

Office of the City Manager

CONSENT CALENDAR  
July 2, 2013

To: Honorable Mayor and Members of the City Council  
From:  Christine Daniels, City Manager  
Submitted by: Robert Hicks, Director, Finance Department  
Subject: Annual Investment Report, Revisions to Investment Policies and Designation of Investment Authority

RECOMMENDATION

Adopt a Resolution accepting the Annual Investment Report, accepting the changes to the investment policies and renewing the delegation of authority to make investments to the Director of Finance for FY 2014, and retroactively approving the report for FY 2013 (which had no changes in policies).

FISCAL IMPACTS OF RECOMMENDATION

There are no fiscal impacts from accepting the Annual Investment Report and renewing the delegation of authority to the Director of Finance to make investments.

CURRENT SITUATION AND ITS EFFECTS

**A. Council Acceptance of the Annual Investment Report and Delegating Authority To Make Investments**

The City's Statement of Investment Policies requires that staff prepare an annual report on the City's investment program and investment activity, and submit to the City Council any recommended changes to the City's Statement of Investment Policies. In addition, the State statutes that govern investment activity require the City Council to annually affirm the Statement of Investment Policies, and to annually confirm the delegation of investment authority, which in the City of Berkeley, is to the Finance Director.

**B. Revisions to the City's Statement of Investment Policies**

The Responsible Investing section of the Investment policy to include the divestment from fossil fuel companies, gun manufacturers, and tobacco companies and to prohibit new investments in any of these companies.

BACKGROUND

The City's Statement of Investment Policies requires that staff prepare an annual report on the City's investment program and investment activity, and submit to the City Council any recommended changes to the City's Statement of Investment Policies. In addition,

the State statutes that govern investment activity require the City Council to annually affirm the Statement of Investment Policies, and to annually confirm the delegation of investment authority.

Following is a brief review of the annual investment report noting the type of interest rate environment staff operated in and what staff expects in the upcoming year, and provides some of the key statistics and results for the year. The annual report, which is a compilation of the four quarterly reports received by the City Council during the fiscal year, is available in the City Clerk’s Office.

**Table 1**

| <b>SUMMARY OF PORTFOLIO RESULTS</b>   |                |                |                |                |                |                                      |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|--------------------------------------|
| <b>Description</b>                    | <b>FY 2008</b> | <b>FY 2009</b> | <b>FY 2010</b> | <b>FY 2011</b> | <b>FY 2012</b> | <b>FY 2013<br/>Thru<br/>03/31/13</b> |
| Portfolio Balance June 30             | \$172,050,981  | \$180,688,060  | \$179,087,145  | \$187,167,504  | \$219,316,979  | \$189,043,179                        |
| Annual City Portfolio Earnings        | 7,353,247      | 6,033,957      | 6,553,861      | 5,998,897      | 6,030,049      | 4,474,502                            |
| Annual City Portfolio Yield           | 4.843%         | 4.897%         | 4.585%         | 3.470%         | 2.420%         | 1.83%                                |
| City Benchmark<br>(Annual LAIF Yield) | 4.325%         | 2.180%         | 0.695%         | 0.490%         | 0.382%         | 0.350%                               |

**Economic and Interest Rate Environment**

Information received since the Federal Reserve Board’s Federal Open Market Committee held a meeting in January 2013 suggests a return to moderate economic growth following a pause late last year. Labor market conditions have shown signs of improvement in recent months but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the sector has strengthened further, but fiscal policy has become somewhat more restrictive. Inflation has been running somewhat below the Committee’s longer-run objective, apart from temporary variations that largely reflect fluctuations in energy prices. Longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will proceed at a moderate pace and the unemployment rate will gradually decline towards levels the Committee judges consistent with its dual mandate. The Committee continues to see downside risks to the

economic outlook. The Committee anticipates that inflation over the medium term likely will run at or below its 2 percent objective.

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of \$40 billion per month and longer-term Treasury securities at a pace of \$45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holding of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the Federal Funds rate at zero% to .25% and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments.

The Fed's action since June 30, 2008 has resulted in a dramatic decline in short and long-term interest rates. This has created a very difficult interest rate environment to invest in. Fortunately, when the Fed lowered short-term rates to a level close to zero percent and kept them there, staff decided to lock in rates on several long-term securities. This has kept the City's yield from falling to close to zero. In the current interest rate environment, staff expects a return that is lower than the overall rate earned in FY 2013, as some long-term securities will mature. However,, the rate earned will be exceptional compared to the City's benchmark (State LAIF) and other cities in California. The City's investment strategy will continue to focus on (1) locking in rates on long-term investments, as much as practical and (2) matching of investment maturities to cash flow.

