

CITY OF RANCHO SANTA MARGARITA

FY 2007/08

STATEMENT OF INVESTMENT POLICY

I. PURPOSE AND POLICY

This statement is intended to provide guidelines for the prudent investment of the City's temporary idle cash, and to outline the procedures for maximizing the efficiency of the City's cash management system.

It is the policy of the City of Rancho Santa Margarita to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the entity and conforming to all state and local statutes governing the investment of public funds.

II. SCOPE

This investment policy applies to all financial assets of the City of Rancho Santa Margarita. These funds are accounted for in the official City accounting records and the City of Rancho Santa Margarita's **Comprehensive Annual Financial Report** and include the following funds:

- A. General Fund
- B. Special Revenue Funds
- C. Capital Project Funds
- D. Specific Reserve Funds

III. PRUDENCE

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

The standard of prudence to be used by investment officials shall be the "**prudent person**" and/or "**prudent investor**" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and the 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 timely and appropriate action is immediately taken to control adverse developments.

IV. OBJECTIVE

The City's cash management system is designed to accurately monitor and forecast revenues, expenditures and available balances, thus enabling the City to invest funds for the maximum term possible.

In conformance with California Government Code Sec. 53600.5, the City attempts to obtain the highest yield obtainable as long as investments meet the criteria established for safety and liquidity.

Objectives for selecting investments and the order of priority are:

1. **Safety** - The safety and risk associated with an investment refers to the potential loss of principal, interest or a combination of these amounts. The City should select only those investments that are considered very safe. The City shall not engage in speculation.
2. **Liquidity** - This refers to the ability to "cash in" at any moment in time with a minimal chance of losing some portion of principal or interest. Liquidity is an important investment quality especially when the unexpected need for funds occurs.
3. **Yield** – The annual rate of return on an investment, expressed as a percentage.

V. DELEGATION OF AUTHORITY

Authority to manage the City of Rancho Santa Margarita's investment program is derived from City Council Resolution. Management responsibility for the investment program is hereby delegated to the City Manager who shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials and their procedures in the absence of the City Manager.

The City Manager is also the City Treasurer.

VI. INVESTMENT PROCEDURES

The City Manager shall establish written investment policy procedures for the operation of the investment program consistent with this policy. The procedures should include reference to safekeeping, wire transfer agreements, banking service contracts and collateral/depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the City Manager.

VII. ETHICS AND CONFLICTS OF INTEREST

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the City Manager any material financial interests in financial institutions that conduct business within their jurisdiction, and they shall further disclose any large personal

financial/investment positions that could be related to the performance of investments held by the City of Rancho Santa Margarita.

VIII. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS

The Treasurer will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker/dealers selected by credit worthiness who are authorized to provide investment services in the State of California. These may include “primary” dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (uniform net capital rule). No public deposit shall be made except in a qualified public depository as established by state laws.

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the Treasurer with the following: audited financial statements, proof of National Association of Security Dealers certification, trading resolution, proof of state registration, completed broker/dealer questionnaire, and certification of having read entity’s investment policy and depository contracts.

An annual review of the financial condition and registrations of qualified bidders will be conducted by the Treasurer. Also, a current audited financial statement is required to be on file for each financial institution and broker/dealer in which the City of Rancho Santa Margarita invests.

The Treasurer will require all authorized financial institutions with which City funds are on deposit to provide a copy of the institution’s annual report. The annual report shall include audited financial statements and any other information deemed pertinent by the Treasurer.

IX. AUTHORIZED AND SUITABLE INVESTMENTS

The following investments are authorized by the California Government Code:

- Local Agency Investment Fund {Sec. 16429.1}
- County Treasurer demand deposits {Sec. 53684}
- Passbook savings demand deposits {Sec. 53635}
- Certificates of Deposit (5-year maximum) {Sec. 53601 & 53635}
- Bonds issued by the City of Rancho Santa Margarita {Sec. 53601 (a)}
- Securities of the U.S. Government, or its agencies {Sec. 53601 (b)& (e)}
- Registered securities of the State of California {Sec. 53601 (c)}
- Securities of other local agencies within the State of California {Sec. 53601 (d)}
- Bankers acceptances (40% maximum) {Sec. 53601 (f)}
- Commercial paper (30% maximum) {Sec. 53601 (g)}
- Negotiable certificates of deposit (30% maximum) {Sec. 53601 (h)}
- Repurchase agreements (1-year term maximum) (98% of underlying collateral maximum) {Sec. 53601 (i)}
- Reverse repurchase agreements (92-days maximum, 20% maximum) {Sec. 53601 (i)}
- Medium term notes of corporations or licensed depository institutions (5-year maximum) (30% maximum) {Sec. 53601 (j)}

- Mutual funds that invest only in State of California authorized investments (20% maximum combined with 53601(k)(B) below) {*Sec. 53601 (k)(A)*}
- SEC-registered money market mutual funds (20% maximum combined with Sec. 53601 (k)(A) above) {*Sec. 53601 (k)(B)*}
- Asset-backed and mortgage-backed securities (20% maximum) {*Sec. 53601 (m),(n), Sec. 53651 & Sec. 53652*}

