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**city of san luis obispo**

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**INVESTMENT MANAGEMENT PLAN**

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**April 2008**

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# **INVESTMENT MANAGEMENT PLAN**

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**city of san luis obispo**

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# INVESTMENT MANAGEMENT PLAN

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# 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 Investment Policy, which was adopted by the Council in conjunction with their approval of the Financial Plan.

## 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

### ① 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.
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.

## INTRODUCTION

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.
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 Standard & Poor's' 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 will 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. Accordingly, the will use 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 as otherwise stated in this Investment Management Plan.
2. The City shall maintain a minimum of three months (20%) of budgeted operating expenditures in short-term investments (90 days or less).
3. The duration of that part of the portfolio that is not needed for liquidity purposes shall at all times be approximately equal to the duration of an index of U.S. Treasury and Federal Agency Securities with maturities that meet the City's needs for cash flow and level of risk tolerance (the Benchmark Index). plus or minus 10%.

# INTRODUCTION

## ② Liquidity

The investment portfolio will 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). A portion of the portfolio may be placed in money market mutual funds or local government investment pools that 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).

## ③ Yield: Return on Investments

The City's investment portfolio shall be designed with the objective of attaining a market 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. Securities shall not be sold before maturity with the following exceptions:

1. A declining credit security could be sold early to minimize loss of principal.
2. A security swap would improve the quality, yield or target duration in the portfolio.
3. Liquidity needs of the portfolio require that the security be sold.
4. A capital gain would be realized that better positions the overall portfolio in achieving Investment Policy goals.

## 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

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

## **INTRODUCTION**

controlled by federal law, specific provisions of the City's adopted plan and individual employee decisions.

### **USE OF STATE GUIDELINES**

Government Code Sections 16429.1-16429.4, 16481.2, 53600-53609 and 53630-53686 of the State of California regulate the investment practices. It is the City's policy to use the State's provisions for local government investments in the developing and implementing the City's investment policies and practices.

### **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. Under this direction, the City's first Investment Management Plan was prepared and issued by the City Treasurer in December of 1989.

As it was originally viewed as an administrative "companion" to the Council adopted Investment Policy, the Council did not formally approve the Investment Management Plan at that time, although it was distributed to them. However, given legitimate public concerns regarding the stewardship of funds arising from the unprecedented losses experienced by the Orange County investment pool, formal approval of the Investment Management Plan by the Council is now recommended in order to provide a broader awareness and understanding of the strategic framework, policy guidelines and administrative practices followed in managing the City's investments.

As required under Government Code Sections 16481.2 and 53646, the Council will review the Statement of Investment Policy annually. The Council will only formally review the Investment Management Plan when significant 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.

# 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 is delegated to the Finance 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.

**Transactions 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.

## 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.

## 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 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 care to be applied by the Director/City Treasurer will 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 City. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law.*

## 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.

### USE OF AN INVESTMENT ADVISOR

#### Background

In September 2007, the Council approved the use of an investment advisor in more effectively managing the City's portfolio. As noted at that time, there are three primary reasons for contracting with an investment advisor:

1. **Expertise.** By contracting for portfolio management services, the City benefits from specialized professional expertise, risk management and continuity in the investment function. With today's volatile market and complex investment instruments, a professional investment manager is best suited to achieving the City's investment goals while minimizing portfolio risk. The investment advisor's knowledge of securities and access to the market should also result in enhanced investment earnings.
2. **Portfolio Diversification.** Prior to contracting with an investment, the City's portfolio was primarily invested in the State of California Local Agency Investment Fund (LAIF). Over the past couple of years, because of staffing resource limitations and competing priorities, as portfolio investments matured, the proceeds were largely placed in LAIF rather than reinvested in other instruments. While LAIF is a secure investment that was yielding market earnings at the time that met the City's investment yield objective, a concentration of the City's portfolio in LAIF did not meet the diversification objective of the Investment Management Plan. Turning to the expertise of an outside professional allows the City to better diversity its portfolio, using various investment strategies and instruments as appropriate.
3. **More Effective Use of Staff Resources.** Contracting with an investment advisor frees-up City staff to perform functions where they can better use their expertise and add value. Additionally, in times of staffing turnover, continuity in the investment function is better assured.

## INVESTMENT AUTHORITY AND RESPONSIBILITIES

The Council approved issuing a comprehensive request for proposals (RFP) to a broad range of qualified investment advisors and authorized the City Administrative Officer (CAO) to award the contract most qualified proposer. Following a detailed review of the ten proposals received response to the City's RFP, the CAO awarded the contract to Chandler Asset Management in December 2007.

