



INVESTMENT POLICY: ANNUAL STATEMENT

A. Purpose, Authority, Scope and Prudence

- **Purpose** It is the policy of the City of Santa Clara (City) to invest public funds, including bond proceeds, reserves and other special City funds, in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the City and conforming to all state and local statutes governing the investment of public funds.
- **Authority** Article IX, Section 904 of the City of Santa Clara Charter gives the Director of Finance the authority and responsibility to deposit and invest all City funds. It authorizes the Director to invest City's idle cash in allowable investment vehicles with a maximum remaining maturity of five years at the time of purchase. The City Council may grant express authority either specifically or as part of an approved investment program to invest in vehicles with remaining maturity that exceeds the five-year restriction. Authority must be given to the Director at least three months prior to the investment. California Government Code Section 53601 also allows the City to invest in the same investment vehicles as authorized by the City Council.
- **Scope** This policy applies to all assets of the City, its subsidiaries, the Redevelopment Agency and the Sport and Open Space Authority. These funds are accounted for in the City's Comprehensive Annual Financial Report and include the General Fund, Special Revenue Funds, Debt Service Funds, Capital Project Funds, Trust and Agency Funds, and Enterprise Funds.
- **Prudence** 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.

The standard of prudence to be used by investment officials shall be the “prudent person” and/or “prudent investor” standard and shall be applied in the context of managing an overall portfolio. Investment officers 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 or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

B. Investment Objectives and Criteria

The primary objectives, in priority order, of the City's investment activities shall be:



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

- **Safety.** Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, the City will diversify its investments by investing funds among a variety of securities offering independent returns and financial institutions.
- **Liquidity.** The investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements, which might be reasonably anticipated.
- **Return on Investment.** The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow characteristics of the portfolio.

C. Delegation of Authority

Authority to manage the City's investment program is derived from the City Charter. Management responsibility for the investment program is hereby delegated to the Director of Finance who shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials and their procedures in the absence of the Director of Finance.

The Director of Finance shall establish written investment policy procedures for the operation of the investment program consistent with this policy. The procedures should include reference to: safekeeping, PSA repurchase agreements, wire transfer agreements, banking service contracts and collateral/depository agreements. 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 procedures established by the Director of Finance.

D. Ethics and Conflicts of Interest

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 impair their ability to make impartial investment decisions. Employees and investment officials shall disclose in their annual conflict of interest statement all material financial interests in financial institutions that conduct business within the City, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City.



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

E. Authorized Financial Dealers and Institutions

The Director of Finance 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 & Exchange Commission Rule 15C3-1 (uniform net capital rule). No public deposit shall be made except in a qualified public depository as established by State laws.

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must provide audited financial statements, proof of required licenses or registration, and written confirmations of having read and abide by the City's investment policy.

Financial conditions and registrations of financial institutions and broker/dealers that deal with the City shall be reviewed periodically by the Director of Finance.

F. Authorized and Suitable Investments

Special care must be taken to ensure that the list of instruments includes only those allowed by law and those that local investment managers are trained and competent to handle. The City is empowered by the State of California Government Code and the City Charter to invest in the following types of securities. Additionally, bond proceeds are invested in accordance with the requirements outlined in the specific Bond Indenture of Trust.

- **U.S. Treasury Bills, Notes and Bonds** issued by the U.S. Treasury, local agencies, federal agencies such as the Federal Home Loan Bank (FHLB), the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), the Federal Farm Credit Bank (FFCB), and other U. S. government-sponsored enterprises.
- **Negotiable Certificates of Deposit** issued by a nationally or state-chartered bank or by a state-licensed branch of a foreign bank. Purchases may not exceed 30% of City's idle funds.
- **Bankers Acceptances** of any domestic or foreign commercial bank which are acceptable to the Federal Reserve. Purchases may not exceed 180 days maturity or 40% of idle funds that may be invested.
- **Commercial Paper** of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided by Moody's Investors Service, Inc., Standard and Poor's Corporation, or Fitch Financial Services, Inc. Eligible paper is further limited to paper issued by any U.S. corporation having total assets in excess of \$500 million and having an



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

“A” or higher rating for the issuer’s debt. Purchases of eligible commercial paper may not exceed 270 days maturity nor represent more than 10% of the outstanding paper of an issuing corporation. Total commercial paper may not exceed 25% of City’s idle funds.

- **Local Agency Investment Fund of the State of California.** Purchases may not exceed \$40 million per account.
- **Repurchase Agreements** can be entered subject to requirements of the California Government Code Sections 53601(i). A Master Repurchase Agreement must be signed with the bank or dealer. The market value of securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly.
- **Reverse Repurchase Agreements.** Reverse repurchase agreements can be entered with the prior approval of the City Council and subject to requirements of the California Government Code Sections 53601(i).
- **Tax Exempt Securities** purchased for yield restriction purposes.
- **Negotiable Certificates of Deposit** issued by nationally or state-chartered banks and savings associations, a state or federal credit union, or a state-licensed branch of a foreign bank.
- **Medium Term Corporate Notes** issued by corporations doing business in the United States with remaining maturity less than five years at time of purchase. These corporations must be rated in the top three rating categories by two of the three largest nationally recognized rating services. Purchases may not exceed 15% of idle funds.
- **Mutual Funds and Investment Pools** consisting of investment vehicles permitted under Sections 53601 and 53635 of the California Government Code. To be eligible for City investments, companies providing mutual funds shall have either of the following:
 1. The highest rating provided by not less than two of the three largest nationally recognized rating services.
 2. An investment advisor registered with the Securities and Exchange Commission for not less than five years having investment experience in the underlying securities and with assets under management in excess of \$500 million.
 3. The purchase price of the shares shall not include any commission that these companies may charge, and investment



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

in mutual fund should not exceed 20% of the City's portfolio and may not exceed 10% in any one mutual fund.