However, the City of Rancho Santa Margarita limits its investments to the following vehicles:

- Securities of the U.S. Government, or its agencies (US T-Bills, US T-Notes, Federal Agency Issues such as FICB's, FFCB's, FLB's, FHLB's, FNMA's, SBA's, GNMA's, TVA's, and SALLIE MAE's)
- Certificates of Deposit (*5-year maximum*)
- Commercial Paper rated A-1 by Standard & Poor's Corporation or P-1 by Moody's Commercial Paper Record
- Banker's Acceptances
- Local Agency Investment Fund (LAIF)
- Passbook savings demand deposits
- Mutual funds that invest only in State of California authorized investments
- SEC-registered money market mutual funds

Any newly developed derivative of an allowable investment that is not specifically mentioned in this policy must be recommended by the City Treasurer for inclusion in the policy. Any amendments to the policy must be submitted to the City Council for review and approval.

X. INVESTMENT POOLS AND MUTUAL FUNDS

A thorough investigation of the pool/fund is required prior to investing, and on a continual basis. There shall be a questionnaire developed which will answer the following general questions:

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

XI. PROHIBITED INVESTMENTS

Pursuant to Government Code Section 53601.6, local agencies are prohibited from making investments in the following vehicles:

Inverse floaters, range notes, or mortgage-derived interest-only strips
Zero-interest coupon securities

The City further limits investments by expressly prohibiting investments in the following:

- Stocks
- Futures and options
- Medium term corporate notes
- Asset-backed and mortgage backed securities
- Registered securities of the State of California or other local agencies within the State of California
- Repurchase agreements
- Reverse repurchase agreements
- Leveraged investments of any kind
- Derivative securities

XII. SAFEKEEPING AND CUSTODY

Deposits of surplus funds must be made in State or National banks, State or Federal savings associations or State or Federal credit unions within the State of California. The deposits cannot exceed the amount of the institution's paid-up capital and surplus.

The institution must collateralize deposits of public funds with eligible securities having a market value of at least 110% of the total amount of the deposit, except that as eligible collateral, first trust deeds must have a market value of at least 150% of the total amount of the deposits and letters of credit drawn on the Federal Home Loan Bank may have a minimum market value of 105%. {*Sec. 53652*}

The City Treasurer may waive collateral for that portion of a deposit which is insured pursuant to Federal law. Currently, the first \$100,000 of a deposit is federally insured. Deposits in excess of \$100,000 are collateralized as previously indicated.

All security transactions entered into by the City of Rancho Santa Margarita shall be conducted on a **delivery-versus-payment (DVP)** basis. Securities will be held by a third party custodian designated by the Treasurer and evidenced by safekeeping receipts.

XIII. DIVERSIFICATION

The City of Rancho Santa Margarita will diversify its investments by security type and institution. Securities purchases and holdings are maintained within statutory limits imposed by the California Government Code. The City further limits its investments as follows (as a percentage of the overall portfolio):

Savings Account	No limit
U.S. Treasury Bills	60%
U.S. Treasury Notes	40%
Federal Agency Securities	20%
The Local Agency Investment Fund	\$40,000,000
Certificates of Deposit	10%
Banker's Acceptances	10%
Commercial Paper	10%

XIV. MAXIMUM MATURITIES

To the extent possible, the City of Rancho Santa Margarita will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, and with prior City Council approval, the City will not directly invest in securities maturing more than five (5) years from the date of purchase.

XV. INTERNAL CONTROL

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

XVI. PERFORMANCE STANDARDS

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

The City's investment strategy is passive. Given this strategy, the basis used by the Treasurer to determine whether market yields are being achieved shall be to compare to the Average Federal Funds Rate.

XVII. REPORTING

The City Treasurer shall render a monthly investment report to the City Council and the City Manager. The report shall include the type of investment, institution, date of maturity, par value and amount of investment, rate of interest, current market value, source of the market value, and such other data as may be required by the City Council. The report shall also include a statement denoting the ability of the City to meet its expenditure requirements for the ensuing six (6) months or an explanation as to why sufficient funds may not be available and a statement that the City's investment portfolio is in compliance with the City's Investment Policy or the manner in which it may not be in compliance. {Sec. 53646}

XVIII. INVESTMENT POLICY ADOPTION:

The City's investment policy shall be adopted by resolution of the City Council of the City of Rancho Santa Margarita. The policy shall be reviewed annually by the City Council and any modifications made thereto must be approved by the City Council.

GLOSSARY OF TERMINOLOGY

SECTION A – TYPES OF INVESTMENTS

U.S. Treasury Bills - are direct obligations of the United States Government issued weekly with maturity dates up to one year. They are issued and traded on a discount basis with interest computed on a 360-day basis. They are issued in amounts of \$10,000 and up, in multiples of \$5,000. They are a highly liquid security. The City limits its U.S. Treasury Bill investments to no more than 60% of its portfolio.