### **Investment Advisor Authority**

As set forth in the RFP approved by the Council, the Investment Advisor has discretionary authority over the portfolio that it manages on behalf of the City, subject to the following restrictions:

1. ***Compliance with the Investment Management Plan.*** As set forth above under "Authorized Investment Officers," the investment advisor must act in accordance with the City's primary investment objectives and within the guidelines set forth in the Investment Management Plan.
2. ***Transition Plan.*** Based on detailed analysis of cash flow needs, the City will retain about 15% of its portfolio in LAIF and other short-term investments. The City will also retain control over investments for debt service reserve requirements, certificates of deposit and the U.S. Treasury Bond maturing in 2016 (market value of \$1.4 million). The balance of the City's portfolio (about \$50 million in April 2008) will be managed by the Investment Advisor. The initial configuration of the portfolio will be approved by the Director/City Treasurer before placement.
3. ***Sale of Investments with a Capital Loss.*** The investment advisor will consult with the Director/City Treasurer before selling investments at a capital loss, which may be appropriate in repositioning the portfolio for better gains in the future in meeting the City's performance goals.

# **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.

## **INVESTMENT VEHICLES**

### **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 creditworthiness 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 government agency issues or LAIF) 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 (negotiable and collateralized) placed by the City shall not constitute more than 15% of the total assets of the institution; and negotiable certificates of deposit will only be placed with institutions with total assets in excess of \$200 million and that maintain a ratio of equity to total assets of at least 5%.

### **CERTIFICATION AND REPORTING REQUIREMENTS**

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 (including a minimum capital requirement of \$10 million 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).

## **INVESTMENT VEHICLES**

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

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 California Government Code Section 53600 et seq. 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 negotiable, collateralized and other time 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 \$100,000.
3. Reasonable efforts will be made to place deposits of less than \$100,000 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.

### **STATE OF CALIFORNIA LIMITATIONS**

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

### **SUITABLE AND AUTHORIZED INVESTMENTS**

City funds may be invested in the following:

## INVESTMENT VEHICLES

1. **Treasury Obligations:** Treasury bills, Treasury notes, Treasury bonds and Treasury STRIPS with maturities not exceeding five years from the date of purchase except as otherwise stated in this Investment Management Plan.
2. **Government Sponsored Enterprise (GSE) Securities:** Debentures, discount notes, global securities, callable securities and stripped principal or coupons with maturities not exceeding five years from the date of purchase, except as otherwise stated in this Investment Management Plan, issued by U.S. Government Sponsored Enterprises (GSE). Examples include government agency securities such as the Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB), Federal Home Loan Mortgage Corporation (FHLMC) and Federal Farm Credit Bank (FFCB). GSE securities must be rated AAA by either Moody's or Standard & Poor's.
3. **Commercial Paper:** Issued by a corporation organized and operating in the U.S. and having assets in excess of \$500,000,000. The paper must be denominated in U.S. currency with a maturity not exceeding 270 days from the date of purchase. It must be rated at least A-1/P-1/F-1 by one or more nationally recognized statistical-rating organizations (NRSRO). If the commercial paper issuer has issued long-term debt it must be rated "A". At the time of purchase, no more than 25% of the City's surplus funds may be invested in commercial paper and no more than 5% of the City's surplus funds may be invested in any one issuer.
4. **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. At the time of purchase, the notes must mature within five years and must be rated "AA" or better by one or more nationally recognized statistical-rating organizations (NRSRO). At the time of purchase, no more than 30% of the City's surplus funds may be invested in medium term notes and no more than 5% of the City's surplus funds may be invested in any one issuer.
5. **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.
6. **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 at least 102%. The market value of the collateral shall be marked-to-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.

## INVESTMENT VEHICLES

7. **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.
8. **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 state-licensed branch of a foreign bank. At the time of purchase, the maturity of the certificate may not exceed five years, 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.
9. **Collateralized Bank Deposits:** Shall be evaluated in term of Federal Deposit Insurance Corporation (FDIC) coverage. For deposits in excess of the insured maximum of \$100,000, 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 5% of the portfolio can be placed with any one financial institution.
10. **Money Market Mutual Funds:** Registered under the Investment Company Act of 1940 which:
  - a. Are "no-load" (no commission fee shall be charged on purchases or sales of shares)
  - b. Have a policy to strive to maintain a constant daily net asset value per share
  - c. Limit assets of the fund to those securities authorized in this Investment Management Plan
  - d. Have a maximum stated maturity and weighted average maturity in accordance with Federal Securities Regulation 2A-7
  - e. Are rated in the highest ranking or the highest letter and numerical rating provided by not less than two NRSRO's.

