

CITY OF EL CENTRO

POLICY STATEMENT

Policy Statement No: 303
Category: Investments
Subject: Investment Policy

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Distribution: All Departments

I. Purpose

The City Council of the City of El Centro recognizes that the City's invested assets are essential to the City's financial strength, its ability to pay claims, and its ability to improve service or reduce costs and, therefore, wishes to adopt a fiscally responsible Statement of Investment Policy (the Policy) in order to promote the wise investment of City funds.

This Policy shall govern the investment of City funds. It takes into consideration the City's particular investment needs including preservation of capital, appropriate levels of liquidity and yield on invested assets. This Statement of Investment Policy is based upon principles of prudent money management and State law. When the Policy is more restrictive than State law, the Policy shall govern investment practices.

II. Investment Objectives

The City's primary objectives, in priority order, shall be to:

- ensure the safety of principal,
- maintain a sufficiently liquid investment portfolio to ensure that the City has adequate cash to meet reasonably anticipated operating requirements, and
- earn a reasonable yield consistent with the objectives of safety and liquidity.

III. Investment Philosophy

The City's investment philosophy is to invest conservatively in order to minimize risk. Investments shall be made in the context of the Prudent Investor Rule for trustees of local government money pursuant to government Code Section 53600.3 as follows:

When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. Within the limitations of this section and considering individual

investments as part of an overall strategy investments may be acquired as authorized by law.

This standard of prudence is to be used by all investment staff and will be applied in the context of managing an overall portfolio.

The fundamental principles of the City's investment philosophy are:

- diversification of the portfolio by investment type,
- quality standards for securities issuers,
- limits on the maximum maturity of investments,
- passive investment strategy of purchasing investments with the intent to hold them until maturity.

The City's passive investment strategy does not prohibit the City from selling a security prior to its maturity and recording a gain or loss in order to improve the quality, liquidity, or yield of the portfolio in response to market conditions or City needs. However, the City's philosophy prohibits speculation, i.e., the purchase of securities with the intent to profit from favorable changes in market prices or market conditions. Leveraging or borrowing money for the purpose of investing is specifically prohibited.

IV. Investment Constraints

1. For repurchase agreements of longer than three (3) days, the underlying collateral must be at least 102% of the repurchase agreement amount and must be delivered to the City's safekeeping account. The only acceptable collateral for repurchase agreements are U.S. Treasury issues and Federal Agency issues. Collateral is not required for repurchase agreements of three days or less.
2. The City shall not use reverse repurchase agreements for the investment of funds.
3. Bankers Acceptances may not exceed 180 days maturity nor more than 40% of the City's investments.
4. Negotiable certificates of deposit may not exceed 30% of the City's investments.
5. Medium-term notes may not exceed 30% of the City's investments.

Instruments issued by a federal agency or U.S. government enterprise may only be purchased as indicated in Appendix A. The City may invest only as shown in Table 1 and shall not invest in inverse floaters, range notes, or interest-only strips that are derived from a pool of mortgages .

The City shall not invest in any security that could result in zero interest accrual if held to maturity. Commercial paper eligible for investment shall have the highest ranking of Moody's Investors Service, Inc. (Moody's), Standard and Poor's (S&P), or Fitch Financial Services, Inc (Fitch). The

STATEMENT OF INVESTMENT POLICY (cont.)

corporation that issues the commercial paper shall be organized and operating within the United States, shall have total assets in excess of five hundred million dollars (\$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. Eligible commercial paper shall have a maximum maturity of 270 days or less. No more than 25 percent of total investments may be invested in eligible commercial paper. No more than 10 percent of the outstanding commercial paper of any single corporate issue may be purchased.

Any investment owned by the City at the time of the adoption of this policy shall be exempt from these provisions. Upon the maturity or liquidation of such investments, any monies reinvested shall be in accordance with the provisions of this policy.

V. SAFEKEEPING OF SECURITIES

The City shall utilize an independent third party financial institution for the safekeeping of securities. The City shall not purchase securities from, nor sell securities to, the financial institution responsible for the safekeeping of the City's securities.

