



CITY OF SAN LUIS OBISPO

INVESTMENT MANAGEMENT PLAN

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INVESTMENT MANAGEMENT PLAN

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CITY OF SAN LUIS OBISPO

INVESTMENT MANAGEMENT PLAN

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I. INTRODUCTION

PURPOSE

The purpose of the investment management plan is to establish strategies, practices and procedures to be used in administering the City's portfolio in accordance with the City's Statement of Investment Policy. Included in the Appendix is a copy of the City's most recently adopted Investment Policy.

PRIMARY INVESTMENT OBJECTIVE

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.

In determining individual investment placements, the following factors shall be considered in priority order:

1. Safety
2. Liquidity
3. Yield.

Safety. 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. To attain this objective, the City will diversify its investments so that the impact of potential losses from any one type of security or from any one individual issuer will be minimized. The objective is to mitigate credit risk and interest rate risk summarized as follows:

Credit Risk. Credit risk is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt. The City shall mitigate credit risk by adopting the following strategies:

1. Limiting investments to the safest types of securities.
2. Pre-qualifying the financial institutions, broker/dealers, intermediaries and advisors with which the City will do business. If the City has an investment advisor, the investment advisor may use its own list of authorized broker/dealers to conduct transactions on behalf of the City.
3. It is the intent of the City to diversify the investments within the portfolio to avoid incurring unreasonable risks inherent in over-investing in specific instruments, individual financial institutions or maturities. The asset allocation in the portfolio should, however, be flexible depending upon the outlook for the economy, the securities market, and the City's anticipated cash flow needs.

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4. No more than 5% of the total portfolio may be invested in securities of any single issuer, other than the US Government, its agencies and instrumentalities approved local agency investment pools, LAIF, money market funds, and the City's main financial institution.
5. The City may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or the City's risk preferences.
6. If securities owned by the City are downgraded by either Moody's or S&P to a level below the quality required by this Investment Management Plan, it shall be the City's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.
 - a. If a security is downgraded below the level required by this policy, the City Treasurer determine whether to sell or hold the security based on its current maturity, the economic outlook for the issuer, and other relevant factors.
 - b. If a decision is made to retain a downgraded security in the portfolio, it will be monitored and reported monthly to the City Council.

Interest Rate Risk. Interest rate risk is the risk that the portfolio will decline in value (or will not optimize its value) due to changes in the general level of interest rates. The City recognizes that, over time, longer-term portfolios achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return.

The City will mitigate interest rate risk by providing adequate liquidity for short-term cash needs, and by making some longer-term investments only with funds that are not needed for current cash flow purposes. The City further recognizes that certain types of securities, including variable rate securities, securities with principal pay downs prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The City, therefore, adopts the following strategies to control and mitigate its exposure to interest rate risk:

1. The maximum stated final maturity of individual securities in the portfolio shall be five years, except that up to 10% of the portfolio can be invested in Treasury and GSE securities maturing over 5 years. .
2. The City shall maintain a minimum of three months of budgeted operating expenditures in short term investments. The level of operating expenses shall be measured once per year and shall be based on the most recently adopted budget.
3. The duration of that part of the portfolio that is not needed for liquidity purposes shall typically be approximately equal to the duration of an index of US Treasury and Federal Agency Securities with maturities which meet the Authority's needs for cash flow and level of risk tolerance (the Benchmark Index) plus or minus 10%.

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Liquidity. 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). Alternatively, a portion of the portfolio may be placed in money market mutual funds or local government investment pools which offer same-day liquidity for short-term funds. Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity).

Yield: Return on Investments. The City's investment portfolio shall be designed with the objective of attaining a market benchmark rate of return throughout budgetary and economic cycles, commensurate with the City's investment risk constraints and the cash flow characteristics of the portfolio. Return on investment is of least importance compared to the safety and liquidity objectives described above. The core of investments is limited to relatively low risk securities in anticipation of earning a reasonable return relative to the risk being assumed.

SCOPE OF INVESTMENT MANAGEMENT PLAN

Included in the scope of the City's investment management plan are the following major guidelines and practices to be used in achieving the City's primary investment objective:

1. Investment authority and responsibilities
2. Capital preservation and risk
3. Eligible financial institutions
4. Allowable investment vehicles
5. Investment maturity
6. Cash management
7. Evaluation of investment performance
8. Investment reporting
9. Investment management plan review
10. Socially responsible investment guidelines

These guidelines apply to all cash-related 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. The only exception is funds invested in the City's deferred compensation plan, which are controlled by federal law, specific provisions of the City's adopted plan and individual employee decisions.

USE OF STATE GUIDELINES

The California Government Code (including sections 16429.1, 16481.2, 53600-53609, 53630-53634, 53635, 53635.2, 53635.3, 53635.8, 53637-53638 and 53684) regulates public agency investment and investment reporting practices. It is the policy of the City of San Luis Obispo to use the State's provisions for local government investments in developing and implementing the City's investment policies and practices.

I. INTRODUCTION

PREPARATION AND ADMINISTRATION OF THE PLAN

As set forth in the Statement of Investment Policy, the City Treasurer is responsible for developing and monitoring the Investment Management Plan.

