



FY ~~2016~~2017
Statement of Investment Policy

Finance Department
[Acting Director of Finance, ~~Tracy Vesely~~Dustin Claussen](#)
Policy Recommended Changes: ~~October 24~~November 16, 2014~~2016~~
Policy last amended: ~~February 4~~November 17, 2014~~2015~~

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FY ~~2016~~-2017 - Statement of Investment Policy

Table of Contents

I. Introduction	3
II. Statement of Objectives	3
III. Use of State Investment Guidelines	4
IV. Delegation of Authority	4
V. Investment Advisory Committee	5
VI. Ethics and Conflict of Interest	5
VII. Investment Policy Adoption	5
VIII. Standard of Prudence	5
IX. Reporting	6
A. <i>Monthly</i>	6
B. <i>Periodic</i>	6
C. <i>Annual</i>	6
X. Investment Instruments	7
A. <i>United States Treasury Notes, Bonds, Bills, or Certificates of Indebtedness</i>	7 ⁸
B. <i>Federal Agency or United States Government-Sponsored Enterprise (GSE) Obligations</i>	8
C. <i>Banker's Acceptances</i>	8
D. <i>Prime Commercial Paper</i>	8
E. <i>Negotiable Certificates of Deposit</i>	9
F. <i>Repurchase Agreements</i>	9
G. <i>Medium-Term Notes</i>	9
H. <i>Money Market Funds</i>	9
I. <i>Alameda County Investment Pool</i>	10
J. <i>State of California's Local Agency Investment Fund</i>	10
K. <i>Collateralized Certificates of Deposit</i>	10
L. <i>Municipal Bonds</i>	11
M. <i>Supranationals</i>	11
N. <i>Asset-Backed Securities</i>	11
XI. Prohibited Investments	12
XII. Credit Downgrade	12
XIII. Maturity and Diversification	12
XIV. Internal Controls	12

FY ~~2016~~-2017 - Statement of Investment Policy

XV. Banks and Security Dealer Selection14

XVI. Risk Tolerance14

XVII. Safekeeping and Custody16

 Appendix A17

 Comparison and Interpretation of Credit Ratings¹17

 Appendix B.....18

 Glossary18

FY ~~2016~~-2017 - Statement of Investment Policy**I. Introduction**

The purpose of this document is to identify various policies and procedures that enhance opportunities for a prudent and systematic investment policy and to organize and formalize investment-related activities. Activities that comprise good cash management include accurate cash projections, the expeditious collection of revenue, the control of disbursements, cost-effective banking relations, and arranging for a short-term borrowing program that coordinates working capital requirements and investment opportunities.

A. Included – Funds included in this Statement of Investment Policy are described in the City's annual financial report, and include: General Fund, Special Revenue Funds, Capital Projects Funds, Enterprise Funds, Internal Service Funds, Fiduciary Funds, Housing Finance Agency Funds, Successor Hayward Housing Authority funds, and Hayward Redevelopment Agency Successor Agency funds. The Statement of Investment Policy applies to all transactions involving the financial assets and related activity of the foregoing funds.

B. Excluded – The following funds are excluded from the Statement of Investment Policy: Deferred Compensation Fund assets and monies held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness, or obligations under a lease, installment sale, or other agreement of the City, or certificates of participation in those bonds, indebtedness, or lease installment sale, or other agreements may be invested in accordance with the ordinance, resolution, indenture or agreement approved by the City Council which govern the issuance of those bonds, or lease installment sale, or other agreement, rather than this Statement of Investment Policy.

II. Statement of Objectives

It is the policy of the City of Hayward to invest public funds not required for immediate day-to-day operations in safe and liquid investments with maturities under five years, in conformance with the California state statutes governing the investment of public funds. Investments are intended to achieve a reasonable rate of return while minimizing the potential for capital losses arising from market changes or issuer default.

FY ~~2016~~2017 - Statement of Investment Policy

In managing the City of Hayward's Investment Portfolio, the City's primary objectives are safety, liquidity, and yield.

1. **Safety** – Safety of principal is the foremost objective of the City, followed by liquidity and yield. Each investment transaction shall seek to first ensure that capital losses are avoided, whether they are from securities defaults or erosion of market value.
2. **Liquidity** – The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements that might be reasonably anticipated.
3. **Yield** – The City may establish a performance benchmark based on current investment objectives and constraints. The investment portfolio shall be managed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the City's policy constraints and cash flow requirements. The City should not take undue risk to obtain above-market rates of return.
4. **Diversification** – The City's investment portfolio will be diversified to avoid concentrating investments in specific security types or in individual financial institutions.