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.

## CITY POLICIES

### Debt Reserve Funds

Reserve funds from the proceeds of debt issues may be invested by the Director/City Treasurer in government agency securities with terms exceeding five (5) years if the maturities of such investments are made to coincide as nearly as practicable with the life of the debt issue. In all other cases, Council approval to make investments with terms in excess of 5 years is required on a case-by-case basis.

## **INVESTMENT VEHICLES**

### **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.

### **Allowed Investments But Use Unlikely**

The City is allowed to invest in state and local government bonds or other indebtedness. However, given their tax exempt status (which is not of economic value to the City), their use in meeting the City's investment objectives is unlikely. However, there may be policy circumstances where their use may be warranted. In these cases, Council approval is required.

### **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 government 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. While the City is allowed to invest in financial futures or option contracts, these are excluded in accordance with the City's overall objective of achieving reasonable yields on public funds while minimizing risk and capital losses. Although the potential exists for greater interest yields with these vehicles, their potential level of risk exceeds their benefits except in very limited circumstances. Accordingly, Council approval is required on a case-by-case for any investments in financial futures or option contracts.
8. 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 until

## INVESTMENT VEHICLES

such time as the Director/City Treasurer is confident that adequate regulatory reform has taken place that would make these securities consistent with the City’s primary investment objective.

### 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 <sup>a</sup> None None
2. GSE Securities	5 Years None None	5 Years <sup>a</sup> None None
3. Commercial Paper	270 Days 25% per type; 10% per issuer A-1/P-1/F-1; Long-term “A”	270 Days 25% per type; 5% per issuer A-1/P-1/F-1; Long-term “A”
4. Medium Term Notes	5 Years 30% per type; none per issuer “A”	5 Years 30% per type; 5% per issuer “AA”
5. Bankers’ Acceptances	180 Days 40% per type; 30% per issuer None	180 Days 40% per type; 5% per issuer None
6. Repurchase Agreement	1 Year None  None	1 Year None per type; 5% per counterparty Primary Dealers/ Collateralization requirements
7. LAIF	N/A None None	N/A None None
8. Negotiable CDs	5 Years 30% per type; none per issuer None	5 Years 30% per type; 5% per issuer None
9. Collateralized Bank Deposits	5 Years None None	5 Years None per type; 5% per institution None
10. 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
11. Mortgage Pass-Throughs	5 Years 20% per type; none per issuer “AA” for issue; “A” for issuer	Not allowed at this time

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

## 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. Under this practice, a minimum of 20% of the portfolio will be invested in securities maturing in one year or less. Up to 80% of the portfolio can be invested in securities with a maturity over one year, with no more than 10% of the portfolio invested in securities with a maturity over five years. 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.

## **CASH MANAGEMENT**

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.

## **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 Merrill Lynch 0-to-5 year U.S. Treasury Bond Index.

## INVESTMENT REPORTING

Consistent with Sections 16481.2 and 53646 of the Government Code, the Director/City Treasurer shall submit an annual Statement of 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 Director/City Treasurer is responsible for developing and maintaining this Investment Management Plan.

In addition to the submittal of an annual Statement of Investment Policy and the preparation of an Investment Management Plan, the Director/City Treasurer shall provide the Council and Investment Oversight Committee with a monthly investment report providing the following information for each investment or security:

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

The Monthly Investment Report will include all investments as of the end of the month from all funds held in the City's portfolio, including funds held and invested by trustees exclusive of deferred compensation plan funds; and will be issued within 30 days after the end of the monthly reporting period.

## **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 will form an Investment Oversight Committee whose membership consists of the City Administrative Officer, Assistant City Administrative Officer, Director/City Treasurer, Finance Manager and the City's Independent Certified Public Accountant. The Investment Oversight Committee is responsible for:

1. Reviewing the City's portfolio at least quarterly to determine compliance with the Investment Management Plan.
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 auditors' engagement duties, which include 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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# APPENDIX

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## APPENDIX

### INVESTMENT POLICY

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#### *Excerpt from the 2007-09 Financial Plan*

- A. **Responsibility.** Investments and cash management are 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 20% of operating expenditures, 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 Section 53601.
- 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 percent of the total net worth of any institution and may be reduced further or refused altogether if an institution's financial situation becomes unhealthy.

## APPENDIX

- 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 & Information Technology/City Treasurer, Finance 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 53607. This reporting system will provide the Council and the Investment Oversight Committee with appropriate investment performance information.

