



**SAN RAFAEL**  
THE CITY WITH A MISSION

**Agenda Item No: 6.b**

**Meeting Date: June 17, 2024**

## **SAN RAFAEL CITY COUNCIL AGENDA REPORT**

**Department: Finance**

**Prepared by: Paul Navazio,  
Finance Director**

**City Manager Approval:** \_\_\_\_\_

A handwritten signature in blue ink, appearing to be 'CA'.

**TOPIC: CITY INVESTMENT POLICY**

**SUBJECT: RESOLUTION APPROVING THE CITY OF SAN RAFAEL INVESTMENT POLICY**

### **RECOMMENDATION:**

Staff recommends that the Council adopt the resolution approving the investment policy as presented.

### **BACKGROUND:**

Consistent with best practices in public investing, the City's existing investment policy must be reviewed and updated, as needed, on an annual basis. The City's Investment Policy was last presented to the City Council in June 2022. The review scheduled for June 2023 was delayed due to the transition resulting from the Administrative Services / Finance Director position vacancy.

This agenda item has been prepared to present proposed revisions to the City's Investment Policy based on the review and recommendations from the Finance Director and the City's investment advisor, Chandler Asset Management. A discussion of the proposed revisions to the investment policy was held with the Finance Subcommittee at their meeting on April 4, 2024.

The California Government Code limits the types of investments open to local municipalities. The City's investment priorities – in order - are safety, liquidity, and yield. The City pursues a fair market return on its investments after considering the security of the investment's principal, cash flow requirements, and current investment portfolio structure.

### **ANALYSIS:**

The last revisions to the City's Investment Policy were made in June 2021. They were limited to adding a "Total Portfolio" definition to include all investments and deposits, including funds in any money market accounts and government pools such as the Local Agency Investment Fund (LAIF).

A review of the City's investment policy suggests that proposed revisions are warranted and can be characterized as follows:

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**FOR CITY CLERK ONLY**

**Council Meeting:**

**Disposition:**

1) Investment Policy Best Practices – several sections are proposed to be added to the Investment Policy consistent with best practices and model investment policies. Examples include:

- Prohibited Investment Vehicles and Practices
- Investment Pools / Mutual Funds
- Maximum Maturity
- Risk Management / Diversification
- Collateralization

2) Technical Revisions – several sections of the policy are proposed to be updated to reflect changes in state law governing the investment of public funds. These incorporate, as appropriate, new investment instruments that have been developed that are permissible for a local government portfolio and modifications to the “ratings” of permissible investments.

2) Portfolio Performance – Investment policies are required to establish the benchmark against which the investment portfolio’s performance is measured. The City’s existing Investment Policy establishes this benchmark as “the average yield on the US Treasury security that most closely corresponds to the portfolio actual weighted-average effective maturity.” The portfolio performance benchmark is recommended to be revised to a market index with a similar duration to the portfolio. (For example, the portfolio has recently been benchmarked against the Bank of America 1-3 Year US Treasury & Agency Index – See Attached Management Directive, dated December 29, 2022).

3) Prohibited Investments – In the context of the City’s existing investment policy, prohibited investments are considered investment vehicles not specially listed as “Authorized Securities” or otherwise prohibited under applicable CA Government Code. Examples of prohibited securities include equities (stocks), futures, options, and securities that represent excessive risk as measured by applicable “ratings” criteria. Among the recommendations contained in the draft update of the investment policy is the formal adoption of the prohibition on “direct investments in issuers whose primary business revenue is derived from the exploration, extraction, and processing of fossil fuels.” This provision has been in place since December 2022, as provided for in the management directive to the City’s outside investment advisor. The proposed investment policy merely incorporates this provision within the formal investment policy.

**FISCAL IMPACT:**

There is no direct fiscal impact from accepting the policy as proposed.

**RECOMMENDED ACTION:**

Staff recommends that the Council adopt the resolution approving the investment policy as presented.

**ATTACHMENTS:**

1. Resolution with Exhibit A to Resolution: Investment Policy
2. Redline edits to Investment Policy (2022 version)
3. Management Directive, dated December 29, 2022

**RESOLUTION NO.**

**A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF SAN RAFAEL TO APPROVE THE CITY OF SAN RAFAEL INVESTMENT POLICY**

**WHEREAS**, the City Council of the City of San Rafael exercises its responsibility for the stewardship of the City's public funds through adoption of policies and practices related to cash management and investments; and

**WHEREAS**, the investment policy is intended to provide a long-term strategy for prudent care of the City's cash; and

**WHEREAS**, all funds are invested in accordance with the investment policy and applicable sections of the California Government Code; and

**WHEREAS**, in order to remain current and consistent with applicable statutes and best practices, the City's Investment Policy requires annual review and re-adoption;

**NOW, THEREFORE, BE IT RESOLVED** that the City Council of the City of San Rafael hereby adopts the updated Investment Policy that is attached hereto as Exhibit A.

I, **LINDSAY LARA**, Clerk of the City of San Rafael, hereby certify that the foregoing resolution was duly and regularly introduced and adopted at a regular meeting of the City Council of said City held on Monday the 17<sup>th</sup> day of June 2024, by the following vote, to wit:

AYES: COUNCILMEMBERS:

NOES: COUNCILMEMBERS:

ABSENT: COUNCILMEMBERS:

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LINDSAY LARA, City Clerk

# City of San Rafael Investment Policy

PROPOSED June 17, 2024

The City Council of the City of San Rafael (the City) has adopted this Investment Policy (the Policy) in order to establish the investment scope, objectives, delegation of authority, standards of prudence, reporting requirements, internal controls, eligible investments and transactions, diversification requirements, risk tolerance, and safekeeping and custodial procedures for the investment of the funds of the City. All such funds will be invested in accordance with this Policy and with applicable sections of the California Government Code. This Policy was endorsed and adopted by the City Council on the approved date noted above. It replaces any previous investment policy or investment procedures of the City.

## SCOPE

It is intended that this Policy cover all short-term operating funds and investment activities of the City. These funds are accounted for in the annual audit report, and include:

- General Fund
- Special Revenue Funds
- Debt Service Funds
- Capital Projects Funds
- Enterprise Funds
- Internal Service Funds
- Fiduciary Funds

Additional funds that may be created from time to time shall be administered in accordance with the provisions of this Policy.

All cash shall be pooled for investment purposes. The investment income derived from the pooled investment account shall be allocated to the contributing funds based upon the proportion of the respective average balances relative to the total pooled balance in the investment portfolio. Investment income shall be distributed to the individual funds not less than annually.

## OBJECTIVES

The City's funds shall be invested in compliance with all applicable City Municipal Codes, California State statutes, and Federal regulations, and in a manner designed to accomplish the following objectives, which are listed in priority order:

1. Preservation of capital and protection of investment principal.
2. Maintenance of sufficient liquidity to meet anticipated cash flows.
3. Attainment of a market value rate of return.
4. Diversification to avoid incurring unreasonable market risks.

## **DELEGATION OF AUTHORITY**

The management responsibility for the City's investment program is delegated annually by the City Council to the Treasurer pursuant to California Government Code Section 53607. The Treasurer may delegate the authority to conduct investment transactions and to manage the operation of the investment portfolio to other specifically authorized staff members. The Treasurer shall maintain a list of persons authorized to transact securities business for the City. No person may engage in an investment transaction except as expressly provided under the terms of this Policy.

The City Manager and the Treasurer jointly shall develop written administrative procedures and internal controls, consistent with this Policy, for the operation of the City's investment program. Such procedures shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, or imprudent actions by employees of the City.

The City may engage the support services of outside investment advisors in regard to its investment program, so long as it can be clearly demonstrated that these services produce a net financial advantage or necessary financial protection of the City's financial resources.

## **PRUDENCE**

The standard of prudence to be used for managing the City's investments shall be California Government Code Section 53600.3, the prudent investor standard which states, "When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee 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 agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency."

The City's overall investment program shall be designed and managed with a degree of professionalism that is worthy of the public trust. The City recognizes that no investment is totally without risk and that the investment activities of the City are a matter of public record. Accordingly, the City recognizes that occasional measured losses may be desirable in a diversified portfolio and shall be considered within the context of the overall portfolio's return, provided that adequate diversification has been implemented and that the sale of a security is in the best long-term interest of the City.

The Treasurer and authorized investment personnel acting in accordance with written procedures and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided that the deviations from expectations are reported in a timely fashion to the City Manager and appropriate action is taken to control adverse developments.

## **ETHICS AND CONFLICTS OF INTEREST**

Elected officials and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program or that could impair or create the appearance of an impairment of their ability to make impartial investment decisions. Employees and investment officials shall disclose to the City Manager any business interests they have in financial institutions that conduct business with the City and they shall subordinate their personal investment transactions to those of the City. In addition, the City Manager and the Treasurer shall file a Statement of Economic Interests each year pursuant to California Government Code Section 87203 and regulations of the Fair Political Practices Commission.