A thorough investigation of the pool/fund is required prior to investing, and on a continual basis. Evaluation shall include creditworthiness, size, safety, ease of investment liquidation, frequency of earnings distributions, frequency of account statements, and investment portfolio strategy.

- **Joint Powers Authority Investment Pools** organized pursuant to Section 6509.7 that invests in the securities and obligations under Sections 53601 of the California Government Code. To be eligible for City investments, the joint powers authority issuing the shares shall have retained an investment adviser that meets all of the following criteria:
 1. The adviser is registered or exempt from registration with the Securities and Exchange Commission.
 2. The adviser has not less than five years of experience investing in the securities and obligations authorized in under Section 53601.
 3. The adviser has assets under management in excess of five hundred million dollars (\$500,000,000).

G. Collateralization

Collateralization of marketable securities will be required on certificates of deposit and repurchase agreements in accordance with California Government Code Section 53601. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be at least 102% of market value of principal and accrued interest.

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

H. Safekeeping and Custody

All security transactions, including collateral for repurchase agreements, entered into by the City shall be conducted on a delivery-versus-payment (DVP) basis. Securities shall be held by a third party custodian designated by the Director of Finance and evidenced by safekeeping receipts.



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

I. Diversification

The City will diversify its investments by security type and institution. With the exception of U.S. Treasury and Federal Agencies securities, and unless stated elsewhere in this policy statement, no more than 5% or the maximum percentage allowed under the California Government Code Section 53601 of the City's idle funds shall be invested in a single security type or with a single financial institution. No more than 10% may be invested in any one mutual fund.

J. Maximum Term of Investment

To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than five years from the date of purchase without Council approval. Effective May 25, 1998, the City Council has authorized staff to purchase securities with maturities greater than five years, specifically for the Electric Cost Reduction Fund.

Reserve funds may be invested in securities exceeding five years if the maturity of such investments is made to coincide as nearly as practicable with the expected use of the funds.

K. Internal Control

The Director of Finance shall establish a process of independent review by an external auditor. This review shall provide internal control by assuring compliance with policies and procedures.

L. Performance Standard

The investment portfolio shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles commensurate with investment risk constraints and the cash flow needs.

M. Reporting

The Director of Finance shall provide monthly investment reports to the City Council. The reports shall contain, but not limited to, the following:

- A listing of individual securities held at the end of the reporting period by authorized investment category
- The return of unrestricted investment portfolio
- Final maturity of all investment listed
- Coupon, discount or earnings rate



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

- Par value, amortized book value and market value
- Percentage of the portfolio represented by each investment category

N. Investment Policy Adoption

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 by the City Council.

GLOSSARY

AGENCIES: Federal agency securities and/or Government-sponsored enterprises.

ASKED: The price at which securities are offered.

BANKERS' ACCEPTANCE (BA): A draft or bill of exchange accepted by a bank of trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

BID: The price offered by a buyer of securities. (When you are selling securities you ask for a bid.) See offer.

BROKER: A broker brings buyers and sellers together for a commission.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

COMMERCIAL PAPER: Short-term obligations with maturity ranging from 2 to 270 days issued by banks, corporations, and other borrowers to investors with temporarily idle cash. Such instruments are unsecured and usually discounted, although some are interest-bearing.

COUPON: Interest rate on a debt security the issuer promises to pay to the holder until maturity, expressed as an annual percentage of face value.

DEBENTURE: A bond secured only by the general credit of the issuer.

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

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

DISCOUNT: The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT RATE: Interest rate that the Federal Reserve charges member banks for loans, using government securities or eligible paper as collateral.

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.

DISCOUNT YIELD: Yield on a security sold at a discount.

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

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits.

FEDERAL FUNDS RATE: The rate of interest at which Fed 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, thrift 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.

FEDERAL FARM CREDIT BANK (FFCB): A government-sponsored institution that consolidates the financing activities of the Federal Land Banks, the Federal Intermediate Credit Banks, and the Banks for Cooperatives.

FEDERAL HOME LOAN MORTGAGE CORPORATION (FHLMC): A publicly chartered agency that buys qualifying residential mortgages from lenders, packages them into new securities backed by those pooled mortgages, provides certain guarantees, and then resells the securities on



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

the open market. FHLMC's stock is owned by savings institutions across the U.S. and is held in trust by the FHLB System.

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: 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 United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae): 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 holders are 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.

GUARANTEED INVESTMENT CONTRACT (GIC): A contract between an insurance company and a corporate profit-sharing or pension plan that guarantees a specific rate of return on the invested capital over the life of the contract.

IDLE FUNDS: Money in the treasury not required for the immediate needs of the local agency.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

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--reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement often specifies, 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.

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

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked 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 reserves 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.

PORTFOLIO: A combined holding of a variety of investments. The purpose of a portfolio is to reduce risk by diversification.

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

PRIMARY MARKET: A market for new issues of securities. A market is primary if the proceeds of sales go to the issuer of the securities sold.

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.



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which 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 eligible collateral having a value of not less than its maximum liability and which has been 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.

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/her for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money, that is, increasing bank services.

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

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 15C3-1: See Uniform Net Capital Rule

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations that have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) into 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.

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 maturity more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturity from two to 10 years.



INVESTMENT POLICY: ANNUAL STATEMENT (cont.)

UNIFORM 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 the 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.

YIELD: The rate of annual income return on an investment, expressed as a percentage.

(a) **INCOME YIELD** is obtained by dividing the current dollar income by the current market price for the security. (b) **NET YIELD** or **YIELD TO MATURITY** is the current income yield minus any premium above par or plus any discount from par in the purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

Reference: *Annual Statement for 2005, Approved by City Council*