While the City will not make investments for the purpose of trading or speculation as the dominant criterion, the Director of Finance shall seek to enhance total portfolio return by means of active portfolio management.

III. Use of State Investment Guidelines

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

IV. Delegation of Authority

The responsibility for conducting the City's investment program is hereby delegated to the Director of Finance, who has established written procedures for the operation of the investment program, consistent with this Statement of Investment Policy. The Finance Director has further authority, with consent of the City Council, to engage the services of one or more external investment managers to assist in the management of the City's investment portfolio in a manner consistent with the City's Statement of Investment Policy. Such managers must be registered under the Investment Advisors Act of 1940.

FY ~~2016~~-2017 - Statement of Investment Policy**V. Investment Advisory Committee**

The City Manager will appoint an Investment Advisory Committee (IAC). The IAC shall, at minimum, consist of the Assistant City Manager, Director of Finance or Deputy Director of Finance, City Attorney or Assistant City Attorney, one department head, and a minimum of one non-City employee that possesses financial skills to be chosen by the City Manager as available.

The IAC shall meet at least quarterly for the purpose of overseeing the implementation of the City's investment program and assuring it is consistent with the Statement of Investment Policy as approved by the Council. The committee shall include in its discussions such topics as economic outlook, portfolio diversification and maturity structure, potential risks to the City's funds, approval of authorized financial institutions, and the performance of the investment portfolio. Written investment procedures must be approved by the IAC.

VI. Ethics and Conflict of Interest

Officers and employees involved in the investment process shall refrain from personal business activities that could conflict with proper execution of the investment program or impair their ability to make impartial decisions.

All members of the City's IAC shall annually file Statements of Economic Interests (SEIs or Form 700) with the California Fair Political Practices Commission.

VII. Investment Policy Adoption

The City's Statement of Investment Policy shall be annually reviewed and approved by the Investment Advisory Committee and thereafter shall be reviewed and approved by the City Council at a public meeting.

VIII. Standard of Prudence

All participants in the investment process shall act responsibly as custodians of the public trust. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. Nevertheless, in a diversified portfolio, it must be recognized that occasional measured losses are inevitable, and must be considered within the context of the overall portfolio's investment return, provided that adequate diversification has been implemented.

The standard of prudence to be used by investment officials shall be the "prudent investor standard," which states:

"When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a

 FY ~~2016~~-2017 - Statement of Investment Policy

like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency.”

Investment officers acting in accordance with written procedures and the Statement of 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 the liquidity and the sale of securities are carried out in accordance with the terms of this Policy.

IX. Reporting

The following investment activity reports will be completed.

A. Monthly

While there is no legislative requirement for monthly investment activity reporting, the Director of Finance shall post a monthly investment and transaction summary to the City's public website that will be available to the City Manager, Investment Advisory Committee, City Council Budget & Finance Committee, City Council, and the general public.

The investment summary will list investment transactions executed during the month, and will report key aspects of the investment portfolio, including the following information about each investment instrument: issuer, par amount, purchase price, sales price, realized gains and losses, maturity dates, credit ratings, and the percentage of the portfolio by each type of investment.

B. Periodic

While there is no legislative requirement for quarterly investment activity reporting, the Director of Finance shall submit periodic investment reports to the City Manager, Investment Advisory Committee, City Council Budget & Finance Committee, and City Council.

A periodic report shall include all components of the City's monthly report, highlight key aspects of information contained in the investment reports, and inform readers of economic conditions affecting the portfolio. The report will present recent investment performance and future investment strategy; disclose any perceived threats to portfolio quality, security or liquidity; compare the portfolio performance to that of the City's established performance benchmark, state compliance with the Investment Policy and include a statement denoting the ability to meet expenditure requirements for the next six months.

C. Annual

While there is no legislative requirement for submission of an annual investment report, the Director of Finance shall present a comprehensive annual report on the investment program and investment activity no later than 180 days following the end of the fiscal year. This report shall be presented to the Investment Advisory Committee. The annual report shall include a performance summary, shall suggest policies and improvements that might enhance the investment program, and include an investment plan for the

FY ~~2016-2017~~ - Statement of Investment Policy

ensuing fiscal year. In conjunction with its review of the annual investment report, the Investment Advisory Committee shall review and reaffirm the Statement of Investment Policy of the City, whether or not specific policy modifications are suggested.

Following the annual review of the Statement of Investment Policy by the Investment Advisory Committee, the Investment Policy shall be submitted to the City Council, together with any changes recommended by the Investment Advisory Committee. The City Council shall consider any such recommended changes and approve the Statement of Investment Policy at a public meeting of the City Council.

X. Investment Instruments

A summary and description of authorized investment instruments is below.