## **AUTHORIZED SECURITIES AND TRANSACTIONS**

All investments and deposits of the City shall be made in accordance with California Government Code Sections 16429.1, 53600-53609 and 53630-53686, except that, pursuant to California Government Code Section 5903(e), proceeds of bonds and any moneys set aside or pledged to secure payment of the bonds may be invested in securities or obligations described in the ordinance, resolution, indenture, agreement, or other instrument providing for the issuance of the bonds. Within the investments permitted by the Code, the City seeks to further restrict eligible investments to the guidelines listed below. In the event a discrepancy is found between this policy and the Code, the more restrictive parameters will take precedence. In accordance with California Government Code listed above, the "Total Portfolio" includes all investments and deposits including funds in any money market accounts and governmental pools such as LAIF. Any percentage limitations are deemed to be calculated on the "Total Portfolio" and are measured based on the market value of the investment at the time of purchase. Minimum credit quality requirements apply at time of purchase.

The City has further restricted the eligible types of securities and transactions as follows:

1. United States Treasury bills, notes and bonds and other government obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest with a final maturity not exceeding five years from the date of trade settlement. There are no limits on the dollar amount or percentage that the City may invest in U.S. Treasury obligations
2. Federal Agency securities or United States Government-Sponsored Enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises with a final maturity not exceeding five years from the date of trade settlement. No more than 30% of the portfolio may be invested in any single Agency/GSE issuer. The maximum percent of agency callable securities in the portfolio will be 20%.
3. Mortgage and Asset-Backed Obligations: 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 from issuers not defined in paragraphs 1 and 2 of the

Authorized Securities and Transactions section of this policy, with a final maturity not exceeding five years from the date of trade settlement. Investments in mortgage and asset-backed obligations shall be be rated in a rating category of “AA” or the equivalent or better by at least one nationally recognized statistical rating organization (NRSRO). Purchases of securities authorized by this section may not exceed 20% of the City’s total portfolio. No more than 5% of the portfolio may be invested in any single asset-backed or commercial mortgage security issuer.

4. Supranational Securities: United States dollar denominated, senior unsecured and unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank, with a maximum maturity not exceeding five years from the date of trade settlement, and eligible for purchase and sale within the United States. Investments in supranational securities shall be rated in a rating category of “AA” or the equivalent or better by at least one NRSRO and shall not exceed 30% of the City’s total portfolio. No more than 10% of the portfolio may be invested in any single issuer.
5. Medium-Term Notes 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, with a final maturity not exceeding five years from the date of trade settlement, and rated in a rating category of “A” or the equivalent or better by at least one NRSRO. No more than 5% of the portfolio shall be invested in medium-term notes of any one issuer, and the aggregate investment in medium-term notes shall not exceed 30% of the City’s total portfolio.
6. Negotiable Certificates of Deposits (CDs) issued by a nationally or state-chartered bank, a savings association or a federal association, a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank rated at least A-1, or the equivalent or better by at least one NRSRO, or with long-term obligations rated in a rating category of “A” or the equivalent or better by at least one NRSRO, with maturities not exceeding five years from the date of trade settlement. Amounts up to the FDIC limit do not require any credit ratings. Amounts above the FDIC limit must follow the credit requirements listed above. In addition, the City may not invest in the CD of a state or federal credit union where any person with investment decision making authority at 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. No more than 5% of the portfolio may be invested in the CDs of any one issuer, and the aggregate investment in CDs shall not exceed 30% of the portfolio.
7. Non-negotiable Certificates of Deposit and savings deposits with a maturity not exceeding five years from the date of trade settlement, in FDIC insured state or nationally chartered banks or savings banks that qualify as a depository of public funds in the State of California as defined in California Government Code Section 53630.5. No more than 5% of the portfolio may be invested in the CDs of any one issuer, and the aggregate investment in CDs shall not exceed 20% of the portfolio.

Deposits in excess of the insured amount shall be secured pursuant to California Government Code Section 53651 and 53652. The City shall comply with and act to secure

compliance with the security (collateralization) system specified in the Government Code Section 53649 and 56652.

Deposits may be placed using a private sector entity that assists in the placement of deposits per section 53601.8 and 53635.8 in the Government Code. No more than 5% of the portfolio may be invested through any one private sector entity that assists in the placement of such deposits and the aggregate investment in CDs shall not exceed 20% of the portfolio.

8. Municipal Securities including obligations of the State of California and any local agency within the State of California, including Special Assessment District Obligations issued by the City of San Rafael as Limited Obligation Improvement Bonds related to special assessment districts and special tax districts. Municipal securities shall be rated in a rating category of "A" or its equivalent or better by at least one NRSRO. No more than 5% of the portfolio may be invested in any single issuer. No more than 30% of the portfolio may be in Municipal Securities. The maximum maturity shall not exceed five (5) years. Investment in Special Assessment District Obligations issued by the City of San Rafael as Limited Obligation Improvement Bonds requires the approval of the City Council and maturities may extend to 30 years from the date of trade settlement.
9. Municipal Securities (Registered Treasury Notes or Bonds) of any of the other 49 states in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 states, in addition to California. The securities are rated in a rating category of "A" or its equivalent or better by at least one NRSRO. No more than 5% of the portfolio may be invested in any single issuer. No more than 30% of the portfolio may be in Municipal Securities. The maximum maturity does not exceed five (5) years.
10. Prime Commercial Paper with a maturity not exceeding 270 days from the date of purchase with the highest ranking or of the highest letter and number rating as provided for by at least one NRSRO. The entity that issues the commercial paper shall meet all of the following conditions in either sub-paragraph A. or sub-paragraph B. below:
  - A. The entity shall (1) be organized and operating in the United States as a general corporation, (2) have total assets in excess of five \$500,000,000 and (3) Have debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.
  - B. The entity shall (1) be organized within the United States as a special purpose corporation, trust, or limited liability company, (2) have program-wide credit enhancements, including, but not limited to, over collateralization, letters of credit or surety bond and (3) have commercial paper that is rated "A-1" or higher, or the equivalent, by a NRSRO.

Purchases of eligible commercial paper may not represent more than 10% of the outstanding commercial paper of any single corporate issuer. No more than 5% of the City's total portfolio, shall be invested in the commercial paper of any one issuer, and the



aggregate investment in commercial paper shall not exceed 25% of the City's total portfolio.

11. Eligible Banker's Acceptances issued by FDIC insured commercial banks, rated at least A-1 or the equivalent or better by at least one NRSRO with maturities not exceeding 180 days from the date of purchase. If issuers have senior debt outstanding, it shall be rated in a rating category of at least "A" or the equivalent or better by at least one NRSRO. No more than \$2,000,000 shall be invested in banker's acceptances of any one commercial bank, and the aggregate investment in banker's acceptances shall not exceed 40% of the City's total portfolio.
12. Repurchase Agreements with a final termination date not exceeding one year collateralized by U.S. Treasury obligations, Federal Agency securities, or Federal Instrumentality securities listed in items 1 or 2 above with the maturity of the collateral not exceeding five years. For the purpose of this section, the term collateral shall mean purchased securities under the terms of the City's approved Master Repurchase Agreement. The purchased securities shall have a minimum market value including accrued interest of 102% of the dollar value of the funds borrowed. Collateral shall be held in the City's custodian bank, as safekeeping agent, and the market value of the collateral securities shall be marked-to-the-market daily.

Repurchase Agreements shall be entered into only with broker/dealers who are recognized as Primary Dealers by the Federal Reserve Bank of New York or have a primary dealer within their holding company structure. Repurchase agreement counterparties shall execute a City approved Master Repurchase Agreement with the City. The Treasurer shall maintain a copy of the City's approved Master Repurchase Agreement along with a list of the broker/dealers who have executed same.

13. State of California's Local Agency Investment Fund (LAIF), pursuant to California Government Code Section 16429.1.
14. Money Market Funds registered under the Investment Company Act of 1940 that (1) are "no-load" (meaning no commission or fee shall be charged on purchases or sales of shares); (2) have a constant daily net asset value per share of \$1.00; (3) invest only in United States Treasury securities, United States Agency securities and Federal Instrumentality securities and (4) have a rating equivalent to the highest letter and numerical rating by at least two NRSROs. The aggregate investment in money market funds shall not exceed 20% of the City's total portfolio.
15. Collateralized Bank Deposits. City's deposits with financial institutions will be collateralized with pledged securities per California Government Code, Section 53651. There are no limits on the dollar amount or percentage that the City may invest in collateralized bank deposits.

It is the intent of the City that the foregoing list of authorized securities and transactions is strictly interpreted.

## **PROHIBITED INVESTMENT VEHICLES AND PRACTICES**

- State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to futures and options.
- In accordance with Government Code, Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.
- Investment in any security that could result in a zero interest accrual if held to maturity is prohibited. Under a provision sunseting on January 1, 2026, securities backed by the U.S. Government that could result in a zero- or negative-interest accrual if held to maturity are permitted.
- Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.
- Purchasing or selling securities on margin is prohibited.
- The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited.
- The purchase of foreign currency denominated securities is prohibited.
- Agencies that are not Qualified Institutional Buyers (QIB) as defined by the Securities and Exchange Commission are prohibited from purchasing Private Placement Securities. The SEC defines a QIB as having at least \$100,000,000 in securities owned and invested.
- Direct investments in issuers whose primary business revenue is derived from the exploration, extraction, and processing of fossil fuels.

