CITY OF GOLETA

Agenda Item C.2
DISCUSSION/ACTION ITEM
Meeting Date: July 16, 2019

TO: Mayor and Councilmembers

FROM: Luke Rioux, Finance Director

SUBJECT: Investment Strategy Update

RECOMMENDATION:

Receive information and overview of City's investment strategy and provide direction to implement an investment strategy.

BACKGROUND:

The City's Investment Policy was created in June 2005, and is annually reviewed, updated if needed and adopted by City Council. The Investment Policy establishes guidelines, strategies, practices, and procedures used with investing public funds in accordance with California Government Code (Government Code) sections 53600-53610, which establish legally permitted investments for local governments statewide. The Investment Policy has since included revisions to be consistent with industry best practices, provided by the California Debt and Investment Commission (CDIAC), California Municipal Treasurer's Association (CMTA) and Government Finance Officers Association (GFOA). While not required by statute, annual review and adoption of the investment policy is a recommended best practice, and also a requirement of the City's Investment Policy. In addition, the Investment Policy allows annual delegation of authority to the City Treasurer (Finance Director) for management and responsibility of the investment program for all transactions and must make a monthly and quarterly report to the legislative body, as required by Government Code Section 53607 and 53646.

On January 15, 2019, the City Council had its most recent annual review, delegation of authority and adoption of the City's Investment Policy for Fiscal Year (FY) 2018/19. The FY 2018/19 Investment Policy included administrative updates that added clarity and additional definitions in the glossary. Other updates to the policy included enhancements to the investment strategy section, which now encompasses the 1-year and 2-Year U.S. Treasury Rates as additional useful benchmarks, in addition to the Local Agency Investment Fund (LAIF) apportionment rate.

The City's current investment practice is to hold investments in its overnight funds or daily (same-day) liquidity funds. Liquidity refers to the ability to convert an investment into cash. The City utilizes two same-day liquidity funds, which includes the LAIF and a collateralized money market account with the City's primary banking institution, Community West Bank (CWB). LAIF is a pooled voluntary investment fund open to government entities in California managed by the State Treasurer's Office. LAIF offers local agencies the opportunity to participate in a major portfolio, which invests hundreds of millions of dollars, using the investment expertise of the State Treasurer's Office professional investment staff at no additional cost to the taxpayer. Its earnings are derived from the Pooled Money Investment Account (PMIA). Through the PMIA, the State Treasurer invests taxpayer's money to manage the State's cash flow and strengthen the financial security of local governmental entities. The PMIA has three primary sources of funds, the State general fund, special funds held by State agencies, and moneys deposited by cities, counties and special districts, known as LAIF. While LAIF is not insured, due to the portfolio's characteristics, credit risk is minimal.

Additionally, funds held in the money market account with CWB are fully collateralized, ensuring safety as collateralization acts as a second line of defense, to ensure all funds are available in the event of a bank default. This investment practice has ensured the City's investment program has met the primary objectives of the investment policy, in order of priority, safety, liquidity and yield. The funds are safe due to portfolio characteristics with the LAIF and collateralization provided by CWB. They are liquid as funds are available daily to meet its cash flow needs and investment yield have been deemed acceptable, based on safety of principle and cash flow needs, while earning a rate equivalent to the LAIF.

Staff has been providing monthly investment transaction reports as part of its regular monthly check register reporting, in addition to the quarterly treasury reports. These reports provide transparency and confirm investment policy compliance meeting expenditure requirements or its cash needs for the next six months, or if necessary, providing an explanation as to why money will not be available if that is the case. State legislature has acknowledged the importance of cash flows in reducing liquidity risk by requiring staff to include in their quarterly treasury reports a statement that the agency is able to meet its cash needs for the next six months. The requirement to do so is contained in Government Code Section 53646. Since the City holds all investment funds in all overnight liquidity funds, the City has had no issues meeting this requirement. Finance staff manages cash flow on a daily basis.

Authorized Investments per City's Adopted Investment Policy

The investment policy allows the City to invest public funds not required for immediate day-to-day operations, in safe and liquid investments, having acceptable rates of returns while conforming to all state statutes and investment policy. As outlined in in the investment policy, the City's investments are made on a pooled basis, except when required to be held separately by law (e.g., bond proceeds). Investments are made on a pooled basis to maximize investment earnings and increase efficiencies with regard to investment pricing, safekeeping, administration, and cash flow management to meet its liquidity requirements. Investment income is allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

The following investments are authorized by state law and further limited by the City's investment policy:

(1) Local Agency Investment Fund (LAIF) of the State of California. Investments in accordance with the laws and regulations governing those funds.

(2) Obligations of the U.S. Government, its agencies and instrumentalities, including mortgage-backed securities with a fixed coupon issued by an agency of the U.S. Government.

(3) Certificates of Deposit (CDs). CDs shall not exceed five-year maturity. CDs shall be collateralized as specified in Section 6 of this investment policy. CDs shall be issued by nationally or state chartered banks and cannot exceed thirty percent (30%) of the total portfolio. The City may waive collateral requirements for the portion of any deposit insured up to the amount allowed per account by the FDIC.

(4) Prime Commercial Paper of the highest numerical rating of Moody's Investment Service, Inc. or Standard & Poor's Corporation (S&P) from issuing corporations that are organized and operating within the United States and having total assets in excess of $500 million and having the equivalent to an "AA-" or higher rating from either Moody's or S&P for other debt of the issuer. Commercial Paper shall not exceed 270 days maturity or 25% of the portfolio.

(5) Money market funds with portfolios consisting of one or more of the indicated legal investments and none of the prohibited investments.

(6) Sweep account for the investment of overnight funds when the funds are swept into investments authorized by this policy.

(7) Passbook accounts maintained solely to provide for ongoing operational needs shall be subject to the requirements of this policy.