As recommended by Government Code Section and 53646, the Council will review the Investment Policy annually. The Council will review the Investment Management Plan at a public meeting when changes in strategies, practices or procedures are proposed. In the interim, the City Treasurer is responsible for keeping the Investment Management Plan up-to-date to reflect changes in legislation, organizational structure, and other policies and administrative procedures approved by the Council.

II. INVESTMENT AUTHORITY AND RESPONSIBILITIES

AUTHORIZED INVESTMENT OFFICERS

Authority to manage the investment portfolio is granted to the Director of Finance & Information Technology (Director/City Treasurer) pursuant to Resolution No. 8477. Responsibility for the day-to-day operation of the investment program may be delegated to the Finance Operations Manager, who is responsible for carrying-out established written procedures and internal controls for the operation of the investment program consistent with this plan. These procedures should include references to: safekeeping, delivery vs payment, investment accounting, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking services contracts.

Transactions Directed by City Staff. No person may engage in an investment transaction except as provided under the terms of this plan and the procedures established by the Director/City Treasurer. Although the Director/City Treasurer may delegate these duties to another official in the Department of Finance & Information Technology, every investment transaction must be reviewed and approved by the Director/City Treasurer. Additionally, the Director/City Treasurer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

Transaction Directed by an Investment Advisor. The City may engage the services of an external investment adviser to assist in the management of the City's investment portfolio in a manner consistent with the City's objectives. The external investment adviser may be granted discretion to purchase and sell investment securities in accordance with the City's Investment Policy and this Investment Management Plan. The investment adviser must be registered under the Investment Advisers Act of 1940. (The investment adviser shall be required to provide a certification that it has read and understands the applicable sections of the California Government Code relating to municipal investments, this Investment Management Plan and the City's Investment Policy).

INTERNAL CONTROLS

The Director/City Treasurer is responsible for ensuring compliance with the City's Investment Policy as well as for establishing systems of internal control designed to prevent losses due to fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by City officers and employees. Additionally, the Director/City Treasurer is responsible for the physical security of City investments and shall use custodial safekeeping for negotiable and bearer instruments whenever possible.

INVESTMENT MANAGEMENT RESOURCES

The concept of reasonable assurance recognizes that the:

1. Cost of a control procedure should not exceed the benefits likely to be derived.
2. Valuation of costs and benefits requires estimates and judgments by management. Accordingly, the Director/City Treasurer shall establish a process for annual independent review by an external auditor to assure compliance with policies and procedures.

II. INVESTMENT AUTHORITY AND RESPONSIBILITIES

Internal controls shall address the following points:

1. **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.
2. **Custodial safekeeping.** 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 as evidenced by safekeeping receipts in the City of San Luis Obispo's name.
3. **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.
4. **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. Securities will be held by a third party custodian as evidenced by safekeeping receipts.
5. **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.
6. **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 or e-mail and the safekeeping institution has a list of authorized signatures.
7. **Developing wire transfer agreements with the lead bank or third party custodian.** This agreement should outline the various controls, security provisions, and delineate responsibilities of each party making and receiving wire transfers.

EVALUATION OF INVESTMENT OFFICER ACTIONS

The standard of prudence to be applied by the Director of Finance/City Treasurer shall be the "prudent investor" standard, as defined under Government Code Section 53600.3 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 like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the Agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law.

II. INVESTMENT AUTHORITY AND RESPONSIBILITIES

Investment officers acting in accordance with written procedures and this Investment Management Plan, 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.

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 the City.

In accordance with Government Code Section 53607, the Treasurer shall prepare a report of monthly investment transactions for the City Council's review. In addition, the City Council shall determine each year whether the delegation of investment authority to the Treasurer shall be renewed.

RESPONSIBILITIES OF AN INVESTMENT ADVISOR

When the services of an investment advisor are contracted for by the City, the responsibilities and obligations of the investment advisor shall be identified within the terms of the contract and shall, at a minimum, include the following:

1. Investment Advisor will provide investment research and supervision of the managed assets and conduct a continuous program of investment, evaluation and, when appropriate, sale and reinvestment of the managed assets.
2. Investment Advisor shall continuously monitor investment opportunities and evaluate investments of the managed assets. Investment Advisor shall furnish City with statistical information and reports with respect to investments of the managed assets.
3. Investment Advisor shall place all orders for the purchase, sale, or exchange of portfolio securities for City's account with brokers or dealers recommended by Investment Advisor and/or City, and to that end Investment Advisor is authorized as agent of City to give instructions to the custodian designated by City (the "Custodian") as to deliveries of securities and payments of cash for the account of City.
4. In connection with the selection of such brokers and dealers and the placing of such orders, Investment Advisor is directed to seek for City the most favorable execution and price, the determination of which may take into account, subject to any applicable laws, rules and regulations, whether statistical, research and other information or services have been or will be furnished to Investment Advisor by such brokers and dealers.
5. Investment Advisor shall not take possession of or act as custodian for the cash, securities or other assets of City and shall have no responsibility in connection therewith.