## **INVESTMENT POOLS/MUTUAL FUNDS**

The City shall conduct a thorough investigation of any pool or mutual fund prior to making an investment, and on a continual basis thereafter. The Treasurer shall develop a questionnaire which will answer the following general questions:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how it is distributed, and how gains and losses are treated.
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.
- A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings.
- Are reserves, retained earnings, etc. utilized by the pool/fund?
- A fee schedule, and when and how is it assessed.
- Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

## **PORTFOLIO MATURITIES AND LIQUIDITY**

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities. The City will not invest in securities maturing more than five years from the date of purchase, unless the City Council has by resolution granted authority to make such an investment at least three months prior to the date of investment.

### **MAXIMUM MATURITY**

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities.

The City will not invest in securities maturing more than five (5) years from the date of trade settlement, unless the City Council has granted authority to make such an investment either specifically or as a part of an investment program approved by the City Council no less than three months prior to the investment. Investment in Special Assessment District Obligations issued by the City of San Rafael as Limited Obligation Improvement Bonds requires the approval of the City Council and maturities may extend to 30 years from the date of trade settlement.

### **RISK MANAGEMENT AND DIVERSIFICATION**

#### Mitigating Credit Risk in the Portfolio

Credit risk is the risk that a security or a portfolio will lose some or all its value due to a real or perceived change in the ability of the issuer to repay its debt. The City will mitigate credit risk by adopting the following strategies:

- The diversification requirements included in the “Authorized Investments” section of this policy are designed to mitigate credit risk in the portfolio.
- No more than 5% of the total portfolio may be deposited with or invested in securities issued by any single issuer unless otherwise specified in this policy.
- The City may elect to sell a security prior to its maturity and record a capital gain or loss in order to manage the quality, liquidity or yield of the portfolio in response to market conditions or City’s risk preferences.
- If a security owned by the City is downgraded to a level below the requirements of this policy, making the security ineligible for additional purchases, the following steps will be taken:
  - Any actions taken related to the downgrade by the investment manager will be communicated to the Treasurer in a timely manner.
  - If a decision is made to retain the security, the credit situation will be monitored and reported to the City Council.

#### Mitigating Market Risk in the Portfolio

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The City recognizes that, over time, longer-term portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The City will mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes.

The City further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The City, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

- The City will maintain a minimum of six months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements.
- The maximum stated final maturity of individual securities in the portfolio will be five (5) years, except as otherwise stated in this policy.
- The duration of the portfolio will generally be approximately equal to the duration (typically, plus or minus 20%) of a Market Benchmark, an index selected by the City based on the City's investment objectives, constraints and risk tolerances.

## **SELECTION OF BROKER/DEALERS**

The Treasurer shall maintain a list of broker/dealers authorized for investment purposes, and it shall be the policy of the City to purchase securities only from those authorized firms. To be eligible, a firm must be licensed by the State of California as a broker/dealer as defined in Section 25004 of the California Corporations Code, and:

1. be recognized as a Primary Dealer by the Federal Reserve Bank of New York or have a primary dealer within its holding company structure, or
2. report voluntarily to the Federal Reserve Bank of New York, or
3. qualify under Securities and Exchange Commission (SEC) Rule 15c3-1 (Uniform Net Capital Rule).

The City may engage the services of investment advisory firms to assist in the management of the portfolio and investment advisors may utilize their own list of approved Broker/Dealers. Selection of broker/dealers used by an external investment adviser retained by the City will be at the sole discretion of the advisor and the list of approved firms shall be provided to the City on an annual basis or upon request.

In the event that an external investment advisor is not used in the process of recommending a particular transaction in the City's portfolio, authorized broker/dealers shall attest in writing that they have received and reviewed a copy of this policy and annually update a City approved Broker/Dealer Information Request form which includes the firm's most recent financial statements. The Treasurer shall maintain a list of the broker/dealers that have been

approved by the City, along with each firm's most recent broker/dealer Information Request form.

The City may purchase commercial paper from direct issuers even though they are not on the approved broker/dealer list as long as they meet the criteria outlined in Item 5 of the Authorized Securities and Transactions section of this Policy.

## **COLLATERALIZATION**

Certificates of Deposit (CDs). The City shall require any commercial bank or savings and loan association to deposit eligible securities with a City of a depository approved by the State Banking Department to secure any uninsured portion of a Non-Negotiable Certificate of Deposit. The value of eligible securities as defined pursuant to California Government Code, Section 53651, pledged against a Certificate of Deposit shall be equal to 150% of the face value of the CD if the securities are classified as mortgages and 110% of the face value of the CD for all other classes of security.

Collateralization of Bank Deposits. This is the process by which a bank or financial institution pledges securities, or other deposits for the purpose of securing repayment of deposited funds. The City shall require any bank or financial institution to comply with the collateralization criteria defined in California Government Code, Section 53651.

Repurchase Agreements. The City requires that Repurchase Agreements be collateralized only by securities authorized in accordance with California Government Code:

- The securities which collateralize the repurchase agreement shall be priced at Market Value, including any Accrued Interest plus a margin. The Market Value of the securities that collateralize a repurchase agreement shall be valued at 102% or greater of the funds borrowed against those securities.
- Financial institutions shall mark the value of the collateral to market at least monthly and increase or decrease the collateral to satisfy the ratio requirement described above.
- The City shall receive monthly statements of collateral.

## **COMPETITIVE TRANSACTIONS**

Where possible, each investment transaction shall be competitively transacted with authorized broker/dealers. At least three broker/dealers shall be contacted for each transaction and their bid and offering prices shall be recorded.

If the City is offered a security for which there is no other readily available competitive offering, the Treasurer will document quotations for comparable or alternative securities. . When purchasing original issue instrumentality securities, no competitive offerings will be required as all dealers in the selling group offer those securities at the same original issue price.

## **SELECTION OF BANKS**

The Treasurer shall maintain a list of banks that are approved to provide banking services for the City. To be eligible for authorization, a bank must be a member of the FDIC and shall qualify as a depository of public funds in the State of California as defined in California Government Code Section 53630.5.

## **SAFEKEEPING AND CUSTODY**

The Treasurer shall select one or more banks to provide safekeeping and custodial services for the City, in accordance with the provisions of Section 53608 of the California Government Code. A Safekeeping Agreement approved by the City shall be executed with each custodian bank prior to utilizing that bank's safekeeping services. Custodian banks will be selected on the basis of their ability to provide services for the City's account and the competitive pricing of their safekeeping related services.

The purchase and sale of securities and repurchase agreement transactions shall be settled on a delivery versus payment basis. All securities shall be perfected in the name of the City. Sufficient evidence to title shall be consistent with modern investment, banking and commercial practices.

All investment securities purchased by the City will be delivered by book entry and will be held in third-party safekeeping by a City approved custodian bank, or its Depository Trust Company (DTC) participant account.

The City's custodian shall be required to furnish the City a list of holdings on at least a monthly basis and safekeeping receipts or customer confirmations shall be issued for each transaction.

## **PORTFOLIO PERFORMANCE**

The investment portfolio shall be designed to attain a market rate of return throughout budgetary and economic cycles, taking into account prevailing market conditions, risk constraints for eligible securities, and cash flow requirements. The performance of the City's investments shall be compared to the return of a similar duration readily available market benchmark.

## **REPORTING**

On a quarterly basis, the Treasurer shall submit to the Council a report of the investment earnings and performance results of the City's investment portfolio. The report shall include the following information:

1. Investment type, issuer, date of purchase, purchase price, date of maturity, par value, current rate of interest and dollar amount invested in all securities, and investments and monies held by the City;
2. A description of the funds, investments and programs;

3. A market value as of the date of the report (or the most recent valuation as to assets not valued monthly) and the source of the valuation;
4. Overall portfolio yield based on historical cost;
5. Weighted average final maturity and weighted average effective maturity;
6. A statement of compliance with this Policy or an explanation for not-compliance;
7. A description of any of the City's funds, investments or programs that are under the management of contracted parties, including lending programs; and
8. A statement of the ability to meet expenditure requirements for six months, as well as an explanation of why money will not be available if that is the case.

The Treasurer shall submit to the Council a report of any changes affecting more than 15% of the investment portfolio within 30 days of such change.

### **POLICY REVIEW**

This Investment Policy shall be reviewed and approved by City Council annually to ensure its consistency with the overall objectives of preservation of principal, liquidity, yield and diversification and its relevance to current law and economic trends. Any additional amendments to this Investment Policy shall be submitted to the City Council for approval.

## GLOSSARY OF INVESTMENT TERMS

**AGENCIES.** Shorthand market terminology for any obligation issued by a *government-sponsored entity (GSE)*, or a *federally related institution*. Most obligations of GSEs are not guaranteed by the full faith and credit of the US government. Examples are:

**FFCB.** The Federal Farm Credit Bank System provides credit and liquidity in the agricultural industry. FFCB issues discount notes and bonds.

**FHLB.** The Federal Home Loan Bank provides credit and liquidity in the housing market. FHLB issues discount notes and bonds.

**FHLMC.** Like FHLB, the Federal Home Loan Mortgage Corporation provides credit and liquidity in the housing market. FHLMC, also called “FreddieMac” issues discount notes, bonds and mortgage pass-through securities.

