

City of Garden Grove

INVESTMENT POLICY

2016

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CITY OF GARDEN GROVE INVESTMENT POLICY

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CITY OF GARDEN GROVE

INVESTMENT POLICY

MISSION STATEMENT

It is the policy of the City of Garden Grove to invest public funds in a manner that will provide in priority order, maximum security, adequate liquidity and sufficient yield, while meeting the daily cash flow demands of the City of Garden Grove and conforming to all sections of California Government Code Section 53600, et seq., and related statutes and regulations governing the investment of public funds.

1. PURPOSE

This statement is intended to provide direction for the investment of the City of Garden Grove's temporary idle cash under the prudent investor standard. California Government Code Section 53600.3 defines the prudent investor as an individual who is authorized to make investment decisions as trustees, and therefore they are considered fiduciaries subject to the prevailing standard. Furthermore, the trustee is to act to safeguard the principal and maintain the liquidity needs of the agency.

The City's ultimate investment goal is 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.

2. SCOPE

This investment policy applies to all financial assets of the City of Garden Grove. These funds are accounted for in the City of Garden Grove's audited Comprehensive Annual Financial Report (CAFR) and include all funds under the direction of the City. Bond Proceeds are excluded from this Policy. Investment of bond proceeds will be made in accordance with applicable bond indentures.

3. PRUDENCE

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.

The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in 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 fashion and appropriate action is taken to control adverse developments.

4. OBJECTIVES

The City's funds shall be invested in accordance with all applicable City policies and codes, State statutes, and Federal regulations, and in a manner designed to accomplish the following objectives.

Section 53600.5 of the California Government Code defines the investment objectives of the investment of public funds and that the primary objective of a trustee is the safety of the principal of funds under its control. The secondary objective is to meet the liquidity needs of the depositor. The third objective is to achieve a return on the funds under its control.

A. Safety

Safety and the minimizing of risk associated with investing refers to attempts to reduce the potential for loss of principal, interest or a combination of the two. The first level of risk control is found in State law that restricts the particular type of investments permissible for municipalities. The second level of risk control is reduction of default risk by investing in instruments that appear upon examination to be the most credit worthy. The third level of risk control is reductions of market risk by investing in instruments that have maturities coinciding with dates of disbursements, thereby eliminating risk of loss from a forced sale. The City of Garden Grove only invests in those instruments that are considered very safe. Safety of principal is the foremost objective of the City of Garden Grove's Investment Program.

B. Liquidity

Liquidity refers to the ability to easily sell at any time with a minimal risk of losing some portion of principal or interest. Liquidity is an important quality for an investment to have, for at any time the City may have unexpected or unusual circumstances that result in larger disbursements than expected. When this occurs the existence of highly liquid investments allows the City to meet the cash requirements without unfavorable forced liquidation penalties. Generally investments and their maturities are selected in anticipation of disbursement needs. The City of Garden Grove's Investment Portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated.

C. Yield

Yield is the potential dollar earnings an investment can provide, and also is sometimes described as the rate of return. To meet the objectives, the City of Garden Grove attempts to obtain the highest yield on its investments consistent with the preservation of principal and liquidity. The yield benchmark for the City is the 6 month Treasury Bill as listed in the Money Rates section of the Wall Street Journal.

5. DELEGATION OF AUTHORITY

The City invests in the spectrum of instruments allowable under the Government Code Section 53600 et seq. of the State of California. The City Council has delegated, by resolution No. 9219-14, the authority to invest with the City Finance Director and the appropriate assistants, subject to the limitations set forth in the Investment Policy and Investment Guidelines. (The City holds its public investor harmless for responsible investment transactions undertaken in accordance with the Investment Policy.)

6. ETHICS AND CONFLICT 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 Finance Director of the City any material financial interest in financial institutions that conduct business with the jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City, particularly with regard to the time of purchases and sales.

7. INVESTMENT GUIDELINES AND INVESTMENT STRATEGY

The City of Garden Grove uses a set of written Investment Guidelines (Attachment 1) that define the procedures for investing within the directives of the Investment Policy. In accordance with the Investment Guidelines, Investment Strategy (Attachment 2) is used to maximize yield depending on market conditions.