II. INVESTMENT AUTHORITY AND RESPONSIBILITIES

6. Authorized investments shall include only those investments which are currently authorized by the state investment statutes, and City's investment policy, and as supplemented by such other written instructions as may from time to time be provided by City to Investment Advisor.
7. Investment Advisor shall be entitled to rely upon City's written advice with respect to anticipated drawdowns of managed assets.
8. Investment Advisor will observe the instructions of City with respect to broker/dealers who are approved to execute transactions involving the managed assets and in the absence of such instructions will engage broker/dealers who Investment Advisor reasonably believes to be reputable, qualified and financially sound.

III. CAPITAL PRESERVATION AND RISK

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.

PORTFOLIO DIVERSIFICATION PRACTICES

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

1. Eligible financial institutions
2. Investment vehicles
3. 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.

Credit criteria listed in these guidelines refer to the credit rating at the time the security is purchased. If an investment's credit rating falls below the minimum rating required at the time of purchase, the Finance Director/City Treasurer will consult with the Investment Advisor and perform a timely review to decide whether to sell or hold the investment.

IV. ELIGIBLE FINANCIAL INSTITUTIONS

PORTFOLIO DIVERSIFICATION AND CREDIT-WORTHINESS STANDARDS

The following general criteria relating to portfolio diversification and credit-worthiness will be used in selecting depositories and broker/dealers (financial institutions) in the placement of City investments:

1. The financial capacity and credit-worthiness of the financial institution shall be considered before the placement of City investments.
2. Current financial statements shall be maintained for each institution in which or through which cash is invested.
3. No more than 5% of the City's portfolio (exclusive of the US Government, its agencies and instrumentalities approved local agency investment pools and money market funds government agency issues, or LAIF and money market funds, and the City's main financial institution) shall be placed with any financial institution.
4. No more than 25% of the City's portfolio shall be invested in collateralized certificates of deposit issued by savings and loan institutions.
5. Certificates of deposit placed by the City shall not constitute more than 15% of the total assets of the institution; and the institution must have total assets in excess of \$200 million.

CERTIFICATION AND REPORTING REQUIREMENTS

Unless the City has engaged an investment advisor, the City shall establish a list of qualified securities dealers based on a certification submitted by all financial institutions with which the City has an investment relationship. The certification shall state that the institution has reviewed the City's Investment Management Plan and that it will:

1. Exercise due diligence in monitoring the activities of its officers and employees engaged in transactions with the City.
2. Ensure that all of its officers and employees offering investments to the City are trained in the precautions appropriate to public sector investments.
3. Submit audited financial statements prepared by an independent certified public accountant to the City on an annual basis within 180 days after the end of the institution's fiscal year.

INDIVIDUAL PLACEMENT OF INVESTMENTS

A list will be maintained of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by creditworthiness (e.g., a minimum capital requirement of \$10,000,000 and at least five years of operation). These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:

IV. ELIGIBLE FINANCIAL INSTITUTIONS

1. Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines
2. Proof of National Association of Securities Dealers (NASD) certification (not applicable to Certificate of Deposit counterparties)
3. Proof of state registration
4. Certification of having read and understood and agreeing to comply with the applicable sections of the California Government Code and the City's Investment Policy and that all securities recommended shall be suitable for the City of San Luis Obispo.

The investment advisor (or City staff if applicable) will strive to obtain competitive bids from at least three brokers or financial institutions on all purchases and sales of investment instruments whenever possible.

INDIVIDUAL PLACEMENT OF DEPOSITS

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

1. Deposits shall only be placed with financial institutions maintaining offices within the City of San Luis Obispo.
2. 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 the amount up to the Federal Deposit Insurance Corporation (FDIC) limit.
3. Reasonable efforts will be made to place deposits of less than the FDIC limit with each eligible institution. Any deposits in excess of this amount shall be awarded based on competitive bids. Documentation relating to rate quotes shall be maintained by Finance for six months.
4. Within the context of the City's policies regarding competitive bidding and portfolio limitations, deposits shall be distributed as evenly as possible between financial institutions.

V. INVESTMENT VEHICLES

STATE OF CALIFORNIA LIMITATIONS

As provided in the applicable sections of the Government Code, the State of California limits the investment vehicles available to local agencies.

SUITABLE AND AUTHORIZED INVESTMENTS

City funds may be invested in the following subject to the following restrictions:

1. No more than 5% of the total portfolio may be invested in securities of any single issuer, other than the US Government, its agencies and instrumentalities, approved local agency investment pools, LAIF, money market funds, and the City's main financial institution.
2. The maximum stated final maturity of individual securities in the portfolio shall be five years, except that up to 10% of the portfolio can be invested in Treasury, municipal, and GSE securities maturing over 5 years.
3. The City shall maintain a minimum of three months of budgeted operating expenditures in short term investments. The level of operating expenses shall be measured once per year and shall be based on the most recently adopted budget.
4. The duration of that part of the portfolio that is not needed for liquidity purposes shall typically be approximately equal to the duration of an index of US Treasury and Federal Agency Securities with maturities which meet the Authority's needs for cash flow and level of risk tolerance (the Benchmark Index) plus or minus 10%.
5. **Treasury Obligations:** Treasury bills, Treasury notes, Treasury bonds and Treasury STRIPS with maturities not exceeding five years from the date of purchase.
6. **Federal Agency or Government Sponsored Enterprise (GSE) Securities:** Federal agency or United States government-sponsored enterprise 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 maturities not exceeding five years from the date of purchase.
7. **Municipal Securities:** include obligations of the City, the State of California, any of the other 49 states, and any local agency within the State of California, provided that the securities are rated "A" or higher by at least one nationally recognized statistical rating organization. No more than 30% of the portfolio may be invested in these securities and no more than 5% of the portfolio may be invested in any issuer.
8. **Commercial Paper:** With "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a NRSRO. The entity that issues the commercial paper must meet all of the following conditions in either paragraph a or paragraph b:
 - a) The entity meets the following criteria: (i) is organized and operating in the United States as a general corporation, (ii) has total assets in excess of five hundred million dollars (\$500,000,000), and (iii) has debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.

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- b) The entity meets the following criteria: (i) is organized within the United States as a special purpose corporation, trust, or limited liability company, (ii) has program-wide credit enhancements including, but not limited to, over collateralization, letters of credit, or surety bond, and (iii) has commercial paper that is rated “A-1” or higher, or the equivalent, by a NRSRO.

Eligible commercial paper will have a maximum maturity of 270 days or less. No more than 40% of the City’s portfolio may be invested in commercial paper. The City may purchase no more than 10% of the outstanding commercial paper of any single issuer.

9. **Medium Term Notes:** Issued by corporations organized and operating in the U.S. or by depository institutions licensed by the U.S. or any state and operating within the U.S., except financial institutions shall not be considered. At the time of purchase, the notes must mature within five years and must be rated in the “A” category or better by two or more nationally recognized statistical-rating organizations (NRSRO). If the notes are issued by a financial institution they must be rated in the “AA” category or better by one or more NRSRO. At the time of purchase, no more than 30% of the City’s portfolio may be invested in medium term notes and no more than 5% of the City’s portfolio may be invested in any one issuer.
10. **Bankers’ Acceptances:** Not exceeding 180 days to maturity. At the time of purchase, no more than 40% of the City’s surplus funds may be invested in bankers’ acceptances and no more than 5% of the City’s surplus funds may be invested in bankers’ acceptances from any one bank.
11. **Repurchase Agreements:** With a term of the agreement not exceeding one year, collateralized by U.S. Treasury and agency securities listed in items 1 and 2 above. The value of the collateral underlying the agreement shall be 102%. The market value of the collateral shall be marked-to-the-market at least weekly based on the bid price and adjustments made when the value falls below 102%. Collateral shall be held in the City’s custodial bank as safekeeping agent. Repurchase Agreements shall be entered into only with dealers who have executed a Master Repurchase Agreement with the City and who are recognized as Primary Dealers with the Market Reports Division of the Federal Reserve Bank of New York. There are no limitations on the amount that can be invested in repurchase agreements. No more than 25% of the portfolio can be invested with any one financial institution.
12. **Local Agency Investment Fund (LAIF):** A local government investment pool established by the State Treasurer of California for the benefit of California local agencies. City funds can be invested in LAIF up to the maximum permitted by State Law.
13. **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 Financial Code), a state or federal credit union, or by a federally or state-licensed branch of a foreign bank. At the time of purchase, the maturity of the certificate may not exceed five years, must be rated at least “AA” or “A-1” by one or more NRSRO, no more than 30% of the City’s surplus funds may be invested in certificates of deposit and no more than 5% of the City’s surplus funds may be invested in certificates from any one bank.

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14. **Collateralized Bank Deposits:** Shall be evaluated in term of Federal Deposit Insurance Corporation (FDIC) coverage. For deposits in excess of the FDIC insured limit, approved collateral at the percentage above market value as specified by California Government Code, Sections 53651 et seq. and Sections 53652 et seq. shall be required. No more than 25% of the portfolio can be placed with any one financial institution. This limit may be exceeded if necessary to allow the City to meet its short term operational needs.
15. **Money Market Mutual Funds:** Shall be registered under the Investment Company Act of 1940. To be eligible for investment pursuant to this subdivision, these companies will either:
(i) attain the highest ranking letter or numerical rating provided by at least two NRSROs or
(ii) have retained 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 \$500,000,000.

At the time of purchase, no more than 20% of the City's surplus funds may be invested in money market mutual funds and no more than 10% of the City's surplus funds may be invested in any one fund.

16. **Local Government Investment Pools:** Shares of beneficial interest issued by a joint powers authority (Local Government Investment Pools) organized pursuant to Government Code Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (o) of California Government Code Section 53601, inclusive. Each share will represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority. The Pool will be rated in a rating category "AAA" or its equivalent by a NRSRO. To be eligible under this section, the shares will maintain a stable net asset value (NAV) and the joint powers authority issuing the shares will have retained an investment adviser that meets all of the following criteria:
- a) The adviser is registered or exempt from registration with the Securities and Exchange Commission.
 - b) The adviser has not less than five years of experience investing in the securities and obligations authorized in subdivisions (a) to (o) Government Code Section 53601, inclusive.
 - c) The adviser has assets under management in excess of five hundred million dollars (\$500,000,000).

