

# CITY OF VERNON



## ANNUAL STATEMENT OF INVESTMENT POLICY FISCAL YEAR 2025/2026~~2024/2025~~

Alice Hui~~Joaquin Leon~~  
Director of Finance/City Treasurer~~Deputy City Treasurer~~

July 1, 2025~~2024~~

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## **0.0 PREFACE**

This Annual Statement of Investment Policy (the "Investment Policy") sets forth the course of action necessary to guide the decision-making of the City Council, and to the extent authorized under Section 4.0 hereof, City Treasurer and all persons authorized to make investment decisions on behalf of the City of Vernon (the "City") in the administration of the City's investment portfolio.

While some portions of this Investment Policy are a restatement of the laws of the State of California (the "State"), it is viewed that these restatements are integral to the purpose and flow of this Investment Policy. In most instances the use of future tense throughout this Investment Policy is intended to mean a continued practice or a practice which shall be continued.

The following statements are intended to ensure the achievement of the purpose, the goals and objectives in an orderly and accurate manner. However, there is no guarantee that problems, errors or losses will not arise in the course of administering the investment of idle or surplus funds.

Among the obstacles and deterrents in achieving the goals and objectives of the portfolio are: unforeseen national or international events or crises, deviation of actual cash flow from forecasted cash flow, unforeseen demands on cash flow, policies made with regard to investment in local depositories, errors in data or advice used to make decisions, as well as any other unanticipated event that may have an effect on local, national or international financial markets, economies or politics which in turn has a decided effect upon the portfolio.

This Investment Policy is designed to achieve, keeping in mind the obstacles and deterrents in pursuing portfolio goals and objective, the safety of the principal of all City funds, consistent with limited risk and prudent investment practices.

## **1.0 SCOPE**

This Investment Policy governs the deposit, safekeeping and investment of the funds of the Treasury, as well as all related transactions and investment activities. The investment of bond proceeds and amounts held under indentures and other security agreements with respect to bonds as provided in Section 6.12 will be governed by the provisions of the relevant bond documents.

## **2.0 PURPOSE**

The purpose of the Investment Policy is to facilitate accomplishment of the goals and objectives of the Treasurer with regard to the investment of surplus funds (funds not required for the immediate needs of the City), to provide a framework within which to carry out the business of administering and investing the surplus funds of the Treasury, and to improve communications at all levels between those involved and those interested in the process of investing and administering the surplus funds of the Treasury.

## **3.0 OBJECTIVE**

### **3.1 Legal Compliance**

All investments shall be made in accordance with this Investment Policy, California Government Code Section 53600 et seq., and any forthcoming amendments or additions to the California Government Code in relation to the investment of local agency surplus funds.

### **3.2 Prudence**

The administration of surplus funds of the City Treasurer, as a fiduciary trustee, shall be performed in accordance with the prudent investor standard pursuant to California Government Code Section 53600.3.

The City Treasurer and the City Council of the City and all persons authorized to make investment decisions on behalf of the City are "trustees" and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee of the City shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the City, 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 satisfy the liquidity needs of the City. Within the limitations of this Investment Policy and Section 53600.3 of the California Government Code and considering individual investments as part to an overall strategy, the City Treasurer and all persons authorized to make investment decisions on behalf of the City are authorized to acquire investments as authorized by law.

As prudence shall be applied in the context of portfolio management, investment officers and their advisors, acting in accordance with written procedures and exercising due diligence, shall report deviations from expectation in an individual security's performance to the Treasurer in a timely fashion evaluate and appropriate action to be taken to control adverse developments.

### **3.3 Investment Criteria Goals**

The Treasurer's primary goals for the investment of surplus funds (in the City's Treasury or monies in a sinking fund) are, in order of priority pursuant to California Government Code Section 53600.5:

- 3.3.1 **Safety** -- Safety of capital shall mean the safeguarding of capital through the selection of investments and investing procedures to best protect against loss, whether arising from various investment risks (such as interest rate risk, market risk, counterparty risk, etc.) or from default, fraud, or error.
- 3.3.2 **Liquidity** -- The City's portfolio shall be invested so as to always have the ability to convert sufficient securities in the portfolio to cash, with little or no loss in value, to cover cash flow needs of the City to meet contingency needs.

- 3.3.3 Yield -- Yield refers to earning a reasonable rate of return and shall take into consideration current market conditions, the present phase of the market cycle, both present and future cash flow needs, and the other primary goals of Safety and Liquidity.

