City of Aliso Viejo
Statement of Investment Policy
For Fiscal Year 2019-20

As Adopted June 19, 2019

City Council

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Statement of Investment Policy

This Statement of Investment Policy ("Policy"), as set forth by the City of Aliso Viejo ("City"), provides the guidelines for prudent investment of the City's idle or reserve cash and outlines the policies essential to ensuring the safety and financial strength of the City's investment portfolio.

This Policy is based on the principles of prudent money management and conforms to all applicable Federal and State Laws governing the investment of public funds. In instances in which the Policy is more restrictive than Federal or State Law, the Policy will supersede.

Objectives

It is the policy of the City to invest public funds in a manner which will provide for the preservation of capital while meeting the daily cash flow requirements of the City and attaining a market average rate of return within an acceptable and defined level of risk.

The Policy has three primary objectives, in order of priority:

1. **Preservation of Capital (Safety)** – the protection of principal is the foremost consideration when undertaking investment decisions that affect public funds. The objective is to mitigate credit risk and interest rate risk.

Credit Risk

Credit Risk is the risk of loss of principal due to the failure of the security issuer. Credit Risk can be mitigated by:

- Limiting investments to the safest types of securities.
- Pre-qualifying accountants, auditors, financial institutions, broker/dealers, financial advisors, and other outside consultants with which the City does business.
- Diversifying the investment portfolio so that potential losses are minimized.

Interest Rate Risk

Interest rate risk is the risk that the market value of securities will fall due to a rise in general market interest rates. It is the policy of the City to hold individual securities to maturity in an effort to meet liquidity demands. Interest rate risk can be mitigated by:

- Holding individual securities to maturity - Structuring the investment portfolio so that securities mature to meet cash flow requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity.
- Employing a laddering strategy whereby staggering maturities of individual securities so that bonds come due in increments, assuring an overall liquidity pattern.
- Limiting maturities of individual securities and the average maturity of the overall portfolio.

2. **Liquidity** – the investment portfolio shall remain sufficiently liquid to meet all daily cash flow and operating requirements that may be reasonably expected or anticipated.

3. **Return or Yield** – attain a rate of return consistent with the primary objectives of safety and liquidity, throughout budgetary and economic cycles.

Scope of Funds

The investment policy applies to all financial assets and investment activities of the City, except for proceeds of debt issuance. Debt proceeds shall be invested in accordance with the "Permitted Investments" provisions for each specific bond indenture.

The Policy applies to the following funds and is accounted for in the City's annual audited financial statements.

A. General Fund

B. Special Revenue Funds

C. Debt Service Funds

D. Capital Improvement Funds

E. Enterprise Funds

F. Internal Service Funds

G. Agency Funds

Prudent Investor Standard

The standard to be used by investment officials shall be that of a "prudent person" and shall be applied in the context of managing all aspects of the City's investment portfolio

The Prudent Person Standard:

Governing bodies of local agencies or persons authorized 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. When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. Within the limitations of sections 16429.1 and 53600 through 53684 of the California Government Code and considering individual investments as a part of an overall strategy, a trustee is authorized to acquire investments as authorized by law.

Investment Philosophy

It is the investment philosophy of the City to make investment decisions based on an overall passive management style that embodies a prudent investor standard and such that investments are purchased with the intent to hold until maturity.

Accordingly, the City's conservative philosophy prohibits active trading and speculation; i.e., the purchase of securities with the intent to profit from favorable market changes in market prices or market conditions. Leveraging or borrowing money for the purpose of investing is specifically prohibited. However, 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 City needs.

Delegation of Authority

The City's Resolution No. 2003-018 appoints the Director of Financial Services to also serve as City Treasurer. The Treasurer, or his or her designee, has the authority to manage the City's investment portfolio in accordance with California Government Code Sections 53600 and 53630 *et seq*. and all related State and Federal laws.

The Treasurer will provide prior written notification to the City Manager and City Council regarding the designation of responsibilities.

The Treasurer shall establish written procedures for the operation and management of the City's investment portfolio consistent with this investment policy. The procedures should include reference to safekeeping, repurchase agreements, wire transfer agreements, banking service contracts, collateral or depository agreements, competitive bid process, and due diligence. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction, except as provided under the terms of this policy and the investment procedures established by the Treasurer and approved by the City Manager.

Public Trust

All participants in the investment process shall act as custodians of public funds. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. The overall program shall be designed and managed with a degree of professionalism that is worthy of public trust. In a diversified portfolio, it must be recognized that occasional measured losses are inevitable and must be considered in the context of the overall portfolio's investment return, provided that adequate diversification has been implemented.

Ethics and Conflicts of Interest

Elected officials and employees of the City 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 decisions under the Political Reform Act and Government Code Section 1090 *et seq*. Elected officials and employees shall disclose to the City Manager any material interests in financial institutions that conduct business with the City, and they shall further disclose any personal investment position or financial asset that could be related to the performance of the City's investment program. Elected officials and employees shall subordinate their personal investment transactions to those of the City particularly with regard to the time of purchases and sales.