17. **Investments in Community Banks**

Provided that the requirements of these guidelines and California Code sections 53630-53653 are adhered to, funds may be invested in community banks within the San Luis Obispo County service area under the following criteria:

- a) The bank must be based and have its headquarters in San Luis Obispo County, with at least one branch within the City of San Luis Obispo.
- b) As indicated by Government Code Section 53635.2 the bank must receive an overall rating of not less than "satisfactory" from the appropriate federal supervisory agency for meeting

V. INVESTMENT VEHICLES

the criteria specified in Section 2906 of Title 12 of the U.S. Code (Community Reinvestment Act of 1977).

- c) The bank must provide certification and supporting information that indicates at least 25% in loans is invested within the City of San Luis Obispo.
- d) To ensure the City obtains a competitive rate for investments in the program, any potential investment or proposal must enjoy a rate of return equal to or greater than the Local Agency Investment Fund (LAIF) average quarterly rate existing at the time of the investment;
- e) Participating banks shall make a presentation to the City of San Luis Obispo Investment Oversight Committee about their community involvement at least once per year.
- f) Upon the Investment Oversight Committee's review of community involvement, the existing investment will be evaluated for renewal by City finance staff.

CITY POLICIES

Debt Funds. Reserve funds from the proceeds of debt issues shall be invested by the Director/City Treasurer in accordance with bond covenants.

Deferred Compensation. These policies do not apply to deferred compensation plans. Individual investment policies are adopted by each deferred compensation plan and approved independently by Council. Further, individual investments are directed solely by the employee.

Prohibited Investment Vehicles and Practices

1. State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to, mutual funds (other than money market funds as described above in No. 10), unregulated and/or unrated investment pools or trusts, collateralized mortgage obligations and futures and options.
2. In accordance with Government Code Section 53601.6, investment in inverse floaters, range notes or mortgage derived interest-only strips is prohibited.
3. Investment in any security that could result in a zero interest accrual if held to maturity is prohibited.
4. Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.
5. Purchasing or selling securities on margin is prohibited.
6. The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited without Council approval.
7. The City is allowed to invest in mortgage pass-through and asset-backed securities, provided that such securities have a maximum stated final maturity of five years and are rated AA by Standard & Poor's or Aa by Moody's; and that purchase of such securities does not exceed 20% of the portfolio. However, given the "melt-down" in these types of securities in 2007 – even when rated "AAA/Aaa" by NRSRO's – the City will not invest in these securities.

V. INVESTMENT VEHICLES

AUTHORIZED INVESTMENTS SUMMARY

Investment Type	Government Code Maximum Maturity Maximum % of Portfolio Quality Requirements	San Luis Obispo Maximum Maturity Maximum % of Portfolio Quality Requirements
1. Treasury Obligations	5 Years None None	5 Years ^a None None
2. GSE Securities	5 Years None None	5 Years ^a None None
3. Municipal Securities ^b	5 years None None	5 years ^a 30% per type; 5% per issuer “A” or better
4. Commercial Paper	270 Days 25% per type; none per issuer A-1/P-1/F-1; Long-term “A”	270 Days 25% per type; 10% per issuer A-1/P-1/F-1; Long-term “A”
5. Medium Term Notes	5 Years 30% per type; none per issuer “A”	5 Years 30% per type; 5% per issuer “A” or better “AA” or better for financial issuers
6. Bankers’ Acceptances	180 Days 40% per type; 30% per issuer None	180 Days 40% per type; 5% per issuer None
7. Repurchase Agreement	1 Year None None	1 Year None per type; 5% per counterparty Primary Dealers/ Collateralization requirements
8. LAIF	N/A None None	N/A Limit per Gov’t Code None
9. Negotiable CDs	5 Years 30% per type; none per issuer None	5 Years 30% per type; 5% per issuer “AA” or “A-1”
10. Collateralized Bank Deposits	5 Years None None	5 Years Non per type; 25% per institution None
11. Money Market Mutual Funds	N/A 20% per type; 10% per issuer Highest rating of at least two NRSRO	N/A 20% per type; 10% per issuer Highest rating of at least two NRSRO
12. Local Government Investment Pools (LGIPs)	N/A N/A Advisor requirements	N/A N/A Advisor requirements/“AAA”

a. Up to 10% of the portfolio can be invested in Treasury and GSE securities maturing over 5 years. This includes municipal obligations.

b. Includes State Obligations, City of San Luis Obispo obligations and California Local Agency obligations

VI. INVESTMENT MATURITY

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. In implementing this policy, the following guidelines will be used:

1. Projected cash flow requirements are the primary factor to be used in determining investment maturity terms.
2. After cash flow needs have been met, investments may be structured in longer-term securities within a disciplined investment program and process that is based on long-term expectations and is not speculative.
3. Investments may be sold before maturity for cash flow purposes or to rebalance the risk profile of the portfolio.
4. Council approval to make investments with terms in excess of 5 years is required at least three months prior to the initial investment.