### **3.4 Performance Measurement**

The investment portfolio will be managed in accordance with the parameters specified within this Investment Policy. The methods of measuring investment performance and performance benchmarks shall be articulated in the internal policies of the City Treasurer's Department.

### **3.5 Maintenance of Public Trust**

As the Treasurer has been entrusted with the safekeeping of public monies received from all sources, the Treasurer, in managing the investment portfolio, shall exercise a high degree of professionalism to ensure and sustain public confidence, remembering that both the investment instruments and the methods of transacting investment business are subject to public review and scrutiny.

## **4.0 DELEGATION OF AUTHORITY**

The management responsibility for the City's investment program is hereby delegated to the City Treasurer in accordance with California Government Code Section 53607. Pursuant to California Government Code Sections 53601, the City Treasurer shall be responsible for the investment of the City's funds (including the purchase, sale, or exchange of securities), the monitoring and reviewing of all investments for consistency under this Investment Policy, and the establishment of a system of controls to regulate the activities of subordinate officials.

The Treasurer shall have the responsibility to execute investment transactions on a day to day basis. When circumstances warrant, the responsibility to execute investment transactions may be delegated to the Deputy City Treasurer or to the City Treasurer's authorized designee. Each and every transaction must be approved by the City Treasurer. However, the City Council hereby authorizes the Deputy City Treasurer, in the absence of the City Treasurer, to report directly to the City Council, subject to the provisions of the Charter of the City of Vernon, or the Code of the City of Vernon, or as prescribed by the City Council and to assume such other powers, duties and responsibilities of the City Treasurer as necessary concerning investment transactions or any other transaction provided for under the laws of the State of California, the Government Code of the State of California and such other powers and duties as prescribed by resolutions or ordinances adopted by the City Council.

Any persons authorized to make investment decisions on behalf of the City, shall be subject to daily oversight and monitoring by the City Treasurer or the Treasurer's Office in order to insure full and complete compliance with this Investment Policy and the Government Code of the State of California, relating to the deposit and investment of funds and local agency finances.

NO PERSON MAY ENGAGE IN AN INVESTMENT TRANSACTION EXCEPT AS PROVIDED UNDER THE LIMITS OF THIS POLICY.

## **5.0 INVESTMENT PROGRAM**

### **5.1 Investment in Long Term Securities**

The City Treasurer and the authorized designees of the City Treasurer shall actively manage the City's portfolio of investments in order to take advantage of changing economic conditions and to insure that the liquidity needs of the City are satisfied. As part of the City's investment program, the City Treasurer has the express authority to make investments in securities that have a term, or a term remaining to maturity, at the time of investment, in excess of five years, as long as such investments, taken in the aggregate in relation to the City's entire investment portfolio, do not adversely impact the ability to satisfy the liquidity needs of the City and its funds and enterprises.

Notwithstanding anything contained in this Investment Policy to the contrary, it is the policy of the City to limit the investment of money in the Electric Fund, including operating, reserve and surplus funds, in an amount up to one hundred million dollars (\$100,000,000), to investments otherwise permitted for such Fund under this Investment Policy which mature no later than five years from the time of such investment.

### **5.2 Active Portfolio Management**

The City Treasurer has the express authority to sell, as he deems prudent, any securities in the City's portfolio of investments prior to the maturity date of the particular security. The City Treasurer has the express authority to invest in, as he deems prudent, any security authorized by this Investment Policy with the objective of selling that same security prior to its maturity date. The City Treasurer's authority to buy and sell securities for investment on behalf of the City includes the authorization to buy and sell the same security on the same trading day.

## **6.0 INSTRUMENTS AUTHORIZED FOR INVESTMENT**

The City, having money in a sinking fund of, or surplus money in, its treasury not required for the immediate needs of the City may invest any portion of the money that it deems wise or expedient in those investments set forth below. If the City purchases or obtains any securities prescribed in this Section 6.0, in a negotiable, bearer, registered, or nonregistered format, the City shall require delivery of the securities to the City, including those purchased for the City by financial advisors, consultants, or managers using the City's funds, by book entry, physical delivery, or by third party custodial agreement. The transfer of securities to the Counterparty bank's customer book entry account may be used for book entry delivery. For purposes of this Section 6.0, "Counterparty" means the other party to the transaction. A Counterparty bank's trust department or separate safekeeping department may be used for the physical delivery of the security if the security is held in the name of the City.

