONFLICTS OF INTEREST

City Investment Officials involved in the investment process shall refrain from personal business activity that could conflict with proper execution of investments subject to this Policy. City Investment Officials shall avoid all conflicts of interest or appearance of conflicts of interest when performing duties in furtherance of this investment program. The Director of Finance shall immediately disclose any financial interest which is subject to disclosure under the California Political Reform Act or would constitute a conflict of interest under Government Code Section 1090 to the City Manager and the City Attorney. All other City Investment Officials shall immediately disclose any financial interest which is subject to disclosure under the California Political Reform Act or would constitute a conflict of interest under Government Code Section 1090 to the Director of Finance, who in turn will immediately notify the City Manager and the City Attorney. Additionally, City Investment Officials shall comply with the City's Code of Ethics, conflict of interest requirements under state law and the disclosure requirements of the Political Reform Act.

7.0 AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS

A. Standards for Financial Institutions eligible to transact investment business with the City include (collectively, "Financial Institutions"):

- Primary government dealers as designated by the Federal Reserve Bank of New York (Exhibit A)
- Broker/dealer licensed by the State of California
- Member of National Association of Security Dealers
- National or state chartered banks
- Direct issuers of securities eligible for purchase by the City

~~—~~B. The Director of Finance will maintain a list of financial institutions authorized to provide investment services and a list of approved security broker/dealers after a careful review of their qualifications and creditworthiness. All financial institutions and broker/dealers who desire to do business with the City shall provide the necessary information (e.g. audited financial statements, proof of state registration, proof of National Association of Security Dealers certification, etc.) from which the City can determine their creditworthiness, the existence of any pending legal action against the firm or the individual broker/dealer as well as an understanding of the security markets that they serve.~~ice.~~

The Director of Finance will conduct an annual review of the financial condition and registrations of qualified financial institutions and security broker/dealers. ~~Current a~~Audited financial statements, collected as part of the annual ~~will~~review will be on file (either paper or electronic) for each financial institution and broker/dealer with which the City invests.

~~After a review of the financial statement and all other relevant information, t~~The Director of Finance ~~City~~ will make a determination on whether an Agreement (consultant or ~~e whether a~~ service agreement) needs to ~~should~~ be executed with the financial institution based on the scope of services and compensation provided. For example, City currently executes an Agreement for Investment Custodial Services and to the extent any broker/dealer is providing investment advisory services, the City will enter into an Agreement for those services. Additionally, any firm in which the City enters into a Repurchase Agreement must meet the requirements outlined in Section 8.0(7) of the Policy. ~~standards outlined in this Policy.~~ The City requires that an agreement for services be executed prior to entrusting its funds to any dealer or financial institution, and that up-to-date financial statements be sent to the Director of Finance upon their issuance.

C. ~~Upon revision of the Policy and a~~After the annual Council adoption of the Policy, t~~T~~he Director of Finance shall ~~annually~~ send a copy of the current edition of ~~revised~~ Policy to all Financial Institutions and broker/dealers, which are approved to execute investment transactions with the City. Confirmation of receipt of this policy shall be considered evidence that the Financial Institution and broker/dealer understands the City's Policy and intends to sell the City only appropriate investments authorized by this Policy.

8.0 AUTHORIZED INVESTMENTS

All investments shall conform to Sections 53600 et seq. of the California Government Code and as described within the Policy ("Permitted Investments"). Permitted Investments and applicable limitations shall include:

1) United States Treasury Obligations, including Bonds, Notes and Bills:

- There is no maximum portfolio limit.
- Purchase in Treasury securities shall not exceed five years to maturity.

2) United States Government Agency Issues

- The purchase of United States Federal Government Agency securities will be limited to issues of the Federal Farm Credit Banks (FFCBs), the Federal Home Loan Banks (FHLBs), Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA) and the Student Loan Marketing Association (SLMA). This limitation shall not apply to money market mutual funds described in Subsection 10.
- There is no maximum portfolio limit.
- Purchase in eligible Agency securities shall not exceed five years to maturity.

3) Bankers Acceptances (BAs)

- The purchase is limited to BAs issued by domestic U.S. or foreign banks and which must be rated by Fitch Financial Services Inc. ("Fitch") as follows: an issuer rating of "B" or better for domestic U.S., "C" or better for California banks, or "A/B" or better for foreign banks.
- Foreign BAs must be dollar-denominated.

- No more than 5% of the portfolio shall be invested in any single institution.
- No more than 25% of the portfolio shall be invested in BAs.
- The maturity of any BA shall not exceed 180 days.

4) Time Deposits

- Deposits up to $100,000 are federally insured and are limited to banks and savings and loans with offices located in the San Jose area.
  - No more than $10 million of the portfolio shall be invested in federally insured time deposits of which no more than 5% shall be invested in one issuer.
  - Deposits shall not exceed the net worth of the bank or savings and loan.
  - The maturity of such deposits shall not exceed three years.
- Deposits over $100,000 are limited to banks and savings and loans in the San José area.
  - Depositories must have an issuer rating of “B” or better by Fitch.
  - Deposits shall be collateralized in the manner prescribed by State law for depositories.
  - No more than $10 million of the portfolio shall be invested in non-negotiable and collateralized deposits of which no more than 5% shall be invested in one issuer.
  - Deposits shall not exceed the net worth of the bank or savings and loan.
  - The maturity of non-negotiable and collateralized deposits shall not exceed 18 months.

