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WHEREAS, Government Code Section 53646 requires the filing of an annual Statement of Investment Policy by local public agencies; and

PURPOSE: This statement is intended to provide a guideline for the prudent investment of temporary idle cash, trust funds and restricted moneys and to outline a policy for maximizing the efficiency of the cash management system. Ultimate investment goals include the enhancement of economic status and the protection of pooled cash investments.

OBJECTIVE: The cash management system of the City of Hermosa Beach is designed to accurately monitor and forecast expenditures and revenues, thus insuring the investment of moneys to the fullest extent possible. The city attempts to obtain highest interest yields possible as long as investments meet the criteria required for safety and liquidity.

POLICY: The City of Hermosa Beach operates its investment program with State and self-imposed constraints. It does not buy stocks; it does not speculate; it does not deal in futures, options or security loan agreements. With regard to investment companies, the City will deal only with investment companies registered with the Securities and Exchange Commission. The City Treasurer will have sole discretion over Security Trading, except in the case of monies invested in the State of California Local Agency Investment Fund(LAIF) and the Los Angeles County Pooled Investment fund(LACPIF). Longer term investments (over one year) are generally limited to maturates of 3 years or less, but will never exceed five years.

Criteria for selecting investments and the absolute order of priority are:

1. **Safety:** The safety and risk associated with an investment refers to the potential loss of principal, interest or a combination of these amounts. Since it is the primary duty and responsibility of the Treasurer to protect, preserve and maintain cash and investments placed in his/her trust on behalf of the citizens of the City, Hermosa Beach only invests in those instruments that are considered very safe.

2. **Liquidity:** This refers to the ability to "cash in" at any moment in time with minimal chance of losing some portion of the principal or interest. An adequate percentage of the portfolio should be maintained in liquid short-term investments which can be converted to cash if necessary to meet disbursement requirements. Since all cash requirements cannot be anticipated, investments in securities with active secondary or resale markets is highly recommended. Emphasis should be on marketable securities with low sensitivity to market risk.

3. **Yield:** yield is the potential dollar earnings an investment can provide, and sometimes is described as the rate of return. It should become a consideration only after the basic requirements of safety and liquidity have been met.

The City's investment philosophy is to insure the safety of principle and to provide money when needed. A high dollar yield on investments, though important, ranks third in the priority of investment strategy.

Depository Services

Money must be deposited in state or national banks, state or federal savings associations, or state or federal credit unions in the state. It may be in inactive deposits, active deposits or interest-bearing active deposits which are insured or collateralized as required by Government Code Section 53630 at seq. The deposits generally may not exceed the amount of the bank's shareholders' equity, the savings and loan's networth or the credit union's unimpaired capital and surplus. We require that each financial institution submit current financial statements which are evaluated prior to the investment of funds. We use the following criteria:

The institution must have been in business at least three years. The institution must submit audited financial statements. In addition, examination is made of the Reserve for Loan Losses category to evaluate the financial trend of the institution's asset base. Whenever possible, the use of several year

1 financial data is evaluated to present a trend of activity in the institution. We also require the interest be
2 paid to the City on a monthly basis (current state law only requires quarterly payment).

3 4 **Authorized Investments**

5 Generally, investments shall be made in the context of the "prudent person" rule, which states that,
6 "investments shall be made with judgment and care, under circumstances then prevailing, which
7 persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not
8 for speculation, but for investment, considering the probable safety of their capital as well as the
9 probable income to be derived." The City is further governed by the California Government Code,
10 Sections 53600 et seq. Within the context of these limitations, the following investments are
11 authorized, as further limited herein:

12 **Negotiable Certificates of Deposit.** No more than 5% of the City's portfolio is invested in any one
13 institution. Time Certificates of Deposits are safekept in a legally acceptable safekeeping account.
14 Total purchases are not to exceed 30% of surplus funds. An institution must meet the following criteria
15 to be considered by the City:

- 16 1. The institution must be located in California.
- 17 2. The institution must have current financial information, signed contract and waiver on file
18 with the City.
- 19 3. The institution must maintain a net worth to asset ratio of a least 5%, and have a positive
20 earnings record.
- 21 4. The institution must be at least 3 years old.