Investments may be made in any security authorized by this Section 6, and by Section 53601 of the California Government Code, that has at the time of investment, a term, or a term remaining to maturity, in excess of five years, as long as such investment comports with the policies and objectives of this Investment Policy and the provisions of the California Government Code.

### **6.1 Bonds Issued by the City**

Bonds issued by the City, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the City or by a department, board, agency, or authority of the City.

### **6.2 United States Treasury Bonds**

United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

### **6.3 Bonds of the State of California**

Registered State warrants or treasury notes or bonds of the State, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the State or by a department, board, agency, or authority of the State.

### **6.4 Bonds of State of California Local Agencies**

Bonds, notes, warrants, or other evidences of indebtedness of any local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.

### **6.5 Obligations Issued by Federal Agency or United States Government - Sponsored Enterprises**

Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments, issued by, or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises.

### **6.6 Bills of Exchange**

Bankers' acceptances otherwise known as bills of exchange or time drafts that are drawn on and accepted by a commercial bank. Purchases of bankers' acceptances may not exceed 180 days maturity or 40 percent of the City's surplus money that may be invested pursuant to this Section 6. However, no more than 30 percent of the City's money may be invested in the bankers' acceptances of any one commercial bank pursuant to this Investment Policy.

### **6.7 Commercial Paper**

Commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by Moody's Investors Service, Inc. ("Moody's"), or the Standard & Poor's Corporation ("S&P") or Fitch Financial Services, Inc. ("Fitch"). The corporation that issues the commercial paper shall be organized and operating within the United States, shall have total assets in excess of five hundred million dollars (\$500,000,000) and shall issue debt, other than

commercial paper, if any, that is rated "A" or higher by Moody's, S&P or Fitch. Eligible commercial paper shall have a maximum maturity of 270 days or less. The City may invest no more than 25% of its money in eligible commercial paper. The City may purchase no more than 10 percent of the outstanding commercial paper of any single corporate issue.

## **6.8 Negotiable Certificates of Deposit**

Negotiable certificates of deposit issued by a nationally or state-chartered bank, savings association or a federal association (as defined by Section 5102 of the California Financial Code), a state or federal credit union, or by a state-licensed branch of a foreign bank. Purchases of negotiable certificates of deposit may not exceed 30 percent of the City's money which may be invested pursuant to this Investment Policy. For purposes of this Section 6.8, negotiable certificates of deposit do not come within Article 2 of the California Government Code (commencing with Section 53630), except that the amount so invested shall be subject to the limitations of California Government Code Section 53638 concerning maximum deposits. The City Council of the City and the City Treasurer or other official of the City having legal custody of the money are prohibited from investing City funds, or funds in the custody of the City, in negotiable certificates of deposit issued by a state or federal credit union if a member of the City Council of the City, or any person with investment decision making authority in the City Administrator's Office, Budget-Auditor's Office, Treasurer's Office or Finance Department of the City, also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or the supervisory committee of the state or federal credit union issuing the negotiable certificates of deposit.

## **6.9 Repurchase, Reverse Repurchase and Securities Lending Agreements**

- 6.9.1 Investments in repurchase agreements or reverse repurchase agreements or securities lending agreements of any securities authorized by this Section 6, as long as the agreements are subject to this Section 6.9, including, the delivery requirements specified in this Section 6.9.
- 6.9.2 Investments in repurchase agreements may be made, on any investment authorized in Section 6, when the term of the agreement does not exceed one year. 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. Since the market value of the underlying securities is subject to daily market fluctuations, the investments in repurchase agreements shall be in compliance if the value of the underlying securities is brought back up to 102 percent no later than the next business day.
- 6.9.3 Reverse repurchase agreements or securities lending agreements may be utilized only when all of the following conditions are met:
  - 6.9.3.1 The security to be sold on reverse repurchase agreement or securities lending agreement has been owned and fully paid for by the City for a minimum of 30 days prior to sale.



6.9.3.2 The total of all reverse repurchase agreements and securities lending agreements on investments owned by the City does not exceed 20 percent of the base value of the portfolio.

6.9.3.3 The agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security.

6.9.3.4 Funds obtained or funds within the pool of an equivalent amount to that obtained from selling a security to a counterparty by way of a reverse repurchase agreement or securities lending agreement, shall not be used to purchase another security with a maturity longer than the maturity of the reverse repurchase agreement or securities lending agreement.