(8) Investment Trust of California, a Joint Powers Authority, doing business as CalTRUST. The City may invest in CalTRUST, a pool created by local public agencies to provide a method for local public agencies to pool their assets for investment purposes

Additionally, the City's Investment Policy also has restrictions on the maximum maturity levels, along with diversification restrictions with single issuers. Those restrictions include the following:

Maximum Maturities

(1) At least thirty-five percent (35%) of the portfolio value shall be invested in instruments within one year from the investment date.
(2) No more than twenty-five percent (25%) of the entire portfolio shall have a maturity date between three (3) and five (5) years from the investment date, unless the City Treasurer can demonstrate with a comprehensive cash-flow analysis that higher percentages allow the City to meet its cash-flow requirements.
(3) Investments having a maturity greater than five (5) years shall not be made. *(Five years is the maximum maturity amount set by state law for certain types of investments.)*

Diversification

(1) No more than ten percent (10%) of the value of City's portfolio will be placed with any single issuer, with exception of the U.S. Treasury/Federal agency securities, authorized pools and collateralized investments.

The authorized investments and investment portfolio as structured by maximum maturities and diversification requirements, allows the City to ensure safety of principle as its top priority, followed by liquidity, and yield. As the City considers its cash needs, it also coincidentally must consider its investment returns. In a normal interest rate environment, long-term investments generate higher rates of return than short-term investments when all other factors are held equal, while short-term investments offer greater flexibility at lower yields than long-term investments. Given the tradeoff between liquidity and yield, the City must balance its yield objectives with the liquidity needs of the portfolio. While the policy allows City staff to pursue investments according to policy, City staff has been in ongoing discussion with the Finance Committee about a recommended investment strategy. The purpose of this report is to provide the City Council information and an overview of the recommended investment strategy staff plans to implement and to receive their feedback.

DISCUSSION:

The City's Investment Policy states that a buy and hold strategy shall generally be followed. That means once investments are made, they are held to maturity, the date the principal or stated value of an investment becomes due and payable. A buy and hold strategy will result in unrealized gains or losses as market interest rates fall and rise from the coupon rate of the investment. Unrealized gains or losses, however, will diminish as the maturity dates of the investments are approached or as market interest rates move closer to the coupon rate of the investment. A buy and hold strategy requires that the portfolio be kept sufficiently liquid to prevent the undesirable sale of investments prior to maturity. As existing securities mature, they are replaced with higher or lower yielding securities, as it will depend where rates are at the time of investment. However, the investment policy does allow for flexibility, should the City's investments be in a position where it may be more advantageous to sell prior to maturity. As described in the Investment Strategy, Section 8 of the Investment Policy, "Occasionally, the City Treasurer may find it advantageous to sell an investment prior to maturity, such as when the return for an alternative investment would significantly exceed the loss on the current investment. The sale of investments prior to maturity should be only on an exception basis and only when it is clearly favorable to do so." Additionally, the Investment Strategy section includes benchmarks for comparative yield purposes, which now include the 1 and 2-year U.S. Treasury rate, in addition to the LAIF rate, to serve as useful benchmarks to measure whether or not the City's portfolio net yields are matching or surpassing the market yields. As the City enhances its investment program, these additional benchmarks will be appropriate for comparison purposes. A benchmark should represent a close correlation to the level of risk and average duration of the portfolio's investment. The investment performance and benchmarks will be reviewed by the Finance and Audit Standing Committee as the market conditions warrant or when the benchmarks are not met for a consecutive one-year period.

Investment Strategy

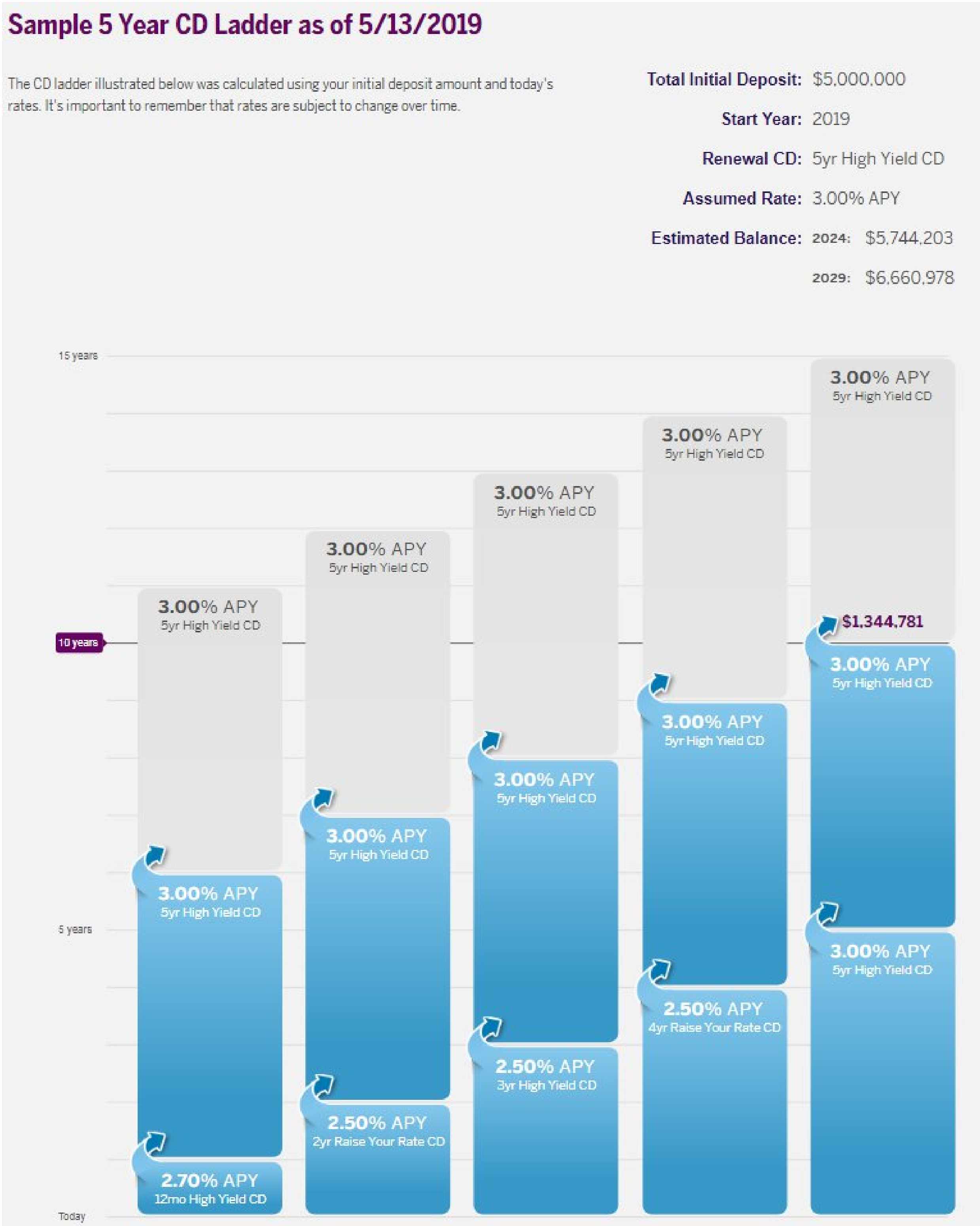
In meeting the investment priorities in order of safety, liquidity and yield, followed by the allowable investment options, maturity levels, diversification requirements, staff is recommending implementing a CD laddering strategy.