Interest income from the City's investment portfolio for all City funds for FY 2012 increased by \$31,152 and interest income for all City funds is expected to decline by \$1,555,547 to \$4,474,502 in FY 2013.

**Table 2**

| <b>Rate of Growth in Gross Domestic Product<br/>And Interest Rates for Treasury Notes</b> |                                    |                                    |                                    |                                    |
|---|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| <b>Description</b>  | <b>3<sup>rd</sup> Qtr<br/>2012</b> | <b>4<sup>th</sup> Qtr<br/>2012</b> | <b>1<sup>st</sup> Qtr<br/>2013</b> | <b>2<sup>nd</sup> Qtr<br/>2013</b> |
| Gross Domestic Product  | 2.00%                              | -0.01%                             | 2.50%                              | N/A                                |
| 2 Year Treasury Note  | 0.26%                              | 0.26%                              | 0.26%                              | 0.23%                              |
| 5 Year Treasury Note  | 0.67%                              | 0.70%                              | 0.82%                              | 0.71%                              |
| 10 Year Treasury Note   | 1.72%                              | 1.72%                              | 1.96%                              | 1.76%                              |

The City's performance was higher than the investment benchmark, which is the rate earned by the State Local Agency Investment Fund (LAIF). In FY 2012, the City earned an average of 2.42%, above the .382% earned by LAIF, a difference of 204 basis points (2.04%).

**Investment Oversight**

All investments included in the portfolio comply with the City's adopted investment policies and State law.

**RATIONALE FOR RECOMMENDATION**

This action is required by the State.

**ALTERNATIVE ACTIONS CONSIDERED**

None.

**CONTACT PERSON**

Rosario Riche, Revenue Collection Manager, 981-7334

**Attachments:**

- 1: Resolution
2. Investment Policies (July 2, 2013)

RESOLUTION NO. ##,###-N.S.

ACCEPTING THE ANNUAL REPORT ON INVESTMENTS, AUTHORIZING THE CHANGE TO THE INVESTMENT POLICIES AND RENEWING THE DELEGATION OF AUTHORITY TO MAKE INVESTMENTS TO THE DIRECTOR OF FINANCE

WHEREAS, by Resolution No. 65,436-N.S. dated September 20, 2011, the City Council adopted the Statement of Investment Policies for the City of Berkeley; and

WHEREAS, the Statement of Investment Policies requires the Director of Finance to submit an annual report and make recommendations for amendments to the investment program; and

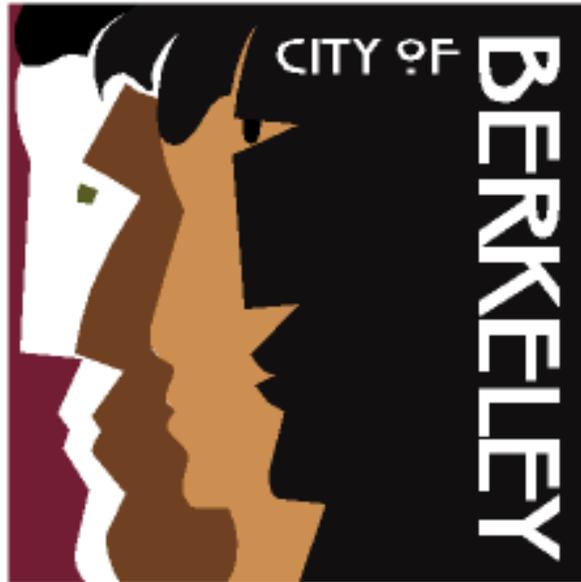
WHEREAS, the Director of Finance has submitted the annual report with recommendations for amendments to the investment program to the City Council.

NOW THEREFORE, BE IT RESOLVED by the Council of the City of Berkeley that the Annual Investment Report for the Fiscal Year ended June 30, 2013, a copy of which is on file in the Office of the City Clerk, is hereby accepted as the annual report required by the investment policies of the City of Berkeley.

BE IT FURTHER RESOLVED that the Council authorizes the recommended change in the investment policies and that the authority of the Director of Finance, or his or her designee, to make investments pursuant to the investment policies is hereby renewed for FY2014.

CITY OF BERKELEY

# INVESTMENT POLICY



Effective July 1, 2013

**City of Berkeley**  
**INVESTMENT POLICIES**  
**July 1, 2013**

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## **I. INTRODUCTION**

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Pursuant to Sections 2.44.040 and 2.44.060 of the Berkeley Municipal Code, Resolution No. 45,087-N.S., and Sections 53601, 53607, 53636 and 53648 of the State Government Code, the Director of Finance, the Treasurer of the City, is authorized to make investments of the City's idle funds. The Code also directs the City to present an annual investment policy to the City Council for approval. This Investment Policy, after approval of the amendments by the City Council, will serve as the Investment Policy for the City of Berkeley for fiscal year 2014.