VI. MATURITIES

From time to time, the condition of the fixed income markets presents opportunities for high interest rates on high grade securities with a low risk exposure. It is in the best interest of the City to maintain diversified investments that will ensure safety, liquidity and the increase of acceptable yield from these situations.

No more than 65% of the City's funds may be invested in securities with maturities longer than two years from the date of purchase. Securities with maturities longer than five years must be U.S. Treasury notes or bonds, Federal National Mortgage Association bonds or Federal Home Loan Bank bonds.

The percentage of long-term maturities shall not exceed the following:

- A maximum of thirty percent of the City's invested funds may be invested in securities over five years;
- A maximum of fifteen percent of the City's invested funds may be invested in securities over seven years;
- No security may have a maturity greater than ten years from the date of purchase.

Any moneys held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness, or obligations under a lease, installment sale, or other agreement of the City, or certificates of participation in those bonds, indebtedness, or lease installment sale, or other agreements, may be invested in accordance with the statutory provisions governing the issuance of those bonds, indebtedness, or lease installment sale, or other agreement, or to the extent not inconsistent therewith or if there are no specific statutory provisions, in accordance with the

STATEMENT OF INVESTMENT POLICY (cont.)

ordinance, resolution, indenture, or agreement of the City providing for the issuance.

VII. INVESTMENTS

Eligible investments under state law and their acceptability to the City are shown in the table below.

Investment Type	Eligible for Local Gov't Investment	Acceptable for city
Bonds issued by the City	x	x
United States Treasury issues	x	x
Registered California State Warrants or notes or bonds	x	
Debt issued by a California local government	x	x
Instruments issued by a federal agency or United States government-sponsored enterprise	x	x
Bankers Acceptances (with maturities of 180 days or less)	x	x
Prime Commercial Paper (as defined in Gov't Code section 53601)	x	x
Negotiable certificates of deposit	x	x
Repurchase Agreements with Primary dealers of the Federal Reserve Bank of New York	x	x
Reverse Repurchase Agreements with Primary dealers of the Federal Reserve Bank of New York	x	
Medium-term notes (5 yr. maturity or less) of domestic corporations or depository institutions	x	x
shares in diversified management companies investing in permitted securities	x	x
Obligations backed by a first priority security interest in acceptable collateral for local agency deposits	x	
Mortgage-backed securities	x	
State of California Local Agency Investment Fund	x	x
Shares of beneficial interest issued by the CAL-TRUST Joint Powers Authority, authorized pursuant to Gov't Code Sections 6509.7 and 53601 (p)	x	x

VIII. DEPOSITORY SERVICES

STATEMENT OF INVESTMENT POLICY (cont.)

Legal Constraints

Money must be deposited in state or national banks, state or federal savings associations, or state or federal credit unions in the State of California. It may be in inactive deposits, active deposits or interest-bearing active deposits. Deposits shall not exceed the shareholders' equity of any depository bank or the net worth of any depository savings and loan association.

The bank or savings and loan must secure the active and inactive deposits with eligible securities having a market value of 110% of the total amount of the deposits. If funds are to be collateralized, the collateral must be United States government securities.

Security may be waived for that portion of a deposit which is insured pursuant to federal law. Currently, the first \$250,000.00 of a deposit is federally insured. The collateral requirement for the first \$250,000.00 may be waived if the City will receive a higher interest rate.

Depository services

Active deposits are demand or checking accounts which receive revenues and pay disbursements. Interest bearing active deposits are Money Market accounts at a financial institution (i.e. bank, savings and loan, credit union). These accounts are demand accounts (i.e. checking accounts) with restricted transaction activity.

Inactive deposits are Certificates of Deposit issued in any amount for periods of time as short as 14 days and as long as several years.

IX. REPORTING

The Director of Finance shall render a monthly report to the City Council and City Manager within thirty (30) days following the month covered by the report. The report shall include:

- The type or kind of each investment,
- The issuer of each investment,
- The purchase date of each investment,
- The maturity date of each investment,
- The par and dollar amount of each investment,
- Current market values and sources of the valuations,
- The amount of cash held by the City,
- A description of any of funds, investments, or programs that are under the management of contracted parties,
- A statement regarding compliance with this Statement of Investment Policy,
- A statement denoting the ability of the City to meet its expenditure requirement for the next six months.