There are two types of ladders, a non-rolling ladder and rolling ladder. A non-rolling ladder is a bond or CD ladder in which bonds or CDs are not rolled over to new bonds or CDs at the prevailing rate. In a rolling ladder, as bonds and CDs mature they are replaced with bonds or CDs of similar maturity, so that the duration of the ladder remains approximately constant. This type of ladder is essentially equivalent to a bond fund, with the added advantage that it can be converted to a non-rolling ladder at no cost by simply not rolling over bonds or CDs as they mature.

As the City begins to expand its investment portfolio, staff is recommending building a CD rolling ladder strategy of approximately $5 million. The reason for this strategy is that the Federal Deposit Insurance Corporation (FDIC) insures CDs up to $250,000, and yields are locked in by the issuing bank until the maturity date of the CD. Laddering is a technique of holding CDs of different maturity dates in a portfolio in order to balance yield and liquidity. In a normal yield curve environment, long-dated CD's have a higher yield than shorter-dated ones. However, long-dated CDs, by definition, lock money into an illiquid holding. A ladder provides a way to take advantage of the highest-yielding CDs while improving liquidity of (access to) money. In addition, the CD ladder will ensure funds are held safe and FDIC insured, and allow the Finance Committee and City Council to become familiar with its investment portfolio and investment reporting. In addition, the $5 million will allow the City to maintain a safe liquid position, as it maintains an average of approximately $50 million cash balance held in its money market and LAIF accounts (overnight funds) and allow the City to have sufficient funds available to meet the six month expenditure requirement. Additionally, the $5 million will be below the 30% allocation requirement (approximately $15 million) of total portfolio value). The excess funds will continue to be invested in the City's overnight funds, LAIF and money market account to maximize interest earnings. As the City grows its investment portfolio, staff will continue to ensure it has enough liquidity to meet its obligations as they come due and confirm compliance with the investment policy and state law.

CD Ladder Strategy Example

Typically, ladders are created by allocating funds into fixed income securities of staggered maturity dates of years or parts. As described above, staff is recommending a 5-Year rolling CD ladder strategy to coincide with its maximum allowable maturity terms, and evenly distributing between short, intermediate, and long-term maturities. This is a great strategy for any interest rate environment, as it adjusts accordingly, avoids timing the market, and is used as a hedge against unpredictable rates. Staff is recommending the purchasing of CDs of 1, 2, 3, 4, and 5-year terms. When the 1-year CD matures, the principal is then used ("rolled") to purchase a new 5 year CD. After 4 years, all funds will have been in invested in 5 year CDs, but 1/5th of the money is available every year. As each CD matures, it can be decided whether to reinvest it all or in part. It becomes a rolling ladder when the decision is to reinvest, as existing securities mature and are replaced with higher-yielding securities (in a normal yield curve environment). Below is a graphic, displaying an example of a $5 million, 5-year rolling CD ladder:



At an assumed initial investment of $5 million and assumed rates stated above, the investment of $5 million is estimated to be at $5,744,203 or approximately have earned $744,203 in interest earnings over 5 years.

Investment Strategy Comparison to Current Practice

To further clarify and for presentation purposes, staff has provided examples comparing the possible additional investment earnings the City may experience with a CD laddering strategy versus keeping funds invested in all overnight funds, the LAIF or money market account.

Below, staff has put together examples of interest earnings by implementing a $5 million, five-year CD ladder over five years and utilizing interest rates as of 2/13/2019. Assumptions made for this example, assume as the 1-year CD matures at the end of each year, it is reinvested back out to the current 5-year rate. Below is a summary of the laddery strategy over five years for each year, and a walkthrough summary describing activity each year:

Year 1			
Maturity	**Par Amount**	**Interest Rate**	**Annual interest**
1 Year	1,000,000.00	2.5	25,000.00
2 Year	1,000,000.00	2.6	26,000.00
3 Year	1,000,000.00	2.8	28,000.00
4 Year	1,000,000.00	2.925	29,250.00
5 Year	1,000,000.00	3.15	31,500.00
Totals/Avg Rate	**5,000,000.00**	**2.80**	**139,750.00**

***Year 1*.** *The first year of a $5 million, 5-year CD ladder. This means four different CD's of $250k each for $1 million total in each CD maturity year. Based on this structure and assumed rates, the total annual interest earnings for the first year is estimated to be $139,750, with a weighted average yield of 2.80%. After the first year, the 1 Year CD matures and is available to reinvest ("roll") the funds in longer-term CD (5 Year) at the prevailing rate or kept back into City's overnight funds. This new five-year CD will mature at year six, keeping the ladder going. For presentation purposes we assume the 1-Year CD's of $1 million matures and the $1 million is then rolled into a 5 Year CD in Year 2.*

Year 2			
Maturity	**Par Amount**	**Interest Rate**	**Annual interest**
1 Year	1,000,000.00	2.6	26,000.00
2 Year	1,000,000.00	2.8	28,000.00
3 Year	1,000,000.00	2.925	29,250.00
4 Year	1,000,000.00	3.15	31,500.00
5 Year	1,000,000.00	3.15	31,500.00
Totals/Avg Rate	**5,000,000.00**	**2.93**	**146,250.00**