6.9.4 Investments in reverse repurchase agreements, securities lending agreements or similar investments in which the City sells securities prior to purchase with a simultaneous agreement to repurchase the security, may only be made upon prior approval of the City Council of the City and shall only be made with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a significant banking relationship with the City.

6.9.4.1 For purposes of this Section 6.9, "significant banking relationship" means any of the following activities of a bank:

6.9.4.1.1 Involvement in the creation, sale, purchase, or retirement of the City's bonds, warrants, notes, or other evidence of indebtedness.

6.9.4.1.2 Financing of the City's activities.

6.9.4.1.3 Acceptance of the City's securities or funds as deposits.

## 6.9.5 Definitions

### 6.9.5.1 Repurchase Agreement

Repurchase Agreement means a purchase of securities by the City pursuant to an agreement by which the counterparty seller will repurchase the securities on or before a specified date and for a specified amount and the counterparty will deliver the underlying securities to the City by book entry, physical delivery, or by third party custodial agreement. The transfer of underlying securities to the counterparty bank's customer book-entry account may be used for book-entry delivery.

#### **6.9.5.2 Securities**

Securities mean securities of the same issuer, description, issue date, and maturity.

#### **6.9.5.3 Reverse Repurchase Agreement**

Reverse Repurchase Agreement means a sale of securities by the City pursuant to an agreement by which the City will repurchase the securities on or before a specified date and includes other comparable agreements.

#### **6.9.5.4 Securities Lending Agreement**

Securities Lending Agreement means an agreement under which the City agrees to transfer securities to a borrower who, in turn, agrees to provide collateral to the City. During the term of the agreement, both the securities and the collateral are held by a third party. At the conclusion of the agreement, the securities are transferred back to the City in return for the collateral.

#### **6.9.5.5 Base Value**

Base Value of the City's pool portfolio shall be that dollar amount obtained by totaling all cash balances placed in the pool by all pool participants, excluding any amounts obtained through selling securities by way of reverse repurchase agreements or other similar borrowing methods.

#### **6.9.5.6 Spread**

Spread means the difference between the cost of funds obtained using the reverse repurchase agreement and the earnings obtained on the reinvestment of the funds.

### **6.10 Medium-Term Notes**

Medium-term notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Notes eligible for investment under this Section 6.10 shall be rated "A" or better by a nationally recognized rating service. Purchases of medium-term notes shall not include other instruments authorized by Section 6 and may not exceed 30 percent of the City's surplus money which may be invested.

## **6.11 Diversified Management Company Shares**

- 6.11.1 Shares of beneficial interest issued by diversified management companies that invest in the securities and obligations as authorized by Sections 6.1 to 6.10, inclusive, or Sections 6.13 or 6.14 and that comply with the investment restrictions of Article 1 (commencing with Section 53600 of the California Government Code) and Article 2 (commencing with Section 53630 of the California Government Code). However, notwithstanding these restrictions, a counterparty to a reverse repurchase agreement is not required to be a primary dealer of the Federal Reserve Bank of New York if the company's board of directors finds that the counterparty presents a minimal risk of default, and the value of the securities underlying a repurchase agreement may be 100 percent of the sales price if the securities are marked to market daily.
- 6.11.2 Shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1, et seq.).
- 6.11.3 If investment is in shares issued pursuant to Section 6.11.1, the company shall have met either of the following criteria:
  - 6.11.3.1 Attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations; or
  - 6.11.3.2 Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by Sections 6.1 to 6.10, inclusive, or Sections 6.13 or 6.14 and with assets under management in excess of five hundred million dollars (\$500,000,000).
- 6.11.4 If investment is in shares issued pursuant to Section 6.11.2, the company shall have met either of the following criteria:
  - 6.11.4.1 Attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations; or
  - 6.11.4.2 Retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience managing money market mutual funds with assets under management in excess of five hundred million dollars (\$500,000,000).

6.11.5 The purchase price of shares of beneficial interest purchased pursuant to this Section 6.11 shall not include any commission that the companies may charge and shall not exceed 20 percent of the City's surplus money that may be invested pursuant to this Section 6. However, no more than 10 percent of the City's surplus funds may be invested in shares of beneficial interest of any one mutual fund pursuant to Section 6.11.1.