VII. SOCIALLY RESPONSIBLE INVESTING

City funds should be guided by the following provisions when investing in securities of non-governmental entities:

1. Priority shall be given to investments in entities that support community well-being through safe and environmentally sound practices and fair labor practices.
2. Priority shall be given to investments in entities that promote equality of rights regardless of race, religion, color, ancestry, age, national origin, gender, marital status, sexual orientation, disability or place of birth.
3. Priority shall be given to investments in entities that promote community economic development.

In addition, the direct investment of City funds is restricted as follows:

1. No investments are to be made in tobacco, electronic cigarette, or tobacco-related products.
2. No investments are to be made to support the direct production or drilling of fossil fuels.

The City Treasurer shall periodically verify compliance with the guidelines either through direct contact with the company or with its Investors Responsibility Center.

VIII. CASH MANAGEMENT PRACTICES

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

1. 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.
2. 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.
3. 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.
4. Maximize the cash flow information available by using only one operating bank account.

IX. EVALUATION OF INVESTMENT PERFORMANCE

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 overall portfolio in achieving this objective, it is expected that yields on City investments will regularly meet or exceed the average return on three month U. S. Treasury Bills. It is also expected that the portfolio managed by the investment advisor will meet or exceed the BofA Merrill Lynch 0-to-5 year U.S. Treasury Bond Index.

X. INVESTMENT REPORTING

Consistent with the guidance provided by California Government Code Section 53646 and the City's practice of reviewing the Financial Policies each year, the Finance Director/City Treasurer may submit the Investment Policy to the Council for consideration at a public meeting. This statement will generally be reviewed by the Council in conjunction with the Financial Plan review and approval process. In accordance with this Statement of Investment Policy, the City Treasurer is responsible for developing and maintaining this Investment Management Plan.

Though optional, pursuant to California Government Code Section 53646 (b)(1), the Finance Director/City Treasurer will provide the Council and Investment Oversight Committee with a quarterly investment report providing the following information for each investment or security:

1. Issuer (financial institution)
2. Type of investment
3. Amount paid for the investment
4. The par amount of the investment, if applicable
5. Certificate or other reference number if applicable
6. Percentage yield on an annualized basis
7. Purchase date
8. Maturity date for each investment and the weighted average maturity of all the investments within the portfolio
9. Current book value
10. Current market value
11. Total cost and market value, including source of this valuation, of the City's portfolio
12. A description of the compliance with the Statement of Investment Policy
13. Information demonstrating that the City's expenditure requirements can be met in the following six months
14. Other information regarding the City's portfolio as appropriate

The 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 exclusive of deferred compensation plan funds; and shall be issued within 30 days after the end of the quarterly reporting period.

X. INVESTMENT REPORTING

1. Within 60 days from the start of each fiscal year, the City Treasurer shall provide the Investment Oversight Committee (IOC) with the value that represents the City's minimum liquidity requirement which is equal to 3 months of operating costs based on the most recently adopted annual budget. Any adjustments to this amount which the Treasurer feels are required to meet cash demands from time to time shall be identified by the Treasurer at each meeting of the IOC as these amounts become known.
2. At the regularly scheduled IOC meeting which next follows the end of a fiscal year, the Treasurer shall file a report which identifies how the invested balances were adjusted to accommodate the City's liquidity requirement and the extent to which investment maturity limits were adjusted to follow the City's benchmark duration value.

XI. INVESTMENT MANAGEMENT PLAN REVIEW

The Director/City Treasurer shall review the City's Statement of Investment Policy and Investment Management Plan on an ongoing basis to ensure its continued value in administering the City's portfolio. Additionally, the City shall maintain an Investment Oversight Committee whose membership shall consist of the City Administrative Officer, Assistant City Administrative Officer, Director/City Treasurer, Finance Operations Manager, the City's Independent Certified Public Accountant and a member of the public at large. The Investment Oversight Committee is responsible for:

1. Reviewing the City's portfolio at least quarterly to determine compliance with the Investment Management Plan; and
2. Reviewing and making recommendations as appropriate regarding the City's investment policies and practices at least annually.

It is important to note the distinction between the committee's oversight responsibility in ensuring compliance with the policies and overall framework established in this plan, and the responsibility of the Director/City Treasurer in managing the City's investment portfolio in accordance with this plan.

This distinction between management and oversight is especially important to make as it applies to the role of the City's independent auditors on this committee. The committee's oversight function is consistent with the scope of the auditor's engagement duties, which includes reviewing for compliance with City financial policies and procedures, and for making recommendations for improvements in the City's fiscal operations. However, in this oversight context, the auditors retain their independence from responsibility for managing any aspects of the City's operations; this responsibility lies solely with the City's elected leadership and staff.

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INVESTMENT POLICY

A. **Responsibility.** Investments and cash management is the responsibility of the City Treasurer or designee. It is the City's policy to appoint the Director of Finance & Information Technology as the City's Treasurer.