***Year 2*.** *In the second year, the original 1 Year CD had matured and is now reinvested in a 5 Year CD at the assumed rate of 3.15%. The 2 Year CD now matures in 1 year, the 3 Year CD now matures in 2 years, the 4 Year CD now matures in 3 years, and the 5 Year CD now matures in 4 years. As previously mentioned, the original 1 Year CD has been reinvested into a 5 Year CD earning the assumed rate of 3.15%. Total annual interest is estimated to be $146,250 for the second year with a weighted average yield of 2.93%.*

Year 3			
Maturity	**Par Amount**	**Interest Rate**	**Annual interest**
1 Year	1,000,000.00	2.8	28,000.00
2 Year	1,000,000.00	2.925	29,250.00
3 Year	1,000,000.00	3.15	31,500.00
4 Year	1,000,000.00	3.15	31,500.00
5 Year	1,000,000.00	3.15	31,500.00
Totals/Avg Rate	**5,000,000.00**	**3.04**	**151,750.00**

***Year 3*.** *In the third year, the original 2 Year CD has matured and is now reinvested in a 5 Year CD at an assumed rate of 3.15%. All previously bought CD's maturity years now shift down. Total annual interest*

earnings is estimated to be $151,750 for the third year with a weighted average yield of 3.04%.

Year 4			
Maturity	**Par Amount**	**Interest Rate**	**Annual interest**
1 Year	1,000,000.00	2.925	29,250.00
2 Year	1,000,000.00	3.15	31,500.00
3 Year	1,000,000.00	3.15	31,500.00
4 Year	1,000,000.00	3.15	31,500.00
5 Year	1,000,000.00	3.15	31,500.00
Totals/Avg Rate	**5,000,000.00**	**3.11**	**155,250.00**

***Year 4**. In the fourth year, the original 3 Year CD has matured and is now reinvested in a 5 Year CD at an assumed rate of 3.15%. All previously bought CD's maturity years now shift down a year. Total annual interest earnings is estimated to be $155,750 for the fourth year with a weighted average yield of 3.11%.*

Year 5			
Maturity	**Par Amount**	**Interest Rate**	**Annual interest**
1 Year	1,000,000.00	3.15	31,500.00
2 Year	1,000,000.00	3.15	31,500.00
3 Year	1,000,000.00	3.15	31,500.00
4 Year	1,000,000.00	3.15	31,500.00
5 Year	1,000,000.00	3.15	31,500.00
Totals/Avg Rate	**5,000,000.00**	**3.15**	**157,500.00**

***Year 5**. In the fifth year, the original 4 Year CD has matured and is now reinvested in a 5 Year CD at an assumed rate of 3.15%. All previously bought CD's maturity years now shift down a year. The original 5 Year CD purchase during the first year now matures as a 1 Year CD. The total annual interest earnings is estimated to be $157,500 for the fifth year, with a weighted average yield of 3.15%.*

Implementing this five-year rolling CD ladder strategy would have earned the City $750,000 in interest earnings over the course of five years. The following table summarizes the interest earned each year along with the effective rate earned for each year.

Interest Summary		
Year	**Interest**	**Average Rate**
Year 1	139,750.00	2.80
Year 2	146,250.00	2.93
Year 3	151,750.00	3.04
Year 4	155,250.00	3.11
Year 5	157,500.00	3.15
Total	**750,500.00**	

Before comparing the 5-Year CD ladder strategy as described above to the LAIF or money market rates, it is important to take in account the historical LAIF rates, as rates fluctuate as they are based on the Pooled Money Investment Account (PMIA) managed by the State. The chart below displays the LAIF quarterly apportionment rates starting in 2008, along with a corresponding annual percentage yield (APY) for each year. LAIF quarterly apportionment rates are derived from the quarter's previous three month, monthly average yield of the PMIA.

LAIF Quarterly Apportionment Rates:

	March	June	September	December	Average APY
2008	4.18	3.11	2.77	2.54	3.15
2009	1.91	1.51	0.9	0.6	1.23
2010	0.56	0.56	0.51	0.46	0.52
2011	0.51	0.48	0.38	0.38	0.44
2012	0.38	0.36	0.35	0.32	0.35
2013	0.28	0.24	0.26	0.26	0.26
2014	0.23	0.22	0.24	0.25	0.24
2015	0.26	0.28	0.32	0.37	0.31
2016	0.46	0.55	0.6	0.68	0.57
2017	0.78	0.92	1.07	1.2	0.99
2018	1.51	1.9	2.16	2.4	1.99

In 2014, the City contracted banking services with Community West Bank, which guaranteed an overnight money market account rate of 0.7%. When LAIF/PMIA began rising, they agreed to match the rate, but never go below the contracted amount should rates fall. In 2019, the City entered into a new five-year banking agreement with Community West Bank with those same terms.

At the start of the 2008 recession, LAIF rates significantly decreased and have been low over the last ten years. For comparison purposes, an average quarterly yield for the calendar year of LAIF is utilized to provide a fair comparison of interest earned over a 1-year period. In 2018, the LAIF average annual yield was 1.99%. If the City were to hold this same $5,000,000 in LAIF, the interest earnings would be approximately $99,500 each year (assuming average annual yield stayed at 1.99% for the next 5 years), for a total of $497,500 over a five-year period, as shown in the LAIF Interest Summary table below.

LAIF Interest Summary – Over Five Years

Interest Summary		
Year	**Interest**	**Effective Rate**
Year 1	99,500.00	-
Year 2	99,500.00	1.99
Year 3	99,500.00	1.99
Year 4	99,500.00	1.99
Year 5	99,500.00	1.99
Total	**497,500.00**	

When comparing the CD ladder strategy versus holding investments with LAIF, this results in an overall difference of $253,000 of interest earnings in a five-year period. The Investment Strategy Comparison table below summarizes the differences by year.