### **A. SCOPE OF POLICIES**

These investment policies apply to the investments of the City of Berkeley, the Rent Stabilization Board and the Retiree Medical Plan Trust Funds. All financial assets of any funds, including the general fund and other funds that may be created from time to time, shall be administered in accordance with the provisions of these policies.

### **B. INVESTMENT OBJECTIVES**

The City's primary investment objective is to achieve a reasonable rate of return on public funds while minimizing the potential for capital losses arising from market changes or issuer default. Although the generation of revenues through interest earnings on investments is an appropriate City goal, the primary consideration in the investment of City funds is capital preservation in the overall portfolio. As such, the City's yield objective is to achieve a reasonable rate of return on City investments rather than the maximum generation of income, which could expose the City to unacceptable levels of risk.

The following investment objectives, in order of priority, shall be applied in the management of City funds: safety, liquidity and yield.

1. **Safety** of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective is to mitigate credit risk and interest rate risk, summarized as follows:
  - a. **Credit risk.** This is the risk of loss due to the failure of the security issuer or backer. Credit risk may be mitigated by:
    - Limiting investments to the safest types of securities.
    - Determining the credit worthiness of the financial institutions, broker/dealers, and intermediaries with which the City does business.
    - Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

- b.* Interest rate risk. This is the risk that the market value of securities in the portfolio will fall due to changes in general interest rates. Interest rate risk may 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 prior to maturity; and
  - Investing operating funds primarily in shorter-term securities.
2. **Liquidity** - No investment shall be made that could not appropriately be held to maturity without compromising liquidity requirements. 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 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 City's 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 reasonable return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:
- Liquidity needs of the portfolio require that the security be sold.
  - A security swap would improve the quality, yield, or target duration in the portfolio.
4. **Responsible Investing-** Investment policies of the City of Berkeley shall comply with the letter of the following ordinances, resolutions and directives:
- Nuclear-Free Berkeley Act
  - Responsible Investment Ordinance
  - Resolution No. 59,853-N.S.-Oppressive States Contract prohibition
  - Divestment from Gun Manufacturers and Tobacco Companies
  - Divestment from Publicly Traded Fossil Fuel Companies
- a. Nuclear-Free Berkeley Act
- To the extent possible, without compromising the City's safety, liquidity and yield objectives, it is the City's policy to prefer investments in U.S. Agency securities. They are preferred because of their generally higher yields and generally socially preferable uses, such as housing loans or student loans, versus investments in Treasury securities with their association with nuclear weapons. The following paragraphs outline a mechanism for choosing to invest in Treasury securities:

- For each type of investment instrument being considered by the Finance Officer, a “normal spread range” which that instrument yields in excess of Treasury issues of comparable maturity shall be established. When the actual spread is less than the minimum of the normal range, the Finance Officer may choose to invest in Treasury issues, on the grounds that the City is not being compensated for the additional credit risk of non-Treasury investments. Conversely, when the spread is larger than the maximum of the normal range, the Finance Officer may choose to invest in Treasury issues, on the grounds that the financial markets are evaluating alternative instruments as having higher than normal risk. In either case, the Finance Officer shall continue to monitor spreads, and when they return to the “normal range”, evaluate the feasibility of selling any Treasury holdings and reinvesting in non-Treasury instruments.

Treasury issues may also be purchased when six dealers are unable to provide non-Treasury investments of the desired maturity and dollar amounts.

In any event, whenever Treasury instruments are purchased, the next quarterly report shall include an explanation of the circumstances and reasons under which they were purchased. All financial institutions, which hold deposits or investments of the City, shall file a statement with the Director of Finance indicating the percentage of the bank’s assets which are loaned to or invested in nuclear weapons agents as defined in Section 13 of the Nuclear-Free Berkeley Act. The Director of Finance shall use this information as a factor in selecting banks which have minimum involvement in the nuclear weapons industry. A summary of these reports shall be attached to the annual Statement of Investment Policies.