B. **Investment Objective.** The City's primary investment objective is to achieve a reasonable rate of return while minimizing the potential for capital losses arising from market changes or issuer default. Accordingly, the following factors will be considered in priority order in determining individual investment placements:

1. Safety
2. Liquidity
3. Yield

C. **Tax and Revenue Anticipation Notes: Not for Investment Purposes.** There is an appropriate role for tax and revenue anticipation notes (TRANS) in meeting legitimate short-term cash needs within the fiscal year. However, many agencies issue TRANS as a routine business practice, not solely for cash flow purposes, but to capitalize on the favorable difference between the interest cost of issuing TRANS as a tax-preferred security and the interest yields on them if re-invested at full market rates.

As part of its cash flow management and investment strategy, the City will only issue TRANS or other forms of short-term debt if necessary to meet demonstrated cash flow needs; TRANS or any other form of short-term debt financing will not be issued for investment purposes. As long as the City maintains its current policy of maintaining fund/working capital balances that are 25% of operating expenditures as reflected in the most recently adopted budget, it is unlikely

that the City would need to issue TRANS for cash flow purposes except in very unusual circumstances.

D. **Selecting Maturity Dates.** The City will strive to keep all idle cash balances fully invested through daily projections of cash flow requirements. To avoid forced liquidations and losses of investment earnings, cash flow and future requirements will be the primary consideration when selecting maturities.

E. **Diversification.** As the market and the City's investment portfolio change, care will be taken to maintain a healthy balance of investment types and maturities.

F. **Authorized Investments.** The City will invest only in those instruments authorized by the California Government Code.

The City will not invest in stock, will not speculate and will not deal in futures or options. The investment market is highly volatile and continually offers new and creative opportunities for enhancing interest earnings. Accordingly, the City will thoroughly investigate any new investment vehicles before committing City funds to them.

G. **Authorized Institutions.** Current financial statements will be maintained for each institution in which cash is invested. Investments will be limited to 20% of the total net worth of any institution and may be reduced further or refused altogether if an institution's financial situation becomes unhealthy.

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- H. **Consolidated Portfolio.** In order to maximize yields from its overall portfolio, the City will consolidate cash balances from all funds for investment purposes, and will allocate investment earnings to each fund in accordance with generally accepted accounting principles.
- I. **Safekeeping.** Ownership of the City's investment securities will be protected through third-party custodial safekeeping.
- J. **Investment Management Plan.** The City Treasurer will develop and maintain an Investment Management Plan that addresses the City's administration of its portfolio, including investment strategies, practices and procedures.
- K. **Investment Oversight Committee.** As set forth in the Investment Management Plan, this committee is responsible for reviewing the City's portfolio on an ongoing basis to determine compliance with the City's investment policies and for making recommendations regarding investment management practices.
- Members include the City Administrative Officer, Assistant CAO, Director of Finance/City Treasurer, Revenue Manager and the City's independent auditor.
- L. **Reporting.** The City Treasurer will develop and maintain a comprehensive, well-documented investment reporting system, which will comply with Government Code Section 53646. This reporting system will provide the Council and the Investment Oversight Committee with appropriate investment performance information.
- M. If the City has an investment advisor, the investment advisor may use its own list of authorized broker/dealers to conduct transactions on behalf of the City.
- N. **Socially Responsible Investing.** The City should prioritize investments that support community well-being and equal rights. The City will not invest in entities involved to the tobacco industry, nor in direct producers and drillers of fossil fuels.

Glossary

Bankers' Acceptances are short-term credit arrangements to enable businesses to obtain funds to finance commercial transactions. They are time drafts drawn on a bank by an exporter or importer to obtain funds to pay for specific merchandise. By its acceptance, the bank becomes primarily liable for the payment of the draft at maturity. An acceptance is a high-grade negotiable instrument.

Benchmark is a market index used as a comparative basis for measuring the performance of an investment portfolio. A performance benchmark should represent a close correlation to investment guidelines, risk tolerance and duration of the actual portfolio's investments.

Bond is a financial obligation for which the issuer promises to pay the bondholder (the purchaser or owner of the bond) a specified stream of future cash flows, including periodic interest payments and a principal repayment.

Broker-Dealer is a person or a firm who can act as a broker or a dealer depending on the transaction. A broker brings buyers and sellers together for a commission. They do not take a position. A dealer acts as a principal in all transactions, buying and selling for his own account.

Certificates of Deposit

- 1. Negotiable Certificates of Deposit** are large-denomination CDs. They are issued at face value and typically pay interest at maturity, if maturing in less than 12 months. CDs that mature beyond this range pay interest semi-annually. Negotiable CDs are issued by U.S. banks (domestic CDs), U.S. branches of foreign banks (Yankee CDs), and thrifts. There is an active secondary market for negotiable domestic and Yankee CDs. However, the negotiable thrift CD secondary market is limited. Yields on CDs exceed those on U.S. treasuries and agencies of similar maturities. This higher yield compensates the investor for accepting the risk of reduced liquidity and the risk that the issuing bank might fail. State law does not require the collateralization of negotiable CDs.
- 2. Non-negotiable Certificates of Deposit** are time deposits with financial institutions that earn interest at a specified rate for a specified term. Liquidation of the CD prior to maturity incurs a penalty. There is no secondary market for those instruments, therefore, they are not liquid. They are classified as public deposits and financial institutions are required to collateralize them. Collateral may be waived for the portion of the deposits that are covered by FDIC insurance.