Any firm proposing to provide any type of investment service to the City shall acknowledge their familiarity with the provisions of the Political Reform Act, Government Code Section 81000 *et seq*. and CA Code of Regulations 18110 *et seq*. and the provisions limiting contractual conflicts of interest under Government Code Section 1090 *et seq*. Any firm proposing to provide any type of investment service to the City shall also acknowledge their familiarity with and agree to abide by any Federal or State law, regulation, rule, or policy pertaining to or limiting campaign contributions by such firms, their employees, spouses, or agents.

All persons, firms, broker/dealers, financial institutions, and advisors providing investment services or bond issue assistance shall disclose to the City Manager and the Treasurer all fee sharing, fee-splitting, and commission arrangements with other entities or persons prior to the City agreeing to buy an investment or issue bonds.

Internal Investment Controls

The Treasurer will implement and maintain a system of internal investment controls and segregate responsibilities of investment functions in order to prevent fraud, theft, loss of principal, loss of control over funds, inaccurate reporting, and negligence.

The Treasurer will assign designee(s) to assist in carrying out these functions and will establish an Oversight Reviewer function that may be carried out by a designated member of staff, independent individuals, or independent expert contractor to perform specified tasks.

In addition to the specified requirements placed on investment types, quality, maturity, and diversification, further controls will include:

- **Safekeeping of Securities**

  To protect against losses caused by the collapse of individual securities dealers, all securities owned by the City are required to be held by a third-party safekeeping institution. Third-party safekeeping institutions may not act as custodians for any securities which that institution has issued or sold to the City.

  Collateral must be held at safekeeping, as defined in the Safekeeping and Custody section of the Policy.

  Payment procedures for all securities transactions will be Delivery v. Payment (DVP)

- **Competitive Bidding of Investments**

  The City's investment procedures require that approved broker/dealers compete for investment purchases and sales in order for the City to obtain the highest yield available in the market and to ensure that investment transactions are free from favoritism.

  Qualified Bids will be required for purchase of all investment transactions. The Treasurer shall select the best bid and is required to keep a record of each investment transaction. The Treasurer will rotate the purchase of investments among the pool of qualified broker/dealers.

- **Annual Management Review and Audit**

  An annual audit of the City's Investment Policy, practices, procedures, and portfolio status will be conducted by an independent auditor of all items including, but not limited to, items specified in the Audit Checklist provided in the City's Procedure Manual. The auditor will provide the City with written observations and recommendations regarding the adequacy of investment controls.

- **Segregated Investment Execution, Recordkeeping and Reporting**

  An independent member of City staff will record the Treasurer's investment records or confirmations to the City's general ledger. In addition, independent staff will perform the monthly reconciliation of bank, broker/dealer, and safekeeping confirmations.

- **Secondary Approval Required**

  The City Manager will review and approve the establishment of investment accounts, broker/dealer, and financial institution relationships and any agreements or contracts related to investments or investment related activity.

- **Wire Transfer Controls**

  All City wire transfers will be executed in accordance with a written agreement specifying control procedures required for wire transfers of funds, including the establishment of repetitive wires to pay for securities transactions with approved securities dealers as well as any other routine money transfers. All other non-repetitive wires require City Manager approval prior to release.

Investment Policy Adoption

The City Council's primary responsibilities over the investment function includes establishing investment policies, annually reviewing such policies, appointing a City Treasurer, reviewing quarterly investment reports issued by the Treasurer, authorizing bond documents and financing transactions, and adopting recommended changes to the City's Investment Policy as deemed necessary.

The City's investment policy shall be adopted by resolution of the City Council. The policy shall be reviewed annually by the City Council and any modifications made thereto must be approved the City Council.

Indemnification of Investment Officials

Any investment officer exercising his/her authority with due diligence, prudence, and care and in accordance with the Investment Policy and all written procedures shall be relieved of personal responsibility and liability for an individual security's losses or losses incurred by the portfolio. However, any investment officer also bears the responsibility of reporting deviations from expectations in a timely manner to City Council and appropriate action is taken to control adverse developments and mitigate loss of principal.

Investment Portfolio Compliance

Should the portfolio, for any reason, fall out of compliance with this Investment Policy, immediate liquidation of securities in order to bring the portfolio back into compliance will not be required. However, the Treasurer must take action to bring the portfolio into compliance within 12 months from the date the portfolio was determined to be in non-compliance with the provisions of this Investment Policy. Additionally, adequate disclosure of all instances of noncompliance, and the efforts undertaken to bring the portfolio into compliance, must be made on the monthly Treasurer's Report.

Reporting

The Treasurer shall submit a "Monthly Treasurer's Report" to the City Manager and City Council within 30 days following the last day of the month to be agendized for official action at a regular Council meeting thereafter. These reports shall disclose information relevant to the risk characteristics of the City's investment portfolio and shall include the following information:

Monthly Treasurer's Report

A. Cash receipts, disbursements, and balances in total.

B. A summary of the investment portfolio.

C. An asset list showing the issuer, type of investment, par value, maturity date, and interest rate.

D. Average rate of return on the City's investment portfolio.

E. Maturity aging grouped by type of investment.

F. Diversification of the investment portfolio.

G. A listing of individual investment transactions during the month, as required by Government Code section 53607.

H. A statement of ability to meet upcoming operating expenses and spending requirements for the next six months.

I. A statement of compliance with the Investment Policy, including a schedule of any transactions or holdings which do not comply with this policy or with the California Government Code, including a justification for their presence in the portfolio, and a timetable for resolution.