- Investments in United States Treasury securities may be made by the City of Berkeley only when no other reasonable alternative exists under the procedure described above. Short-term investments in United States Treasury securities repurchase agreements of 14 days or more shall be authorized by a continuing resolution of the City Council with each resolution to expire within 60 days.
- The City of Berkeley shall ensure that any City funds, or any funds controlled by the City, invested through trustees or other third parties, are invested according to the provisions of this section and, to this end, shall obtain written assurances to this effect from any such trustees or third parties.

b. Divestment From Publicly-Traded Fossil Fuel Companies

The City of Berkeley has a responsibility to protect the lives and livelihoods of its inhabitants from the threat of climate change. While fossil fuel companies provide an attractive return on investment, the City of Berkeley will suffer greater economic and financial losses from the impact of unchecked climate change. The City’s infrastructure, businesses and communities would face greater risk of damages and losses due to that climate change. The City believes that its investments should support a future where all citizens can live healthy lives without the negative impacts of a warming environment. For the purposes of the Investment Policy, a “fossil fuel company “ shall be defined as any of the two hundred publicly-traded companies with the largest coal, oil and gas reserves as

measured by the gigatons of carbon dioxide that would be emitted if those reserves were extracted and burned, as listed in the Carbon Tracker Initiative’s “Unburnable Carbon” report.

Staff responsible for managing the City’s investment portfolio are directed to divest all City funds held in fossil fuel companies and are prohibited from making any new investments in such companies.

c. **Divestment from Gun Manufacturers and Tobacco Companies**

The City of Berkeley has a responsibility to protect the lives and livelihoods of its inhabitants from the threat of dangerous weapons and products. There is no better role for city government than to protect people. If the City invests in companies that are putting dangerous weapons and dangerous products on our streets, then the City is part of the problem.

Staff responsible for managing the City’s investment portfolio are directed to divest all City funds held in gun manufacturers and tobacco companies and are prohibited from making any new investments in such companies.

These guidelines apply to all cash-equivalent assets included within the scope of the City's audited financial statements and held either directly by the City or held and invested by trustees or fiscal agents.

**C. USE OF STATE INVESTMENT GUIDELINES**

Government Code Sections 16481.2, 53601, 53607, 53635, and 53646 of the State of California regulate the investment practices. It is the policy of the City of Berkeley to use the State's provisions for local government investments as the base for developing and implementing the City's investment policies and practices.

As required under Government Code Sections 16481.2 and 53646, the Statement of Investment Policies will be reviewed by the Council annually.

**II. INVESTMENT AUTHORITY AND RESPONSIBILITIES**

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**A. AUTHORIZED INVESTMENT OFFICERS**

*1. Idle Funds:*

Pursuant to Sections 2.44.040, 2.44.060 of the Berkeley Municipal Code, Resolution No. 45,087-N.S., and Sections 53601, 53636 and 53648 of the State Government Code, the Director of Finance, the Treasurer of the City, is authorized to make investments of the City’s idle funds. Responsibility for the operation of the investment program is hereby delegated to the Director of Finance, who shall carry out established written procedures and internal controls for the operation of the investment program consistent with this plan. Procedures should include references to: safekeeping, delivery versus payment basis of settling transactions, investment accounting, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking services contracts. In the exercise of this

responsibility, the authority to perform specific investment tasks and duties is delegated as follows:

- Revenue Collection Manager. In the absence, and under the direction, of the Finance Director, to invest idle funds on a daily basis as required for cash flow purposes pursuant to the requirements of the Statement of Investment Policies.
- Senior Accountant or Accounting Manager. To execute necessary investment documents, and obtain the approval of the Director of Finance to authorize wire transfers and execute bank authorizations.
- Deputy City Manager. To execute necessary investment documents, authorize wire transfers, execute bank authorization in absence of the Director of Finance, Revenue Collection Manager in the Treasury Division, Senior Accountant, and the Accounting Manager.

2. *Retiree Medical Trust Funds:*

A Trust is to be established by the City for the purpose of holding and investing assets separate and apart from the other funds of the City to fund the benefits of the Program. The specific terms governing the Trust are to be set forth in a separate trust instrument.

- The trustee of the Trust (the “Trustee”) may be the City Treasurer (i.e., Director of Finance) or an independent third party qualified to act as a trustee under California law and designated by the City.
- The Trustee shall be a fiduciary of the Program and shall act solely in the interest of the Participants, minimizing employer contributions to the Trust, and defraying reasonable expenses of administering the Program.
- The City Manager may, with the written concurrence of the City Council, appoint an “investment manager” (as that term is defined in section 3(38) of the Employee Retirement Income Security Act) to have responsibility for investment of the Trust assets. In this case, the Trustee shall act as directed by the investment manager. The investment manager shall act as a fiduciary of the Program and shall act with the same duties and responsibilities set out in “Investment Objectives” section above.
- To the extent required by governing law, Trust investments shall be limited to investments that are allowed for the City’s assets.