5) Commercial Paper (CP)

- The California Government Code restricts cities to investing in commercial paper of prime quality of the highest rankings or of the highest letter and number rating as provided for by Moody’s Investment Service (Moody’s), Standard and Poor’s (S&P) or Fitch.
- Issuing corporations must be organized and operating within the United States and have total assets in excess of $500,000,000 and shall issue debt, other than commercial paper, if any, that is rated “A” or higher by Moody’s, S&P or Fitch.
- Purchase of commercial paper may not represent more than 10% of an issuing corporation’s commercial paper.
- No more than 5% of the portfolio shall be invested in any single institution.
- No more than 20% of the portfolio shall be invested in commercial paper.
- The maturity of the commercial paper shall not exceed 270~~180~~ days.

6) Negotiable Certificates of Deposit (NCDs)

- Depositories shall be limited to banks and savings and loans with an issuer rating of “A/B” or better by Fitch.
- No more than the lesser of the net worth of the institution or 5% of the portfolio shall be invested in any single institution.
- No more than 25% of the portfolio shall be invested in NCDs.
- The maturity of the NCDs shall not exceed 180 days.

7) Repurchase Agreements (Repos)

- Repos are executed only with primary dealers of the Federal Reserve Bank of New York and financial institutions which have entered into the City's Master Repurchase Agreement and any subsequent amendments to the Master Repurchase Agreement.

- Securities accepted as collateral for repurchase agreements are U.S. Treasury or U.S. Federal Government Agency issues permitted by this Policy and the limitations set for under Section 8.0(2).
- The market value of securities accepted as collateral as authorized by this Policy shall be at the time of transfer equal to at least 102 percent of the face value of the Repo.
- For other than overnight investments, the securities transferred shall be marked to market on a daily basis and maintained at a market value equal to at least 102 percent of the repurchase agreement's face value.
- There is no maximum portfolio limit.
- The maturity of any Repo shall not exceed 10 days.

8) Corporate Notes
- Securities eligible for investment must be rated "A" or better by two of the three nationally recognized rating services.
- No more than 5% of the portfolio shall be invested in any single institution.
- Medium-term corporate notes may not exceed 15% of the City's portfolio.
- The maturity of any corporate note shall not exceed three years.

9) Local Agency California Investment Fund (LAIF)
- Funds may be invested in LAIF; a State of California managed investment pool, up to the maximum dollar amounts per separate legal entity in conformance with the account balance limits authorized by the State Treasurer.
- Annual review of LAIF's Pool Money Investment Board Annual Report will be conducted to continue to ensure LAIF's investment policy, standards and rate of return are compatible with the City's risk tolerance.

10) Money Market Mutual Fund
- An investment objective of the fund must be the maintenance of a price per share of $1.00.
- Fund is registered with the Securities and Exchange Commission (SEC)
- Must meet either one of the following credit criteria for investment:
  - ~~The fund is registered with the Securities and Exchange Commission (SEC)~~
  - ~~a~~Obtained the highest ranking or highest letter and numerical rating provided by not less than two nationally recognized rating organizations; or ~~nd is rated AAA by S&P or Aaa by Moody's.~~

  a.

  b. Retained an investment adviser registered with the SEC, or exempt from the SEC registration requirements with not ~~The fund has retained an investment adviser registered or exempt from registration with the SEC with not~~ less than five years ~~'~~ experience investing in securities and obligations authorized by the California Government Code 53601 and managing money market mutual funds with assets under management in excess of $500 million.
- The fund invests only in U.S. Treasury and U.S. Federal Government Agency securities, and in repurchase agreements backed by U.S. Treasury and U.S. Federal Government Agency securities.
- No more than 5% of the portfolio shall be invested in any one mutual fund.
- No more than 15% of the portfolio shall be invested in money market mutual funds.

11) Reverse Repurchase Agreements (Reverse Repos)

- Except as otherwise authorized by the City Council, the use of reverse repurchase agreements will be limited to those occasions where unanticipated, short-term cash requirements can be met more advantageously by initiating a reverse repurchase agreement than by selling a security into the secondary market prior to its maturity.
- Reverse repurchase agreements are executed only with primary dealers of the Federal Reserve Bank of New York which have signed the City's Master Repurchase Agreement and any subsequent amendments to the Master Repurchase Agreement.
- Under no circumstances shall the City sell securities through reverse repurchase agreements for the purpose of financing the acquisition of other securities.
- The term of any reverse repurchase agreement shall be limited to 30 days.
- The amount of the agreement may not exceed the lesser of $25 million or 20% of the base value of the portfolio, and only a single agreement shall be in effect at one time.
- Prior written approval by the City Manager or his or her designee is required to enter into a reverse repurchase agreement, and the fact that such a reverse repurchase agreement has been executed will be reported in writing within 72 hours to the City Manager, City Council and City Auditor and will also be included in the Monthly Investment Report.

12) California Municipal Bonds

- California municipal bonds are debt obligations issued by the State of California and local governments and their agencies within the State of California including cities, counties, government retirement plans, school districts, state universities, sewer districts, municipally owned utilities and authorities operating bridges, airport and other transportation facilities. No more than 20% of the total portfolio shall be invested in California municipal bonds. California municipal bond categories are:
  - Category 1 -Bonds issued by the City or agency[3] of the City
    - Securities eligible for investment must be rated AA or better by two of the three nationally recognized credit rating organizations (Moody's, Standard & Poor's or Fitch). Such rating must be the issuing agency's underlying rating, irrespective of any credit enhancements obtained from third party organizations.
    - No more than 5% of the total portfolio for each separate legal entity with an aggregate limit in bonds issued by the City or its agencies not to exceed 15% of the total portfolio.
    - The maturity shall not exceed five years.