8. INVESTMENT INSTRUMENTS

The City invests in the following investment instruments as approved by the California Government Code, Sections 53600 et seq. subject to the limitations stated in the City's Investment Guidelines and Investment Strategy:

1. Securities of the U. S. Government or its Agencies
An obligation of the U. S. Government, backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market.
2. Federal Home Loan Bank (FHLB)
Members of the Home Loan Bank system issue consolidated bonds and discount notes as joint and severable obligations of the Home Loan Bank System. Although the banks operate under federal charter with government supervision, there is no explicit federal guarantee of Federal Home Loan Bank debt. The reserves against the debt, which must be maintained, are considerable and this investment is considered very safe.
3. Federal National Mortgage Association (FNMA)
FNMA purchases conventional mortgages which are generated from the sale of corporate obligations to private investors. Its strong secondary market is financed in part through issuance of short-term notes that resemble commercial paper. The notes range up to 360 days.
4. Federal Farm Credit Bank (FFCB)
Farm Credit Bonds are high credit quality bonds. The Farm Credit System's status as a Government-sponsored enterprise, results from its public mission and ties to the federal government; the traditionally strong governmental support of the agricultural sector; and the System's strong financial performance in recent years, including favorable earnings and strong capital ratios. Farm Credit Debt Securities are the joint and several obligations of the Farm Credit System Banks and are not obligations of and are not guaranteed by the United States or any Federal agency instrumentality, other than the Banks.
5. Local Agency Investment Fund (LAIF)
The LAIF is established by the State Treasurer for the benefit of local agencies in which their money is pooled as a method for managing funds.
6. Local Agency Bonds
Bonds, notes, warrants, or other evidences 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.

7. Certificate of Deposit (CD)
A time deposit with a specific maturity evidenced by a certificate.
8. Bankers Acceptances
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.
9. Negotiated Certificates of Deposit
Unsecured obligations of a financial institution, bank or savings and loan, bought at par value with the promise to pay face value plus accrued interest at maturity. They are high-grade negotiable instruments, paying a higher interest rate than regular certificates of deposit.
10. Commercial Paper
An unsecured short-term promissory note issued by corporations, with maturities ranging from 2 to 180 days.
11. Repurchase Agreements (Overnight)
An agreement of one party to purchase securities at a specified price from a second party and a simultaneous agreement by the first party to resell the securities at a specified price or at a specified later date.
12. Passbook Savings Account
13. Other investments that are, or may become, legal investments through the State of California Government Code.

9. DELIVERY

All security transactions entered into by the City shall be conducted on a delivery-versus-payment (DVP) basis to ensure that securities are deposited in an eligible financial institution prior to the release of the funds. Securities will be held by a third party custodian designated by the Finance Director and evidenced by safekeeping receipts and monthly reports.

10. POLICY CONSTRAINTS

The City operates its investment program with many State and self-imposed constraints. It does not speculate; it does not buy stocks or corporate bonds; it does not deal in futures or options; it does not purchase on margin through Reverse Repurchase Agreements. The weighted average life of the portfolio is maintained within limits dictated by the cash flow needs of the City, the economy, and the Investment Guidelines. The City diversifies its investments to reduce

potential default on market risks. The portfolio is carefully monitored to assure the prudent management of the portfolio.

11. INVESTMENT CONTROLS

The City has developed a System of Internal Investment Controls and a Segregation of Responsibilities of Investment Functions in order to assure an adequate system of internal control over the investment function.

The Finance Director 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.

12. INVESTMENT REPORTS

The Finance Director renders a monthly Investment Report to the City Manager and City Council, through the Manager's Memo, showing the type of investment, institution, date of maturity, amount of deposit, current market value for all securities under the City control, rate of interest, amount of interest received during the month and Par Value. A graph is included which indicates the percent of the portfolio that is invested in each type of investment instrument.

GLOSSARY

ACCRUED INTEREST – Interest earned but not yet received.

AGENCIES – Agencies of the Federal government set up to supply credit to various classes of institutions (e.g., S&L's, small business firms, students, farmers, housing agencies, etc.). Examples include Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB) and Federal Farm Credit Bank (FFCB).

BANKERS' ACCEPTANCE (BA) – A draft or bill of exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill as well as the issuer.