X. Appendix A – GLOSSARY

STATEMENT OF INVESTMENT POLICY (cont.)

XI. Appendix B - INVESTMENT CRITERIA FOR FINANCIAL INSTITUTIONS

XII. Review

The investment policy shall be reviewed and approved by the city council on an annual basis.

APPENDIX A GLOSSARY

BANKERS ACCEPTANCES - are short-term credit arrangements to enable businesses to obtain funds to finance commercial transactions. They are time drafts drawn on a bank by an exporter or importer to obtain funds to pay for specific merchandise. By its acceptance, the bank becomes primarily liable for the payment of the draft at maturity. An acceptance is a high grade negotiable instrument. Acceptances are purchased in various denominations for 30 to 180 days but no longer than 270 days. The interest is calculated on a 360 day discount basis similar to Treasury Bills. Local agencies cannot invest more than forty per cent of their surplus money in Bankers Acceptances; the City limits investment in Bankers Acceptances to 40% of its portfolio.

CERTIFICATES OF DEPOSIT - are investments for inactive funds issued by banks, savings and loans and credit unions.

Negotiable Certificates of Deposit are large-denomination CDs issued in \$1 million increments. These securities have average trades in the secondary market of \$5 million to \$10 million. They are issued at face value and typically pay interest at maturity, if maturing is less than 12 months. CDs which mature beyond this range pay interest semi-annually. Negotiable CDs are issued by U.S. banks (domestic CDs), U.S. branches of foreign banks (Yankee CDs) and thrifts. There is an active secondary market for negotiable domestic and Yankee CDs. However, the negotiable thrift CD secondary market is limited. Yields on CDs exceed those on U.S. treasuries and agencies of similar maturities. This higher yield compensates the investor for accepting the risk of reduced liquidity and the risk that the issuing bank might fail. State law does not require the collateralization of negotiable CDs.

Non-negotiable Certificates of Deposit are time deposits with financial institutions which earn interest at a specified rate for a specified term. Liquidation of the CD prior to maturity incurs a penalty. There is no secondary market for those instruments, therefore, they are not liquid. They are classified as public deposits and financial institutions are required to collateralize them. Generally, financial institutions use mortgages to collateralize these deposits. The City only accepts U.S. government-issued or U.S. government-backed securities as collateral.

Non-negotiable CDs of \$100,000 are insured respectively by the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Share Insurance Fund (NCUSIF). For deposits exceeding \$100,000 we require the financial institution to collateralize.

COLLATERAL - consists of securities, evidence of deposits, or other property which a borrower pledges to secure repayment of a loan. It also refers to securities pledged by a bank to secure deposits of public monies. In California, repurchase agreements, reverse repurchase agreements, negotiable CDs purchased at a California institution, and public deposits must be collateralized. Collateral acceptable to the City must be U.S. Treasury or Federal Agency issues. This type of collateral must equal 110% of the deposit being secured.

COMMERCIAL PAPER - is a short term, unsecured, promissory note issued by a corporation to raise working capital. These negotiable instruments may be purchased at a discount to par value or interest bearing. Eligible commercial paper is issued by corporations organized and operating within the United States and having total assets in excess of \$500 million. This would include firms such as General Motors Acceptance Corporation, American Express, Bank of America, Wells Fargo Bank, et cetera.

Local agencies are permitted to invest in commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided by Moody's Investor's Service, Inc., Standard and Poor's Corporation, or Fitch Financial Services, Inc. Purchases of eligible commercial paper may not exceed 270 days maturity nor exceed 25% of the local agency's surplus funds.

DELIVERY - of securities may be accomplished two ways: delivery vs. payment and delivery vs. receipt (also called free). Delivery vs. payment is delivery of securities with an exchange of money for the securities; this is the method of delivery used by the City. Delivery vs. receipt is delivery of securities with an exchange of a signed receipt for the securities.