## **6.12 Moneys Pledged to Payment or Security of Bonds of the City**

Moneys held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness, or obligations under a lease, installment sale, or other agreement of the City, or certificates of participation in those bonds, indebtedness, or lease installment sale, or other agreements, may be invested in accordance with the statutory provisions governing the issuance of those bonds, indebtedness, or lease installment sale, or other agreement, or to the extent not inconsistent therewith or if there are no specific statutory provisions, in accordance with the ordinance, resolution, indenture, or agreement of the City providing for the issuance.

## **6.13 Bonds Secured by Government Code Section 53651 Eligible Securities**

Notes, bonds, or other obligations that are at all times secured by a valid first priority security interest in securities of the types listed by Section 53651 of the California Government Code as eligible securities for the purpose of securing local agency deposits having a market value at least equal to that required by Section 53652 of the California Government Code for the purpose of securing local agency deposits. The securities serving as collateral shall be placed by delivery or book entry into the custody of a trust company or the trust department of a bank which is not affiliated with the issuer of the secured obligation, and the security interest shall be perfected in accordance with the requirements of the Uniform Commercial Code or federal regulations applicable to the types of securities in which the security interest is granted.

## **6.14 Mortgage Pass-Through Security**

Any Mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate, or consumer receivable-backed bond, in each case, of a maximum of five years maturity. Securities eligible for investment under this Section 6.14 shall be issued by an issuer having an "A" or higher rating for the issuer's debt as provided by a nationally recognized rating service and rated in a rating category of "AA" or its equivalent or better by a nationally recognized rating service. Purchase of securities authorized by this Section 6.14 may not exceed 20 percent of the City's surplus money that may be invested pursuant to Section 6.

## **6.15 Pooled Investment Funds**

6.15.1 County Pooled Investment Funds in accordance with the laws and regulations governing those Funds and Section 53684 of the California Government Code.

- 6.15.2 State of California pooled “Local Agency Investment Fund” in accordance with the laws and regulations governing those Funds and Section 16429.1 et seq. of the California Government Code.

## **7.0 DESIGNATED ENTITIES FROM WHOM THE CITY MAY PURCHASE AUTHORIZED INVESTMENTS**

The purchase by the City of any investment authorized pursuant to California Government Code Sections 53601 or 53601.1, not purchased directly from the issuer, shall be purchased either from an institution licensed by the State as a broker-dealer, as defined in Section 25004 of the California Corporations Code, or from a member of a federally regulated securities exchange, from a national or state-chartered bank, from a savings association or federal association (as defined by Section 5102 of the California Financial Code) or from a brokerage firm designated as a primary government dealer by the Federal Reserve Bank.

## **8.0 PROHIBITED INVESTMENTS**

**8.1** The City shall not invest any funds pursuant to this Investment Policy or pursuant to California Government Code, Article 2, Deposit of Funds (commencing with Section 53630) in inverse floats, range notes, or mortgage-derived, interest-only strips.

**8.2** The City shall not invest any funds pursuant to this Investment Policy or pursuant to California Government Code, Article 2, Deposit of Funds (commencing with Section 53630) in any security that could result in zero interest accrual if held to maturity. However, the City may hold prohibited instruments currently owned by the City until their maturity dates. The limitation in this Section 8.2 shall not apply to City investments in shares of beneficial interest issued by diversified management companies registered under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1, and following) that are authorized for investment pursuant to Section 6.11.

**8.3** The City is prohibited under this policy from engaging in speculative activities typical to many organizations orientated toward profit maximization. Taking risks in order to arbitrage market opportunities, or risks unrelated to the City’s normal business activities is prohibited. These include investments in derivatives such as contracts-options, swaps, and futures/forward contracts without a clear, identifiable, justifiable, and effective hedgeable item.

**8.4** Prior to entering into an allowable hedgeable transaction, such as a swap agreement, the City shall review legal documentation subject to the transaction to understand the terms of the transaction, the risks taken on by the parties, and the remedies available to them. These documents may include, among others, the ISDA Master Agreement, Schedule, Confirmation and Credit Support Annex. Such documentation will be retained to support the basis of the decision.

## **9.0 ALLOWABLE HEDGABLE TRANSACTIONS**

**9.1** Interest rate swap contract in conjunction with debt issuances shall be reviewed as part of the City's overall financial position considering both the potential benefits and potential risks. Prior to submitting a swap agreement for City Council's approval, the potential benefits and potential benefits are to be analyzed. The results of the analysis shall be provided to City Council at the time of approval.