INVESTMENT INSTRUMENT SUMMARY				
Security Type	Maximum Maturity	Min Credit Quality	Authorized Investment Limit	Per Issuer Limit
A. US Treasury Notes/Bills	5 Years	None	100%	100%
A. US Agencies–Fully Backed	5 Years	None	100%	100%
B. US Agencies–Sponsored	5 Years	None	100%	40%
C. Banker’s Acceptance (BA)	180 days	A-1	40%	5%
D. Commercial Paper	270 days	A-1	25%	5%
E. Negotiable Certificates of Deposit	5 Years	“A”	30%	5%
F. Repurchase Agreements	1 Year	None	20%	20%
G. Medium Term Notes (MTN)	5 Years	“A”	30%	5%
H. Money Market Fund	N/A	AAAm	20%	10%
I. Alameda County Investment Pool	None	None	10%	10%
J. LAIF	None	None	\$50M 65M per account	N/A
K. Collateralized Certificates of Deposit	5 Years	None	25%	20%
L. Municipal Bonds	5 Years	“A”	20%	5%
M. Supranationals	5 Years	“AA”	30%	30%
N. Asset-Backed Securities	5 Years	“AA”	20%	5%

The following sections describe individual investment types. The sections specify a percentage limitation for a particular category of investment. That percentage is applied on the date of purchase. A later increase in a percentage resulting from a change in values or assets shall not constitute a violation of the Policy restriction.

Unless stated otherwise in the Policy, no more than 5% of the City’s portfolio may be invested in securities issued by any one issuer.

A. United States Treasury Notes, Bonds, Bills, or Certificates of Indebtedness, or

 FY ~~2016-2017~~ - Statement of Investment Policy

those for which the faith and credit of the United States are pledged for the payment of principal and interest with a final maturity not exceeding five years from the date of trade settlement.

CA Govt Code 53601(b)

B. Federal Agency or United States Government-Sponsored Enterprise (GSE)

Obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies, or United States government-sponsored enterprises with a final maturity not exceeding five years from the date of trade settlement. There is no limit to the amount of the City's portfolio that may be invested in federal agency or GSE securities, except that the aggregate investment in federal agency mortgage-backed securities shall not exceed 20% of the City's total portfolio. Furthermore, the aggregate investment in any one federal agency or GSE issuer shall not exceed 40% of the City's total portfolio.

CA Govt Code 53601(f) and CA Govt Code 53601(o)

C. Banker's Acceptances, otherwise known as bills of exchange or time drafts, that are drawn on and accepted by a commercial bank with a final maturity not exceeding 180 days from the date of trade settlement, rated at least "A-1" or the equivalent by a nationally recognized statistical-rating organization (NRSRO). The aggregate investment in banker's acceptances shall not exceed 40% of the City's total portfolio.

CA Govt Code 53601(g)

D. Prime Commercial Paper with the highest letter and numerical rating as provided for by a NRSRO. The entity that issues the commercial paper shall meet all of the following conditions in either paragraph 1 or paragraph 2 below:

(1) The entity meets the following criteria:

- is organized and operating in the United States as a general corporation;
- has total assets in excess of five hundred million dollars (\$500,000,000); and
- has debt other than commercial paper, if any, that is rated in a rating category of at least "A" or higher by a NRSRO.

(2) The entity meets the following criteria:

- is organized within the United States as a special purpose corporation, trust, or limited liability company;
- has program wide credit enhancements including, but not limited to, over-collateralization, letters of credit, or surety bond; and
- has commercial paper that is rated "A-1" or higher, or the equivalent, by a NRSRO.

Eligible commercial paper shall have a final maturity not exceeding 270 days from the date of trade settlement. The aggregate investment in commercial paper shall not exceed 25% of the City's total portfolio. Furthermore, the City may purchase no more than 10 percent of the outstanding commercial paper of any single issuer.

FY ~~2016-2017~~ - Statement of Investment Policy

CA Govt Code 53601(h)

- E. Negotiable Certificates of Deposit** issued by a nationally- or state-chartered bank, a savings association or a federal association as defined by Section 5102 of the California Financial Code, a state or federal credit union, or by a federally-licensed or state-licensed branch of a foreign bank with a final maturity not exceeding five years from the date of trade settlement. Deposits are limited to institutions which have long-term debt rating in a rating category of at least "A" or the equivalent by a NRSRO. The aggregate investment in negotiable certificates of deposit shall not exceed 30% of the City's total portfolio.