Annual Report

The annual report will be prepared by the City Treasurer and submitted to the City Manager each fiscal year to ensure consistency. The annual report will include an overall analysis of the portfolio and shall suggest policies and improvements to enhance the City's investment program. These enhancements will be annually considered by City Council and the authority to amend the Policy rests with City Council.

Authorized and Suitable Investments

Investment of City funds is governed by the California Government Code Sections 53600, 53601, 53601.5, 53601.6, 53635, and 53635.5 *et seq*. Within the context of the limitations, the following investments are authorized, as further limited herein:

Matrix of Suitable Investment Options and Restrictions				
Investment Type:	Maximum Maturity:	Maximum percentage of Portfolio:	Maximum Par Value per Issuer:	Credit Quality and Requirements:
U.S. Treasury Bills, Notes and Bonds	5 Years	75 percent	N/A	Explicit Full Faith and Credit Guarantee of United States Government
Federal Agency Obligations	5 Years	60 percent 35 percent / Agency	$7,000,000	Implied Guarantee of the United States Government
Bankers' Acceptances (BA's)	180 Days	20 percent	$3,000,000	Domestic banks only - deemed eligible for purchase by the Federal Reserve Bank
Certificates of Deposit or Time Deposits* (CD's)	5 Years	30 percent	$15,000,000	Senior debt only from top 15 percent of peer group rated banks, savings & loans and credit unions. Defined by Section 5102 of the Financial Code.
Negotiable Certificates of Deposit	5 Years	30 percent	$250,000	Brokered CD's insured by FDIC for a maximum of $250,000 per issuer.
Local Agency Investment Fund (LAIF)	N/A	100 percent	$50,000,000 (per entity)	Treasurer will review investment policies and practices to determine if consistent with the Policy
Commercial Paper	270 Days	20 percent	10% of portfolio	Highest letter and number rating as provided for by a nationally recognized statistical-rating organization (NRSRO)
Money Market Mutual Funds	N/A	10 percent	$10,000,000 (SEC Registered) ($1.00 NAV)	Highest rating from NRSRO. Must also comply with Govt. Code 53601(l) and 53601.6 (b) and the weighted average to maturity is less than 180 days.
Repurchase Agreements*	30 Days	10 percent	$2,000,000	Signed security loan agreement on file. Underlying securities maintained at 102% of original value. Reverse repurchase agreements are specifically not authorized under the Policy.
Medium Term Corporate Notes	5 Years	10 percent	$1,000,000	Rated "A" or better by a nationally recognized rating service.

* *Denotes a collateral requirement either initially, or at a pre-determined threshold. Please refer to Collateral section of the Policy for specific requirements.*

Ratings and Rating Agencies

When possible, two ratings should be obtained to determine if an investment meets the Policy's quality standard. Currently under this Policy, only Standard and Poor's (S&P) and Moody's Investor Service (Moody's) are recognized investment ratings providers, and the City has established the following minimum standards to be applied at time of purchase and for reporting purposes:

Investment Type:	Standard & Poor's	Moody's
Banker's Acceptances	**A1**	**P1**
Commercial Paper	**A1**	**P1**
Certificates of Deposit	**AA**	**Aa**
Money Market Mutual Funds	**AAA**	**Aaa**
Medium Term Corporate Notes	**AA**	**Aa1**
Repurchase Agreement – Provider	AA	Aa

Prohibited Investments

State and Federal laws notwithstanding, any investment not specifically described herein including, but not limited to, reverse repurchase agreements, derivatives, options, futures, zero coupon bonds, inverse floaters, range notes, first mortgages or trust deeds, collateralized mortgage obligations (CMO's), limited partnerships, real estate investments trusts (REIT's), open-end mutual funds, closed-end mutual funds, mutual funds with a weighted average maturity greater than 180 days, unregulated and/or uninsured investment pools, common stock, preferred stock, commodities, precious metals, securities with high price volatility, limited marketability (less than three active bidders), securities that may default on interest payments, and any other speculative investment deemed inappropriate under the Prudent Investor standard are strictly prohibited. In addition, any investment transaction that might impair public confidence in the Aliso Viejo City government is to be avoided.

Collateralization

Collateral for Certificates of Deposit (CD) and Negotiated Certificates of Deposit (NCD) must comply with Government Code, Chapter 4, Bank Deposit Law Section 16500 *et seq.* and the Savings and Loan and Credit Union Deposit Law Government Code Section 16600 *et seq*. In addition, if the CD is not FDIC insured or goes over the FDIC $250,000 limit, collateral is required equal to 100 percent of principal.

Collateral for Repurchase Agreements shall be 102 percent of market value of principal and accrued interest. Collateral can be either US Treasury securities or Federal Agency securities. This will provide an addition level of security due to inevitable changes in market conditions.