**9.2** Potential benefits: Accessing the swap market increases the array of options available to the City for hedging risk. Using swaps, can in some circumstances, reduce costs or improve cash flows, thereby increasing resources available for debt service, other public purposes, and contributing to the City's overall mission. The City shall consider the following benefit factors when determining the applicability as part of different strategies:

**9.2.1 Reducing borrowing costs**, by using floating-to-fixed rate swaps combined with variable rate bonds to achieve costs lower than those available with fixed-rate bonds, or by using fixed-to-floating rate swaps to create synthetic floating rate debt and achieve lower costs without external liquidity or remarketing support.

**9.2.2 Improving cash flows**, by using basis swaps where the City expects the payments received from the counterparty to be greater, over time, than the payments made to the counterparty.

**9.2.3 Locking in current rates** for future transactions, through forward-starting swaps or swaptions.

**9.2.4 Matching assets and liabilities**, by using a swap contract so that fixed-rate debt is matched with fixed-rate assets and floating-rate debt is matched with floating-rate assets.

**9.2.5** The City shall take into account the potential benefits of swap transactions in conjunction with debt issuances by recognizing that in the proper circumstances they can have a positive effect on the City's financial position.

**9.3 Potential Risks:** Interest rate swaps involve certain risks that shall be considered when doing an analysis. Prior to submitting a swap agreement to City Council for approval, the potential risk factors will be examined and analyzed. They will be presented as part of the overall staff report in order to provide a full perspective of both the risks and benefits. There are five potential risk factors that encompass ten different separate elements:

### **9.3.1 Risk Factor No. 1: Cash flows and/or net revenues**

**9.3.1.1 Basis Risk:** The risk that variable rate payments received will be less than variable rate payments they were designed to offset, because the variable rate payments received and the variable rate payments owed are based on different indexes, and the ratio between those indexes changes over time.

**9.3.1.2 Tax Risk:** The risk that the City's costs will raise because federal income tax rates fall, or because the tax exemption for municipal debt is eliminated or is modified in a way that reduces its value.

**9.3.1.3 Yield Curve Risk:** The risk is that the City's cash flow will be adversely affected because the slope of the yield curve is not as the City anticipated when entering into the swap. This is an aspect of basis risk that may affect the termination value for swaps contracts.

**9.3.1.4 Amortization Mismatch:** The risk that the notional amount of the swap and the outstanding principal amount of the debt intended to be hedged will no longer be equal. Such mismatch may be a feature of the transaction at its inception or may be caused by subsequent events, such as redemption of bonds before maturity or termination of the swap before bond maturity.

### **9.3.2 Risk Factor No. 2: Balance Sheet**

**9.3.2.1 Termination Risk:** The risk that the City will be required to make a payment based on the market value of the swap in connection with an unforeseen termination of the swap, at a time when the market value is negative to the issuer.

**9.3.2.2 Collateral Posting Risk:** The risk that the City will be required to post collateral, upon a downgrade of its credit rating or other trigger event a time when the market value is negative.

### **9.3.3 Risk Factor No. 3: Counterparty Risk**

**9.3.3.1** The risk that the counterparty will no longer perform its obligations under the contract, or that the counterparty's credit quality will decline to the point where there is uncertainty about its ability to perform.

### **9.3.4 Risk Factor No. 4: Future Financial Management**

**9.3.4.1 Market Access Risk:** The risk that the City will be unable to obtain derivatives contracts when needed in the future on reasonably favorable terms, including new derivatives upon early or scheduled termination of existing hedges ("Rollover Risk").

**9.3.4.2 Loss of Flexibility:** The risk that a swap contract will limit the issuer's debt management options in the future due to an inability to modify or terminate the swap without cost.

### **9.3.5 Risk Factor No. 5: Management Complexity**

**9.3.5.1** The risk that certain swap contracts may add a level of complexity to financial management that will require ongoing commitment of additional resources. The utilization of a financial advisory firm to assist or review transactions prior to entering into an arrangement may be required.

## **10.0 STATEMENTS OF INVESTMENT ACTIVITIES**

### **10.1 Annual Statement of Investment Policy**

The City Treasurer shall annually render to the City Council a statement of investment policy, which the City shall consider at a public meeting. Any changes in the investment policy shall also be considered by the City Council of the City at a public meeting.