CA Govt Code 53601(i)

- F. Repurchase Agreements** with a final termination date not exceeding 360 days from the date of trade settlement collateralized solely by United States Treasury, federal agency, or United States government sponsored enterprises permitted by this Statement of Investment Policy. The purchased securities (the "collateral") shall have a minimum market value of 102% of the dollar value of the funds invested. The market value of the collateral securities shall be marked-to-the-market daily and the value shall be adjusted no less frequently than weekly. No substitution of collateral shall be allowed without the prior approval of the Finance Director. All collateral securing repurchase agreements must be delivered to the City's custodian bank or handled under a tri-party repurchase agreement. The City or its trustee shall have a perfected first security interest under the Uniform Commercial Code in all securities subject to repurchase agreement.

Approved repurchase agreement counterparties shall have a repurchase agreement counterparty credit rating of at least "A-1" or the equivalent and a long-term credit rating of at least "A" or the equivalent by a NRSRO. Repurchase agreement counterparties shall execute a City approved master repurchase agreement with the City. No more than 20% of the City's total portfolio shall be invested in repurchase agreements.

CA Govt Code 53601 (j)

- G. Medium-Term Notes** issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States, with a final maturity not exceeding five years from the trade settlement, and rated in a rating category of at least "A" or the equivalent by a NRSRO at the time of purchase. The aggregate investment in medium-term notes shall not exceed 30% of the City's total portfolio.

CA Govt Code 53601 (k)

- H. Money Market Funds.** Shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C.

FY ~~2016-2017~~ - Statement of Investment Policy

Sec. 80a-1, et seq.). To be eligible for investment pursuant to this subdivision these companies shall either:

- (1) attain the highest ranking letter or numerical rating provided by not less than two of the three largest NRSROs, or
- (2) have an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years of experience managing money market mutual funds and with assets under management in excess of \$1,000,000,000.

The purchase price of shares shall not exceed 20% of the City's total portfolio and shall not include any commission that the companies may charge. Furthermore, no more than 10% of the City's total portfolio may be invested in any one money market fund.

CA Govt Code 53601 (l)

- I. Alameda County Investment Pool.** The City's maximum investment in the Alameda County pool is limited to 10% of the City's total aggregate portfolio.

CA Govt Code 53684

- J. State of California's Local Agency Investment Fund (LAIF).** The City's participation in LAIF shall conform to State Regulation. The City maintains a total of three LAIF investment accounts and may invest up to ~~\$50-65~~ million in each account. In general, it is the City's intention to use investment in LAIF as a temporary repository for short-term funds needed for liquidity purposes. The Finance Director shall maintain appropriate information concerning LAIF's current investment policies, practices and performance on file. The Finance Director shall also maintain files on LAIF's requirements for participation, including, but not limited to, limitations on deposits or withdrawals and the composition of the portfolio.

CA Govt Code 16429.1

- K. Collateralized Certificates of Deposit** in FDIC-insured financial institutions located in California with a maximum maturity no longer than five years from the date of deposit. Deposits are limited to banks who have a long-term debt rating in a rating category of at least "A" or the equivalent and a short-term debt rating of at least "A-1" or the equivalent by a NRSRO. The City may waive collateral for any portion of its deposit that is covered by federal deposit insurance.

Money shall not be deposited in any state or federal credit union if a member of the legislative body of the City, or any person with investment decision making authority of the administrative office, manager's office, budget office, auditor-controller's office, or treasurer's office of the City, also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or supervisory committee, of the state or federal credit union.

 FY ~~2016-2017~~ - Statement of Investment Policy

The amount on deposit shall not exceed the total paid-up capital (to include capital notes and debentures) and surplus of any depository bank, or the total of the net worth of any savings and loan association. However, deposits in collateralized certificates of deposit shall not exceed 25% of the City's total portfolio, nor shall the City deposit more than 20% of its total portfolio in the collateralized certificates of deposit of any one bank.

CA Govt Code 53649

- L. Municipal Bonds** issued by the state of California and any local agency within the state, including bonds payable solely out of revenues from a revenue-producing property owned, controlled, or operated by the state or any local agency, or by a department, board, agency or authority of the state or any local agency.

Registered treasury notes or bonds of any of the other 49 United States in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 United States, in addition to California.

The aggregate investment in municipal bonds may not exceed 20% of the City's total portfolio.

CA Govt Code 53601(c), CA Govt Code 53601(d), and CA Govt Code 53601(e)

- M. Supranationals** defined as United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank, with a final maturity not exceeding five years from the trade settlement, and eligible for purchase and sale within the United States. Supranationals shall be rated in a rating category of at least -at least "AA" or the equivalent by a NRSRO at the time of purchase.

The aggregate investment in supranationals may not exceed 30% of the City's total portfolio.