## **B. INTERNAL CONTROLS**

The Director of Finance shall establish a system of internal controls designed to prevent losses of public funds arising from fraud, employee error, misrepresentation of third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City of Berkeley. 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. These controls shall include:

- Separation of transaction authority from accounting and physical custody.
- By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.
- Also, 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.
- Avoidance of physical delivery of securities by using a delivery versus payment “Basis of Settlement Only”.
- All trades will be executed on a delivery versus payment (DVP) basis. This ensures that securities are delivered to the City’s safekeeping bank at the same time the funds are released by the City’s safekeeping bank.
- Third-Party custodial safekeeping of securities held in the name of the City. Delivered securities must be properly safeguarded against loss or destruction. Book entry securities are recorded in electronic records and the potential for fraud and loss increases with physically delivered securities. All investment securities, except collateralized certificates of deposit and money market funds, purchased by the City will be delivered by either book entry or physical delivery and will be held in third-party safekeeping by a City-approved custodian bank, its correspondent New York Bank or the Depository Trust Corporation (DTC). Whenever possible, securities purchased are to be recorded in “book entry” form.
- All securities and applicable collateral will be held by the City’s third party custodian and evidenced by safekeeping receipts. All book entry securities owned by the City shall be evidenced by a safekeeping receipt issued to the City by the custodian bank to acknowledge that the securities are held in the Federal Reserve system in a “customer account” for the custodian bank which names the City as “customer”;

The Director of Finance will require each approved safekeeping financial institution to submit a copy of its Consolidated Report of Condition and Income (Call Report) to the City within 60 days after the end of each calendar quarter.

- Competitive bidding on investment transactions. Before the City invests any funds, competitive bids shall be requested. If a specific maturity date is required, either for cash flow purposes or for conformance to maturity guidelines, bids will be requested from at least three financial institutions for instruments which meet the maturity requirement. If no specific maturity is required, a yield curve analysis will be conducted to determine which maturities would be most advantageous.
- Written confirmation and documentation of all financial transactions.
- Due to the potential for error and improprieties arising from telephone transactions, all telephone transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and the safekeeping institution has a list of authorized signatures.
- Rapid deposit of funds received by the City (i.e., large checks.)
- Bonding of all investments officials.

### **C. EVALUATION OF INVESTMENT OFFICER ACTIONS**

Section 53600.3 of the Government Code identifies trustees as those persons authorized to make investment decisions on behalf of a local agency. As a trustee, the standard of prudence to be used by investment officials shall be the "prudent investor" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures, 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 the liquidity and the sale of securities are carried out in accordance with the terms of this plan.

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.

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 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 their entity.

## **III. CAPITAL PRESERVATION AND RISK**

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### **A. OVERVIEW**

Some level of risk is inherent in any investment transaction. Losses may be incurred due to issuer default, market price changes, or technical cash flow complications such as investments in non-marketable certificates of deposit. Diversification of the City's portfolio by institution, investment vehicle, and maturity term is the primary tool available to the City in minimizing investment risk and capital losses by safeguarding the overall portfolio from any individual loss.

### **B. PORTFOLIO DIVERSIFICATION PRACTICES**

The following sections summarize the City's major portfolio diversification practices and guidelines in determining:

- Authorized Dealers
- Investment Vehicles
- Investment Maturity

Portfolio limitations included in these guidelines are to be based on the portfolio composition and investment management plan policies in effect at the time of placement; the actual composition of the City's investments may vary over time from plan limitations due to overall

portfolio changes from when the individual placement was made as well as changes in the City's investment management plan.

#### **IV. ELIGIBLE FINANCIAL INSTITUTIONS**

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##### **A. AUTHORIZED DEALERS**

- Investments shall be purchased only through well-established, financially sound institutions. The Finance Director shall maintain a list of financial institutions and broker/dealers approved for investment. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions will be given a copy of the City's Statement of Investment Policies, and a return cover letter which must be signed indicating that the Statement of Investment Policies has been read and understood.

Qualified financial institutions and broker/dealers must supply the Director of Finance with the following:

##### Financial Institutions

Current audited financial statements

Depository contracts, as appropriate

A copy of the latest FDIC call report or the latest FHLBB report, as appropriate.

##### Broker/Dealers

Current audited financial statements

Proof that brokerage firm is a member in good standing with a national securities exchange.

- Except for repurchase agreements, investments shall be awarded based on competitive bids. Documentation relating to investment quotes shall be maintained by the Finance Department for a period of one year.

##### **B. INDIVIDUAL PLACEMENT OF DEPOSITS**

Individual placement of negotiable, collateralized, and other time certificates of deposit with eligible financial institutions shall be based on the following practices and procedures:

- Deposits shall only be placed with financial institutions maintaining offices within the City of Berkeley.
- Unless collateralized by eligible securities as provided in Sections 53651 and 53652 of the Government Code, the maximum amount of Certificates of Deposit to be placed with any single institution is \$250,000.