Collateral will always be held by an independent third party with whom the City has a current custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the City and retained. The right of collateral substitution is granted within the parameters and constraints of this Policy.

Investment Pools

Government sponsored investment pools (Pools) are permitted under California Government Code Section 53601 *et seq*. and are an excellent short-term investment option for cash management facilities. These pools can provide safety, liquidity, and yield in a single diversified investment. However, thoughtful investigation and due diligence are required both initially at time of purchase and on an ongoing basis with analysis to determine that the investment pool is being managed in a manner consistent with the objectives of the Policy. The following guidelines include, but are not limited to:

- The Pool shall have attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations, or shall be insured by a municipal insurance corporation.
- The Pool marks to market weekly at a minimum.
- The Pool provides comprehensive, timely monthly reports which include detailed transaction listings, report realized and unrealized gains and losses, provide accurate market values for each security, provide quality rating for individual securities, take delivery DVP, provide third party safekeeping of all investments, and for whom an audit is conducted annually by an independent auditor with no relationship to the Pool.

Money Market Mutual Funds

Money market mutual funds provide another safe, liquid, and diversified investment option for the City's surplus capital. However, certain conditions need to be met both initially and on an ongoing basis. The money market may only invest in US Government securities permitted under this policy and under California Government Code Section 53601 *et seq*. with final stated maturities of one year or less "Government Money Market Funds."

In order to be an eligible money market investment under this section, the primary objective of the money market, as stated in the funds prospectus, is to maintain a constant $1.00 Net Asset Value (NAV). The following additional guidelines include, but are not limited to:

- The money market only invests in US Government securities, and the weighted average maturity of the portfolio is less than 180 days.
- The fund shall be registered with the SEC.
- The money market shall have attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations and shall maintain these ratings for the duration of the investment.

Maturity Limits

The longer the maturity of securities, the greater the market volatility. Therefore, the maximum maturity limit for any given security in the investment portfolio shall not exceed five (5) years.

It is also important to note that specific investments, detailed under the "Authorized and Suitable Investments" section, may be restricted to a shorter maturity.

The weighted average life of the portfolio may not exceed three (3) years in duration.

At a minimum, 10 percent of the portfolio shall remain liquid, accessible on demand by the City without restriction or penalty.

The investment portfolio shall be structured for liquidity purposes; therefore, 25 percent of the portfolio shall not exceed a 90-day weighted average maturity.

Maturities will be selected based on a sufficiently detailed cash flow projection that facilitates selecting investment maturity dates to approximately match the projected dates of budgeted expenditures. Once cash flow needs are matched, maturities are selected based on a "laddering strategy" and the shape of the yield curve.

Extensions in the maximum maturity and average weighted life of the portfolio must be supported by detailed cash flow forecasts demonstrating the adequacy of cash from maturing assets to meet one hundred twenty-five percent (125%) of monthly expenditures for each prospective quarter, ending with the current maximum including capital expenditures funded on a pay-as-you-go basis. Recommendations to extend maturities must be reviewed and approved by the City Manager and City Council.

Qualifications for Financial Institutions and Broker/Dealer's

The Treasurer will maintain a list of qualified financial institutions and broker/dealers authorized to transact business with the City, as stated in Appendix "B". The financial entities eligible to transact investment business with the City are:

I. Federal Reserve Bank:

Direct purchase of U.S. Treasury Bills, Notes, and Bonds using primary government dealers as designated by the Federal Reserve are exempt from quality requirements and are encouraged due to commission or mark-up discounts.

II. Nationally or State Chartered Banks, Savings and Loans, and Credit Unions:

The City may purchase investments offered from Banks, Savings and Loans, and Credit Unions provided the institutions are:

- Nationally or State Chartered Institutions.
- Registered as investment securities dealers.
- Ranked in the top 15 percent of institutions within their respective peer group.
- The signatures of two individuals shall be required for the opening and closing of any bank account (the Treasurer, City Manager, Mayor, or Mayor Pro Tem). The Accounting Officer, who is independent of the investment function, shall keep a record of all opened and closed accounts. On an annual basis, the Accounting Officer shall provide a list of accounts to the independent auditor.

III. Broker/Dealers:

The City will purchase investments from primary dealers whenever possible. However, if an investment deemed appropriate for the portfolio is not available through the primary market, then the Treasurer may use an authorized broker/dealer from the pre-approved list of broker/dealers on record.

For a broker/dealer to be considered for placement on the pre-approved list, they must comply with the following:

- Primary or Regional dealers that qualify for SEC Rule 15c3-1
- Provide audited financial statements from the two most frequent years
- A statement certifying that the institution has reviewed the City's Investment Policy and California Government Code Section 53600 *et seq.* and that all securities offered to the City shall comply fully with all provisions of the Policy and the California Government Code.
- The signatures of two individuals shall be required for the opening and closing of any broker/dealer account (the Treasurer, City Manager, Mayor or Mayor Pro Tem). The Accounting Officer, who is independent of the investment function, shall keep a record of all opened and closed accounts. On an annual basis, the Accounting Officer shall provide a list of accounts to the independent auditor.
- Settlement of securities traded through qualified broker/dealers shall occur trade date plus three days (T3), the current industry standard.