CA Govt Code 53601(q)

- N. Asset-Backed Securities** defined as all mortgage pass-through securities, collateralized mortgage obligations, mortgage-backed or other pay-through bonds, equipment lease-backed certificates, consumer receivable pass-through certificates, and consumer receivable-backed bonds, with a final maturity not exceeding five years from the trade settlement.

Asset-backed securities shall be rated in a rating category of a-at least "AA" or the equivalent by a NRSRO at the time of purchase. Additionally, securities eligible for investment under this subsection shall be issued by an issuer whose debt is rated in a rating category of at least "A" or the equivalent by a NRSRO at

FY ~~2016~~-2017 - Statement of Investment Policy

the time of purchase.

The aggregate investment in asset-backed securities may not exceed 20% of the City's total portfolio.

CA Govt Code 53601(o)

XI. Prohibited Investments

Investments not specifically approved by this Statement of Investment Policy are prohibited, including inverse floaters, range notes, mortgage derived interest-only strips, and securities that could result in zero interest accrual if held to maturity.

XII. Credit Downgrade

The minimum rating criteria for particular investment categories is applied on the date of purchase. The City may from time to time be invested in a security whose rating is downgraded. In the event a rating drops below the minimum allowed rating category for that given investment type, the securities shall be reviewed and a plan of action shall be recommended by the Director of Finance or investment manager. The Director of Finance may consult the Investment Advisory Committee on the action to be taken and shall advise its Chairman and Members of the final disposition of the matter either by e-mail or fax.

If an investment advisor is used, the investment advisor will immediately notify the Director of Finance if a purchased security has been downgraded below accepted minimums specified herein, or if the security is placed on negative credit watch, where downgrade could result in a rate drop below acceptable levels of that fact. The course of action to be followed will then be decided on a case-by-case basis, considering such factors as the reason for the rate drop, prognosis for recovery or further drop, and market price of the security. The City Council will be advised of the situation and intended course of action by e-mail or fax.

XIII. Maturity and Diversification

Maturities shall be based on a review of cash flow forecasts. Maturities will be scheduled to permit the City to meet all projected obligations.

The City may not invest in a security that exceeds five years from the date of purchase unless City Council has granted express authority to make that investment no less than three months prior to the investment.

XIV. Internal Controls

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

FY ~~2016~~-2017 - Statement of Investment Policy

include:

- **Clearly delegating authority to subordinate staff members.** Subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.
- **Separating transaction authority from accounting and record keeping.** 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.
- **Delivery versus payment.** All trades where applicable will be executed by delivery vs. payment (DVP). This ensures that securities are deposited in the eligible financial institution before the release of funds. A third party custodian as evidenced by safekeeping receipts will hold securities.
- **Avoiding physical delivery securities.** Book entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.
- **Confirming telephone transactions for investments and wire transfers in writing.** 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.
- **Developing wire transfer agreements with the lead bank or third party custodian.** This agreement should outline the various controls and security provisions, and delineate responsibilities of each party making and receiving wire transfers.

XV. Banks and Security Dealer Selection

The Investment Advisory Committee shall approve all financial institutions from which securities are purchased or sold.

In selecting financial institutions for the deposit or investment of City funds, the Finance Director shall consider the creditworthiness of institutions. The Finance Director shall continue to monitor financial institutions' credit characteristics and financial history throughout the period in which City funds are deposited or invested.

Only primary government securities dealers that report to the New York Federal Reserve shall be used for the purchase of repurchase agreements. (It is acknowledged that inclusion on the primary dealer listing of the Federal Reserve Bank of New York is not a guarantee of creditworthiness.)

Effective October 14, 1987, the City shall be prohibited from investing funds with any person who is knowingly or intentionally engaged in the development or production of nuclear weapons. Person is defined as any person, private corporation, institution or other entity, which is within the jurisdiction of the City of Hayward.

If a third-party investment advisor is authorized to conduct investment transactions on the City's behalf, the investment advisor may use its own list of approved broker/dealers and financial institutions for investment purposes.

XVI. Risk Tolerance

The City recognizes that investment risks can result from issuer defaults, market price changes, or various technical complications leading to temporary illiquidity. Portfolio diversification is employed as a way to control risk. Investment managers are expected to display prudence in the selection of securities as a way to minimize default risk. No individual investment transaction shall be undertaken that jeopardizes the total capital position of the overall portfolio.

The Director of Finance shall periodically establish guidelines and strategies to control risks of default, market price changes and illiquidity. All investment reports shall specifically address whether current investment results have been affected by any of the foregoing risks, and shall explain what actions investment officials have taken to control or correct for such risks.