  - Category 2 - Bonds issued by the State of California
    - Obligations must be rated in the AA or better category by two of the three nationally recognized credit rating organizations (Moody's, Standard &

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[3] "*Agency of the City*" includes all "component units" of the City of San José as defined in the City's Comprehensive Annual Financial Report (CAFR) in accordance with generally accepted accounting principles, including, but is not limited to, the Redevelopment Agency of the City of San José ("Redevelopment Agency"), the City of San José Financing Authority, the San José – Santa Clara Clean Water Financing Authority, the City of San José Parking Authority and any other Joint Powers Authority created in which the City and/or the Redevelopment Agency is a majority obligor or participant.

Poor's or Fitch). Such rating must be the issuing agency's underlying rating, irrespective of any credit enhancements obtained from third party organizations.
- No more than 5% of the total portfolio shall be invested in bonds issued by the State of California.
- The maturity shall not exceed five years.

- Category 3 - Bonds issued by any other local agency within the State of California
  - Obligations must be rated in the AA or better category by two of the three nationally recognized credit rating organizations (Moody's, Standard & Poor's or Fitch) or, must be rated AAA through credit enhancements the issuing agency has obtained from third party organizations.
  - No more than 5% of the total portfolio shall be invested in any one issuer.
  - No more than 10% of the total portfolio shall be invested in bonds of other local agencies.
  - The maturity shall not exceed five years.

13) Investment Agreements (IA): An IA is a contract providing for the lending of issuer funds to a financial institution (the "Provider") which agrees to repay the funds with interest under predetermined specifications. IAs may be used for the investment of bond proceeds in accordance with the permitted investment provisions of the specific bond indentures. To reduce the risk associated with a Provider's inability to meet its contractual obligations, the following safeguards are required in the use of an IA:

- Competitive bidding of the investment agreement pursuant to the Internal Revenue Code and any regulations promulgated thereto;
- Provider (or guarantor of Provider) rated AA or above from at least one national rating agency and ratings in the "AA" category from at least one other national rating agency;
- Provider's participation in the financing will not adversely affect the transaction, including the expected rating on the Bonds;
- Provider downgrade provisions in order to (i) allow the City to terminate the Agreement and withdraw the par value (outstanding principal balance and accrued interest) of the invested proceeds with no penalty or (ii) to require the Provider to increase the collateral level;
- Collateralization of at least 104%;
- The collateralization requirement does not apply to Conduit Financings;
- Collateral held by a third party;
- Only top-rated securities be used as collateral (U.S. Treasuries or Agencies);
- Agreement to include termination provisions in the event of Provider breach or Provider downgrade; and
- Trustee to monitor the Provider's rating, securities, and collateral value on a weekly basis.

14) Stocks: Any stock received as a gift, through bankruptcies or as payment in lieu of monies due the City shall be sold immediately upon receipt, unless received through a gift or bequest with restrictions on its sale. Sale proceeds will be distributed to the appropriate program fund. If the stock has no market value or if the cost of selling it exceeds the market value, the stock will be written off or~~and~~ monitored periodically to be sold when a break-even market value can be realized.

15) Ineligible Investments

- Ineligible investments include common stock (with the exception noted above in Section 8~~.0~~.14~~2~~), inverse floaters, range notes, mortgage-derived interest-only strips, or any security that could result in zero interest accrual if held to maturity and any investments not authorized by this Policy unless otherwise approved by the City Council.

~~9.0 INVESTMENT POOLS/MUTUAL FUNDS~~

~~A thorough investigation of the LAIF or any money market mutual fund is required prior to investing, and on a continual basis while City's funds are invested in LAIF or the money market mutual fund. Periodically, LAIF and these funds will be required to update their responses to an investment pool questionnaire. Investment staff will monitor LAIF and the money market mutual funds to ensure that the criteria for qualifying these investment pools and funds remain unchanged.~~

9.0 COLLATERALIZATION

Collateralization is required on two types of investments: non-negotiable and collateralized time deposits and repurchase agreements.

1) Non-negotiable and collateralized time deposits with banks and savings and loans
   - Shall be collateralized in the manner prescribed by California Government Code 53652 for depositories accepting municipal investment funds.

2) Repurchase Agreements
   - The types of securities to be accepted as transferred securities in repurchase agreements in which the City is the buyer shall be limited to U.S. Treasury or U.S. Federal Government Agency issues permitted under this Policy. The City shall maintain a preference for collateral of shorter-term maturities.
   - The market value of the securities used as collateral for the repurchase agreements shall not be allowed to fall below 102% of the value of the repurchase agreement as provided in the Master Repurchase Agreement.
   - Substitutions of transferred securities shall be limited to U.S. Treasury Bills and may not be made without prior approval by the City.

10~~1~~.0 SAFEKEEPING AND CUSTODY

All securities owned by the City shall be held in safekeeping by the City's custodial bank or by a third party bank trust department, acting as agent for the City under the terms of a custody agreement or master repurchase agreement. All security transactions, including collateral for repurchase agreements, entered into by the City shall be conducted on a delivery-versus-payment (DVP) basis through the City's safekeeping agent. Securities held in custody for the City shall be independently audited on an annual basis to verify investment holdings.

11~~2~~.0 DIVERSIFICATION

The City, consistent with the primary objectives of safety, liquidity and yield, will diversify its investment by security type, issuer and maturity dates. Portfolio percentage and/or dollar limits are indicated in Section 8.0 of this Policy.

12~~3~~.0 MAXIMUM MATURITIES

The City's investment portfolio shall be structured to provide that sufficient funds from investments are available to meet the City's anticipated cash needs. The choice of investment instruments and maturities shall be based upon an analysis of anticipated cash needs, existing and anticipated revenues, interest rate trends and specific market opportunities. The average maturity of the investment portfolio will not exceed two years, and no investment will have a maturity of more than five years from its date of purchase.