22 **U. S. TREASURIES** are direct obligations of the United States Government.

23 U.S. TREASURY BILLS are issued weekly with maturity dates up to one year. They are issued and
24 traded on a discount basis and the interest is figured on the 360 day basis, actual number of days. They
25 are issued in amounts of \$10,000 and up, in multiples of \$5,000. They are a highly liquid security.

26 U.S. TREASURY NOTES are initially issued with two to ten years maturities. They are actively traded
27 in a large secondary market and are very liquid.

1 **MEDIUM-TERM NOTES** (MTNs) are corporate notes. Issuers include well recognized
2 banks and bank holding companies, insurance companies, finance companies and industrial
3 corporations. A large percentage of MTNs are unsecured senior debt obligations, although a number of
4 recent issues have come to market on a collateralized or secured basis. Maturity bonds are from 9
5 months to one year, one year to 18 months, 18 months to 2 years, and annually thereafter. Typically,
6 rates are established at a positive spread over a Treasury security of comparable maturity. Credit ratings
7 on MTNs are established by nationally recognized rating services. Standard and Poor's, Moody's
8 Investors Service and Fitch Investors Service. Credit supported MTNs typically carry the Aaa/AAA
9 long term rating, based on the credit-worthiness of the support entity. Collateralized MTNs receive the
10 same rating based on the over collateralization limits set by Standard and Poor's and Moody's.
11 Although a rating of A is required for Municipal investment as per sections 53601 and/or 53635, this
12 agency, as policy, will only consider investments with Aa/aa or better. There can be only 30% of the
13 total surplus funds used for MTN investment as per section 53635. MTNs offer safety, yield and
14 liquidity through a strong secondary market.

15 **BANKER'S ACCEPTANCES** are negotiable time drafts drawn to finance the export, import,
16 shipment or storage of goods, and they are termed "Accepted" when a bank guarantees to pay the face
17 value at maturity. A Banker's Acceptance constitutes an irrevocable obligation of the accepting bank
18 and a contingent obligation of the drawer and of any endorsees whose names appear upon it. The bank
19 is protected by its customer's agreement to provide the necessary funds in advance of the maturity of the
20 Acceptance and also by the pledge of documents such as bills of lading, independent warehouse of
21 terminal receipts, and other documents evidencing ownership and the insurance of the goods so
22 financed.

23 Cities and other local agencies are authorized to purchase Banker's Acceptances, subject to several
24 restrictions. First, the Banker's Acceptance must be eligible for purchase by the Federal Reserve
25 System. Second, purchases of Banker's Acceptances must not exceed one hundred eighty (180) days
26 maturity or 40% of the City's surplus money invested under Sections 53601 and/or 53635. Finally, no
27 more than 5% of the agency's surplus funds may be invested in the Banker's Acceptances of any one
28 commercial bank .

1 **LOCAL AGENCY INVESTMENT FUND (LAIF)** is a pooled investment fund in the State
2 Treasury which local agencies may use to deposit funds for investment. There is no minimum
3 investment period and the minimum transaction is \$5,000, in multiples of \$1,000 above that, with a
4 maximum of \$40,000,000 for any agency. The City is restricted to a maximum of fifteen (15)
5 transactions per month. It offers high liquidity because deposits can be converted to cash in twenty-four
6 hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate
7 share determined by the amounts deposited and the length of time they are deposited. Interest is paid
8 quarterly via direct deposit. The State keeps an amount for reasonable costs of making the investments,
9 not to exceed one-quarter of one percent of the earnings. The interest rates are fairly high because of the
10 pooling of the State surplus cash with the surplus cash deposited by local governments. This creates a
11 multi-billion dollar money pool and allows diversified investments. In a high interest rate market, we
12 do better than LAIF, but in times of low interest rates, LAIF yields are higher. The City continually
13 invests in the Local Agency Investment Fund (Government Code Section 16429).

14 **LOS ANGELES COUNTY POOLED INVESTMENT FUND (LACPIF)** Pursuant to Government
15 Code Section 53684, local agencies in the County of Los Angeles may deposit excess funds in
16 LACPIF for the purpose of investment by the county treasurer Government Code Sections 53601 and
17 53635;

18 The County keeps an amount for reasonable costs of making the investments, not to exceed sixteen (16)
19 basis points per month. The number of monthly transactions are not restricted.

20 **Safekeeping**

21 Certificates of Deposit or Receipts of Public Funds must be mailed or delivered to the City. Banker's
22 acceptances are actual "physical" securities, meaning they are evidenced by actual certificates. All
23 Treasury bills and most other Treasury securities are "book entry" securities, meaning they are held at
24 the Federal Reserve Union Bank of California where only a book entry is used to denote ownership.

25 Collateral for time deposits in banks and savings and loans are held by the Federal Home Loan Bank
26 (FHB) or an approved Agency of Depository of the financial institution.

27 Securities purchased from broker/dealers shall be held in third party safekeeping.

28 **Public Trust**

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

7 **Risk Tolerance**

8 The City Council recognizes that investment risks can result from issuer defaults, market price changes
9 or various technical complications leading to temporary illiquidity. Portfolio diversification is
10 employed as a way to control risk. Investment Managers are expected to display prudence in the
11 selection of securities, as a way to minimize default risk. No individual investment transaction shall be
12 undertaken which jeopardizes the total capital position of the overall portfolio. The Treasurer shall
13 periodically establish guidelines and strategies to control risks of default, market price changes, and
14 illiquidity.

15 **Reporting**

16 The Treasurer or his deputy shall submit a monthly investment report to the City Council. This report
17 will include all required elements of the monthly report as prescribed by Government Code Section
18 53646. Under the City's current Investment Policy, of the monthly report shall include:

- 19 a. Type of investment
- 20 b. Name of issuer
- 21 c. Date of investment
- 22 d. Date of maturity
- 23 e. Amount of deposit or cost of the security
- 24 f. Current market value
- 25 g. Rate of Interest
- 26 h. A statement of compliance with California Code Section 53646, from the City

Treasurer certifying that sufficient investment liquidity and anticipated revenues are available to meet the City's budgeted expenditure requirement for the next six months; and

NOW, THEREFORE, THE CITY COUNCIL OF THE CITY OF HERMOSA BEACH DOES
HEREBY RESOLVE AS FOLLOWS:

Section 1. That the annual Statement of Investment Policy for the City of Hermosa Beach, as set forth in the recitals hereof, filed by the City Treasurer in compliance with Section 53646 (a) of the Government Code, is hereby approved.

Section 2. That this policy applies to investments effective January 1, 2005.

PASSED, APPROVED AND ADOPTED THIS 11th DAY OF January 2005

PRESIDENT of the City Council and MAYOR
of the City of Hermosa Beach, California.

ATTEST: _____ CITY CLERK

APPROVED AS TO FORM: _____ CITY ATTORNEY

January 3, 2005

Honorable Mayor and Members of
the Hermosa Beach City Council

City Council Meeting
January 11, 2005

ADOPTION OF ANNUAL STATEMENT OF
INVESTMENT POLICY FOR
CALENDAR YEAR 2005

RECOMMENDATION

It is recommended that the City Council adopt the annual statement of investment policy for calendar year 2005

BACKGROUND

Government Code section 53646 requires the filing of an annual Statement of Investment Policy by local public agencies.

ANALYSIS

With safety as a focus and the primary concern being the security of principal, the investments described will continue to earn current reasonable returns.

Respectfully submitted,

NOTED:

John M. Workman
City Treasurer

Stephen R. Burrell
City Manager

Noted for fiscal impact:

Viki Copeland
Finance Director