A thorough investigation of any money market fund or investment pool, including LAIF and the Alameda County Pool, is required prior to investing, as well as on an ongoing basis. The following information should be obtained and analyzed:

- I. A description of eligible investment securities
- II. A written statement of investment policies and objectives
- III. A description of interest calculation and their distribution, and the treatment of gains and losses
- IV. A description of how the securities are safeguarded and how often the

 FY ~~2016~~-2017 - Statement of Investment Policy

- securities are priced and the program audited
- V. Information about the size and frequency of deposits and withdrawals allowed, and how much notice is needed for withdrawals
- VI. A schedule for receiving statements and portfolio listings
- VII. A fee schedule, as well as how and when the fees are assessed
- VIII. The rating of the pool/fund
- IX. Information about investment advisers, including registration with the Securities and Exchange Commission, length of experience and total assets under management

In addition to these general policy considerations, the following specific policies will be strictly observed:

1. All investment funds will be placed directly with qualified financial institutions. The City will not deposit or invest funds through third parties or money brokers.
2. A competitive bid process, utilizing financial institutions approved by the Investment Advisory Committee, will be used to place investment purchases. Based on annual evaluation, securities dealers, banks, and other financial institutions will be dropped or continued on the eligibility list. The following criteria will be used in the evaluation:
 - a. Number of transactions competitively won
 - b. Prompt and accurate confirmation of transactions
 - c. Efficient securities delivery
 - d. Accurate market information account servicing

If a third party investment advisor is authorized to conduct investment transactions on the City's behalf, the investment advisor may rely on its review process and use its own list of approved broker/dealers for investment purposes.

3. The Finance Director may designate an official to manage investments and designate a second official to perform investment management during absences of the primary designee. The Finance Director shall ensure that competent investment management is maintained and shall ensure that, if both designated investment officials are replaced or are simultaneously absent, any temporary replacement(s) shall be closely supervised, indoctrinated in the requirements of this Statement of Investment Policy, and given written investment procedures regulating the authority to invest in maturities beyond six months by means of appropriate controls and restraining requirements.
4. In order to assist in identifying "qualified financial institutions," the Finance Director shall forward copies of the City's Statement of Investment Policy to those financial institutions with which the City is interested in doing business and require written acknowledgement of the policy.

XVII. Safekeeping and Custody

To protect against potential fraud and embezzlement, the assets of the City shall be secured through third-party custody and safekeeping procedures.

The investment official shall be bonded to protect the public against possible embezzlement and malfeasance. An independent auditor shall review safekeeping procedures annually. The auditor may conduct surprise audits of safekeeping and custodial procedures.

All cash and securities in the City's portfolio shall be held in safekeeping in the City's name by a third party bank trust department, acting as agent for the City under the terms of a custody agreement executed by the bank and the City.

All securities will be received and delivered using standard delivery versus payment (DVP) procedures; the City's safekeeping agent will only release payment for a security after the security has been properly delivered. The only exception to the foregoing shall be depository accounts and securities purchases made with: (i) local government investment pools, and (ii) money market funds, since the purchased securities are not deliverable.

FY ~~2016-2017~~ - Statement of Investment Policy

Appendix A

Comparison and Interpretation of Credit Ratings¹

Long-Term Debt Ratings

Rating Interpretation	Moody's	Standard & Poor's	Fitch
Best Quality Grade	Aaa	AAA	AAA
High Quality Grade	Aa1 Aa2 Aa3	AA+ AA AA-	AA+ AA AA-
Upper Medium Grade	A1 A2 A3	A+ A A-	A+ A A-
Medium Grade	Baa1 Baa2 Baa3	BBB+ BBB BBB-	BBB+ BBB BBB-
Speculative Grade	Ba1 Ba2 Ba3	BB+ BB BB-	BB+ BB BB-
Low Grade	B1 B2 B3	B+ B B-	B+ B B-
Poor Grade to Default	Caa	CCC+	CCC
In Poor Standing	- -	CCC CCC-	- -
Highly Speculative Default	Ca C	CC -	CC -
Default	- - -	- - D	DDD DD D

Short-Term/Commercial Paper Investment Grade Ratings

Rating Interpretation	Moody's	Standard & Poor's	Fitch
Superior Capacity	P-1	A-1+/A-1	F1+/F1
Strong Capacity	P-2	A-2	F2
Acceptable Capacity	P-3	A-3	F3

¹ These are general credit rating guidelines and are for information only.

Appendix B

Glossary

ASK PRICE: The price at which a seller offers to sell a security to a buyer.

ASSET-BACKED SECURITIES: Bonds created from various types of consumer debt. Returns on these securities come from customer payments on their outstanding loans. The primary types of asset-backed securities are mortgages, home equity loans, auto loans, leases, credit card receivables and student loans.