**FNMA.** Like FHLB and FreddieMac, the Federal National Mortgage Association was established to provide credit and liquidity in the housing market. FNMA, also known as “FannieMae,” issues discount notes, bonds and mortgage pass-through securities.

**GNMA.** The Government National Mortgage Association, known as “GinnieMae,” issues mortgage pass-through securities, which are guaranteed by the full faith and credit of the US Government.

**PEFCO.** The Private Export Funding Corporation assists exporters. Obligations of PEFCO are not guaranteed by the full faith and credit of the US government.

**TVA.** The Tennessee Valley Authority provides flood control and power and promotes development in portions of the Tennessee, Ohio, and Mississippi River valleys. TVA currently issues discount notes and bonds.

**ASKED.** The price at which a seller offers to sell a security.

**ASSET BACKED SECURITIES.** Securities supported by pools of installment loans or leases or by pools of revolving lines of credit.

**AVERAGE LIFE.** In mortgage-related investments, including CMOs, the average time to expected receipt of principal payments, weighted by the amount of principal expected.

**BANKER’S ACCEPTANCE.** A money market instrument created to facilitate international trade transactions. It is highly liquid and safe because the risk of the trade transaction is transferred to the bank which “accepts” the obligation to pay the investor.

**BENCHMARK.** A comparison security or portfolio. A performance benchmark is a partial market index, which reflects the mix of securities allowed under a specific investment policy.

**BID.** The price at which a buyer offers to buy a security.

**BROKER.** A broker brings buyers and sellers together for a transaction for which the broker receives a commission. A broker does not sell securities from his own position.

**CALLABLE.** A callable security gives the issuer the option to call it from the investor prior to its maturity. The main cause of a call is a decline in interest rates. If interest rates decline since an issuer issues securities, it will likely call its current securities and reissue them at a lower rate of interest. Callable securities have reinvestment risk as the investor



may receive its principal back when interest rates are lower than when the investment was initially made.

**CERTIFICATE OF DEPOSIT (CD).** A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs may be marketable.

**CERTIFICATE OF DEPOSIT ACCOUNT REGISTRY SYSTEM (CDARS).** A private placement service that allows local agencies to purchase more than \$250,000 in CDs from a single financial institution (must be a participating institution of CDARS) while still maintaining FDIC insurance coverage. CDARS is currently the only entity providing this service. CDARS facilitates the trading of deposits between the California institution and other participating institutions in amounts that are less than \$250,000 each, so that FDIC coverage is maintained.

**COLLATERAL.** Securities or cash pledged by a borrower to secure repayment of a loan or repurchase agreement. Also, securities pledged by a financial institution to secure deposits of public monies.

**COLLATERALIZED MORTGAGE OBLIGATIONS (CMO).** Classes of bonds that redistribute the cash flows of mortgage securities (and whole loans) to create securities that have different levels of prepayment risk, as compared to the underlying mortgage securities.

**COMMERCIAL PAPER.** The short-term unsecured debt of corporations.

**COST YIELD.** The annual income from an investment divided by the purchase cost. Because it does not give effect to premiums and discounts which may have been included in the purchase cost, it is an incomplete measure of return.

**COUPON.** The rate of return at which interest is paid on a bond.

**CREDIT RISK.** The risk that principal and/or interest on an investment will not be paid in a timely manner due to changes in the condition of the issuer.

**CURRENT YIELD.** The annual income from an investment divided by the current market value. Since the mathematical calculation relies on the current market value rather than the investor's cost, current yield is unrelated to the actual return the investor will earn if the security is held to maturity.

**DEALER.** A dealer acts as a principal in security transactions, selling securities from and buying securities for his own position.

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

**DELIVERY VS. PAYMENT (DVP).** A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser's agent.

**DERIVATIVE.** Any security that has principal and/or interest payments which are subject to uncertainty (but not for reasons of default or credit risk) as to timing and/or amount, or any security which represents a component of another security which has been separated from other components ("Stripped" coupons and principal). A derivative is also defined as a financial instrument the value of which is totally or partially derived from the value of another instrument, interest rate, or index.

**DISCOUNT.** The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as T-bills and banker's acceptances, are known as discount securities. They sell at a discount from par, and return the par value to the investor at maturity without additional interest. Other

securities, which have fixed coupons, trade at a discount when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

**DIVERSIFICATION.** Dividing investment funds among a variety of investments to avoid excessive exposure to any one source of risk.

**DURATION.** The weighted average time to maturity of a bond where the weights are the present values of the future cash flows. Duration measures the price sensitivity of a bond to changes in interest rates. (See modified duration).

**FEDERAL FUNDS RATE.** The rate of interest charged by banks for short-term loans to other banks. The Federal Reserve Bank through open-market operations establishes it.

**FEDERAL OPEN MARKET COMMITTEE.** A committee of the Federal Reserve Board that establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

**LEVERAGE.** Borrowing funds in order to invest in securities that have the potential to pay earnings at a rate higher than the cost of borrowing.

**LIQUIDITY.** The speed and ease with which an asset can be converted to cash.

**LOCAL AGENCY INVESTMENT FUND (LAIF).** A voluntary investment fund open to government entities and certain non-profit organizations in California that is managed by the State Treasurer's Office.

**LOCAL GOVERNMENT INVESTMENT POOL.** Investment pools that range from the State Treasurer's Office Local Agency Investment Fund (LAIF) to county pools, to Joint Powers Authorities (JPAs). These funds are not subject to the same SEC rules applicable to money market mutual funds.

**MAKE WHOLE CALL.** A type of call provision on a bond that allows the issuer to pay off the remaining debt early. Unlike a call option, with a make whole call provision, the issuer makes a lump sum payment that equals the net present value (NPV) of future coupon payments that will not be paid because of the call. With this type of call, an investor is compensated, or "made whole."

**MARGIN.** The difference between the market value of a security and the loan a broker makes using that security as collateral.

**MARKET RISK.** The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates.

**MARKET VALUE.** The price at which a security can be traded.

**MARKING TO MARKET.** The process of posting current market values for securities in a portfolio.

**MATURITY.** The final date upon which the principal of a security becomes due and payable.

**MEDIUM TERM NOTES.** Unsecured, investment-grade senior debt securities of major corporations which are sold in relatively small amounts on either a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

**MODIFIED DURATION.** The percent change in price for a 100 basis point change in yields. Modified duration is the best single measure of a portfolio's or security's exposure to market risk.

**MONEY MARKET.** The market in which short-term debt instruments (T-bills, discount notes, commercial paper, and banker's acceptances) are issued and traded.

**MORTGAGE PASS-THROUGH SECURITIES.** A securitized participation in the interest and principal cash flows from a specified pool of mortgages. Principal and interest payments made on the mortgages are passed through to the holder of the security.

**MUNICIPAL SECURITIES.** Securities issued by state and local agencies to finance capital and operating expenses.

**MUTUAL FUND.** An entity which pools the funds of investors and invests those funds in a set of securities which is specifically defined in the fund's prospectus. Mutual funds can be invested in various types of domestic and/or international stocks, bonds, and money market instruments, as set forth in the individual fund's prospectus. For most large, institutional investors, the costs associated with investing in mutual funds are higher than the investor can obtain through an individually managed portfolio.

**NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO).**

A credit rating agency that the Securities and Exchange Commission in the United States uses for regulatory purposes. Credit rating agencies provide assessments of an investment's risk. The issuers of investments, especially debt securities, pay credit rating agencies to provide them with ratings. The three most prominent NRSROs are Fitch, S&P, and Moody's.

**NEGOTIABLE CD.** A short-term debt instrument that pays interest and is issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

**PREMIUM.** The difference between the par value of a bond and the cost of the bond, when the cost is above par.

**PREPAYMENT SPEED.** A measure of how quickly principal is repaid to investors in mortgage securities.

**PREPAYMENT WINDOW.** The time period over which principal repayments will be received on mortgage securities at a specified prepayment speed.

**PRIMARY DEALER.** A financial institution (1) that is a trading counterparty with the Federal Reserve in its execution of market operations to carry out U.S. monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the U.S. Government securities market.

**PRUDENT PERSON (PRUDENT INVESTOR) RULE.** A standard of responsibility which applies to fiduciaries. In California, the rule is stated as "Investments shall be managed with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of like character and with like aims to accomplish similar purposes."

**REALIZED YIELD.** The change in value of the portfolio due to interest received and interest earned and realized gains and losses. It does not give effect to changes in market value on securities, which have not been sold from the portfolio.

**REGIONAL DEALER.** A financial intermediary that buys and sells securities for the benefit of its customers without maintaining substantial inventories of securities and that is not a primary dealer.

**REPURCHASE AGREEMENT.** Short-term purchases of securities with a simultaneous agreement to sell the securities back at a higher price. From the seller's point of view, the same transaction is a reverse repurchase agreement.

**SAFEKEEPING.** A service to bank customers whereby securities are held by the bank in the customer's name.

**STRUCTURED NOTE.** A complex, fixed income instrument, which pays interest, based on a formula tied to other interest rates, commodities or indices. Examples include inverse floating rate notes which have coupons that increase when other interest rates are falling, and which fall when other interest rates are rising, and "dual index floaters," which pay interest based on the relationship between two other interest rates - for example, the yield on the ten-year Treasury note minus the SOFR rate. Issuers of such notes lock in a reduced cost of borrowing by purchasing interest rate swap agreements.