  The Treasurer is responsible for ensuring that settlement occurs in a timely matter and that execution confirmations reflect accurate trade data. In addition, investment transactions are required to be Delivery v. Payment (DVP).

Diversification Guidelines and Risks

The City recognizes diversification is an investment strategy that will mitigate risk in the investment portfolio. The City's investment portfolio shall be diversified to avoid incurring unreasonable and avoidable risks with regard to specific investment types. Within investment types, the City shall also maintain a mix of securities to avoid concentrations within individual financial institutions, geographic areas, industry types, and maturities.

The City will only invest in fixed rate, fixed maturity securities and, with the exception of U.S. Treasury securities or the Local Agency Investment Fund (LAIF), no more than 60 percent of the investment portfolio shall be invested in any single investment type or financial institution.

Safekeeping and Custody

All security transactions, including collateral for repurchase agreements and certificates of deposit, shall be transacted on a Delivery vs. Payment (DVP) basis. This means that the securities shall be delivered to the City or the City's designated custodian upon receipt of payment by the City.

All securities that may be purchased, including collateral, shall be held by a third-party custodian designated by the Treasurer whenever possible. These securities shall be held in the City's name and control, and the third-party custodian shall be evidenced by safekeeping receipts. The third-party custodian shall send the City, on a monthly basis, a summary of safekeeping assets, and this statement shall be reconciled to the City's records on a monthly basis. Securities held in custody for the City shall be independently audited on an annual basis to verify investment holdings.

Performance Standards and Evaluation

Investment performance is continually monitored and evaluated by the City Treasurer. Investment activity reports are generated on a monthly basis for presentation to the City Manager and City Council.

The weighted average maturity of the pooled portfolio shall not exceed three years and shall be designated to attain a market average rate of return comparable to the average rate of return of the two-year U.S. Constant Maturity Treasury (CMT) as calculated by the Federal Reserve Bank of New York. As an added reference, the monthly average yield of the pooled portfolio will be compared to LAIF and the monthly average 6-month CMT, as calculated by the Federal Reserve Bank of New York.

In addition to the three-year maturity average, the portfolio shall be structured for liquidity purposes, and 25 percent of the investment portfolio shall not exceed 90 days weighted average maturity. The independent auditor will annually verify that the portfolio conforms to the maturity requirements described above.

An annual audit of the City's Investment Policy, practices, procedures, and portfolio status will be conducted by an independent auditor of all items including, but not limited to, items specified in the Audit Checklist provided in the City's Procedure Manual. The auditor will provide the City Manager and City Council with written observations and recommendations regarding the adequacy of investment controls.

Qualifications and Continuing Education

The City Treasurer shall be a City employee or contract employee. The Treasurer shall be selected on the basis of educational background and experience relevant to the Treasury function.

The City recognizes the need for and is committed to providing ongoing education specific to the investment function for the Treasurer and other City staff and officials involved in the investment process.

GLOSSARY OF TERMS

Accrued Interest - Interest earned but not yet received.

Active Deposits - Funds which are immediately required for disbursement.

Agencies - Federal agency securities and/or Government-sponsored enterprises.

Amortization - An accounting practice of gradually decreasing (increasing) an asset's book value by spreading its depreciation (accretion) over a period of time.

Asking Price - The price a broker/dealer offers to sell securities. See Offer

Bankers' Acceptance (BA) - A "draft" or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

Basis Point - One basis point is one hundredth of one percent (.01).

Bear Market - A period of generally pessimistic attitudes and declining market prices.

Bid - The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See Offer.

Bond - A financial obligation for which the issuer promises to pay the bondholder a specified stream of future cash flows, including periodic interest payments and a principal repayment.

Book Value - The value at which a debt security is shown on the holder's balance sheet. Book value is acquisition cost less amortization of premium or plus accretion of discount.

Broker - A broker brings buyers and sellers together for a commission.

Bull Market - A period of generally optimistic attitudes and increasing market prices.

Callables - Securities that the issuer has the right to redeem prior to maturity.

Certificate of Deposit - A time deposit with a specific maturity, evidenced by a certificate. Large-denomination CD's are typically negotiable. CD's may be eligible for FDIC insurance.

Collateral - Securities, evidence of deposit, or pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposit of public moneys.

Commercial Paper - Short-term, unsecured promissory notes issued by a corporation to raise working capital. These negotiable instruments are purchased at a discount to par value or at par value with interest bearing.

Comprehensive Annual Financial Report (CAFR) - The official annual financial report for the City. It includes government-wide and fund financial statements prepared in conformity with Generally Accepted Accounting Principals (GAAP).

Constant Maturity Treasury (CMT) - An average yield of a specific Treasury maturity sector for a specific time frame, or an index of the average yield on United States Treasury securities adjusted to a constant maturity. This is a market index for reference of past direction of interest rates for the given Treasury maturity range.

Coupon - The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value.

Credit Analysis - A critical review and appraisal of the economic and financial conditions or of the ability to meet debt obligations.