#### **V. INVESTMENT VEHICLES**

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## **A. STATE OF CALIFORNIA LIMITATIONS**

As provided in Sections 53601, 53635, and 16429.1 of the Government Code, the State of California limits the investment vehicles available to local agencies to the following:

### **1. U.S. Treasury Instruments**

As authorized in Government Code Section 53601(b), this category includes bills, notes, bonds or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest. There are no portfolio limitations on the amount.

### **2. Government Sponsored Enterprises**

As authorized in Government Code Section 53601(e), this category includes a wide variety of government securities. These securities include U. S. government-sponsored enterprise obligations, such as issues by the Federal National Mortgage Association (FNMA's), Federal Home Loan Bank (FHLB), Federal Farm Credit (FFCB), Student Loan Marketing Association (SLMA), etc. There are no portfolio limitations on the amount.

### **3. Banker's Acceptances**

As provided in Government Code Section 53601(f), 40% of the City's portfolio may be invested in Banker's Acceptances, otherwise known as bills of exchange or time drafts that are drawn on and accepted by a commercial bank, although no more than 30% of the portfolio may be invested in Bankers' Acceptances with any one commercial bank. Additionally, the maturity period cannot exceed 180 days.

### **4. Commercial Paper**

Commercial paper is a short-term, unsecured promissory note issued by financial and non-financial companies to raise short-term cash. As provided in Government Code Section 53601(g) up to 25% of the City's portfolio may be invested in "prime" commercial paper of the highest ranking or of the highest letter and number rating as provided by a nationally recognized statistical-rating organization (i.e., Moody's or Standard and Poor's or Fitch), with maturities not to exceed 270 days. The issuer must have total assets in excess of \$500 million, and have debt other than Commercial Paper rated "A" or higher by a nationally recognized statistical-rating organization.

### **5. Negotiable Certificates of Deposit**

Negotiable certificates of deposit are a fixed deposit certificate that may be negotiated (traded) to a third party. The institution issuing the certificate promises to pay the holder the initial investment plus the interest rate stated on the certificate at maturity. As authorized in Government Code Section 53601(h), the City may invest 30% of its portfolio in negotiable certificates of deposit issued by commercial banks, thrifts and foreign banks.

### **6. Repurchase Agreements**

Repurchase agreements are agreements between the local agency and seller for the local agency to purchase government securities to be resold back to the seller at a specific date and for a specific amount and are authorized by Government Code Section 53601(i). Although the legal maximum maturity on these investments is 360 days, repurchase agreements are generally short-

term investments varying from one day to two weeks. Investments in repurchase agreements must be collateralized, and collateral required for repurchase agreements is limited to Treasury and Agency securities. In order to anticipate market changes and provide a level of security for all funds, the required collateralization level is 102% of market value of principal and accrued interest.

#### **7. Reverse Repurchase Agreements**

Reverse repurchase agreements are a sale of securities by the local agency with a simultaneous agreement for the local agency to repurchase the securities on or before a specified date. As provided in Government Code section 53635(i), reverse repurchase agreements require the prior approval of the City Council. Reverse repurchase agreements can only be made with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a significant banking relationship with the local agency. There are no portfolio limitations on the amount for these investments.

#### **8. Medium-Term Corporate Notes**

As authorized in Government Code Section 53601(j), local agencies may invest in corporate bonds and notes of industrial companies, banks, bank holding companies, insurance companies, thrifts and finance companies that are rated "A" or better by a nationally recognized rating service; and issued by corporations organized and operating in the United States. The maximum remaining maturity is limited to five years, and the amount invested must not exceed 30% of the agency's portfolio.

#### **9. Shares of Beneficial Interest Issued By Diversified Management Companies**

As authorized in Government Code Section 53601(k), local agencies are also authorized to invest in shares of beneficial interest issued by diversified management companies (i.e., mutual funds) as defined in Section 23701(m) of the Revenue and Taxation Code in an amount not to exceed 20% of the agency's portfolio.

#### **10. Financial Futures and Financial Option Contracts**

As authorized in Government Code Section 53601.1, local agencies may invest in financial futures or option contracts in any of the above investment categories subject to the same overall portfolio limitations.

#### **11. Time Certificates of Deposit**

As authorized in Government Code Section 53635, time certificates of deposit are fixed term, non-negotiable investments which are required to be collateralized 110% by eligible pooled securities. The pool is administered by the State, and is composed of a wide variety of government securities, secured by first mortgages on improved residential property located in the State. There are no portfolio limits on the amount, however the maturity period for this investment vehicle may not exceed five years unless approved by the Council.