BROKER/DEALER – An individual or firm acting as principal in a securities transaction.

CALLABLES – Securities that the issuer has the right to redeem prior to maturity.

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 promissory note issued by a corporation (including limited liability companies) to raise working capital. These negotiable instruments are purchased at a discount to par value or at par value with interest bearing. Commercial paper is issued by corporations such as General Motors Acceptance Corporation, IBM, Bank of America, etc.

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

DELIVERY VS PAYMENT – Delivery of securities with a simultaneous exchange of money.

DEMAND ACCOUNT – An account with a commercial bank from which check withdrawals may be made at any time.

DISCOUNT – The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

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 HOME LOAN BANKS (FHLB) – The institutions that regulate and lend to savings and loan associations. The Federal Home Loan Banks play a role analogous to that played by the Federal Reserve Banks vis-à-vis member commercial banks.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA) – FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a Federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, 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 highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

LIQUIDITY – A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL AGENCY INVESTMENT FUND (LAIF) – The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

MARKET VALUE – The price at which a security is trading, usually the liquidation value.

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

PAPER GAIN OR LOSS – Term used for unrealized gain or loss on securities being held in a portfolio based on comparison of current market quotes and their original

cost. This situation exists as long as the security is held while there is a difference between cost value (book value) and the market value.

PORTFOLIO – Collection of securities held by an investor.

PRUDENT PERSON RULE – An investment standard. In some states, the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state—the so-called “legal list.” In other states, the trustee may invest in a security if it is one that would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

RATE OF RETURN – The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond, the current income return.

REPURCHASE AGREEMENT (REPO) – A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security “buyer” in effect lends the “seller” money for the period of the agreement, and the terms of the agreement are structured to compensate them for this.

REVERSE REPURCHASE AGREEMENT (REVERSE REPO) – A reverse-repurchase agreement (reverse repo) involves an investor borrowing cash from a financial institution in exchange for securities. The investor agrees to repurchase the securities at a specific date for the same cash value plus an agreed upon interest rate. Although the transaction is similar to repo, the purpose of entering into a reverse repo is quite different. While a repo is a straightforward investment of public funds, the reverse repo is a borrowing.

SAFEKEEPING – The service provided by banks and trust companies for clients when the bank or trust company stores the securities, takes in coupon payments, and redeems issues at maturity.

SPREAD – a) The yield or price difference between the bid and offer on an issue; b) the yield or price difference between different issues.

TREASURY BILLS – A non-interest bearing discount security 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 BONDS – U.S. Treasury securities that have initial maturities of more than ten years.

TREASURY NOTES – Intermediate-term coupon bearing U.S. Treasury securities having initial maturities of from one year to ten years.

TRUSTEE – A financial institution with trust powers that acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

YIELD – The rate of annual income return on an investment, expressed as a percentage. (a) Income Yield is obtained by dividing the current dollar income by the current market price for the security. (b) Net Yield or Yield to Maturity is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

YIELD CURVE – Yield calculations of various maturities at a given time to observe spread difference.

YIELD TO MATURITY – The current coupon yield minus any premium above par, or plus any discount from par in the purchase price with the adjustment spread over the period from date of purchase to maturity.

INVESTMENT GUIDELINES

INVESTMENT GUIDELINES STATE THE PARAMETERS OF HOW INVESTING IS TO BE ACCOMPLISHED.

1. CASH AVAILABILITY GUIDELINES

A. Cash flow analysis is developed which serves as a basis for determining the cash available for investment and maturity dates needed to cover future disbursements.

B. A close rapport is maintained with all other departments having a significant impact on cash flow to ensure receipt of timely and accurate data.

C. Revenue receipts are consolidated into one bank account and invested on a pooled concept basis. This provides maximum interest with minimal accounting steps. Interest earnings are allocated according to fund cash and investment balances.

D. Active bank balances are kept as low as possible without jeopardizing good banking relationships by maintaining investment of available cash as near to 100 percent as possible.

E. Bank balances are obtained daily to assure fast, accurate, and detailed information.

F. Sufficient funds are maintained in very liquid investments to meet most unexpected contingencies.

2. INVESTING GUIDELINES

A. Based on the economy a close working relationship is maintained with a list of well-established brokers, and bankers whose expertise is of assistance in making investing decisions.