Investment Strategy Comparison

CD Ladder Interest Summary			LAIF Interest Summary		Difference	
Year	Interest	Effective Rate	Interest	Effective Rate	Interest Difference	Effective Rate Difference
Year 1	139,750.00	2.80	99,500.00	1.99	40,250.00	0.81
Year 2	146,250.00	2.93	99,500.00	1.99	46,750.00	0.94
Year 3	151,750.00	3.04	99,500.00	1.99	52,250.00	1.05
Year 4	155,250.00	3.11	99,500.00	1.99	55,750.00	1.12
Year 5	157,500.00	3.15	99,500.00	1.99	58,000.00	1.16
Total	**750,500.00**		**497,500.00**		**253,000.00**	

Since it is unknown what the LAIF apportionment rate will be until after the interest generated by the PMIA is realized, the above comparison with LAIF is assuming the average yield is held constant at 1.99%. If staff were to assume assumptions, and for additional comparison purposes assumed the LAIF rate to grow by 6% each year (average yield rate change since 2008), total interest earnings would result approximately $560,890.75 over a five-year period. The table below summarizes this comparison,

Interest Strategy Comparison (with LAIF Rate Increase Assumptions)

CD Ladder Interest Summary			LAIF Interest Summary		Difference	
Year	Interest	Effective Rate	Interest	Effective Rate	Interest Difference	Effective Rate Difference
Year 1	139,750.00	2.80	99,500.00	1.99	40,250.00	0.81
Year 2	146,250.00	2.93	105,470.00	2.11	40,780.00	0.82
Year 3	151,750.00	3.04	111,798.20	2.24	39,951.80	0.80
Year 4	155,250.00	3.11	118,506.09	2.37	36,743.91	0.73
Year 5	157,500.00	3.15	125,616.46	2.51	31,883.54	0.64
Total	**750,500.00**		**560,890.75**		**189,609.25**	

When comparing the assumed LAIF rate increase to the 5-Year CD Ladder Strategy, the LAIF interest earnings is still lower by approximately $189,609.25.

Overall, both investment vehicles are very different and are not necessarily a fair comparison, as each investment vehicle holds its own purpose, and allows for diversification. LAIF is designed to be very liquid, and is considered an overnight fund, like the City’s money market account, as it can be accessed on the same day. It is a daily cash flow tool that preserves principle and allowing to earn additional interest. LAIF is a safe investment option for municipalities. As mentioned earlier, the LAIF apportionment rate is applied quarterly and is based off the interest earnings generated by the PMIA. The PMIA yield is generally not as high due to the types of investments held and shorter durations. LAIF and the money market account should be used at all times in investing excess cash and managing daily cash flow and liquidity needs.

CD’s are fixed rate and have established maturity dates. Based on the CD rate and length of maturity, the longer the maturity terms typically has higher yields. Additionally, CD’s are FDIC insured, up to $250,000. With investments in CD’s you are essentially trading liquidity for higher yields, but ensuring the safety of the principal amount. The

CD ladder strategy addresses the liquidity issue, and with a 5 Year CD ladder strategy, one-fifth (1/5) of the funds become available every year, should the City decide not to reinvest the principle amount.

Additionally, the ladder strategy, addresses the timing issue with changes in interest rates. The pooled funds held in the ladder strategy are less affected by both high and low points in the market. The ladder reduces the risk typically associated with buying all CDs of a longer-term maturities and potentially increases your overall portfolio return over time. In other words, if rates were to drop in the next few years, the CD's locked in at higher rates with longer maturity dates would significantly benefit. If rates were to rise, the City will still have the advantage and opportunity to purchase CD's at the higher rates when CD's with shorter maturity dates, mature each year. By laddering annual reinvestments, there is no second-guessing of where to place funds. In summary, the ladder strategy provides protection for interest rate risk and gives the ability to adjust cash flow needs. This strategy can also be used on different investment vehicles in the future, such as agency bonds issued by Government Sponsored Enterprises (GSE's) which are bonds issued by U.S. government-sponsored agency, which are backed by the U.S. government, but not guaranteed by the government. Common GSE agency bonds include bonds issued by such agencies as Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage (Freddie Mac).

FINANCE COMMITTEE REVIEW:

The Finance Committee met to review and discuss investment options and investment strategy on December 3, 2018, February 11, 2019 and February 27, 2019 and were in support of recommended strategy.

FISCAL IMPACTS:

There are no fiscal impacts except staff time on additional reporting requirements and investment transactions. Investment transaction reporting practices are currently in place with the Monthly Investment Transaction Report and Quarterly Treasurer's Report. The funds held in the investment strategy are insured and complies with state law and investment policy. Including a $5 million CD Ladder strategy in the City's overall investment portfolio, additional investment income may be experienced, while at the same time, ensuring FDIC insured investments, minimizing risk, diversifying and meeting benchmarks. Future investment income is dependent upon where rates are at the time of investment. Excess funds will continue to be invested in LAIF and money market account. Should the investment accounting and reporting become administratively burdensome, staff will evaluate treasury management software such as SymPro, which is an industry standard within municipal government to assist with investment portfolio accounting, reporting, analysis and managing cash flow.

ALTERNATIVES:

City Council may direct staff not to pursue investment strategy and remain status quo with its current practice. Doing so may not meet benchmarks,

Legal Review By:

Michael Jenkins
City Attorney

Approved By:

Michelle Greene
City Manager

ATTACHMENTS:

1. FY 2018/19 Investment Policy

ATTACHMENT 1:

FY 2018/19 Investment Policy

CITY OF GOLETA, CALIFORNIA
INVESTMENT POLICY
FISCAL YEAR 2018/19

1. PURPOSE

It is the purpose of the City's investment policy to establish strategies, practices and procedures to be used in investing public funds in a prudent manner, which will provide the maximum security while meeting daily cash flow needs and conforming to all statutes governing the investment of public funds.

Secondly, this document will identify policies that enhance opportunities for a prudent and systematic investment of public funds. This policy is intended to guide the investment of City funds toward the goals of safety, liquidity and yield.

2. POLICY

It is the policy of the City of Goleta, hereafter referred to as the "City", to invest public funds not required for immediate day-to-day operations, also referred to as idle funds, in safe and liquid investments having acceptable rates of return while conforming to all state statutes and this City's Investment Policy.

Any conflict between this City Investment Policy and Government Code Section 53600 et. seq., shall be interpreted in favor of the Government Code.

3. SCOPE

It is intended that this policy cover all funds and investment activities of the City. These funds are reflected in the annual audit report and include:

- General Fund
- Special Revenue Funds
- Debt Service Funds
- Capital Projects Funds
- Fiduciary Funds

Any additional funds that may be created from time to time shall also be administered within the provisions of this policy and comply with the California State Government Code. This policy covers the investment activities of idle funds under the direct authority of the City.

A. **Pooled Investments**
Investments for the City and its component units will be made on a pooled basis, except as provided for below.

B. **Investments Held Separately**
In some instances, investments cannot be included in the City's investment pool. These may include investments of bond proceeds. In

such cases the funds will be held separately when required by law, contract or other authority.

4. OBJECTIVES

Section 53600.5 of the California Government Code outlines the primary objectives of a trustee investing public money. The primary objectives, in order of priority, of the City's investment activities shall be:

A. **Safety**
Safety of principal is the foremost objective of the investment program. Investments by the City shall be undertaken in a manner that seeks to ensure preservation of capital in the overall portfolio and reduce both credit and market risk. The type of investment instruments and diversification of investments are critical components to ensuring investment portfolio safety.

B. **Liquidity**
The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated. Liquidity also refers to the ability to convert an investment to cash without loss of principal and minimal loss of interest.

C. **Yield**
Investment return becomes a consideration only after the basic requirements of safety and liquidity have been met. The City shall attempt to obtain an acceptable return for additional income for City operations relative to the risk being taken.

The City Treasurer shall strive to maintain the level of investment of all idle funds as close to 100% as possible. While the objectives of safety and liquidity must first be met, it is recognized that investment assets represent a potential source of significant revenues. It is to the benefit of the City that these assets be managed to produce optimum revenues consistent with State statutes and local policies.

5. AUTHORIZED INVESTMENTS

A. **Pooled Monies for Investment Purpose**. The City Treasurer may invest City funds in the following instruments as specified in California Government Code Section 53601, and as further limited in this policy.

(1) Local Agency Investment Fund (LAIF) of the State of California. Investments in accordance with the laws and regulations governing those funds.

(2) Obligations of the U.S. Government, its agencies and instrumentalities, including mortgage-backed securities with a fixed coupon issued by an agency of the U.S. Government.

(3) Certificates of Deposit (CDs). CDs shall not exceed five-year maturity. CDs shall be collateralized as specified in Section 6 of this investment policy. CDs shall be issued by nationally or state chartered banks and cannot exceed thirty percent (30%) of the total portfolio. The City may waive collateral requirements for the portion of any deposit insured up to the amount allowed per account by the FDIC.

(4) Prime Commercial Paper of the highest numerical rating of Moody's Investment Service, Inc. or Standard & Poor’s Corporation (S&P) from issuing corporations that are organized and operating within the United States and having total assets in excess of $500 million and having the equivalent to an “AA-” or higher rating from either Moody’s or S&P for other debt of the issuer. Commercial Paper shall not exceed 270 days maturity or 25% of the portfolio.

(5) Money market funds with portfolios consisting of one or more of the indicated legal investments and none of the prohibited investments.

(6) Sweep account for the investment of overnight funds when the funds are swept into investments authorized by this policy.

(7) Passbook accounts maintained solely to provide for ongoing operational needs shall be subject to the requirements of this policy.

(8) Investment Trust of California, a Joint Powers Authority, doing business as CalTRUST. The City may invest in CalTRUST, a pool created by local public agencies to provide a method for local public agencies to pool their assets for investment purposes

B. **Investments Held Separately**. Investments of bond funds shall be made in conformance with the trust indenture for each issue. Such investments shall be held separately when required.

6. <u>COLLATERALIZATION</u>

Investments in certificates of deposit, sweep accounts and passport accounts shall be fully insured up to the limit set by the Federal Deposit Insurance Corporation or the Federal Savings & Loan Insurance Corporation (FDIC). Investments in certificates of deposit, sweep accounts and passport accounts in excess of the FDIC limit shall be properly collateralized as required by law.

7. UNAUTHORIZED INVESTMENTS/INVESTMENT ACTIVITIES

Investments not specifically authorized herein are disallowed. Additionally, Section 53601.6 of the California Government Code disallows the following: inverse floaters, range notes, or interest-only strips that are derived from a pool of mortgages. Futures, options, all leveraged purchases, reverse repurchases, and speculations on interest rates are specifically not allowed by this policy.

8. INVESTMENT STRATEGY

A. **Buy and Hold.** A buy and hold strategy shall generally be followed. A buy and hold strategy requires that the portfolio be kept sufficiently liquid to preclude the undesirable sale of investments prior to maturity. Occasionally, the City Treasurer may find it advantageous to sell an investment prior to maturity, such as when the return for an alternative investment would significantly exceed the loss on the current investment. The sale of investments prior to maturity should be only on an exception basis and only when it is clearly favorable to do so. To further provide for liquidity, investments will be made only in readily marketable securities actively traded in the secondary market.

B. **Benchmark.** The City's overall investment strategy is passive. The City intends to hold its investments to maturity. The City shall use the LAIF apportionment rate, the 1-year U.S. Treasury Note and the 2-year U.S. Treasury Note as useful benchmarks to measure whether or not the City's portfolio net yields are matching or surpassing the market yields. The benchmarks and investment performance will be reviewed by the Finance and Audit Standing Committee as market conditions warrant or when the benchmarks are not met for a consecutive one-year period.

C. **Per Indenture Provisions.** Investments held separately for bond proceeds will follow the trust indenture for each issue.

9. MAXIMUM MATURITIES

A. **Pooled Monies for Investment Purpose.** A policy of laddered portfolio shall be followed for pooled investments. At least thirty-five percent (35%) of the portfolio value shall be invested in instruments maturing within one year from the investment date. No more than twenty-five percent (25%) of the entire portfolio value shall have a maturity date between three (3) and five (5) years from the investment date, unless the City Treasurer can demonstrate via a comprehensive cash-flow analysis that higher percentages allows the City to meet its cash-flow requirements. Investments having a maturity greater than five (5) years shall not be made.

B. **Investments Held Separately.** Maturities for investments held separately shall conform to the trust indenture for each issue.

10. DIVERSIFICATION

The portfolio instrument composition shall be diversified to the extent feasible to avoid incurring unreasonable and avoidable risks regarding specific security types indicated in Section 5 of this investment policy. No more than ten percent (10%) of the value of the City's portfolio will be placed with any single issuer, with the exception of the U.S. Treasury/Federal agency securities, authorized pools, and collateralized investments.

11. SELECTION OF FINANCIAL INSTITUTIONS AND BROKERS/DEALERS

A. **General.** Investments shall be purchased only through well-established, financially sound institutions. All financial institutions and broker/dealers who desire to become qualified vendors for investment transactions will be given a copy of the City's investment policy and certification form. The completion and submission of the certification form by a broker-dealer or financial institution shall constitute proof that it has received the City’s Statement of Investment Policy, read it, and intends to comply with it. Qualified financial institutions must provide current audited financial statements and provide either verification of a federal or a state charter or of being an eligible institution per the California Government Code. Broker/dealers must provide current audited financial statements and verification that the firm is in good standing with one of national securities exchange that is registered with the Securities Exchange Commission.

B. **Authorized Financial Institutions.** The City Treasurer shall maintain an Approved List of all commercial banks and all savings and loan associations which may serve as public depositories of City monies. That list will be reviewed by the Finance and Audit Standing Committee within three months of modifying the list.

The City shall only deposit public monies in financial institutions that have: (1) at least $500 million in total assets; (2) a core capital-to-total assets ratio of at least five percent; (3) favorable ratings from a recognized financial institution rating service, as determined by the City Treasurer; (4) a federal or a state charter; or are eligible institutions per the California Government Code and (5) a branch office within Santa Barbara County.

Under no circumstances shall the City’s deposits in a financial institution exceed the total shareholders’ equity of that institution.

C. **Authorized Broker-dealers.** The City will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker-dealers selected by credit worthiness who are authorized to provide investment services in the State of California. These may include primary dealers or regional dealers that qualify under Securities and Exchange Commission Rule 15c3-1 (uniform new capital rule). All financial institutions and broker-dealers for investment transactions must supply the City with the following: audited financial statements, proof of Financial Industry Regulatory Authority (FINRA) certification, proof of State of California registrations, completed broker-dealer questionnaire, and certificate of having read the City's investment policy.

12. PAYMENT, DELIVERY, SAFEKEEPING AND CUSTODY

All security transactions entered into by the City shall be conducted on a delivery-vs.-payment basis. Transactions, including wiring instructions, must be approved in writing by the City Treasurer or his/her designee, identified in advance in writing, or the City Manager. All investment transactions in excess of $100,000 (except for deposits or withdrawals from the LAIF) shall also require the signature of the City Manager or his/her designee.

All securities owned by the City, (except the collateral for certificates of deposit in banks and/or savings and loans) shall be held by a third-party custodian designated by the City Treasurer. The third-party custodian shall annually provide a copy of their most recent report of internal controls. The custodian shall also provide periodic statements of the securities owned by the City listing the specific instrument, rate, maturity and other pertinent information. All securities shall be held in the nominee name of the custodian.

13. PRUDENCE

Section 53600.3 of the California Government Code identifies as trustees, those persons authorized to make investment decisions on behalf of a local agency. As a trustee, the standard of prudence to be used shall be the "prudent investor standard" and shall be applied in the context of managing the overall portfolio. Investments shall be made with judgment and care, under circumstances then prevailing which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

Trustees or City investment officials, acting in accordance with written procedures and the investment policy and exercising due diligence, shall be relieved of personal responsibility for an individual security's credit risk changes or market price changes, provided deviations from expectations are reported in a timely manner and appropriate action is taken to control adverse developments.

14. DELEGATION OF AUTHORITY

Authority to manage the City's investment program is derived from the California Government Code Sections 53600 through 53609. The management of idle cash and the investment of funds identified in paragraph 3(A) is the responsibility of the Finance Department. The Finance Department is under the control of the Finance Director, and appointed by the City Manager as the City Treasurer. Management responsibility for the investment program is hereby delegated to the Finance Director/City Treasurer as directed by the City Council. Under the authority granted by the City Council, no person may engage in an investment transaction covered by the terms of this policy unless directed by the City Treasurer.

In the execution of this delegated authority, the City Treasurer may establish accounts with qualified financial institutions and brokers/dealers for the purpose of effecting investment transactions in accordance with this policy. The criteria used to select qualified financial institutions and brokers/dealers are identified in Part 11 of this policy.

This delegation of authority shall be in effect for one fiscal year. The City Council may renew the authority annually and may revoke the authority at any time.

15. INTERNAL CONTROL

The City Treasurer shall establish and maintain a system of appropriate internal controls to ensure compliance with policies and procedures. The controls are designated to prevent losses of public funds arising from fraud, error, or imprudent actions by employees and officers of the City.

16. ETHICS AND CONFLICTS OF INTEREST

All participants in the City's investment process shall act responsibly as custodians of the public trust. Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program or which could impair their ability to make impartial investment recommendations and decisions. Investment officials and employees shall make all disclosures appropriate under the Fair Political Practices Act, and shall seek and follow the advice of the City Attorney and the Fair Political Practices Commission whenever there is a question of personal, financial or investment positions that could represent potential conflicts of interest.

17. REPORTING

A. **Pooled Investments.** The investment report shall be submitted to the City Council on a quarterly basis by the City Treasurer. The quarterly report shall include the following elements:

- Itemized listing of portfolio investments by type, date of maturity, yield to maturity, and issuer.
- Par value, dollar amount invested, book value and current market value if applicable. The source of the market values will be cited.
- Statement that the investment portfolio has the ability to meet the City's cash flow demands for the next six months.
- Statement of compliance of the portfolio with the City's investment policy.
- Cash investment balances

B. **Investments Held Separately**. A report of the investments held separately shall be made on a quarterly basis and submitted as an attachment to the City Treasurer's quarterly report.

18. EXCEPTIONS

Occasionally, exceptions to some of the requirements specified in this investment policy may occur for pooled investments because of events subsequent to the purchase of investment instruments. State law is silent as to how exceptions should be corrected. Exceptions may be temporary or more lasting; they may be self-correcting or require specific action. If specific action is required, the City Treasurer should determine the course of action that would correct exceptions to move the portfolio into compliance with State law and City policy. Disclosure of exceptions lasting more than 183 days shall be done in the quarterly investment report immediately following the 183 days. Decisions to correct exceptions should not expose the assets of the portfolio to undue risk, and should not impair the meeting of financial obligations as they fall due. Any subsequent investments should not extend existing exceptions.

19. INVESTMENT POLICY ADOPTION

The City's investment policy and any modifications thereto shall be considered at a public meeting. Any modifications to the Investment Policy must be approved by the City Council.

The City’s investment policy shall be reviewed and adopted annually by the City Council.

INVESTMENT POLICY
GLOSSARY

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

Bond Indenture (or Trust Indenture): Written agreement specifying the terms and conditions for issuing bonds, stating the form of the bond being offered for sale, interest to be paid, the maturity date, call provisions and protective covenants, if any, collateral pledged, the repayment schedule, and other terms. It describes the legal obligations of a bond issuer and the powers of the bond trustee, who has the responsibility for ensuring that interest payments are made to registered bondholders.

Buy and Hold Strategy: Investments in which management has the positive intent and ability to hold each issue until maturity.

Certificates of Deposit: Large denomination ($100,000 or more) interest bearing time deposits, paying the holder a fixed amount of interest at maturity. Funds cannot be withdrawn before maturity without giving advance notice and without a penalty.

City Treasurer: The Finance Director serves as the City Treasurer, as appointed by the City Manager.

Collateralization: To secure a debt in part or in full by pledge of collateral, asset pledged as security to ensure payment or performance of an obligation. Also refers to securities pledged by a bank to secure deposits of public monies.

Current Yield: The interest paid on an investment expressed as a percentage of the current price of the security.

Delivery versus Payment: Securities industry term indicating payment is due when the buyer has securities in hand or a book entry receipt.

Disallowed Investments: Prohibited investments include any investments not specifically authorized within this policy, inverse floaters, range notes, interest-only strips that are derived from a pool of mortgages; futures, option, all leveraged purchases, reverse repurchases, and speculations on interest rates.

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

Federal Deposit Insurance Corporation (FDIC): The federal agency that insures bank deposits up to $250,000 per deposit at participating banking institutions. In an effort to increase consumer confidence in the banking system, the previous $100,000 insurance limit was temporarily increased to $250,000 in 2008, extended to 2013, and then permanently increased on July 21, 2010 with the passage of the Wall Street Reform and Consumer Protection Act.

Federal Reserve System: The central bank of the United States which consists of a seven member Board of Governors, 12 regional banks, and 5,700 commercial banks that are members.

Fiduciary Funds: Funds held in a trustee or agency capacity for outside parties.

Interest Rate: The annual yield earned on an investment, expressed as a percentage.

Liquidity: Refers to the ability to rapidly convert an investment into cash.

Laddered Portfolio: Bond investment portfolio with securities in each maturity range (e.g. monthly) over a specified period of time (e.g. five years).

Leverage: Investing with borrowed money with the exception that the interest earned on the investment will exceed the interest paid on the borrowed money.

Local Agency Investment Fund (LAIF): A voluntary investment program offering participating agencies the opportunity to participate in a major portfolio which daily invests hundreds of millions of dollars, using the investment expertise of the State Treasurer's Office investment staff at no additional cost to the taxpayer. Investment in LAIF, considered a short-term investment, is readily available for cash withdrawal on a daily basis.

Market Risk: Defined as market value fluctuations due to overall changes in the general level of interest rates. Adverse fluctuation possibilities shall be mitigated by limiting the maximum maturity of any one security to five years, structuring the portfolio based on historic and current cash flow analysis, and eliminating the need to sell securities prior to maturity. Also, avoiding the purchase of long term securities for the sole purpose of short-term speculation mitigates market risk.

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

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

Nominee: Registered owner of a stock or bond if difference from the beneficial owner, who acts as holder of record for securities and other assets. Typically, this arrangement is done to facilitate the transfer of securities when it is inconvenient to obtain the signature of the real owner, or the actual owner may not wish to be identified. Nominee ownership simplifies the registration and transfer of securities.

Pooled Investments: Grouping of resources for the advantage of the participants.

Portfolio: Collection of securities held by an investor.

Primary Dealer: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC) registered securities broker-dealers, banks and a few unregulated firms.

Prime Commercial Paper: Short-term IOU, or unsecured money market obligation, issued by prime rated commercial firms and financial companies, with maturities from 2 days up to 270 days. A promissory note of the issuer used to finance current obligations, and is a negotiable instrument.

Principal: (1) The face amount of par value of a debt instrument. (2) One who acts as a dealer buying or selling for his own account.

Secondary Market: A market is made for the purchase and sale of outstanding issues following the initial distribution.

Sweep Account: Short-term income fund into which all un-invested cash balances from the non-interest bearing checking account are automatically transferred on a daily basis.

Third-Party Custodian: Corporate agent, usually a commercial bank, who, acting as trustee, holds securities under a written agreement for a corporate client and buys and sells securities when instructed. Custody service includes securities safekeeping, and collection of dividends and interest. The bank acts only as a transfer agent and makes no buy-sell recommendations.

Trustee: (1) All governing bodies of local agencies or persons authorized (city investment officials) to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard. (2) A financial institution with trust powers that acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

U.S. Government Securities: Securities issued by the U.S. Government and its agencies which are either directly or indirectly backed by the full faith and credit of the United States. U.S. Government securities include Treasury Bills, Notes and Bonds. Agency securities include those issued by the Federal National Mortgage Association, Federal Home Loan Bank, and similar agencies.

Yield to Maturity: The rate of annual income return on an investment expressed as a percentage, adjusted for any discounts, and spread over the period from the date of purchase to the date of maturity.