#### **12. Local Agency Investment Fund**

As authorized in Government Code Section 16429.1, local agencies may invest in the Local Agency Investment Fund (LAIF), a pooled investment fund managed by the State Treasurer's Office. It operates like a money market fund, but is for the exclusive benefit of governmental

entities within the State. The current maximum amount of money that may be invested is \$40 million.

### **13. Moneys Held By A Trustee Or Fiscal Agent**

As authorized in Government Code Section 53601(l), debt proceeds held by a trustee or fiscal agent, which are pledged to the payment or security of bonds or other indebtedness may be invested in accordance with the statutory provisions governing the issuance of those bonds or other agreement; or to the extent not inconsistent with statutory provisions, or if there are no specific statutory provisions, investments may be made in accordance with the ordinance, resolution, indenture, or agreement of the local agency for the issuance.

This category includes investment agreements approved in writing by insurance companies, supported by appropriate opinions of counsel with notice to Standard and Poor's.

### **14. Other Secured Notes, Bonds Or Other Obligations**

As authorized in Government Code Section 53601(m), notes, bonds, or other obligations that are at all times secured by a valid first priority security interest in securities of the types listed by Section 53651 as eligible securities.

### **15. Mortgage Pass Through, Collateralized Mortgage Obligation, Mortgage-backed Bond, Equipment Lease-backed Certificate, Consumer Receivable Pass through Certificate, and Consumer Receivable-backed Bond**

As authorized in Government Code Section 53601(n), securities in this category must be rated "AA" or its equivalent or better by a nationally recognized rating service. Purchases may not exceed 20% of the agency's portfolio.

## **B. CITY POLICIES**

### **1. Allowable Investment Vehicles and Restrictions**

The Director of Finance/City Treasurer is authorized to invest in any of the investment vehicles allowed by Sections 53601, 53635 and 16429.1 of the Government Code above, with the following limitations:

Financial futures; option contracts, floaters, inverse floaters, range notes, interest-only strips that are derived from a pool of mortgages, or any security that could result in zero interest income if held to maturity may not be purchased. Exclusion of these vehicles is consistent with the City's overall objective of achieving reasonable yields on public funds while minimizing risk and capital losses. Although the potential exists for greater interest yields with these vehicles, it is believed that the potential level of risk exceeds their benefits except in very limited circumstances.

- Reverse repurchase agreements shall be entered into only to effect a "matched" transaction whereby the proceeds of the reverse are reinvested for the same period as the term of the reverse repurchase agreement.

- Funds will only be invested in negotiable Certificates of Deposit that are fully insured by the Federal Deposit Insurance Corporation (FDIC) or the Federal Savings and Loan Insurance Corporation (FSLIC) in amounts up to \$250,000 (including interest).
- The authority to invest in certain securities is restricted by the provisions of the section entitled “Responsible Investing”.
- Commercial paper is limited to a maturity of 180 days, and the issuer must have the highest rating from two nationally recognized rating agencies, not one (as required by the State).
- The greater of \$5 million or 2% of the short-term portfolio can be in the commercial paper of any single corporation or group under essentially common ownership or control.
- Purchases of long-term (i.e., beyond five years) corporate bonds are limited to the Retiree Medical Plan Trust Fund and debt service reserve funds. Issuers must have a Moody’s credit rating of A3 or higher and Standard and Poor’s rating of A- or higher.
- Purchases of such corporate notes as mortgage pass through, collateralized mortgage obligation, mortgage-backed bond, equipment lease-backed certificate, consumer receivable pass through certificate and consumer receivable-backed bond must be rated “Aa” or AA or its equivalent or better by a nationally recognized rating service. As authorized in Government Code Section 53601(j), staff may invest in corporate bonds and notes of industrial companies, banks, bank holding companies, insurance companies, thrifts and finance companies that are rated “A” or better by a nationally recognized rating service; and issued by corporations organized and operating in the United States. The maximum remaining maturity is limited to five years, and the amount invested must not exceed 30% of the agency's portfolio.
- No investment shall be made which involve a “hidden” reduction in the investment rate or yield in order to subsidize other investment programs. For example, suppose the City invests \$10,000,000 for a year at a rate of 1% less than “market” rates.
- Up to 100% of the portfolio may be placed in money market funds.
- Up to 25% of the retiree medical plans funds may be invested in equity mutual funds, equity index funds and preferred stock.

See Exhibit B for the Summary of Maximum Portfolio Amounts and Maturities, which lists the maximum amounts that may be invested in the various investment types and the maximum authorized maturities.