BANKERS' ACCEPTANCE: A letter of credit issued in a foreign trade transaction which allows exporters to receive payment prior to importation of their goods. Banks provide short-term financing to facilitate the transaction and may sell the obligation to a third party. Bankers' Acceptances are secured by the issuer of the bill, while the underlying goods also serve as collateral.

BANK DEPOSITS: Collateral in the form of currency that may be in the form of demand accounts (checking) or investments in accounts that have a fixed term and negotiated rate of interest.

BENCHMARK: A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

BID PRICE: The price at which a buyer offers to purchase a security from the seller.

BOND: A debt investment in which an investor loans money to an entity (corporate or governmental) that borrows the funds for a defined period of time at a fixed interest rate called a coupon payment. Bonds are used by companies, municipalities, states and the U.S. government to finance a variety of projects and operating activities.

BROKER: A broker aligns buyers and sellers of securities and receives a commission when a sale occurs. Brokers generally do not hold inventory or make a market for securities.

CALIFORNIA LOCAL AGENCY OBLIGATIONS: Bonds that are issued by a California county, city, city and county, including a chartered city or county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation.

CD (CERTIFICATE OF DEPOSIT): Time deposits issued by a bank, savings or federal credit union, or state-licensed branch of a foreign bank. Negotiable Certificates of Deposits rely on the credit rating of the issuing entity.

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

FY ~~2016~~-2017 - Statement of Investment Policy

to secure deposits of public monies.

COLLATERALIZATION: Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

COMMERCIAL PAPER: Short-term unsecured promissory note issued by a company or financial institution. Commercial paper is issued at a discount and matures at face value. Usually a maximum maturity of 270 days, and given a short-term debt rating by one or more NRSROs.

COUNTY POOLED INVESTMENT FUNDS: The aggregate of all funds from public agencies placed in the custody of the county treasurer or chief finance officer for investment and reinvestment.

COUPON: The annual rate of interest that a bond's issuer promises to pay the bondholder, expressed as a percentage of the bond's face value.

CREDIT RISK: Credit risk is the likelihood that an issuer will be unable to make scheduled payments of interest or principal on an outstanding obligation.

CUSTODIAN: An agent such as a broker or a bank that stores a customer's investments for safekeeping. The custodian does not have fiduciary responsibilities.

DEALER: A dealer, as opposed to a broker, acts as a principal in security transactions, selling securities from, and buying securities for his/her own position.

DEFAULT: To default is to fail to repay principal or make timely interest payments on a bond or other debt investment security, or failure to fulfill the terms of a note or contract.

DELIVERY VERSUS PAYMENT (DVP): A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser's agent.

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

DURATION: The weighted average time to maturity of a bond where the weights are the present values of future cash flows. Duration measures the price sensitivity of a bond to changes in interest rates.

FIDUCIARY: An individual who holds something in trust for another and bears liability for its safekeeping.

FLOATING RATE INVESTMENTS: Notes whose interest rate is adjusted according to the interest rates of other financial instruments. These instruments provide protection against rising or falling interest rates, but may pay lower yield than fixed rate notes.

FY ~~2016~~-2017 - Statement of Investment Policy

FUTURES: Commodities, which are sold in the present time and are to be delivered at a future date.

INTEREST ONLY STRIPS: Securities with cash flow based entirely on the monthly interest payments received from a mortgage, Treasury, or bond payment. No principal is included in these types of securities.

INVERSE FLOATING RATE INVESTMENTS: Variable-rate notes (such as inverse floating rate notes) whose coupon and value increase as interest rates decrease.

INVESTMENT PROGRAM: The process of modern portfolio management. The process includes establishing investment policy, analysis of the economic and capital markets environment, portfolio monitoring and rebalancing, and measuring performance.

LIQUIDITY: The ease with which investments can be converted to cash at their present market value. Liquidity is significantly affected by the number of buyers and sellers trading a given security and the number of units of the security available for trading.

LOCAL AGENCY BONDS: These bonds are issued by a county, city, city and county, including a chartered city or county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation.

LOCAL AGENCY INVESTMENT FUND (LAIF): A voluntary investment fund open to state and local government entities and certain non-profit organizations in California in which organization pools their funds for investment. LAIF is managed by the State Treasurer's Office.

MARKET RISK: Market risk is the risk that investments will change in value based on changes in general market prices.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold.

MASTER REPURCHASE AGREEMENT: A written contract which includes provisions specific to the governmental agency that is signed by an authorized officer with each counterparty. A master agreement will often specify details to the nature of transactions, the relationship of the parties to the agreement, parameters pertaining to the ownership and custody of collateral, and remedies in the event of default by either party.