GLOSSARY OF TERMS (continued)

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

Custody - A banking service that provides safekeeping for the individual securities in a customer's investment portfolio under a written agreement which also calls for the bank to collect and pay out income, to buy, sell, receive, and deliver securities when ordered to do so by the principal.

Debenture - A bond secured only by the general credit of the issuer.

Delivery v. Payment (DVP) - Delivery of securities with a simultaneous exchange of payment for the securities.

Demand Deposit Account - Accounts whose balance is available to meet immediate cash needs (maturities up to 7 days).

Derivatives - (1) Financial instruments whose return profile is linked to, or derived from, the security and may include a leveraging factor, or (2) financial contracts based upon notional amount whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities, or commodities).

Discount - The difference between the cost of a security and its value at maturity when quoted at lower than face value.

Discount Securities - Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g., U. S. Treasury Bills.

Diversification - Dividing investment funds among a variety of securities offering independent return and risk profiles.

Duration - The weighted average maturity of a bond's cash flow stream, where the present value of the cash flows serves as the weights; the future point in time at which, on average, an investor has received exactly half of the original investment in present value terms; a bond's zero-coupon equivalent; the fulcrum of a bond's present value cash flow time line.

Fannie Mae - Trade name for the Federal National Mortgage Association (FNMA).

Federal Credit Agencies - Agencies of the Federal Government set up to supply credit to various classes of institutions and individuals, e.g., Savings and Loans, small business firms, students, farmers, farm cooperatives, and exporters.

Federal Deposit Insurance Corporation (FDIC) - Insurance provided to customers of a subscribing bank, which guarantees deposits to a set limit (currently $100,000) per account.

Federal Funds Rate - The rate of interest at which Federal funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

Federal Home Loan Banks (FHLB) – Government-sponsored wholesale banks which lend funds and provide correspondent banking services to member commercial banks, thrifty institutions, credit unions, and insurance companies. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

GLOSSARY OF TERMS (continued)

Federal Home Loan Mortgage Corporation (FHLMC) - The FHLMC was created under the Federal Home Loan Mortgage Act, Title III of the Emergency Home Finance Act of 1970 as a stockholder-owned government-sponsored enterprise. Freddie Mac, as the corporation is called, is charged with providing stability and assistance to the secondary home mortgage market by buying first mortgages and participation interests and reselling these securities in the form of guaranteed mortgage securities. Although agency obligations are not explicitly guaranteed by the federal government, the rating agencies believe that in the unlikely event of financial difficulties, the federal government will support the agency to the extent necessary to provide for full and timely payment on their securities.

Federal National Mortgage Association (FNMA) - FNMA, like GNMA, was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

Federal Open Market Committee (FOMC) - Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

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

Fed Wire - A wire transmission service established by the Federal Reserve Bank to facilitate the transfer of funds through debits and credits of funds between participants within the Fed system.

Freddie Mac - Trade name for the Federal Home Loan Mortgage Corporation (FHLMC).

Ginnie Mae - Trade name for the Government National Mortgage Association (GNMA).

Government National Mortgage Association (GNMA) - Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by the full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA, or FmHA mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

Inactive Deposits - Funds not immediately needed for disbursements.

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

Investment Agreements - An agreement with a financial institution to borrow public funds subject to certain negotiated terms and conditions concerning collateral, liquidity, and interest rates.

GLOSSARY OF TERMS (continued)

LAIF (Local Agency Investment Fund) - A special fund in the State Treasury which local agencies may use to deposit funds for investment. There is no minimum investment period, and the minimum transaction is $5,000, in multiples of $1,000 above that, with a maximum balance of $50,000,000 for any agency. It offers high liquidity because deposits can be converted to cash in 24 hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate share basis determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly. California Government Code §16429.3 states, in part:

> "money placed with the State Treasurer for deposit in the Local Agency Investment Fund by cities, counties, or special districts shall not be subject to impoundment or seizure by any state official or state agency."

Liquidity - Refers to the ability to rapidly convert an investment into cash with minimal risk of losing some portion of principal and/or interest.

Local Government Investment Pool (LGIP) - The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

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

Master Repurchase Agreement - A written contract covering all future transactions between the parties to repurchase and/or reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

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

Medium Term Corporate Notes - Unsecured promissory notes issued by a corporation organized and operating in the United States. These are negotiable instruments and are traded in the secondary market. Medium term corporate notes can be defined as extended maturity commercial paper. Local agencies are restricted by the Government Code to investments in corporations rated in the top three note categories by Moody's Investors Service, Inc., and/or Standard and Poor's Corporation. For medium term notes, eligible purchases consist of instruments that have a rating of "A" or better by both Moody's Investors Service, Inc., and Standard and Poor's Corporation.

Money Market - The market in which short-term debt instruments (bills, commercial paper, banker's acceptances, etc.) are issued and traded.