U.S. Treasury Notes - are direct obligations of the United States Government initially issued with two to ten year maturities. They are actively traded in a large secondary market and are very liquid. The Treasury may issue notes with a minimum of \$1,000; however, the average minimum is \$5,000. The City limits its U.S. Treasury Note investments to no more than 40% of its portfolio.

Federal Agency Securities - are guaranteed directly or indirectly by the United States Government. All agency obligations qualify as legal investments and are acceptable as collateral for public deposits. They usually provide higher yields than regular Treasury issues with all of the same advantages. Examples include:

FICB's (Federal Intermediate Credit Bank Debentures) - are loans to lending institutions used to finance the short-term and intermediate needs of farmers, such as seasonal production. They are usually issued monthly in minimum denominations of \$3,000 with a nine-month maturity. Interest is payable at maturity and is calculated on a 360-day basis.

FFCB's (Federal Farm Credit Bank) - are debt instruments used to finance the short and intermediate term needs of farmers and the national agricultural industry. They are issued monthly with three and six month maturities. The FFCB issues larger vehicles (one to ten years) on a periodic basis. These issues are highly liquid.

FLB's (Federal Land Bank Bonds) - are long-term mortgage credits provided to farmers by Federal Land Banks. These bonds are issued at irregular times for various maturities ranging from a few months to ten years. The minimum denomination is \$1,000. They carry semi-annual coupons. Interest is calculated on a 360-day basis.

FHLB's (Federal Home Loan Bank Notes and Bonds) - are issued by the Federal Home Loan Bank System to help finance the housing industry. The notes and bonds provide liquidity and home mortgage credit to savings and loan associations, mutual savings banks, cooperative banks, insurance companies and mortgage-lending institutions. They are issued irregularly for various maturities. The minimum denomination is \$5,000. The notes are issued with maturities of less than one year and interest is paid at maturity. The bonds are issued with various maturities and carry semi-annual coupons. Interest is calculated on a 360-day basis.

GLOSSARY OF TERMINOLOGY

FNMA'S (Federal National Mortgage Association) - are used to assist the home mortgage market by purchasing mortgages insured by the Federal Housing Administration and the Farmers Home Administration, as well as those guaranteed by the Veterans Administration. They are issued about four times a year for maturities ranging from a few months to eight years. They are issued in minimum denominations of \$10,000. They carry semi-annual interest coupons. Interest is computed on a 360-day basis.

Other federal agency issues are Small Business Administration notes (SBA's), Government National Mortgage Association notes (GNMA's), Tennessee Valley Authority notes (TVA's), and Student Loan Association notes (SALLIE-MAE's).

The City limits its Federal Agency securities in total to no more than 20% of its total portfolio.

Certificates of Deposit - are time deposits of a bank or savings and loan. They are purchased in various denominations with maturities ranging from 30 days to several years. The interest is calculated on a 360-day annual basis and is payable monthly.

The City limits its investment in Certificates of Deposit to no more than 10% of its portfolio and each investment must be entirely insured by the Federal Deposit Insurance Corporation (FDIC).

Commercial Paper - are short-term, negotiable, unsecured promissory notes. In order for cities to purchase commercial paper, State law requires maturities to be less than 180 days, the commercial paper to be of the highest quality as provided for by Moody's Investment Service or Standard and Poor's and limited to U.S. corporations. The City limits its investment in Commercial Paper to no more than 10% of its portfolio and may not exceed 10% of a single issuer's outstanding paper.

Banker's Acceptances - are negotiable time drafts drawn to finance the export, import, shipment or storage of goods, and they are termed "accepted" when a bank guarantees to pay the face value at maturity. It is an irrevocable obligation of the accepting bank and a contingent obligation of the drawer. In order for cities to purchase banker's acceptances, State law requires that the banker's acceptance be eligible for purchase by the Federal Reserve System and maturities to be less than 180 days. The City limits its investment in Banker's Acceptances to no more than 10% of its portfolio.

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 thereafter, with a maximum balance of \$40,000,000 for any agency. The City is restricted to a maximum of ten (10) transactions per month. LAIF 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 basis determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly. The State retains an amount for reasonable costs of making the investments, not to exceed one-quarter of one percent of the earnings.

SECTION B – INVESTMENT TERMS

GLOSSARY OF TERMINOLOGY

AGENCIES: Federal agency securities and/or Government-sponsored enterprises.

BID: The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See Offer.

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

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the City of Rancho Santa Margarita. It includes statements for the City as a whole and for each individual fund prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date.

DEBENTURE: A bond secured only by the general credit of the issuer.

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

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

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to \$100,000 per deposit.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value.

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

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Bid.

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PORTFOLIO: Collection of securities held by an investor.

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. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

PRUDENT INVESTOR STANDARD: A standard of conduct where a person acts with care, skill, prudence, and diligence when investing, reinvesting, purchasing, acquiring, exchanging, selling and managing funds. The test of whether the standard is being met is if a prudent person acting in a similar situation would engage in similar conduct to ensure that investments safeguard principal and maintain liquidity.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES & 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.

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.

YIELD: The rate of annual income return on investment, expressed as a percentage.