Collateral refers to securities, evidence of deposits, or other property that a borrower pledges to secure repayment of a loan. It also refers to securities pledged by a bank to secure deposits. In California, repurchase agreements, reverse repurchase agreements, and public deposits must be collateralized.

Commercial Paper is a short-term, unsecured, promissory note issued by a corporation to raise working capital.

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Corporate Note is a debt instrument issued by a corporation with a maturity of greater than one year and less than ten years.

Delivery Versus Payment (“DVP”) is a settlement procedure in which securities are delivered versus payment of cash, but only after cash has been received. Most security transactions, including those through the Fed Securities Wire system and Depository Trust Company (“DTC”), are done DVP as a protection for both the buyer and seller of securities.

Depository Trust Company (“DTC”) is a firm through which members can use a computer to arrange for securities to be delivered to other members without physical delivery of certificates. A member of the Federal Reserve System and owned mostly by the New York Stock Exchange, the Depository Trust Company uses computerized debit and credit entries. Most corporate securities, commercial paper, CDs, and BAs clear through DTC.

Federal Agency Obligations are issued by U.S. Government Agencies or Government Sponsored Enterprises (“GSE”). Although they were created or sponsored by the U.S. Government, most Agencies and GSEs are not guaranteed by the United States Government. Examples of these securities are notes, bonds, bills and discount notes issued by Fannie Mae (“FNMA”), Freddie Mac (“FHLMC”), the Federal Home Loan Bank system (“FHLB”), and Federal Farm Credit Bank (“FFCB”). The Agency market is a very large and liquid market, with billions traded every day.

Investment Advisor is a company that provides professional advice managing portfolios, investment recommendations and/or research in exchange for a management fee.

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

Liquidity refers to the ease and speed with which an asset can be converted into cash without loss of value. In the money market, a security is said to be liquid if the difference between the bid and asked prices is narrow and reasonably sized trades can be done at those quotes.

Local Agency Investment Fund (“LAIF”) is a special fund in the State Treasury that local agencies may use to deposit funds for investment. There is no minimum investment period and the minimum transaction is \$5,000, in multiples of \$1,000 above that, with a maximum of \$50 million for any California public Agency. It offers high liquidity because deposits can be converted to cash in twenty-four hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate share determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly via direct deposit to the Agency’s LAIF account. The State keeps an amount for reasonable costs of making the investments, not to exceed one-quarter of one percent of the earnings.

Market Value is the price at which a security is trading and could presumably be purchased or sold.

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

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Medium-Term Notes are debt obligations issued by corporations and banks, usually in the form of unsecured promissory notes. These are negotiable instruments that can be bought and sold in a large and active secondary market. For the purposes of California Government Code, the phrase “Medium-Term” refers to a maximum remaining maturity of five years or less. They can be issued with fixed or floating-rate coupons, and with or without early call features, although the vast majority are fixed-rate and non-callable. Corporate notes have greater risk than Treasuries or Agencies because they rely on the ability of the issuer to make payment of principal and interest.

Money Market Fund is a type of safe investment comprising a variety of short-term securities with high quality and high liquidity. The fund provides interest to shareholders and must strive to maintain a stable net asset value (“NAV”) of \$1 per share.

NRSRO is a “Nationally Recognized Statistical Rating Organization.” A designated rating organization that the SEC has deemed a strong national presence in the U.S. NRSROs provide credit ratings on corporate and bank debt issues. Only ratings of a NRSRO may be used for the regulatory purposes of rating. Includes Moody’s, S&P, Fitch, and Duff & Phelps among others.

Principal describes the original cost of a security. It represents the amount of capital or money that the investor pays for the investment.

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

Supranational entities are formed by two or more central governments with the purpose of promoting economic development for the member countries. Supranational institutions finance their activities by issuing debt, such as supranational bonds. Examples of supranational institutions include the European Investment Bank and the World Bank. Similarly to the government bonds, the bonds issued by these institutions are considered direct obligations of the issuing nations and have a high credit rating.

U.S. Treasury Issues are direct obligations of the United States Government. They are highly liquid and are considered the safest investment security. U.S. Treasury issues include:

1. **Treasury Bills** which are non-interest-bearing discount securities issued by the U.S. Treasury to finance the national debt. Bills are currently issued in one, three, six, and twelve month maturities.
2. **Treasury Notes** that have original maturities of one to ten years.
3. **Treasury Bonds** that have original maturities of greater than 10 years.

Yield to Maturity is the rate of income return on an investment, minus any premium above par or plus any discount with the adjustment spread over the period from the date of the purchase to the date of maturity of the bond