Negotiable Certificates of Deposit - Unsecured obligations of the financial institution, or bank, bought at par value with the promise to pay face value plus accrued interest at maturity. They are high-grade negotiable instruments, paying a higher interest rate than regular certificates of deposit. The primary market issuance is in multiples of $1,000,000; the secondary market usually trades in denominations of $500,000, although smaller lots are occasionally available. As a matter of practice, only the ten largest U.S. banks where there is a secondary market established for continued liquidity would be considered for investment.

GLOSSARY OF TERMS (continued)

NRSRO - Nationally recognized statistical-rating organization

New Issue - Term used when a security is originally "brought" to market.

Offer - The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asking Price and Bid.

Open Market Operations - Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserve into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

Paper Gain or Loss - Term used for unrealized gain or loss on securities being held in a portfolio based on comparison of current market quotes and their original cost. This situation exists as long as the security is held while there is a difference between cost value (book value) and the market value.

Perfected Delivery - Refers to an investment where the actual security or collateral is held by an independent third party representing the purchasing entity.

Portfolio - Collection of securities held by an investor.

Primary Dealer - A group of government securities dealers that submit daily reports of market activity and security positions held to the Federal Reserve Bank of New York and are subject to its informal oversight.

Prudent Person Rule - An investment standard. In some states, the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state - the so-called legal list. In other states, the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

Purchase Date - The date in which a security is purchased for settlement on that or a later date.

Qualified Public Depositories - A financial institution that does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less approved by the Public Deposit Protection Commission to hold public deposits.

Rate of Return - The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.

Repurchase Agreement (RP or REPO) - A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money, or increasing bank reserves.

GLOSSARY OF TERMS (continued)

Reverse Repurchase Agreement (Reverse REPO) - A transaction where the seller (City) agrees to buy back from the buyer (bank) the securities at an agreed upon price after a stated period of time.

Risk - Degree of uncertainty of return on an asset.

Safekeeping - See Custody.

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

Securities and Exchange Commission - Agency created by Congress to protect investors in securities transactions by administering securities legislation.

SEC Rule 15(C)3-1 - See Uniform Net Capital Rule.

Settlement Date - The date on which a trade is cleared by delivery of securities against funds.

Spread - a) The yield or price difference between the bid and offer on an issue; b) the yield or price difference between different issues.

Structured Notes - Notes issued by government-sponsored enterprises (FHLB, FNMA, etc.) and corporations that have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) in their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options, and shifts in the shape of the yield curve.

Swap - The sale of one issue and the simultaneous purchase of another for some perceived advantage.

Treasury Bills - A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

Treasury Bonds - Long-term coupon-bearing U. S. Treasury securities issued as direct obligations of the U. S. Government and having initial maturities of more than ten years.

Treasury Notes - Medium-term coupon-bearing U. S. Treasury securities issued as direct obligations of the U. S. Government and having initial maturities from two to ten years.

Uniform Net Capital Rule - Securities and Exchange Commission requirement that member firms, as well as nonmember broker-dealers in securities, maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

U.S. Government Agencies - Instruments issued by various U.S. Government Agencies, most of which are secured only by the credit worthiness of the particular agency.

Yield - The rate of annual income return on an investment, expressed as a percentage. It is obtained by dividing the current dollar income by the current market price of the security.

Yield to Maturity - The rate of income return on an investment, minus any premium or plus any discount, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond, expressed as a percentage.

QUALIFIED BROKER/DEALERS

The City has qualified the following Broker/Dealer's:

- Cantella & Co. Inc
- Great Pacific Securities
- Higgins Capital
- Morgan Stanley
- Multi-Bank Securities, Inc
- Mutual Securities, Inc
- Raymond James & Associates, Inc.
- Time Value Investments
- UBS Financial Services, Inc
- Wedbush Securities

ADMINISTRATIVE POLICY

Investment Guidelines, Strategy, and Internal Control

City of Aliso Viejo

ADMINISTRATIVE POLICY

SUBJECT	APPROVED BY:	PROCEDURE NO.	EFF. DATE	PAGE
INVESTMENT GUIDELINES, STRATEGY AND INTERNAL CONTROL	Dave Doyle CITY MANAGER	**11**	**7/1/2015 Rev 7/1/2017**	**1 of 4**

PURPOSE

The purpose of this policy is to establish a framework for the investment of surplus City funds within the established internal control procedures for treasury functions.

POLICY

INVESTMENT GUIDELINES AND STRATEGY

GUIDELINES

1. Investment Transaction - Every investment transaction must be authorized and reviewed by the Director of Finance/City Treasurer or his/her designee.

2. Pooled Cash - Whenever practical, local agency cash is consolidated into one bank account and invested on a pooled concept basis. Interest earnings are allocated monthly according to month-end cash and investment balances for each fund.

3. Competitive Bids - Purchases and sales of securities are made on the basis of competitive offers and bids.

4. Cash Forecast - The cash flow for the City is analyzed with the receipt of revenues and maturity of investments scheduled so that adequate cash will be available to meet disbursement requirements.

5. Investment Limitations - Security purchases and holdings are maintained within statutory limits imposed by the California Government Code.

6. Liquidity - The marketability of a security is considered at the time of purchase, as the security may have to be sold at a later date to meet unanticipated cash demands.