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

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

A Passbook saving account is similar to an inactive deposit but without a fixed term. The interest rate is much lower than CDs, but the savings account allows flexibility. Funds can be deposited and withdrawn according to daily cash needs.

FEDERAL AGENCY INSTRUMENTS - are issued by U.S. Government agencies or quasi-government agencies. These issues are guaranteed directly or indirectly by the United States Government. Examples of these securities are Federal Home Loan Bank (FHLB) notes, Federal National Mortgage Association (FNMA) notes, Federal Farm Credit Bank (FFCB) notes, Government National Mortgage Association (GNMA) notes and Student Loan Association (SLMAE) notes. The City may not invest in federal agency instruments issued by the Small Business Administration or the Government National Mortgage Association. Collateralized mortgage obligations issued by a federal agency may not be purchased by the City.

ISSUER means any corporation, governmental unit or financial institution which borrows money through the sale of securities.

LIQUIDITY - refers to the ease and speed with which an asset can be converted into cash without loss of value. In the money market, a security is said to be liquid if the spread between the bid and asked price is narrow and reasonably sized trades can be done at those quotes. U.S. Treasury bills are very liquid.

LOCAL AGENCY INVESTMENT FUND (LAIF) - is a special fund in the State Treasury which local agencies may use to deposit funds for investment. There is no minimum investment period and the minimum transaction is \$5,000, in multiples of \$1,000 above that, with a maximum of \$ 40 million for any agency. It offers high liquidity because deposits can be converted to cash in twenty-four hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate share determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly via direct deposit to the LAIF account. The State charges an amount for the cost of making the investments, not to exceed one-quarter of one per cent of the earnings.

MATURITY - is the date upon which the principal or stated value of an investment becomes due and payable.

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

Local agencies are restricted by the Government Code to investments in notes rated "A" or higher by a nationally-recognized rating service. Further restrictions are a maximum term of five years to maturity and total investments in Medium Term Corporate Notes may not exceed thirty per cent of the local agency's surplus money.

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

A further restriction is that the purchase price of shares of the mutual funds shall not include any sales commission. Investments in mutual funds shall not exceed fifteen per cent of the local agency's surplus money.

NEGOTIABLE - is the term used to designate a security, the title to which is transferable by delivery.

PORTFOLIO - is the collection or group of securities owned by an investor.

PRINCIPAL - describes the original cost of a security. It represents the amount of capital or money which the investor pays for the investment.

REPURCHASE AGREEMENTS - are short term investment transactions. Banks buy temporarily idle funds from a customer by selling him U.S. Government or other securities with a contractual agreement to repurchase the same securities on a future date at an agreed upon interest rate. Repurchase agreements are typically for one to ten days in maturity. The customer receives interest from the bank. The interest rate reflects both the prevailing demand for Federal Funds and the maturity of the REPO. Repurchase Agreements must be collateralized.

SHARES OF BENEFICIAL INTEREST ISSUED BY A JOINT POWERS AUTHORITY – Organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in gov't code section 53601, subdivisions (a) to (o), inclusive. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority.

U.S. TREASURY ISSUES - are direct obligations of the United States Government. They are highly liquid and are considered the safest investment security.

TREASURY BILLS - are non-interest-bearing discount securities issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months or one year.

TREASURY NOTES - have original maturities of over one year up to ten years.

TREASURY BONDS - have original maturities of up to 30 years.

APPENDIX B INVESTMENT CRITERIA FOR FINANCIAL INSTITUTIONS

Any financial institution proposed for the purchase, sale, or safekeeping of City securities must submit current financial statements for evaluation by the City Treasurer or Deputy City Treasurer prior to the investment of funds. The institution:

- must have been in business at least three years, and
- must have assets of at least \$50 million and a net worth to liability ratio of 4.0% or greater.

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

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

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

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

The City also requires that interest be paid to the City on a monthly basis (current state law only requires quarterly payment). The City will not place more than \$100,000 in a savings and loan, small banks or credit union.