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

MEDIUM TERM NOTES (MTN): Unsecured, investment-grade senior debt securities of major corporations that are sold either on a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to

 FY ~~2016~~-2017 - Statement of Investment Policy

market opportunities or to investor preferences.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

MORTGAGE-BACKED SECURITIES: A debt instrument with a pool of real estate loans as the underlying collateral. The mortgage payments of the real estate assets are used to pay interest and principal on the bonds.

MORTGAGE PASS-THROUGH SECURITIES: A securitized participation in the interest and principal cash flows from a specified pool of mortgages. Principal and interest payments made on the mortgages are passed through to the holder of the security.

MUTUAL FUNDS: An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments.

Money market mutual funds invest exclusively in short-term (1-day to 1-year) debt obligations such as Treasury bills, certificates of deposit, and commercial paper. The principal objective is the preservation of capital and generation of current income.

OFFER: The price asked by a seller of securities. See Ask Price and Bid Price.

OPTION: A contract that provides the right or obligation, depending on the buyer or seller's position within the contract, to buy or to sell a specific amount of a specific security within a predetermined time period at a specified price. A call option provides the right to buy the underlying security. A put option provides the right to sell the underlying security. The seller of the contracts is called the writer.

PORTFOLIO: A 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.

PRINCIPAL ONLY STRIPS: Securities with cash flow based entirely on the principal payments received from an obligation.

RANGE NOTES: A range note is a bond that pays interest if a specified interest rate remains above or below a certain level and/or remains within a certain range.

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

REPURCHASE AGREEMENT (RP, Repo): A contractual transaction between an investor and an issuing financial institution (bank or securities dealer). The investor exchanges cash for temporary ownership or control of collateral securities, with an agreement between the parties that on a future date, the financial institution will

 FY ~~2016~~-2017 - Statement of Investment Policy

repurchase the securities.

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

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

SECURITIES AND EXCHANGE COMMISSION (SEC): A federal government agency comprised of five commissioners appointed by the President and approved by the Senate. The SEC was established to protect the individual investor from fraud and malpractice in the marketplace. The Commission oversees and regulates the activities of registered investment advisers, stock and bond markets, broker/dealers, and mutual funds.

STATE OBLIGATIONS: Registered treasury notes or bonds of the 50 United States, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the 50 United States.

STRIPS: Bonds, usually issued by the U.S. Treasury, whose two components, interest and repayment of principal, are separated and sold individually as zero-coupon bonds. Strips are an acronym for Separate Trading of Registered Interest and Principal of Securities.

SUPRANATIONALS: International financial institutions that are generally established by agreements among nations, with member nations contributing capital and participating in management. Supranational bonds finance economic and infrastructure development and support environmental protection, poverty reduction, and renewable energy around the globe.

TRUSTEE: An individual or organization, which holds or manages and invests assets for the benefit of another. The trustee is legally obliged to make all trust-related decisions with the trustee's interests in mind, and may be liable for damages in the event of not doing so.

U.S. AGENCY OBLIGATIONS: Federal agency or United States government-sponsored enterprise obligations (GSEs), participations, or other instruments. The obligations are issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. Issuers include: Fannie Mae, Farmer Mac, Federal Farm Credit Banks, Freddie Mac, Federal Home Loan Banks, Financing Corporation, Tennessee Valley Authority, Resolution Trust Funding Corporation, World Bank, Inter-American Development Bank, and PEFCO.

U.S. TREASURY OBLIGATIONS (TREASURIES): Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are considered to have no credit risk and are the benchmark for interest rates on all

FY ~~2016~~-2017 - Statement of Investment Policy

other securities in the U.S. and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

Treasury Bills: All securities issued with initial maturities of one year or less are issued as discounted instruments, and are called Treasury Bills (T-bills). The Treasury currently issues 3-month and 6-month T-bills at regular weekly auctions. It also issues "cash management" bills as needed to smooth cash flows.

Treasury Notes: All securities issued with initial maturities of 2- to 10-years are called Treasury Notes (T-notes), and pay interest semi-annually.

Treasury Bonds: All securities issued with initial maturities greater than 10-years are called Treasury Bonds (T-bonds). Like Treasury Notes, they pay interest semi-annually.

YIELD: The rate of annual income return on an investment, expressed as a percentage. Yield does not include capital gains.

Income Yield is obtained by dividing the current dollar income by the current market price for the security.

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.

ZERO-COUPON BOND: A bond on which interest is not payable until maturity (or earlier redemption), but compounds periodically to accumulate to a stated maturity amount. Zero-coupon bonds are typically issued at a discount and repaid at par upon maturity.