## 2. Term

- Reserve funds from the proceeds of debt issues may be invested by the Director of Finance/City Treasurer in government agency securities with terms exceeding five (5) years, if the maturity of such investments are made to coincide as nearly as practicable with the life of the debt issue. In all other cases except for segregated investments, Council approval to make investments with terms in excess of 5 years is required on a case-by-case basis.
- Segregated investments of instruments permitted in Government Code Section 53601 can be made with proper authorization where cash flow or other factors warrant segregation from the commingled pool. Examples that may justify such segregation are bond or note proceeds, Retiree Health funds and Workers Compensation funds, where longer-term or matching term investments are warranted.

For segregated investment funds, no investment shall be made that could not appropriately be held to maturity without compromising liquidity requirements.

In accordance with Government Code Sections 53620-53622, the assets of the City of Berkeley Retiree Medical Plan Trust may be invested in any form or type of investment deemed prudent by the City Council.

**3. New Investments**

No new types of investments will be purchased for the first time without at least two weeks notification to the City Council. For example, although Mortgage Pass through securities are authorized investments, none will be purchased for the first time without such prior City Council notification.

**VI. INVESTMENT MATURITY**

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In addition to the risks associated with the credit-worthiness of the financial institution and the security of the investment vehicle, the maturity period of investments is also a significant consideration in the management of the City's portfolio. In order to minimize the impact of market risk, it is intended that all investments will be held until maturity. Investments may be sold prior to maturity for cash flow or appreciation purposes; however, no investment shall be made based solely on yields resulting from anticipated capital gains.

Also, except for debt proceeds and Retiree Medical Plan Trust funds (which are considered segregated investments), the maximum maturity for any one investment shall not exceed five years unless authority for such investment is expressly granted in advance by the City Council.

**VII. CASH MANAGEMENT**

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To achieve a reasonable return on public funds, the following cash management practices will be followed:

- Maintain maximum investment of all City funds not required to meet immediate cash flow needs while maintaining adequate compensating balances as required under the City's banking services agreement.
- Pool resources available for investment from all City-administered funds, with interest earnings allocated to each of the funds in accordance with generally accepted accounting principles.

- Maximize the City's cash flow through the immediate deposit of all cash receipts, use of direct deposits and wire transfers when available, and appropriate timing of payments to vendors.
- Maximize the cash flow information available through the use of only one operating bank account.

## **VIII. EVALUATION OF INVESTMENT PERFORMANCE**

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As indicated in the Introduction section of this document, it is the City's primary investment objective to achieve a reasonable rate of return on public funds while minimizing risks and preserving capital. In evaluating the performance of the City's portfolio in achieving this objective, it is expected that yields on City investments will regularly meet or exceed the average return on the State Local Agency Investment Fund (LAIF).

## **IX. INVESTMENT REPORTING**

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Consistent with Sections 16481.2 and 53646 of the Government Code, the Department of Finance shall submit an annual Statement of Investment Policies to the Council for consideration at a public meeting.

In addition to the submittal of an annual Statement of Investment Policies, the Department of Finance shall provide the Council with a quarterly and annual investment report providing the following information for each investment or security:

- Issuer or broker/dealer (financial institution)
- Type of investment
- Certificate or other reference number if applicable
- Percentage yield on an annualized basis
- Purchase date
- Maturity date for each investment and the weighted average maturity of all the investments within the portfolio
- Current book value
- Current market value
- Total cost and market value, including source of this valuation, of the City's portfolio
- A description of the compliance with the Statement of Investment Policies
- An evaluation of investment operations for the preceding year. This shall include an evaluation of how well the objectives have been achieved: the accuracy of forecasting expenditures and revenues, as well as a comparison of the average returns on the investment portfolio with that of the Local Agency Investment Fund (LAIF).
- Report of investments. The Director of Finance shall prepare a report that provides a clear status of the current investment portfolio and transactions. The report will be prepared in a manner which allows the City Manager and Council to ascertain whether investment activities during the reporting period have conformed to the investment policies.

- Summary of key or unusual events, including but not limited to:
  - Any exceptions to policies;
  - Adherence to or deviations from social investment goals;
  - Purchases of Treasury securities, other than in repurchase agreements with maturities of seven days or less;
  - Purchases of securities that exceed maturity limits;
  - Sales of securities more than three months before maturity;
  - Changes in investment procedures, dealers, staff, etc.
  
- Investment performance;
  - A glossary, defining all funds or accounts referred to elsewhere in the report; and
  - A listing of banks, securities dealers and custodians that the City has had investment transactions during the period.
  - A summary of the certifications for deposits of City funds.
  - Other information regarding the City's portfolio as appropriate

The Quarterly Investment Report shall include all investments as of the end of the quarter from all funds held in the City's portfolio, including funds held and invested by trustees; and shall be issued within 60 days after the end of the quarterly reporting period to the City Manager, and the City Council; the annual report shall be issued within 90 days after the end of the fiscal year to the City Manager, and the City Council.