Bond reserve funds established by the issuance of bonds may be invested in securities exceeding five years if the maturities of such investments are made to coincide with the expected use of the funds.

13~~4~~.0 INTERNAL CONTROLS

The Director of Finance is responsible for establishing and maintaining an internal control structure designed to ensure that the City's assets are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that those objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits to be derived and that the valuation of costs and benefits requires estimates and judgments by management. Internal control procedures shall address:

- Separation of duties
- Control of collusion
- Custodial safekeeping
- Avoidance of physical delivery of securities
- Written confirmation of transfers for investments and wire transfers
- Written procedures for placing investment transactions
- Delegation of authority to investment officials

14~~5~~.0 PERFORMANCE STANDARDS

The investment portfolio shall be designed with the overall objective of safety, liquidity and a return on investment commensurate with the investment risk constraints and the cash flow needs.

~~15.1~~14.1 MARKET YIELD (BENCHMARK)

The City's investment portfolio is primarily managed ~~primarily~~ on a "buy and hold" ~~hold-to-maturity"~~ strategy. Given this strategy, the basis used by the Director of Finance to determine whether market yields are being achieved shall be to identify a ~~comparable~~ benchmark comparable to the weighted average maturity of the investment portfolio, which varies over time. The City's Investment Portfolio . ~~Current benchmarks are the six-month and one-year moving average yield of the one-year Treasury security and the yield on LAIF.~~

shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into consideration the investment risk tolerance and liquidity needs of the City. Yield on the City's investment portfolio is of secondary importance to the safety and liquidity objectives described in Section 4.0 of the Policy.

14~~5~~.2 RESTRUCTURING TRANSACTIONS

a) General Definitions

The restructuring process involves a change in the composition of the portfolio such that the aggregate portfolio after all transactions are executed meets original goals and constraints of the Policy and performance has been improved. Restructuring opportunities are not a function of time but rather a result of changing market conditions. Conditions that are generally favorable to restructurings are:

- availability of more efficient issues,
- changes in the shape of the yield curve,
- changes in quality or sector spreads.

A restructured portfolio must continue to generate sufficient cash flow to meet the City's cash requirements without impairing the overall quality/diversification constraints of the portfolio.

b) Specific Requirements –

- Restructuring transactions in the City's portfolio shall not exceed $40 million (par value) per month in original securities exchanged for replacement securities.~~, e.g. two $20 million Treasury issues may be sold and replaced with two $20 million agency issues.~~
- Prior conceptual approval shall be obtained in writing from the City Manager and the Director of Finance.
- Executed restructuring transactions will be included in the Monthly Investment Report.
- Net sales gains or losses shall not be incurred to the point of radically altering the current month's earned interest yield (plus or minus 30 basis points).

15~~6~~.0 REPORTING AND DISTRIBUTION

The Director of Finance shall prepare and submit monthly and quarterly investment reports containing the information described in Sections 15.1 and 15.2 to be posted to the City's internet site for public access and distribute a hard copy of the reports to the City Clerk's Office for public review. In addition, the Director of Finance shall distribute these reports through electronic means to the City Council, the City Manager, and the City Auditor. In the event of any unforeseen technological issues which prevent an electronic posting and/or distribution, the Director of Finance shall distribute a hard copy report in a reasonable time after which such report is generated by the Finance Department. In the event there are exceptions to the Policy, the Director must report as described in Section 15.3.

15.1 QUARTERLY INVESTMENT REPORTS

The quarterly reports shall be placed on the next available agenda of the City Council Committee responsible for the review of Finance Department items after the electronic distribution and posting of the reports. At least semi-annually, the Committee shall receive an oral presentation on the contents of the Quarterly Investment Report as described in Section 5.E. ~~submit a quarterly investment report containing detailed information on all securities and investments of the City to the City Council, the City Manager, and the City Auditor within 30 days following the end of the quarter covered by the report. The means of distribution shall be through electronic means. In the event of any unforeseen technological issues which prevent an electronic distribution, the Director of Finance shall distribute a written report.~~ The quarterly investment report will include the following information portfolio statistics, portfolio performance, compliance reporting requirements, investment trading activity and investment strategy:

- Portfolio Statistics
  - Classification of the investment, the percentage of the total portfolio which each type of investment represents, issuer, date of maturity, par and dollar amount invested on all securities and investments
  - Current market value and the source of the market value
  - Weighted average maturity of the investment portfolio
  - Trend of average portfolio maturity
  - Maturity aging by type of investment
  - Unrealized gain or loss resulting from appreciation or depreciation in the market value of securities
  - Portfolio turnover rate and trend

- Portfolio Performance
  - Weighted average yield on reporting quarter's purchases
  - Weighted average yield on reporting quarter's sales and/or maturities
  - Trend of the monthly earned interest yield on investments

- Compliance Reporting Requirements
  - Cash management projection: Statement denoting the ability of the City to meet its expected obligations over the next six months
  - Statement of compliance with the Policy: Reasons for and number of violations or exceptions to the investment policy during the quarter being reported on, as well as prior violations or exceptions which have not yet been corrected
  - ~~Weighted average maturity of the investment portfolio~~

- ~~Trend of average portfolio maturity~~
- ~~Maturity aging by type of investment~~
- ~~Weighted average yield on reporting quarter's purchases~~
- ~~Weighted average yield on reporting quarter's sales and/or maturities~~
- ~~Trend of the monthly earned interest yield on investments~~
- ~~Comparison of budgeted investment earnings to actual earnings for the reporting quarter and fiscal year-to-date~~
- Comparison of budgeted investment earnings to actual earnings for the reporting quarter and fiscal year-to-date
- Distribution reports by bank and broker/dealer

