

January 26, 2006

Honorable Mayor and Members of
the Hermosa Beach City Council

City Council Meeting
February 14, 2006

ADOPTION OF ANNUAL STATEMENT OF
INVESTMENT POLICY FOR
CALENDAR YEAR 2006

RECOMMENDATION

It is recommended that the City Council adopt the annual statement of investment policy for calendar year 2006

BACKGROUND

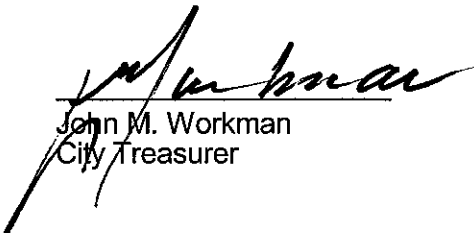
Government Code section 53646 requires the filing of an annual Statement of Investment Policy by local public agencies.

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

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

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

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

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

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

18 **Depository Services**

19 Money must be deposited in state or national banks, state or federal savings associations, or
20 state or federal credit unions in the state. It may be in inactive deposits, active deposits or interest-
21 bearing active deposits which are insured or collateralized as required by Government Code Section
22 53630 at seq. The deposits generally may not exceed the amount of the bank's shareholders' equity,
23 the savings and loan's networth or the credit union's unimpaired capital and surplus. We require that
24 each financial institution submit current financial statements which are evaluated prior to the
25 investment of funds. We use the following criteria:

26 The institution must have been in business at least three years. The institution must submit audited
27 financial statements. In addition, examination is made of the Reserve for Loan Losses category to
28 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
2 be 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
15 criteria 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
27 traded in a large secondary market and are very liquid.

28

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
4 of 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
7 ratings on MTNs are established by nationally recognized rating services. Standard and Poor's,
8 Moody's Investors Service and Fitch Investors Service. Credit supported MTNs typically carry the
9 Aaa/AAA long term rating, based on the credit-worthiness of the support entity. Collateralized MTNs
10 receive the same rating based on the over collateralization limits set by Standard and Poor's and
11 Moody's. Although a rating of A is required for Municipal investment as per sections 53601 and/or
12 53635, this agency, as policy, will only consider investments with Aa/aa or better. There can be only
13 30% of the total surplus funds used for MTN investment as per section 53635. MTNs offer safety,
14 yield and 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
20 the 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-
6 four hours and no interest is lost. All interest is distributed to those agencies participating on a
7 proportionate share determined by the amounts deposited and the length of time they are deposited.
8 Interest is paid quarterly via direct deposit. The State keeps an amount for reasonable costs of making
9 the investments, not to exceed one-quarter of one percent of the earnings. The interest rates are fairly
10 high because of the pooling of the State surplus cash with the surplus cash deposited by local
11 governments. This creates a multi-billion dollar money pool and allows diversified investments. In a
12 high interest rate market, we do better than LAIF, but in times of low interest rates, LAIF yields are
13 higher. The City continually invests in the Local Agency Investment Fund (Government Code Section
14 16429).

15 **LOS ANGELES COUNTY POOLED INVESTMENT FUND (LACPIF)** Pursuant to Government
16 Code Section 53684, local agencies in the County of Los Angeles may deposit excess funds in
17 LACPIF for the purpose of investment by the county treasurer Government Code Sections 53601 and
18 53635;

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

21 **Safekeeping**

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

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

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

1 **Public Trust**

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

8 **Risk Tolerance**

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

16 **Reporting**

17 The Treasurer or his deputy shall submit a monthly investment report to the City Council. This report
18 will include all required elements of the monthly report as prescribed by Government Code Section
19 53646. Under the City's current Investment Policy, of the monthly report shall include:

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