**SUPRANATIONAL.** A Supranational is a multi-national organization whereby member states transcend national boundaries or interests to share in the decision making to promote economic development in the member countries.

**TOTAL RATE OF RETURN.** A measure of a portfolio's performance over time. It is the internal rate of return, which equates the beginning value of the portfolio with the ending value; it includes interest earnings, realized and unrealized gains, and losses in the portfolio.

**U.S. TREASURY OBLIGATIONS.** Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are considered to have no credit risk, and are the benchmark for interest rates on all other securities in the US and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

**TREASURY BILLS.** All securities issued with initial maturities of one year or less are issued as discounted instruments, and are called Treasury bills. The Treasury currently issues three- and six-month T-bills at regular weekly auctions. It also issues "cash management" bills as needed to smooth out cash flows.

**TREASURY NOTES.** All securities issued with initial maturities of two to ten years are called Treasury notes, and pay interest semi-annually.

**TREASURY BONDS.** All securities issued with initial maturities greater than ten years are called Treasury bonds. Like Treasury notes, they pay interest semi-annually.

**VOLATILITY.** The rate at which security prices change with changes in general economic conditions or the general level of interest rates.

**YIELD TO MATURITY.** The annualized internal rate of return on an investment which equates the expected cash flows from the investment to its cost.

# City of San Rafael Investment Policy

PROPOSED June ~~24~~<sup>17</sup>, ~~2022~~<sup>2024</sup>

The City Council of the City of San Rafael (the City) has adopted this Investment Policy (the Policy) in order to establish the investment scope, objectives, delegation of authority, standards of prudence, reporting requirements, internal controls, eligible investments and transactions, diversification requirements, risk tolerance, and safekeeping and custodial procedures for the investment of the funds of the City. All such funds will be invested in accordance with this Policy and with applicable sections of the California Government Code. This Policy was endorsed and adopted by the City Council on the approved date noted above. It replaces any previous investment policy or investment procedures of the City.

## SCOPE

It is intended that this Policy cover all short-term operating funds and investment activities of the City. These funds are accounted for in the annual audit report, and include:

- General Fund
- Special Revenue Funds
- Debt Service Funds
- Capital Projects Funds
- Enterprise Funds
- Internal Service Funds
- Fiduciary Funds

Additional funds that may be created from time to time shall be administered in accordance with the provisions of this Policy.

All cash shall be pooled for investment purposes. The investment income derived from the pooled investment account shall be allocated to the contributing funds based upon the proportion of the respective average balances relative to the total pooled balance in the investment portfolio. Investment income shall be distributed to the individual funds not less than annually.

## OBJECTIVES

The City's funds shall be invested in compliance with all applicable City Municipal Codes, California State statutes, and Federal regulations, and in a manner designed to accomplish the following objectives, which are listed in priority order:

1. Preservation of capital and protection of investment principal.
2. Maintenance of sufficient liquidity to meet anticipated cash flows.
3. Attainment of a market value rate of return.
4. Diversification to avoid incurring unreasonable market risks.

## **DELEGATION OF AUTHORITY**

The management responsibility for the City's investment program is delegated annually by the City Council to the Treasurer pursuant to California Government Code Section 53607. The Treasurer may delegate the authority to conduct investment transactions and to manage the operation of the investment portfolio to other specifically authorized staff members. The Treasurer shall maintain a list of persons authorized to transact securities business for the City. No person may engage in an investment transaction except as expressly provided under the terms of this Policy.

The City Manager and the Treasurer jointly shall develop written administrative procedures and internal controls, consistent with this Policy, for the operation of the City's investment program. Such procedures shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, or imprudent actions by employees of the City.

The City may engage the support services of outside investment advisors in regard to its investment program, so long as it can be clearly demonstrated that these services produce a net financial advantage or necessary financial protection of the City's financial resources.

## **PRUDENCE**

The standard of prudence to be used for managing the City's investments shall be California Government Code Section 53600.3, the prudent investor standard which states, "When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee 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 agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency."

The City's overall investment program shall be designed and managed with a degree of professionalism that is worthy of the public trust. The City recognizes that no investment is totally without risk and that the investment activities of the City are a matter of public record. Accordingly, the City recognizes that occasional measured losses may be desirable in a diversified portfolio and shall be considered within the context of the overall portfolio's return, provided that adequate diversification has been implemented and that the sale of a security is in the best long-term interest of the City.

The Treasurer and authorized investment personnel acting in accordance with written procedures and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided that the deviations from expectations are reported in a timely fashion to the City Manager and appropriate action is taken to control adverse developments.

## ETHICS AND CONFLICTS OF INTEREST

Elected officials and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program or that could impair or create the appearance of an impairment of their ability to make impartial investment decisions. Employees and investment officials shall disclose to the City Manager any business interests they have in financial institutions that conduct business with the City and they shall subordinate their personal investment transactions to those of the City. In addition, the City Manager and the Treasurer shall file a Statement of Economic Interests each year pursuant to California Government Code Section 87203 and regulations of the Fair Political Practices Commission.

## AUTHORIZED SECURITIES AND TRANSACTIONS

All investments and deposits of the City shall be made in accordance with California Government Code Sections 16429.1, 53600-53609 and 53630-53686, except that, pursuant to California Government Code Section 5903(e), proceeds of bonds and any moneys set aside or pledged to secure payment of the bonds may be invested in securities or obligations described in the ordinance, resolution, indenture, agreement, or other instrument providing for the issuance of the bonds. Within the investments permitted by the Code, the City seeks to further restrict eligible investments to the guidelines listed below. In the event a discrepancy is found between this policy and the Code, the more restrictive parameters will take precedence. Any revisions or extensions of these code sections will be assumed to be part of this Policy immediately upon being enacted. However, in the event that amendments to these sections conflict with this Policy and past City investment practices, the City may delay adherence to the new requirements when it is deemed in the best interest of the City to do so. In such instances, after consultation with the City's attorney, the City Manager and the Treasurer will present a recommended course of action to the City Council for approval. In accordance with California Government Code listed above, the "Total Portfolio" includes all investments and deposits including funds in any money market accounts and governmental pools such as LAIF. Any percentage limitations are deemed to be calculated on the "Total Portfolio" and are measured based on the cost-market value of the investment at the time of purchase. Minimum credit quality requirements apply at time of purchase.

The City has further restricted the eligible types of securities and transactions as follows:

1. United States Treasury bills, notes and bonds and other government obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest with a final maturity not exceeding five years from the date of trade settlement. There are no limits on the dollar amount or percentage that the City may invest in U.S. Treasury obligations
2. Federal Agency securities or United States Government-Sponsored Enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises with a final maturity not exceeding five years from the date of trade settlement. No more than 30% of the portfolio may be invested in any single Agency/GSE issuer. The maximum percent of agency callable securities in the portfolio will be 20%.

~~3. Federal Instrumentality (government sponsored enterprise) debentures, discount notes, callable and step-up securities, with a final maturity not exceeding five years from the date of trade settlement.~~

~~4.3. Mortgage and Asset-Backed Obligations: 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 from issuers not defined in paragraphs 1 and 2 of the Authorized Securities and Transactions section of this policy, with a final maturity not exceeding five years from the date of trade settlement. Investments in mortgage and asset-backed obligations shall be issued by an issuer rated at least "A" or the equivalent by a nationally recognized statistical rating organization (NRSRO) and the security shall be rated at least in a rating category of "AA" or the equivalent or better by at least one nationally recognized statistical rating organization (NRSRO). Purchases of securities authorized by this section may not exceed 20% of the City's total portfolio. No more than 5% of the portfolio may be invested in any single asset-backed or commercial mortgage security issuer.~~

~~5.4. Supranational Securities: United States dollar denominated, senior unsecured and unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank, with a maximum maturity not exceeding five years from the date of trade settlement, and eligible for purchase and sale within the United States. Investments in supranational securities shall be rated at least in a rating category of "AA" or the equivalent or better by at least one NRSRO and shall not exceed ~~45~~<sup>30</sup>% of the City's total portfolio. No more than 10% of the portfolio may be invested in any single issuer.~~

~~6.5. Medium-Term Notes 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, with a final maturity not exceeding five years from the date of trade settlement, and rated at least in a rating category of "A" or the equivalent or better by at least one NRSRO. No more than 5% of the portfolio shall be invested in medium-term notes of any one issuer, and the aggregate investment in medium-term notes shall not exceed 30% of the City's total portfolio.~~

~~7.6. Negotiable Certificates of Deposits (CDs) issued by a nationally or state-chartered bank, a savings association or a federal association, a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank of commercial banks rated at least A-1, or the equivalent or better by at least one NRSRO, or with long-term obligations rated in a rating category of "A" or the equivalent or better by at least one NRSRO, with maturities not exceeding five years from the date of trade settlement. Amounts up to the FDIC limit do not require any credit ratings. Amounts above the FDIC limit must follow the credit requirements listed above. In addition, the City may not invest in the CD of a state or federal credit union where any person with investment decision making authority at 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. No more~~



than 5% of the portfolio may be invested in the CDs of any one issuer, and the aggregate investment in CDs shall not exceed 30% of the portfolio.