- Investment Trading Activity
  - All investment transactions occurring during the quarter whether or not the transaction has been fully settled
  - ~~Portfolio turnover rate and trend~~
  - Separation of realized trading gains or losses from interest received on trading activity (Since the City is not involved in active trading, this will occur only when a security must be sold prior to maturity as defined in Section 4.0.B.)
  - ~~Unrealized gain or loss resulting from appreciation or depreciation in the market value of securities~~
  - Aggregate commitments to purchase securities or make other payments to dealers in a manner to permit adequate cash need forecasting
  - A brief description of executed reverse repos and the associated interest cost and interest earnings from the transactions
  - A brief description of executed restructuring transactions. Number and dollar volume of trades executed for the sole purpose of restructuring the portfolio and analysis of benefit derived from those trades

- ~~All investment transactions occurring during the quarter whether or not the transaction has been fully settled~~
- Investment Strategy
  - Description of the current investment strategy and the assumptions upon which it is based
- ~~**Distribution reports by bank and broker/dealer**~~
- ~~**A brief description of executed restructuring transactions. Number and dollar volume of trades executed for the sole purpose of restructuring the portfolio and analysis of benefit derived from those trades**~~

15.2 MONTHLY INVESTMENT REPORTS

An abbreviated monthly investment report summarizing the highlights of the monthly investment activity will be distributed in accordance with provisions in Section 15.0. ~~to the City Council, City Manager and City Auditor within 30 days following the end of the month covered by the report. The means of distribution shall be through electronic means. In the event of any unforeseen technological issues which prevent an electronic distribution, the Director of Finance shall distribute~~

~~a written report.~~ The abbreviated monthly investment report will include the following portfolio statistics, portfolio performance, compliance reporting requirements, and investment strategy.

- Portfolio Statistics
  - Investments in the City's portfolio as of the end of the month
  - Related earnings associated with each investment held during the reporting period
  - Purchase activity associated with each investment broker for the reporting period
  - Classification of the investment, issuer, date of maturity, par and dollar amount invested on all investments as of the end of the month
  - Market value of investments in the City's portfolio as of the end of the month

- Portfolio Performance
  - Comparison of budgeted investment earnings to actual earnings for the reporting period and fiscal year-to-date
  - Investment portfolio performance measurement
  - Trend of the monthly earned interest yield on investments

- Compliance Reporting Requirements
  - Statement of compliance with the Policy: Reasons for and number of violations or exceptions to the Policy during the month being reported on, as well as prior violations or exceptions which have not yet been corrected. If there has been no violations of or exceptions to the Policy during the reporting period, a statement to that effect shall be set forth in the report.
- Investment Strategy
  - Description of the current investment strategy and the assumptions upon which it is based

- ~~Comparison of budgeted investment earnings to actual earnings for the reporting period and fiscal year-to-date~~
- ~~Investment portfolio performance measurement~~
- ~~Trend of the monthly earned interest yield on investments~~

~~Both the abbreviated monthly and detailed quarterly reports to the City Council will be posted on the City's internet site (absent any unforeseen technological issues). Hard copies of the reports will be on file at the City Clerk's Office.~~

15.3~~16.2~~ REPORTING POLICY EXCEPTIONS

While this Policy prescribes various maximums, minimums and other relatively arbitrary numerical limits, it is intended primarily to be a management tool. When the Director of Finance determines that an exception to one of the Policy's numerical limits is in the best interest of the City, and is otherwise consistent with the Policy, such exception is permitted so long as it is consistent with applicable City, State and Federal laws. Whenever an exception or violation of this Policy is made, that fact shall be reported to the City Manager and the City Council within one business day of its discovery. Major exceptions will be reported immediately. All exceptions to the Policy and the appropriate explanation or justification for the exception shall be included in the Monthly Investment Report. Sudden large fluctuations in portfolio assets can cause technical exceptions to the various percentage limits of the Policy which should not be interpreted as "reportable exceptions". Provided that the portfolio make-up can be readjusted to Policy limits within one working day of a significant increase or decrease in portfolio assets, such temporary percentage exceptions need not be reported as violations or exceptions to this Policy.

15.4 SEMI-ANNUAL COMPLIANCE AUDITS

No less than semi-annually each year, a compliance audit shall be conducted of the City's investment program to determine whether the City's investments within the City's pooled portfolio are in compliance with the City's Investment Policy, internal controls, and department procedures. If the City Council does not direct that the compliance audits be included in the City Internal Auditor's annual workplan, then the Director of Finance shall cause such compliance audits to be conducted by an external auditor.

16~~7~~.0 INVESTMENT POLICY REVIEW/ADOPTION

The Policy shall be adopted by resolution of the City Council on an annual basis. This Policy shall be reviewed annually to ensure its consistency with respect to the overall objectives of safety, liquidity and yield, and its relevance to current laws and financial trends. An annual Statement of Investment Policy including any proposed amendments to the Policy shall be prepared by the Director of Finance for the review and recommendation of the City Council Committee assigned the responsibility for review of Finance Department reports ~~Investment Committee~~ prior to submission to the entire City Council for consideration and approval.

17~~8~~.0 GLOSSARY

Definitions of investment-related terms are listed on Exhibit B.

EXHIBIT A

LIST OF THE PRIMARY GOVERNMENT SECURITIES DEALERS REPORTING TO THE GOVERNMENT SECURITIES DEALERS STATISTICS UNIT OF THE FEDERAL RESERVE BANK OF NEW YORK

~~ABN AMRO Bank N.V., New York Branch~~
BNP Paribas SecuritiesCorp.
Banc of America Securities LLC
Barclays Capital Inc.
Bear, Stearns & Co., Inc.
Cantor Fitzgerald & Co.
~~CIBC World Markets Corp.~~
Citigroup Global Markets Inc.
Countrywide Securities Corporation
Credit Suisse Securities (USA) LLC
Daiwa Securities America Inc.
Deutsche Banc Securities Inc.
Dresdner Kleinwort Wasserstein Securities LLC
Goldman, Sachs & Co.
Greenwich Capital Markets, Inc.
HSBC Securities (USA), Inc.
J. P. Morgan Securities, Inc
Lehman Brothers Inc.
Merrill Lynch Government Securities Inc.
Mizuho Securities USA Inc.
Morgan Stanley & Co. Incorporated
Nomura Securities International, Inc.
UBS Securities LLC

NOTE: This list has been compiled and made available for statistical purposes only and has no significance with respect to other relationships between dealers and the Federal Reserve Bank of New York. Qualification for the reporting list is based on the achievement and maintenance of the standards outlined in the Federal Reserve Bank of New York's memorandum of January 22, 1992.

Government Securities Dealers Statistics Unit
Federal Reserve Bank of New York
February 8, 2007~~January 17, 2006~~

NOTE: The City's Finance Department will replace this list in the official Investment Policy as changes are made by the Federal Reserve Bank of New York.

EXHIBIT B

GLOSSARY

ACCRETION: Adjustment of the difference between the price of a bond bought at an original discount and the par value of the bond.

AGENCIES: Federal agency securities and/or Government-sponsored enterprises (GSEs), also known as U.S. Government instrumentalities. Securities issued by Government National Mortgage Association (GNMA) are considered true agency securities, backed by the full faith and credit of the U.S. Government. GSEs are financial intermediaries established by the federal government to fund loans to certain groups of borrowers, for example homeowners, farmers and students and are privately owned corporations with a public purpose. The most common GSEs are Federal Farm Credit System Banks, Federal Home Loan Banks, Federal Home Loan Mortgage Association, and Federal National Mortgage Association.

AMORTIZATION: Accounting procedure that gradually reduces the cost value of a limited life or intangible asset through periodic charges to income. For fixed assets, the term used is "depreciation". It is common practice to amortize any premium over par value paid in the purchase of preferred stock or bond investments.

APPRECIATION: Increase in the value of an asset such as a stock bond, commodity or real estate.

ASKED PRICE: The price a broker/dealer offers to sell securities.

BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer. This money market instrument is used to finance international trade.

BASIS POINT: One-hundredth of one percent (i.e., 0.01%).

BENCHMARK: A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investment.

BID PRICE: The price a broker/dealer offers to purchase securities.

BOND: A financial obligation for which the issuers promises to pay the bondholder a specified stream of future cash flows, including periodic interest payments and a principal repayment.

BOOK VALUE: The value at which a debt security is shown on the holder's balance sheet. Book value is acquisition cost less amortization of premium or accretion of discount.

BROKER: A broker acts as an intermediary between a buyer and seller for a commission and does not trade for his/her own risk and account or inventory.

CALIFORNIA MUNICIPAL BONDS: Debt obligations issued by State of California and local governments and their agencies within the State of California including cities, counties, government retirement plans, school districts, state universities, sewer districts, municipally owned utilities and authorities running bridges, airports and other transportation facilities.

CALLABLE SECURITIES: A security that can be redeemed by the issuer before the scheduled maturity date.

CASH FLOW: An analysis of all changes that affect the cash account during a specified period.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

COMMERCIAL PAPER: Short-term, unsecured, negotiable promissory notes of corporations.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual financial report for the City. It includes combined statements and basic financial statements for each individual fund and account group prepared in conformity with Generally Accepted Accounting Principles (GAAP).

CONDUIT FINANCING: A financing in which a governmental agency issues debt and the proceeds of the issue are loaned to a nongovernmental borrower who then applies the proceeds for a project financing or (if permitted by federal tax laws for a qualified 501(c)(3) bond) for working capital purposes.

CORPORATE NOTE: Debt instrument issued by a private corporation.

COUPON: The annual rate at which a bond pays interest.

CREDIT ANALYSIS: An analysis of the economic and financial conditions to determine creditworthiness or the ability to meet debt obligations.

CREDIT RISK: The risk that an obligation will not be paid and a loss will result due to a failure of the issuer of a security.

CURRENT YIELD: The annual interest on an investment divided by the current market value. Since the 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.

CUSTODIAN: A bank or other financial institution that keeps custody of stock certificates and other assets.

DEALER: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his/her own risk and account or inventory.

DEBENTURES: A bond secured only by the general credit of the issuers.

DEFEASED BOND ISSUES: Issues that have sufficient money to retire outstanding debt when due, so that the agency is released from the contracts and covenants in the bond documents.

DELIVERY VERSUS PAYMENT (DVP): Delivery of securities with a simultaneous exchange of money for the securities.

DERIVATIVE: A financial instrument that is based on, or derived from, some underlying asset, reference date, or index.

DIRECT ISSUER: Issuer markets its own paper directly to the investor without use of an intermediary.

DISCOUNT: The difference between the cost of a security and its value at maturity when quoted at lower than face value.

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent returns and risk profiles.

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

FACE VALUE: The principal amount owed on a debt instrument. It is the amount on which interest is computed and represents the amount that the issuer promises to pay at maturity.

FAIR VALUE: The amount at which a security could be exchanged between willing parties, other than in a forced or liquidation sale. If a market price is available, the fair value is equal to the market value.

FANNIE MAE: Trade name for the Federal National Mortgage Association (FNMA), a U.S. Government sponsored enterprise.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that provides insurance on bank deposits, guaranteeing deposits to a set limit per account, currently $100,000.

FEDERAL FARM CREDIT BANK (FFCB): Government-sponsored enterprise that consolidates the financing activities of the Federal Land Banks, the Federal Intermediate Credit Banks and the Banks for Cooperatives. Its securities do not carry direct U.S. government guarantees.

FEDERAL FUNDS RATE: The rate of interest at which Federal funds are traded. This rate is considered to be the most sensitive indicator of the direction of interest rates, as it is currently pegged by the Federal Reserve through open-market operations.

FEDERAL GOVERNMENT AGENCY SECURITIES: Federal Agency 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.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored enterprise (currently made up of 12 regional banks) that regulates and lends funds and provides correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. Although the banks operate under federal charter with government supervision, the securities are not guaranteed by the U. S. Government.

FEDERAL HOME LOAN MORTGAGE CORPORATION (FHLMC): Government sponsored enterprise that helps maintain the availability of mortgage credit for residential housing. FHLMC finances these operations by marketing guaranteed mortgage certificates and mortgage participation certificates. Its discount notes and bonds do not carry direct U.S. government guarantees.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): Government sponsored enterprise that is the largest single provider of residential mortgage funds in the United States. FNMA is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA securities do not carry direct U.S. Government guarantees.

FEDERAL OPEN MARKET COMMITTEE (FOMC): A committee of the Federal Reserve Board, which establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

FEDERAL RESERVE SYSTEM: The central bank of the U.S. which consists of a seven member Board of Governors, 12 regional banks and about 5,700 commercial banks that are members.

FED WIRE: A wire transmission service established by the Federal Reserve Bank to facilitate the transfer of funds through debits and credits of funds between participants within the Fed system.

FREDDIE MAC: Trade name for the Federal Home Loan Mortgage Corporation (FHLMC), a U.S. government sponsored enterprise.

GINNIE MAE: Trade name for the Government National Mortgage Association (GNMA), a direct obligation bearing the full faith and credit of the U.S. Government.

GOVERNMENT ACCOUNTING STANDARDS BOARD (GASB): A standard-setting body, associated with the Financial Accounting Foundation, which prescribes standard accounting practices for governmental units.

GUARANTEED INVESTMENT CONTRACTS (GICS): An agreement acknowledging receipt of funds, for deposit, specifying terms for withdrawal, and guaranteeing a rate of interest to be paid.

INACTIVE DEPOSITS: Funds not immediately needed for disbursement.

INTEREST RATE: The annual yield earned on an investment, expressed as a percentage.

INTEREST RATE RISK: The risk of gain or loss in market values of securities due to changes in interest-rate levels. For example, rising interest rates will cause the market value of portfolio securities to decline.

INVESTMENT AGREEMENTS: A contract providing for the lending of issuer funds to a financial institution which agrees to repay the funds with interest under predetermined specifications.

INVESTMENT PORTFOLIO: A collection of securities held by a bank, individual, institution or government agency for investment purposes.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash with minimum risk of principal.

LOCAL AGENCY INVESTMENT FUND (LAIF): An investment pool sponsored by the State of California and administered/managed by the State Treasurer. Local government units, with consent of the governing body of that agency, may voluntarily deposit surplus funds for the purpose of investment. Interest earned is distributed by the State Controller to the participating governmental agencies on a quarterly basis.

LOCAL AGENCY INVESTMENT POOL: A pooled investment vehicle sponsored by a local agency or a group of local agencies for use by other local agencies.

MARK TO MARKET: Current value of securities at today's market price.

MARKET RISK: The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates. Systematic risk of a security that is common to all securities of the same general class (stocks, bonds, notes, money market instruments) and cannot be eliminated by diversification (which may be used to eliminate non-systematic risk).

MARKET VALUE: The price at which a security is currently being sold in the market. See FAIR VALUE.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase agreements and reverse repurchase agreements that establish each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date that the principal or stated value of a debt instrument becomes due and payable.

MEDIUM-TERM NOTES (MTNs): Unsecured, investment-grade senior debt securities of major corporations which are sold in relatively small amounts either on 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. This is a measure of a portfolio's or security's exposure to market risk.

MONEY MARKET: The market in which short term debt instruments (Treasury Bills, Discount Notes, Commercial Paper, Banker's Acceptances and Negotiable Certificates of Deposit) are issued and traded.

MUTUAL FUND: An entity that pools money and can invest in a variety of securities which are specifically defined in the fund's prospectus.

NEGOTIABLE CERTIFICATE OF DEPOSIT: A large denomination certificate of deposit which can be sold in the open market prior to maturity.

NEW ISSUE: Term used when a security is originally "brought" to market.

NOTE: A written promise to pay a specified amount to a certain entity on demand or on a specified date.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit: Sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

PAR VALUE: The amount of principal which must be paid at maturity. Also referred to as the face amount of a bond. See FACE VALUE.

PORTFOLIO: The collection of securities held by an individual or institution.

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

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. These dealers are authorized to buy and sell government securities in direct dealing with the Federal Reserve Bank of New York in its execution of market operations to carry out U.S. monetary policy. Such dealers must be qualified in terms of reputation, capacity, and adequacy of staff and facilities.

PRINCIPAL: The face value or par value of a debt instrument, or the amount of capital invested in a given security.

PROSPECTUS: A legal document that must be provided to any prospective purchaser of a new securities offering registered with the Securities and Exchange Commission that typically includes information on the issuer, the issuer's business, the proposed use of proceeds, the experience of the issuer's management, and certain certified financial statements (also known as an "official statement").

PRUDENT INVESTOR STANDARD: A standard of conduct for fiduciaries. Investments shall be made with judgment 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.

PUBLIC DEPOSITS: A bank that is qualified under California law to accept a deposit of public funds.

PURCHASE DATE: The date in which a security is purchased for settlement on that or a later date. Also known as the "trade date".

RATE OF RETURN: 1) The yield which can be attained on a security based on its purchase price or its current market price. 2) Income earned on an investment, expressed as a percentage of the cost of the investment.

REALIZED GAIN (OR LOSS): Gain or loss resulting from the sale or disposal of a security.

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 (RP or REPO): A transaction in which a counterparty or the holder of securities (e.g. investment dealer) sells these securities to an investor (e.g. the City) with a simultaneous agreement to repurchase them at a fixed date. The security "buyer" (e.g. the City) in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate the “buyer” for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money, that is, increasing bank reserves.

REVERSE REPURCHASE AGREEMENT (REVERSE REPO): The opposite of a repurchase agreement. A reverse repo is a transaction in which the City sells securities to a counterparty (e.g. investment dealer) and agrees to repurchase the securities from the counterparty at a fixed date. The counterparty in effect lends the seller (e.g. the City) money for the period of the agreement with terms of the agreement structured to compensate the buyer.

RISK: Degree of uncertainty of return on an asset.

SAFEKEEPING: A service which banks offer to clients for a fee, where physical securities are held in the bank’s vault for protection and book-entry securities are on record with the Federal Reserve Bank or Depository Trust Company in the bank’s name for the benefit of the client. As agent for the client, the safekeeping bank settles securities transactions, collects coupon payments, and redeems securities at maturity or on call date, if called.

SALLIE MAE: Trade name for the Student Loan Market Association (SLMA), a U.S. government sponsored enterprise.

SECURITIES AND EXCHANGE COMMISSION (SEC): Agency created by Congress to protect investors in securities transactions by administering securities legislation.

SEC RULE 15C3-1: See UNIFORM NET CAPITAL RULE.

SECONDARY MARKET: A market for the repurchase and resale of outstanding issues following the initial distribution.

SECURITIES: Investment instruments such as notes, bonds, stocks, money market instruments and other instruments of indebtedness or equity.

SETTLEMENT DATE: The date on which a trade is cleared by delivery of securities against funds.

SPREAD: The difference between two figures or percentages. It may be the difference between the bid (price at which a prospective buyer offers to pay) and asked (price at which an owner offers to sell) prices of a quote, or between the amount paid when bought and the amount received when sold.

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.

STUDENT LOAN MARKET ASSOCIATION (SLMA): Government-sponsored enterprise that purchases student loans from originating financial institutions and provides financing to state student loan agencies. It provides a national secondary market for federally-sponsored student loans and credit to participants in the post secondary education lending sector.

TIME DEPOSIT: A deposit with a California bank or savings and loan association for a specific amount and with a specific maturity date and interest rate. Deposits of up to $100,000 are insured by FDIC. Deposits over $100,000 are collateralized above the insurance with either government securities (at 110% of par value), first trust deeds (at 150% of par value), or letters of credit (at 105% of par value).

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, and includes interest earnings and realized and unrealized gains and losses on the portfolio. For bonds held to maturity, total return is the yield to maturity".

TRUSTEE OR TRUST COMPANY OR TRUST DEPARTMENT OF A BANK: A financial institution with trust powers which acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

UNDERWRITER: A dealer which purchases a new issue of municipal securities for resale.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission requirement that member firms as well as nonmember broker/dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called *net capital rule* and *net capital ratio*. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

U.S. GOVERNMENT AGENCY SECURITIES: Securities issued by U.S. government agencies, most of which are secured only by the credit worthiness of the particular agency. See AGENCIES.

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 the benchmark for interest rates on all other securities in the U.S. The Treasury issues both discounted securities and fixed coupon notes and bonds. The income from Treasury securities is exempt from state and local, but not federal, taxes.

TREASURY BILLS: Securities issued at a discount with initial maturities of one year or less. The Treasury currently issues three-month and six-month Treasury bills at regular weekly auctions. It also issues very short-term "cash management" bills as needed to smooth out cash flows.

TREASURY NOTES: Intermediate-term coupon-bearing securities with initial maturities of one year to ten years.

TREASURY BOND: Long-term coupon-bearing securities with initial maturities of ten years or longer.

UNREALIZED GAIN (OR LOSS): Gain or loss that has not become actual. It becomes a realized gain (or loss) when the security in which there is a gain or loss is actually sold. See REALIZED GAIN (OR LOSS).

VOLATILITY: Characteristic of a security, commodity or market to rise or fall sharply in price within a short-term period.

WEIGHTED AVERAGE MATURITY: The average maturity of all the securities that comprise a portfolio that is typically expressed in days or years.

WHEN ISSUED (WI): Short form of "when, as, and if issued." WI refers to a transaction made conditionally because a security, although authorized, has not yet been issued.

YIELD: The annual rate of return on an investment expressed as a percentage of the investment. See CURRENT YIELD; YIELD TO MATURITY.

YIELD CURVE: Graph showing the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity.

YIELD TO MATURITY: Concept used to determine the rate of return if an investment is held to maturity. It takes into account purchase price, redemption value, time to maturity, coupon yield, and the time between interest payments. It is the rate of income return on an investment, minus any premium or plus any discount, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond, expressed as a percentage.