**APPENDIX**

**APPOINTMENT OF FINANCE DIRECTOR AS CITY TREASURER**

RESOLUTION NO. 8477 (1996 SERIES)

A RESOLUTION OF THE COUNCIL OF THE CITY OF SAN LUIS OBISPO  
UPDATING PAYMENT DISBURSEMENT AND RECEIPT AUTHORITY

WHEREAS, it is the policy of the City of San Luis Obispo for the Director of Finance to concurrently hold the position of City Treasurer; and

WHEREAS, Resolution No. 6148 designates specific positions to act on behalf of the Director of Finance/City Treasurer that no longer exist.

NOW, THEREFORE, be it resolved by the Council of the City of San Luis Obispo as follows:

SECTION 1. The Director of Finance is hereby appointed to concurrently hold the position of City Treasurer.

SECTION 2. The Director of Finance/City Treasurer is hereby authorized to sign all checks, drafts, wire transfers and other orders for and on behalf of the City for deposit, payment or investment in accordance with Government Code Section 53601.

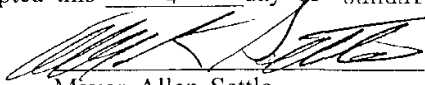
SECTION 3. The Director of Finance/City Treasurer is hereby authorized to designate the following positions with signature and representation authority to act in her or his behalf on the matters set forth above in Section 2 of this Resolution: Revenue Manager, City Administrative Officer, Assistant City Administrative Officer, and other officials formally designated by the Director of Finance/City Treasurer to serve in her or his absence on a case-by-case basis.

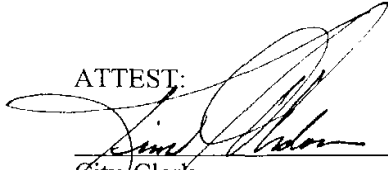
SECTION 4. Resolution No. 6148 (1987 Series) is hereby rescinded.

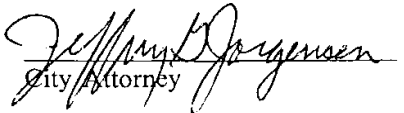
On motion of Vice Mayor Williams, seconded by Council Member Romero and on the following roll call vote;

AYES: Vice Mayor Williams, Council Members Romero, Roalman, Smith, Mayor Settle  
NOES: None  
ABSENT: None

the foregoing Resolution was passed and adopted this 4 day of January, 1996.

  
Mayor Allen Settle

ATTEST:  
  
City Clerk  
by Assistant City Clerk Kim Condon

APPROVED:  
  
City Attorney

R-8477

**APPENDIX**

COUNCIL APPROVAL OF THE INVESTMENT MANAGEMENT PLAN

RESOLUTION NO. 8523 (1996 SERIES)

A RESOLUTION OF THE COUNCIL OF THE CITY OF SAN LUIS OBISPO  
APPROVING THE INVESTMENT MANAGEMENT PLAN

WHEREAS, as set forth in the Statement of Investment Policy, the City Treasurer is responsible for developing and monitoring an investment management plan to guide administration of the City's portfolio, including investment strategies, practices and procedures; and

WHEREAS, given legitimate public concerns regarding the stewardship of funds arising from the unprecedented losses recently experienced by the Orange County investment pool, formal approval of the investment management plan by the Council is recommended in order to provide a broader awareness and understanding of the strategic framework, policy guidelines, and administrative practices followed in managing the City's investments.

NOW THEREFORE BE IT RESOLVED by the Council of the City of San Luis Obispo that the investment management plan dated April 1996 is hereby adopted.

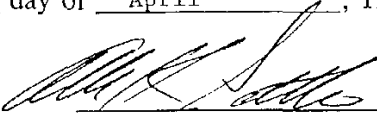
On motion of Council Member Smith, seconded by Council Member Williams, and on the following roll call vote:

AYES: Council Members Smith, Roalman, Romero, Williams, Mayor Settle

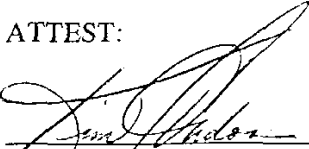
NOES: None

ABSENT: None

the foregoing resolution was adopted this 16 day of April, 1996.

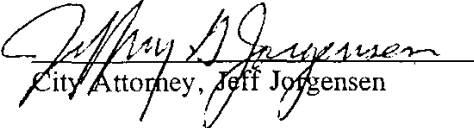
  
\_\_\_\_\_  
Mayor Allen K. Settle

ATTEST:

  
\_\_\_\_\_  
City Clerk

by Asst. City Clerk Kim Condon

APPROVED AS TO FORM:

  
\_\_\_\_\_  
City Attorney, Jeff Jorgensen