~~8.7.~~ Non-negotiable Certificates of Deposit and savings deposits with a maturity not exceeding five years from the date of trade settlement, in FDIC insured state or nationally chartered banks or savings banks that qualify as a depository of public funds in the State of California as defined in California Government Code Section 53630.5. No more than 5% of the portfolio may be invested in the CDs of any one issuer, and the aggregate investment in CDs shall not exceed ~~30~~<sup>20</sup>% of the portfolio.

Deposits in excess of the insured amount shall be secured pursuant to California Government Code Section 53651 and 53652. The City shall comply with and act to secure compliance with the security (collateralization) system specified in the Government Code Section 53649 and 56652.

Deposits may be placed using a private sector entity that assists in the placement of deposits per section 53601.8 and 53635.8 in the Government Code. No more than 5% of the portfolio may be invested through any one private sector entity that assists in the placement of such deposits and the aggregate investment in CDs shall not exceed ~~30~~<sup>20</sup>% of the portfolio.

8. Municipal Securities including obligations of the State of California and any local agency within the State of California, including Special Assessment District Obligations issued by the City of San Rafael as Limited Obligation Improvement Bonds related to special assessment districts and special tax districts. Municipal securities shall be rated in a rating category of "A" or its equivalent or better by at least one NRSRO. No more than 5% of the portfolio may be invested in any single issuer. No more than 30% of the portfolio may be in Municipal Securities. The maximum maturity shall not exceed five (5) years. Investment in Special Assessment District Obligations issued by the City of San Rafael as Limited Obligation Improvement Bonds such obligations requires the approval of the City Council and maturities may extend to 30 years from the date of trade settlement.

9. Municipal Securities (Registered Treasury Notes or Bonds) of any of the other 49 states in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 states, in addition to California. The securities are rated in a rating category of "A" or its equivalent or better by at least one NRSRO. No more than 5% of the portfolio may be invested in any single issuer. No more than 30% of the portfolio may be in Municipal Securities. The maximum maturity does not exceed five (5) years.

~~9.10.~~ Prime Commercial Paper with a maturity not exceeding 270 days from the date of purchase with the highest ranking or of the highest letter and number rating as provided for by ~~a~~<sup>at least one</sup> NRSRO. The entity that issues the commercial paper shall meet all of the following conditions in either sub-paragraph A. or sub-paragraph B. below:

A. The entity shall (1) be organized and operating in the United States as a general corporation, (2) have total assets in excess of five \$500,000,000 and

(3) Have debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.

B. The entity shall (1) be organized within the United States as a special purpose corporation, trust, or limited liability company, (2) have program-wide credit enhancements, including, but not limited to, over collateralization, letters of credit or surety bond and (3) have commercial paper that is rated "A-1" or higher, or the equivalent, by a NRSRO.

Purchases of eligible commercial paper may not represent more than 10% of the outstanding commercial paper of any single corporate issuer. No more than 5% of the City's total portfolio, shall be invested in the commercial paper of any one issuer, and the aggregate investment in commercial paper shall not exceed 25% of the City's total portfolio.

~~10-11.~~ Eligible Banker's Acceptances issued by FDIC insured commercial banks, rated at least A-1 or the equivalent or better by at least one NRSRO with maturities not exceeding 180 days from the date of purchase. If issuers have senior debt outstanding, it shall be rated in a rating category of at least "A" or the equivalent or better by at least one NRSRO. No more than \$2,000,000 shall be invested in banker's acceptances of any one commercial bank, and the aggregate investment in banker's acceptances shall not exceed 40% of the City's total portfolio.

~~11-12.~~ Repurchase Agreements with a final termination date not exceeding one year collateralized by U.S. Treasury obligations, Federal Agency securities, or Federal Instrumentality securities listed in items 1 or, 2 ~~and 3~~ above with the maturity of the collateral not exceeding five years. For the purpose of this section, the term collateral shall mean purchased securities under the terms of the City's approved Master Repurchase Agreement. The purchased securities shall have a minimum market value including accrued interest of 102% of the dollar value of the funds borrowed. Collateral shall be held in the City's custodian bank, as safekeeping agent, and the market value of the collateral securities shall be marked-to-the-market daily.

Repurchase Agreements shall be entered into only with broker/dealers who are recognized as Primary Dealers by the Federal Reserve Bank of New York or have a primary dealer within their holding company structure. Repurchase agreement counterparties shall execute a City approved Master Repurchase Agreement with the City. The Treasurer shall maintain a copy of the City's approved Master Repurchase Agreement along with a list of the broker/dealers who have executed same.

~~12-13.~~ State of California's Local Agency Investment Fund (LAIF), pursuant to California Government Code Section 16429.1.

14. Money Market Funds registered under the Investment Company Act of 1940 that (1) are "no-load" (meaning no commission or fee shall be charged on purchases or sales of shares); (2) have a constant daily net asset value per share of \$1.00; (3) invest only in United States Treasury securities, United States Agency securities and Federal Instrumentality securities and (4) have a rating ~~of at least AAA or the equivalent~~ equivalenting the highest letter and numerical rating by at least two NRSROs.

The aggregate investment in money market funds shall not exceed ~~40~~<sup>20</sup>% of the City's total portfolio.

~~13.15.~~ Collateralized Bank Deposits. City's deposits with financial institutions will be collateralized with pledged securities per California Government Code, Section 53651. There are no limits on the dollar amount or percentage that the City may invest in collateralized bank deposits.

It is the intent of the City that the foregoing list of authorized securities and transactions is strictly interpreted. ~~Any deviation from this list must be preapproved by resolution of the City Council.~~

### **PROHIBITED INVESTMENT VEHICLES AND PRACTICES**

- State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to futures and options.
- In accordance with Government Code, Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.
- Investment in any security that could result in a zero interest accrual if held to maturity is prohibited. Under a provision sunseting on January 1, 2026, securities backed by the U.S. Government that could result in a zero- or negative-interest accrual if held to maturity are permitted.
- Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.
- Purchasing or selling securities on margin is prohibited.
- The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited.
- The purchase of foreign currency denominated securities is prohibited.
- Agencies that are not Qualified Institutional Buyers (QIB) as defined by the Securities and Exchange Commission are prohibited from purchasing Private Placement Securities. The SEC defines a QIB as having at least \$100,000,000 in securities owned and invested.
- Direct investments in issuers whose primary business revenue is derived from the exploration, extraction, and processing of fossil fuels.

### **INVESTMENT POOLS/MUTUAL FUNDS**

The City shall conduct a thorough investigation of any pool or mutual fund prior to making an investment, and on a continual basis thereafter. The Treasurer shall develop a questionnaire which will answer the following general questions:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how it is distributed, and how gains and losses are treated.
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.
- A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings.
- Are reserves, retained earnings, etc. utilized by the pool/fund?
- A fee schedule, and when and how is it assessed.
- Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

## **PORTFOLIO MATURITIES AND LIQUIDITY**

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities. The City will not invest in securities maturing more than five years from the date of purchase, unless the City Council has by resolution granted authority to make such an investment at least three months prior to the date of investment.

### **MAXIMUM MATURITY**

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities.

The City will not invest in securities maturing more than five (5) years from the date of trade settlement, unless the City Council has granted authority to make such an investment either specifically or as a part of an investment program approved by the City Council no less than three months prior to the investment. Investment in Special Assessment District Obligations issued by the City of San Rafael as Limited Obligation Improvement Bonds requires the approval of the City Council and maturities may extend to 30 years from the date of trade settlement.

## **RISK MANAGEMENT AND DIVERSIFICATION**

### Mitigating Credit Risk in the Portfolio

Credit risk is the risk that a security or a portfolio will lose some or all its value due to a real or perceived change in the ability of the issuer to repay its debt. The City will mitigate credit risk by adopting the following strategies:

- The diversification requirements included in the “Authorized Investments” section of this policy are designed to mitigate credit risk in the portfolio.
- No more than 5% of the total portfolio may be deposited with or invested in securities issued by any single issuer unless otherwise specified in this policy.
- The City may elect to sell a security prior to its maturity and record a capital gain or loss in order to manage the quality, liquidity or yield of the portfolio in response to market conditions or City’s risk preferences.
- If a security owned by the City is downgraded to a level below the requirements of this policy, making the security ineligible for additional purchases, the following steps will be taken:
  - Any actions taken related to the downgrade by the investment manager will be communicated to the Treasurer in a timely manner.
  - If a decision is made to retain the security, the credit situation will be monitored and reported to the City Council.

#### Mitigating Market Risk in the Portfolio

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The City recognizes that, over time, longer-term portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The City will mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes.

The City further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The City, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

- The City will maintain a minimum of six months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements.
- The maximum stated final maturity of individual securities in the portfolio will be five (5) years, except as otherwise stated in this policy.
- The duration of the portfolio will generally be approximately equal to the duration (typically, plus or minus 20%) of a Market Benchmark, an index selected by the City based on the City’s investment objectives, constraints and risk tolerances.