B. Economic data, forecasts, and conditions are continuously obtained from financial experts in the field and evaluated as to impact on investing decisions.

C. Business journals are routinely reviewed and education programs attended to enhance knowledge and professional skills required managing an investment portfolio.

D. Only investments authorized by the Investment Policy are transacted.

E. Investments are diversified by (1) type, (2) institution, (3) length of maturity, and (4) broker/dealer/bank used as is consistent with safety, liquidity, yield, and administrative cost.

F. Purchases of investments are made with the intent of holding the investments to maturity.

G. The City does not permit the purchase of securities on margin (the borrowing of funds via Reverse Repurchase Agreements using the security to be purchased as collateral).

H. Competitive bids are obtained and documented on all investments when practical.

I. Every investment transaction is documented and the procedure for monitoring is clearly defined.

J. Security purchases are maintained within statutory limits imposed by the California Government Code.

Current limits are:

Bankers Acceptances-30% and not over 180 days in maturity (53601-f)

Commercial Paper - 15% (53601-g)

Negotiated Certificates of Deposit - 30% (53601-h)

K. The weighted average life of the portfolio is maintained within limits dictated by the cash flow needs of the City and the economy.

L. Investment strategies are reviewed for possible need to change at least quarterly. They are reviewed more frequently as changes in economic conditions dictate.

3. GUIDELINES FOR TYPES OF INVESTMENTS

A. CALIFORNIA STATE-LOCAL AGENCY INVESTMENT FUND

A resolution of the City is on file with the State Treasurer, which permits maintaining an account in the Local Agency Investment Fund. Effective January 01, 2016, the maximum per account balance that can be held in the fund was increased from \$50 million to \$65 million. LAIF has a policy limiting the number of total deposit and withdrawals each month (currently it is a total of 15 transactions). Since periodically LAIF changes the maximum balance and the number of transactions allowed each month, the City will make the necessary adjustments to conform to any new requirements. Interest is paid quarterly on an average of what the fund earned for the quarter.

B. REPURCHASE AGREEMENTS (REPOS)

Repos are used only as a short-term investment not exceeding 30 days.

C. BANKERS ACCEPTANCES

Bankers Acceptances are mainly used for investments with a maturity of one to six months. The City will only invest in the 100 largest banks in the world (in terms of assets). Investment in any one institution will not exceed 10 percent of the City's portfolio. Investment in Bankers Acceptances will not exceed 30 percent of the City's portfolio as per State law. Maturities will be for 180 days or less.

D. TIME CERTIFICATES OF DEPOSITS (TCDs)

Only Time Certificates of Deposits that are insured for \$100,000 by FDIC, FLSIC, or fully collateralized as required by state law if over \$100,000 are purchased. Not more than five percent of the City's portfolio is invested in any one institution. Time Certificates of Deposit are safe kept in the City's vault in a fire file or in an acceptable safekeeping account with a perfected interest in the City's name. The institution must be located in California.

E. COMMERCIAL PAPER

Commercial paper is a short-term unsecured promissory note issued by a corporation to raise working capital. Local agencies are permitted by state law to invest in commercial paper of "prime" quality of highest rank. The City of Garden Grove invests in high quality commercial paper for periods of one to ten days to maximize temporary idle funds.

F. TREASURY NOTES AND FEDERAL AGENCY SECURITIES

Investments in Treasury Notes and Federal Agency Securities are limited to those with maturity of five years or less.

INVESTMENT STRATEGY

1. When making an investment decision, the purchase of an investment is made with the intent of holding that investment to maturity.
2. Fully utilize the cash flow projection to balance the liquidity needs at all times.
3. Maintain close working relationships with bankers and brokers, and contact several with each investment transaction.
4. Obtain, at least weekly, economic forecasts from bankers, brokers or other financial experts in the field.
5. Keep the active bank balance at the lowest possible level without jeopardizing good bank relationships.
6. Maintain sufficient funds in overnight investments to meet current cash flow.
7. Review investment plan and strategy annually or as the need arises.
8. Review investment strategy quarterly and update as needed.