### **10.2 Quarterly Report of Investments**

The City Treasurer shall render a quarterly report to City Council. The quarterly report shall be so submitted within 45 days following the end of the quarter covered by the report. This report shall include the type of investment, issuer, date of maturity par and dollar amount invested on all securities, investments and moneys held by the City and shall additionally include a description of any of the City's funds, investments, or programs that are under the management of contracted parties, including lending programs. With respect to all securities held by the City and under management of any outside party that is not also a local agency or the State of California Local Agency Investment Fund (LAIF), the report shall also include a current market value as of the date of the report, and shall include the source of this same valuation.

For local agency investments that have been placed in the State of California Local Agency Investment Fund (LAIF), in National Credit Union Share Insurance Fund-insured accounts in a credit union, in accounts insured or guaranteed pursuant to Section 14858 of the California Financial Code, or in Federal Deposit Insurance Corporation-insured accounts in a bank or savings and loan association, in a California County investment pool, or any combination of these, the City Treasurer and the Treasurer's Department may supply to the City Council the most recent statements received by the City from these institutions.

The quarterly report shall state compliance of the portfolio to this Investment Policy, or the manner in which the portfolio is not in compliance. The quarterly report shall include a statement denoting the ability of the City to meet its budgeted expenditure requirements for the next six months, or provide an explanation as to why sufficient money shall, or may, not be available. In the quarterly report, a subsidiary ledger of investments may be used in accordance with accepted accounting practices.

### **10.3 Monthly Investment Transaction Report**

The authority of the City Council to invest or to reinvest funds of the City, or to sell or exchange securities so purchased has been delegated for a one-year period by the City Council to the City Treasurer, who shall thereafter assume full responsibility for those transactions and shall make a timely monthly report of those transactions to the City Council.

## **11.0 CONFLICT OF INTEREST**

No City employee shall, outside of regular working hours, engage in any professions, trade, business, or occupation which is incompatible or involves a conflict of interest with his/her duties as a City Officer or employee.



## **12.0 PUBLIC INQUIRY**

The City Treasurer's portfolio and related transactions are a matter of public record. Any member of the public may receive a copy of the portfolio or this Investment Policy by requesting a copy at the Treasurer's Office. The Treasurer may charge a fee for the copy, as allowed by law.

## **13.0 ANALYSIS OF PROSPECTIVE INVESTMENTS**

Due to the complexity of the various investment instruments available and uncertainty of market conditions the Treasurer may seek professional advice in making investment decisions in order to optimize investment selections.

## **14.0 SAFEKEEPING**

As required by California Government Code Section 53601 all investment instruments in a negotiable, bearer, registered, or nonregistered format, shall be delivered to the City's custodial bank by using book entry or physical delivery. The "delivery vs. payment" purchase procedure shall be used.

The City's custodial bank for safekeeping of the bonds, notes, bills, debentures, obligations, certificates of indebtedness, warrants, or other evidences of indebtedness in which the money of the City is invested pursuant to this policy shall be one of the following: (a) a federal or state association (as defined by Section 5102 of the Financial Code), (b) a trust company or a state or national bank located within California, (c) the Federal Reserve Bank of San Francisco or any branch thereof within California, (d) any Federal Reserve Bank, or (e) with any state or national bank located in any city designated as a reserve city by the Board of Governors of the Federal Reserve System.

## **15.0 BROKER/DEALER AND DEPOSITORY INSTITUTION RELATIONSHIPS**

### **15.1 Approved List of Broker/Dealer Institutions**

Subject to Section 7.0, the City Treasurer shall approve and maintain a list of broker/dealers and depository institutions authorized to provide investment and other services to the City. All investments must be made with institutions that have been approved by the City Treasurer prior to investing.

### **15.2 Broker/Dealer Commissions and Fees Chargeable to the City**

All broker/dealers who transact with the City and buy and sell securities on the City's behalf shall earn a commission or charge a fee not to exceed an amount deemed prudent and reasonable by the Financial Industry Regulatory Authority ("FINRA") and what is customary in the industry for the types of securities being purchased by the City.

### **15.3 Deposit and Investment of Funds of the City**

All depository institutions that do business with the City shall be in compliance with the requirements of Article 2, commencing with Section 53630, of the Government Code of the State of California, concerning the deposit of funds, including the overall creditworthiness and credit ratings requirements of the sections of that Article.