7. Diversification - The portfolio should consist of various types of securities, issuers, and maturities.

STRATEGY

1. Economic Forecasts - Economic Forecasts are obtained periodically from economists and financial experts through bankers and brokers to assist the Director of Finance/City Treasurer or his/her designee with the formulation of an investment strategy for the local agency.

2. Implementing Investment Strategy - Investment transactions are executed to conform to anticipated interest rate trends and the current investment strategy plan.

3. Rapport - A close working relationship is maintained with public works, city staff, and large vendors of the city. The objective is to pinpoint when large disbursements will clear the City's bank account. It is essential for good cash control that such large expenditures be anticipated, estimated as to dollar amount, and communicated to the Director of Finance/City Treasurer or his/her designee for liquidity planning purposes.

4. Preserve Portfolio Value - Field standards are developed in order to maintain earnings near the market and to preserve the value of the portfolio.

INTERNAL CONTROL

I. OBJECTIVES OF INTERNAL CONTROL

1. To effectively and efficiently conduct business, including adherence to financial and management policies.
2. Safeguarding its assets and prevention or detection of errors and fraud.
3. Timely preparation of accurate and reliable financial information.
4. Compliance with applicable laws and regulations.

II. COMPONENTS OF INTERNAL CONTROL

1. Control Environment - The control environment is the set of standards, processes, and structures that provides the basis for carrying out internal control across the organization. Management establishes the tone at the top regarding the importance of internal control, including expected standards of conduct, organizational structure, and assignment of authority and responsibility.

2. Risk Assessment - Risk assessment involves a dynamic process for identifying and analyzing risks in achieving the entity's objectives. Risk assessment requires management to consider the impact of possible changes in the internal and external environment that may render established internal controls ineffective.

3. Control Activities - Control activities are the actions established through policies and procedures to ensure that management's directives to mitigate risks are achieved. Segregation of duties is typically built into the development of control activities and may include authorizations, verifications, reconciliations, and reviews.

4. Communication - Communication occurs both internally and externally and provides the organization with the information needed to carry out day-to-day activities.

5. Audits – Audits are the process through which activities can be monitored and evaluated for any internal control deficiencies and communicated to management for taking corrective action.

III. ELEMENTS OF INTERNAL CONTROL

1. Organization - Responsibility for the performance of duties should be assigned and lines of authority and reporting clearly identified and delineated.

2. Segregation of functions - Segregation of functions reduces the risk for an individual to be able to perpetrate and conceal errors or commit fraud in the normal course of duty. If two parts of a transaction are handled by different individuals, collusion is necessary to conceal errors or commit fraud. Functions that should be considered when evaluating segregation of duties are authorization, execution, recording, custody of assets, and reconciliation.

3. Authorization - All transactions should be approved by an authorized individual. The responsibilities and limits of authorization should be clearly delineated. The individual or group authorizing a specific transaction or granting general authority for transactions should be in a position commensurate with the nature and significance of the transactions.

4. Controls over an accounting system - Controls over an accounting system include the procedures, both manual and computerized, carried out independently to ascertain that transactions are complete, valid, authorized, and properly recorded.

IV. LIMITATIONS OF INTERNAL CONTROL

Internal control, no matter how well-designed, implemented, and conducted, can only provide reasonable assurance to management of the achievement of an entity's objectives. Inherent limitations of internal control may include:

1. Recurring, rather than unusual, types of transactions.
2. Human error due to misunderstanding, carelessness, fatigue, or distraction.
3. Potential for collusion that circumvents controls defined by the segregation of functions.
4. Possibility of a management override of the system, despite an otherwise effective system of internal control.

SEGREGATION OF RESPONSIBILITIES FOR TREASURY FUNCTIONS

Function	Responsibility
1. Formal investment policy should be	
* Prepared by	Director of Finance/City Treasurer
* Approved by	City Council
2. Develop Investment Strategy	Director of Finance/City Treasurer or Registered Investment Advisor
3. Receive quotes and recommend investments for purchase	Director of Finance/City Treasurer, Financial Services Manager
4. Approve investment transactions	Director of Finance/City Treasurer, City Manager
5. Execute investment transactions	Director of Finance/City Treasurer
6. Approve investment transactions for compliance with Investment policy and/or State law	Financial Services Manager
7. Record investment transactions in the City's financials	Financial Services Manager/Financial Analyst
8. Verify investment i.e., match broker confirmation to City records	Director of Finance/City Treasurer Financial Services Manager
9. Confirm LAIF and Bank Wires	Director of Finance/City Treasurer Financial Services Manager/Financial Analyst
10. Safeguard assets and records:	
* Reconciliation of City's records to bank statements and safekeeping of records	Financial Services Manager/Financial Analyst
* Annual review of (a) financial institution's financial condition, and (b) safety, liquidity, and potential yields of investment instruments	Director of Finance/City Treasurer, City Manager
11. Annual review of investment portfolio	External Independent Auditors

The segregation of responsibilities as outlined herein is intended to enhance the City's internal controls over treasury functions. It should be noted that from time to time, due to the limited size of the Financial Services staff, segregation of responsibilities may be amended in order to fulfill the business needs of the organization.