### **SELECTION OF BROKER/DEALERS**

The Treasurer shall maintain a list of broker/dealers authorized for investment purposes, and it shall be the policy of the City to purchase securities only from those authorized firms. To

be eligible, a firm must be licensed by the State of California as a broker/dealer as defined in Section 25004 of the California Corporations Code, and:

1. be recognized as a Primary Dealer by the Federal Reserve Bank of New York or have a primary dealer within its holding company structure, or
2. report voluntarily to the Federal Reserve Bank of New York, or
3. qualify under Securities and Exchange Commission (SEC) Rule 15c3-1 (Uniform Net Capital Rule).

The City may engage the services of investment advisory firms to assist in the management of the portfolio and investment advisors may utilize their own list of approved Broker/Dealers. Selection of broker/dealers used by an external investment adviser retained by the City will be at the sole discretion of the advisor. Such Broker/Dealers will comply with the selection criteria above and the list of approved firms shall be provided to the City on an annual basis or upon request.

In the event that an external investment advisor is not used in the process of recommending a particular transaction in the City's portfolio, authorized broker/dealers shall attest in writing that they have received and reviewed a copy of this policy and annually update a City approved Broker/Dealer Information Request form which includes the firm's most recent financial statements. The Treasurer shall maintain a list of the broker/dealers that have been approved by the City, along with each firm's most recent broker/dealer Information Request form.

The City may purchase commercial paper from direct issuers even though they are not on the approved broker/dealer list as long as they meet the criteria outlined in Item 5 of the Authorized Securities and Transactions section of this Policy.

### COLLATERALIZATION

Certificates of Deposit (CDs). The City shall require any commercial bank or savings and loan association to deposit eligible securities with a City of a depository approved by the State Banking Department to secure any uninsured portion of a Non-Negotiable Certificate of Deposit. The value of eligible securities as defined pursuant to California Government Code, Section 53651, pledged against a Certificate of Deposit shall be equal to 150% of the face value of the CD if the securities are classified as mortgages and 110% of the face value of the CD for all other classes of security.

Collateralization of Bank Deposits. This is the process by which a bank or financial institution pledges securities, or other deposits for the purpose of securing repayment of deposited funds. The City shall require any bank or financial institution to comply with the collateralization criteria defined in California Government Code, Section 53651.

Repurchase Agreements. The City requires that Repurchase Agreements be collateralized only by securities authorized in accordance with California Government Code:

- The securities which collateralize the repurchase agreement shall be priced at Market Value, including any Accrued Interest plus a margin. The Market Value of the securities that collateralize a repurchase agreement shall be valued at 102% or greater of the funds borrowed against those securities.
- Financial institutions shall mark the value of the collateral to market at least monthly and increase or decrease the collateral to satisfy the ratio requirement described above.
- The City shall receive monthly statements of collateral.

## **COMPETITIVE TRANSACTIONS**

Where possible, Eeach investment transaction shall be competitively transacted with authorized broker/dealers. At least three broker/dealers shall be contacted for each transaction and their bid and offering prices shall be recorded.

If the City is offered a security for which there is no other readily available competitive offering, the Treasurer will document quotations for comparable or alternative securities. . When purchasing original issue instrumentality securities, no competitive offerings will be required as all dealers in the selling group offer those securities at the same original issue price.

## **SELECTION OF BANKS**

The Treasurer shall maintain a list of banks that are approved to provide banking services for the City. To be eligible for authorization, a bank must be a member of the FDIC and shall qualify as a depository of public funds in the State of California as defined in California Government Code Section 53630.5.

## **SAFEKEEPING AND CUSTODY**

The Treasurer shall select one or more banks to provide safekeeping and custodial services for the City, in accordance with the provisions of Section 53608 of the California Government Code. A Safekeeping Agreement approved by the City shall be executed with each custodian bank prior to utilizing that bank's safekeeping services. Custodian banks will be selected on the basis of their ability to provide services for the City's account and the competitive pricing of their safekeeping related services.

The purchase and sale of securities and repurchase agreement transactions shall be settled on a delivery versus payment basis. All securities shall be perfected in the name of the City. Sufficient evidence to title shall be consistent with modern investment, banking and commercial practices.

All investment securities purchased by the City will be delivered by book entry and will be held in third-party safekeeping by a City approved custodian bank, or its Depository Trust Company (DTC) participant account.



The City's custodian shall be required to furnish the City a list of holdings on at least a monthly basis and safekeeping receipts or customer confirmations shall be issued for each transaction.

## PORTFOLIO PERFORMANCE

The investment portfolio shall be designed to attain a market rate of return throughout budgetary and economic cycles, taking into account prevailing market conditions, risk constraints for eligible securities, and cash flow requirements. The performance of the City's investments shall be compared to the ~~average yield on the U.S. Treasury security that most closely corresponds to the portfolio's actual weighted average effective maturity. When comparing the performance of the City's portfolio, its rate of return will be computed net of all fees and expenses~~return of a similar duration readily available market benchmark.

## REPORTING

On a quarterly basis, the Treasurer shall submit to the Council a report of the investment earnings and performance results of the City's investment portfolio. The report shall include the following information:

1. Investment type, issuer, date of purchase, purchase price, date of maturity, par value, current rate of interest and dollar amount invested in all securities, and investments and monies held by the City;
2. A description of the funds, investments and programs;
3. A market value as of the date of the report (or the most recent valuation as to assets not valued monthly) and the source of the valuation;
4. Overall portfolio yield based on historical cost;
5. Weighted average final maturity and weighted average effective maturity;
6. A statement of compliance with this Policy or an explanation for not-compliance;
7. A description of any of the City's funds, investments or programs that are under the management of contracted parties, including lending programs; and
8. A statement of the ability to meet expenditure requirements for six months, as well as an explanation of why money will not be available if that is the case.

The Treasurer shall submit to the Council a report of any changes affecting more than 15% of the investment portfolio within 30 days of such change.

## POLICY REVIEW

This Investment Policy shall be reviewed and approved by City Council annually to ensure its consistency with the overall objectives of preservation of principal, liquidity, yield and diversification and its relevance to current law and economic trends. Any additional amendments to this Investment Policy shall be submitted to the City Council for approval.





## GLOSSARY OF INVESTMENT TERMS

**AGENCIES.** Shorthand market terminology for any obligation issued by a *government-sponsored entity (GSE)*, or a *federally related institution*. Most obligations of GSEs are not guaranteed by the full faith and credit of the US government. Examples are:

**FFCB.** The Federal Farm Credit Bank System provides credit and liquidity in the agricultural industry. FFCB issues discount notes and bonds.

**FHLB.** The Federal Home Loan Bank provides credit and liquidity in the housing market. FHLB issues discount notes and bonds.

**FHLMC.** Like FHLB, the Federal Home Loan Mortgage Corporation provides credit and liquidity in the housing market. FHLMC, also called “FreddieMac” issues discount notes, bonds and mortgage pass-through securities.

**FNMA.** Like FHLB and FreddieMac, the Federal National Mortgage Association was established to provide credit and liquidity in the housing market. FNMA, also known as “FannieMae,” issues discount notes, bonds and mortgage pass-through securities.

**GNMA.** The Government National Mortgage Association, known as “GinnieMae,” issues mortgage pass-through securities, which are guaranteed by the full faith and credit of the US Government.

**PEFCO.** The Private Export Funding Corporation assists exporters. Obligations of PEFCO are not guaranteed by the full faith and credit of the US government.

**TVA.** The Tennessee Valley Authority provides flood control and power and promotes development in portions of the Tennessee, Ohio, and Mississippi River valleys. TVA currently issues discount notes and bonds.

**ASKED.** The price at which a seller offers to sell a security.

**ASSET BACKED SECURITIES.** Securities supported by pools of installment loans or leases or by pools of revolving lines of credit.

**AVERAGE LIFE.** In mortgage-related investments, including CMOs, the average time to expected receipt of principal payments, weighted by the amount of principal expected.

**BANKER’S ACCEPTANCE.** A money market instrument created to facilitate international trade transactions. It is highly liquid and safe because the risk of the trade transaction is transferred to the bank which “accepts” the obligation to pay the investor.

**BENCHMARK.** A comparison security or portfolio. A performance benchmark is a partial market index, which reflects the mix of securities allowed under a specific investment policy.

**BID.** The price at which a buyer offers to buy a security.

**BROKER.** A broker brings buyers and sellers together for a transaction for which the broker receives a commission. A broker does not sell securities from his own position.

**CALLABLE.** A callable security gives the issuer the option to call it from the investor prior to its maturity. The main cause of a call is a decline in interest rates. If interest rates decline since an issuer issues securities, it will likely call its current securities and reissue them at a lower rate of interest. Callable securities have reinvestment risk as the investor

may receive its principal back when interest rates are lower than when the investment was initially made.

**CERTIFICATE OF DEPOSIT (CD).** A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs may be marketable.

**CERTIFICATE OF DEPOSIT ACCOUNT REGISTRY SYSTEM (CDARS).** A private placement service that allows local agencies to purchase more than \$250,000 in CDs from a single financial institution (must be a participating institution of CDARS) while still maintaining FDIC insurance coverage. CDARS is currently the only entity providing this service. CDARS facilitates the trading of deposits between the California institution and other participating institutions in amounts that are less than \$250,000 each, so that FDIC coverage is maintained.

**COLLATERAL.** Securities or cash pledged by a borrower to secure repayment of a loan or repurchase agreement. Also, securities pledged by a financial institution to secure deposits of public monies.

**COLLATERALIZED MORTGAGE OBLIGATIONS (CMO).** Classes of bonds that redistribute the cash flows of mortgage securities (and whole loans) to create securities that have different levels of prepayment risk, as compared to the underlying mortgage securities.

**COMMERCIAL PAPER.** The short-term unsecured debt of corporations.

**COST YIELD.** The annual income from an investment divided by the purchase cost. Because it does not give effect to premiums and discounts which may have been included in the purchase cost, it is an incomplete measure of return.

**COUPON.** The rate of return at which interest is paid on a bond.

**CREDIT RISK.** The risk that principal and/or interest on an investment will not be paid in a timely manner due to changes in the condition of the issuer.

**CURRENT YIELD.** The annual income from an investment divided by the current market value. Since the mathematical calculation relies on the current market value rather than the investor's cost, current yield is unrelated to the actual return the investor will earn if the security is held to maturity.

**DEALER.** A dealer acts as a principal in security transactions, selling securities from and buying securities for his own position.

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

**DELIVERY VS. PAYMENT (DVP).** A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser's agent.

**DERIVATIVE.** Any security that has principal and/or interest payments which are subject to uncertainty (but not for reasons of default or credit risk) as to timing and/or amount, or any security which represents a component of another security which has been separated from other components ("Stripped" coupons and principal). A derivative is also defined as a financial instrument the value of which is totally or partially derived from the value of another instrument, interest rate, or index.

**DISCOUNT.** The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as T-bills and banker's acceptances, are known as discount securities. They sell at a discount from par, and return the par value to the investor at maturity without additional interest. Other

securities, which have fixed coupons, trade at a discount when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

**DIVERSIFICATION.** Dividing investment funds among a variety of investments to avoid excessive exposure to any one source of risk.

**DURATION.** The weighted average time to maturity of a bond where the weights are the present values of the future cash flows. Duration measures the price sensitivity of a bond to changes in interest rates. (See modified duration).

**FEDERAL FUNDS RATE.** The rate of interest charged by banks for short-term loans to other banks. The Federal Reserve Bank through open-market operations establishes it.

**FEDERAL OPEN MARKET COMMITTEE.** A committee of the Federal Reserve Board that establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

**LEVERAGE.** Borrowing funds in order to invest in securities that have the potential to pay earnings at a rate higher than the cost of borrowing.

**LIQUIDITY.** The speed and ease with which an asset can be converted to cash.

**LOCAL AGENCY INVESTMENT FUND (LAIF).** A voluntary investment fund open to government entities and certain non-profit organizations in California that is managed by the State Treasurer's Office.

**LOCAL GOVERNMENT INVESTMENT POOL.** Investment pools that range from the State Treasurer's Office Local Agency Investment Fund (LAIF) to county pools, to Joint Powers Authorities (JPAs). These funds are not subject to the same SEC rules applicable to money market mutual funds.

**MAKE WHOLE CALL.** A type of call provision on a bond that allows the issuer to pay off the remaining debt early. Unlike a call option, with a make whole call provision, the issuer makes a lump sum payment that equals the net present value (NPV) of future coupon payments that will not be paid because of the call. With this type of call, an investor is compensated, or "made whole."

**MARGIN.** The difference between the market value of a security and the loan a broker makes using that security as collateral.

**MARKET RISK.** The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates.

**MARKET VALUE.** The price at which a security can be traded.

**MARKING TO MARKET.** The process of posting current market values for securities in a portfolio.

**MATURITY.** The final date upon which the principal of a security becomes due and payable.

**MEDIUM TERM NOTES.** Unsecured, investment-grade senior debt securities of major corporations which are sold in relatively small amounts on either a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

**MODIFIED DURATION.** The percent change in price for a 100 basis point change in yields. Modified duration is the best single measure of a portfolio's or security's exposure to market risk.

**MONEY MARKET.** The market in which short-term debt instruments (T-bills, discount notes, commercial paper, and banker's acceptances) are issued and traded.

**MORTGAGE PASS-THROUGH SECURITIES.** A securitized participation in the interest and principal cash flows from a specified pool of mortgages. Principal and interest payments made on the mortgages are passed through to the holder of the security.

**MUNICIPAL SECURITIES.** Securities issued by state and local agencies to finance capital and operating expenses.

**MUTUAL FUND.** An entity which pools the funds of investors and invests those funds in a set of securities which is specifically defined in the fund's prospectus. Mutual funds can be invested in various types of domestic and/or international stocks, bonds, and money market instruments, as set forth in the individual fund's prospectus. For most large, institutional investors, the costs associated with investing in mutual funds are higher than the investor can obtain through an individually managed portfolio.

**NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO).**

A credit rating agency that the Securities and Exchange Commission in the United States uses for regulatory purposes. Credit rating agencies provide assessments of an investment's risk. The issuers of investments, especially debt securities, pay credit rating agencies to provide them with ratings. The three most prominent NRSROs are Fitch, S&P, and Moody's.

**NEGOTIABLE CD.** A short-term debt instrument that pays interest and is issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

**PREMIUM.** The difference between the par value of a bond and the cost of the bond, when the cost is above par.

**PREPAYMENT SPEED.** A measure of how quickly principal is repaid to investors in mortgage securities.

**PREPAYMENT WINDOW.** The time period over which principal repayments will be received on mortgage securities at a specified prepayment speed.

**PRIMARY DEALER.** A financial institution (1) that is a trading counterparty with the Federal Reserve in its execution of market operations to carry out U.S. monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the U.S. Government securities market.

**PRUDENT PERSON (PRUDENT INVESTOR) RULE.** A standard of responsibility which applies to fiduciaries. In California, the rule is stated as "Investments shall be managed with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of like character and with like aims to accomplish similar purposes."

**REALIZED YIELD.** The change in value of the portfolio due to interest received and interest earned and realized gains and losses. It does not give effect to changes in market value on securities, which have not been sold from the portfolio.

**REGIONAL DEALER.** A financial intermediary that buys and sells securities for the benefit of its customers without maintaining substantial inventories of securities and that is not a primary dealer.

**REPURCHASE AGREEMENT.** Short-term purchases of securities with a simultaneous agreement to sell the securities back at a higher price. From the seller's point of view, the same transaction is a reverse repurchase agreement.

**SAFEKEEPING.** A service to bank customers whereby securities are held by the bank in the customer's name.

**STRUCTURED NOTE.** A complex, fixed income instrument, which pays interest, based on a formula tied to other interest rates, commodities or indices. Examples include inverse floating rate notes which have coupons that increase when other interest rates are falling, and which fall when other interest rates are rising, and "dual index floaters," which pay interest based on the relationship between two other interest rates - for example, the yield on the ten-year Treasury note minus the SOFR rate. Issuers of such notes lock in a reduced cost of borrowing by purchasing interest rate swap agreements.

**SUPRANATIONAL.** A Supranational is a multi-national organization whereby member states transcend national boundaries or interests to share in the decision making to promote economic development in the member countries.

**TOTAL RATE OF RETURN.** A measure of a portfolio's performance over time. It is the internal rate of return, which equates the beginning value of the portfolio with the ending value; it includes interest earnings, realized and unrealized gains, and losses in the portfolio.

**U.S. TREASURY OBLIGATIONS.** Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are considered to have no credit risk, and are the benchmark for interest rates on all other securities in the US and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

**TREASURY BILLS.** All securities issued with initial maturities of one year or less are issued as discounted instruments, and are called Treasury bills. The Treasury currently issues three- and six-month T-bills at regular weekly auctions. It also issues "cash management" bills as needed to smooth out cash flows.

**TREASURY NOTES.** All securities issued with initial maturities of two to ten years are called Treasury notes, and pay interest semi-annually.

**TREASURY BONDS.** All securities issued with initial maturities greater than ten years are called Treasury bonds. Like Treasury notes, they pay interest semi-annually.

**VOLATILITY.** The rate at which security prices change with changes in general economic conditions or the general level of interest rates.

**YIELD TO MATURITY.** The annualized internal rate of return on an investment which equates the expected cash flows from the investment to its cost.

December 29, 2022

William Dennehy II, CFA, *Co-Chief Investment Officer*  
Carlos Oblites, *Senior Portfolio Strategist*

Chandler Asset Management  
6225 Lusk Boulevard  
San Diego, CA 92121

RE: Client Directive Regarding Management of the City of San Rafael Investment Program

Dear Messrs. Dennehy and Oblites,

The City of San Rafael entered into a discretionary investment advisory agreement with Chandler Asset Management, a SEC-registered investment advisor, to manage a portion of the City's investment assets in a disciplined, active manner that complies with the City's primary objectives of safety, liquidity and return on investment, as stated in the City of San Rafael Investment Policy.

After a recent consultation with Chandler's investment team, the City agreed to implement a strategy for its core funds that invests in a diversified portfolio of US dollar-denominated fixed income securities managed in compliance with the City's investment policy.

- Chandler will make best efforts to maintain the City's market risk, as measured by modified duration, within +/- 10% of the duration of the **ICE BofA 1-3 Year US Treasury & Agency Index**.
- Chandler will implement the strategy incrementally, as market changes provide opportunities to position the target duration.
- Until further notice, