

STAFF REPORT

F-9



THE CITY OF
NOVATO
CALIFORNIA

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MEETING

DATE: May 22, 2007

TO: City Council

FROM: Deborah Lauchner, Finance Manager

SUBJECT: **CITY OF NOVATO INVESTMENT POLICY**

REQUEST

Consider adopting a resolution approving the Investment Policy for fiscal year 2007/08.

RECOMMENDATION

Adopt resolution

DISCUSSION

California Government Code Section 53646(a) suggests the City Treasurer submit the City's Investment Policy to the City Council for review annually. Attached is a copy of the Investment Policy for fiscal year 2007/08 for review.

Section IX. Reporting has been changed to reflect the current practice of quarterly reporting to the City Council. The current policy provides for monthly reporting in addition to the quarterly reporting.

FISCAL IMPACT

Without a valid investment policy, the City will not be able to invest unexpended funds and the interest revenue will decrease.

ATTACHMENTS

1. Resolution adopting an Investment Policy for the Fiscal Year 2007/08
2. City of Novato Investment Policy

CITY COUNCIL OF THE CITY OF NOVATO

RESOLUTION NO. _____

RESOLUTION OF THE CITY OF NOVATO ADOPTING AN
INVESTMENT POLICY FOR FISCAL YEAR 2007/08

WHEREAS, the City of Novato has unexpended cash that can be managed to generate income; and

WHEREAS, the City of Novato desires to invest this cash in a manner that will first secure the principal, then assure liquidity to accommodate cash needs, and to earn a return; and

WHEREAS, the California State law requires that the City of Novato annually adopt an investment policy.

NOW, THEREFORE, BE IT RESOLVED that the City Council of the City of Novato hereby adopts the investment policy for the fiscal year 2007/08 as detailed in "*Exhibit A*," herein included by reference.

* * * * *

I HEREBY CERTIFY that the foregoing resolution was duly and regularly adopted by the City Council of the City of Novato, Marin County, California, at a meeting thereof, held on the ____ day of _____, by the following vote, to wit:

- AYES: Councilmembers
- NOES: Councilmembers
- ABSTAIN: Councilmembers
- ABSENT: Councilmembers

City Clerk of the City of Novato

INVESTMENT POLICY

I. POLICY

In accordance with the City of Novato Municipal Code and under authority granted by the City Council, the City Treasurer is responsible for investing the unexpended cash in the City Treasury.

The investment of the funds of the City of Novato is directed by the goals of safety, liquidity and yield. The authority governing investments for municipal governments is set forth in the California Government Code, Sections 53600 through 53659.

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

II. SCOPE

The investment policy applies to all financial assets of the City of Novato as accounted for in its Annual Audit. Policy statements outlined in this document focus on the City of Novato's pooled funds, but will also apply to all other funds under the City Treasurers' span of control unless specifically exempted by statute, ordinance or this policy.

III. STANDARD OF CARE

1. Prudence

The standard of prudence to be used by City of Novato investment officials shall be the "prudent person" standard and shall be applied within the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely manner and appropriate action is taken to control adverse developments.

Investments shall be made with judgment and care, under circumstances prevailing at the time the investment is made, which persons of prudence, discretion and intelligence exercise in the management of assets in a fiduciary capacity, not for

speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

2. **Ethics and Conflicts of Interest**

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

3. **Delegation of Authority**

Through the authority granted by City Council, the responsibility of investing unexpended cash is assigned to the City Treasurer. This includes the daily management responsibility of the investment program and the maintenance of procedures for the management of all cash that is consistent with this investment policy. The Finance Manager is authorized to initiate, but not conclude investment transactions.

IV. **OBJECTIVES**

1. **Safety of Principal**

Safety of principal is the foremost objective of the City of Novato. Each investment transaction shall seek to ensure that capital losses are avoided, whether from securities default, broker-dealer default or erosion of market value. The City shall seek to preserve principal by mitigating the two types of risk, credit risk and market risk.

Credit risk, defined as the risk of loss due to failure of the issuer of a security, shall be mitigated by investing in investment grade securities and by diversifying the investment portfolio so that the failure of any one issuer does not unduly harm the City's capital base and cash flow.

Market risk, defined as market value fluctuations due to overall changes in the general level of interest rates, will be mitigated by:

- Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity, and

- By investing operating funds primarily in shorter-term securities.

2. Liquidity

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity).

3. Yield

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of least importance compared to the safety and liquidity objectives described above. The core of investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed.

V. SAFEKEEPING AND CUSTODY OF SECURITIES

1. Safekeeping

To protect against fraud or embezzlement or losses caused by collapse of an individual securities dealer, all securities owned by the City shall be held in safekeeping by a third party bank trust department, acting as agent for the City under the terms of City Council approved custody agreement or investment agreement.

Securities held in custody for the City shall be independently audited on an annual basis to verify investment holdings.

All exceptions to this safekeeping policy must be approved by the City Treasurer in written form and included in quarterly reporting to City Council.

2. Authorized Financial Dealer and Institution

A list will be maintained of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker/dealers selected by creditworthiness who are authorized to provide investment services in the State of California. These may include "primary" dealers or regional dealers that are guaranteed by a primary dealer and qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule).

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the following as appropriate:

- audited financial statements
- proof of National Association of Securities Dealers (NASD) certification
- proof of state registration
- completed broker/dealer questionnaire
- certification of having read the City's investment policy

An annual review of the financial condition and registration of qualified bidders will be conducted by the Investment Committee.

3. **Internal Control**

The City of Novato Finance Manager is responsible for establishing and maintaining an internal controls structure designed to ensure that the assets of the entity are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

The minimum controls in place for the City of Novato shall be:

- a. *Separation of transaction authority from accounting and record keeping.* The City Treasurer, Finance Manager and their designees may make wire transfers between City accounts. Only the City Treasurer may make investments. The Finance Manager is responsible for recording all transactions.
- b. *Custodial safekeeping.* Securities purchased from any bank or dealer including appropriate collateral (as defined by State Law) shall be placed with an independent third party for custodial safekeeping.
- c. *Avoidance of physical delivery securities.* Book entry securities are much easier to transfer and account for since actual delivery of a negotiable document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.
- d. *Wire transfer agreement with the lead bank or third party custodian.* These agreements are on file in the City's Finance Division.

4. **Delivery vs. Payment**

All trades where applicable will be executed by delivery vs. payment (DVP). This ensures that securities are deposited in the eligible financial institution prior to the release of funds. Securities will be held by a third party custodian as evidenced by safekeeping receipts.

5. Collateral Requirements

Collateral is required for investments in certificates of deposit, repurchase agreements and reverse repurchase agreements. In order to reduce market risk, the collateral level will be at least 102% of market value of principal and accrued interest.

Only U.S. Treasury securities or Federal Agency securities will be acceptable collateral.

VI. AUTHORIZED INVESTMENTS

1. Authorized Investments

Investment of City cash is governed by the California Government Code Sections 53600 et seq. Within the context of the limitations, the following investment are authorized:

- a. Bonds issued by the local agency, including bonds payable solely out of the revenues from a revenue -producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the local agency.
- b. United States Treasury Bills, Bonds, and Notes or those for which the full faith and credit of the United States are pledged for payment of principal and interest. There is no percentage limitation of the portfolio which can be invested in this category, although a five year maturity limitation is applicable.
- c. Obligations issued by the Government National Mortgage Association (GNMA), the Federal Farm Credit System (FFCB), the Federal Home Loan Bank Board (FHLB), the Federal National Mortgage Association (FNMA), the Student Loan Marketing Association (SLMA), and the Federal Home Loan Mortgage Association (FHLMC). There is no percentage limitation of the portfolio which can be invested in this category, although a five year maturity limitation is applicable.

With the exception of items in the California Local Agency Investment Fund (LAIF), investments detailed in items d through j below are further restricted for any one issuer to a maximum of 15% of the cost value of the portfolio at the time the investment is made. The total value invested in any one issuer shall not exceed 5% of the issuers net worth. Again, a five year maximum maturity limitation is applicable unless determined otherwise by this policy.

- d. Bonds, notes, warrants, or other evidence of indebtedness of any local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.

- e. Bills of exchange or time drafts drawn on and accepted by commercial banks, otherwise known as banker's acceptances. Banker's acceptances purchased may not exceed 180 days to maturity or 40% of the cost value of the portfolio. However, no more than 30% of the cost value of the portfolio may be invested in the bankers acceptances of any one commercial bank.
- f. Commercial paper ranked P-1 by Moody's Investor Services or A-1 by Standard & Poors, and issued by domestic corporations having assets in excess of \$500,000,000 and having an AA or better rating on its' long term debentures as provided by Moody's or Standard & Poors. Purchases of eligible commercial paper may not exceed 270 days to maturity nor represent more than 10% of the outstanding paper of the issuing corporation. Purchases of commercial paper may not exceed 15% of the cost value of the portfolio.
- g. Negotiable Certificates of deposit issued by nationally or state chartered banks or state or federal savings institutions. Purchases of negotiable certificates of deposit may not exceed 30% of the cost value of portfolio. A maturity limitation of five years is applicable.
- h. Repurchase agreements which specify terms and conditions may be transacted with banks and broker dealers. The maturity of the repurchase agreements shall not exceed 90 days. The market value of the securities used as collateral for the repurchase agreements shall be monitored by the investment staff and shall not be allowed to fall below 102% of the value of the repurchase agreement. An investment agreement is required between the City of Novato and the broker dealer or financial institution for all repurchase agreements transacted.
- i. Reverse repurchase agreements which specifies terms and conditions may be transacted with broker dealers and financial institutions but can not exceed 20% of the cost value of the portfolio value on the date entered into. The City may enter into reverse repurchase agreements only to fund short term liquidity needs. The term of reverse repurchase agreements may not exceed 90 days.
- j. Local Agency Investment Fund (LAIF) which is a State of California managed investment pool may be used up to the maximum permitted by California State Law.
- k. The pooled cash program as managed by the Treasurer of Marin County may be used up to the maximum permitted by California State Law.
- l. Time deposits, non-negotiable and collateralized in accordance with the California Government Code, may be purchased through banks or savings and loan associations. Since time deposits are not liquid, no more than 25% of the cost value of the portfolio may be invested in this investment type.

- m. Medium Term Corporate Notes issued by domestic corporations with a maximum maturity of five years may be purchased. Securities eligible for investment shall be rated A or better by Moody's Investors Service, Standard & Poor's Rating Services or Fitch Ratings Group. Purchase of medium term notes may not exceed 30% of the cost value of the portfolio and no more than 15% of the cost value of the portfolio may be invested in notes issued by one corporation..

Other eligible investments are those that are described under Government Code Section 53601. It is noted that special circumstances may arise that will necessitate the purchase of securities beyond the five year limitation. On such occasions, requests must be approved by City Council prior to purchase.

Various daily cash funds administered for or by trustees, paying agents and custodian banks contracted by the City of Novato may be purchased as allowed under State of California Government Code and per the Trust Indenture.

The following summary of maximum percentage limits, by instrument, are established for the City's total pooled funds portfolio, at the time purchases are made:

Investment	Percentage
Marin County Investment Pool	0 to 100%
Repurchase Agreements	0 to 100%
Local Agency Investment Fund	0 to 100% <i>up to LAIF's maximum</i>
Local Government Agency Debt	0 to 100%
US Treasury Bonds/Notes/Bills	0 to 100%
US Government Agency Obligations	0 to 100%
Bankers' Acceptances	0 to 40%
Commercial Paper	0 to 15%
Negotiable Certificates of Deposit	0 to 30%
Time Certificates of Deposit	0 to 25%
Medium Term Corporate Notes	0 to 30%
Reverse Repurchase Agreements	0 to 20%

2. Legislative Changes

Any State of California legislative action, that further restricts allowable maturities, investment type or percentage allocations, will be incorporated into the City of Novato's Investment Policy and supersede any and all previous applicable language.

3. Interest Earnings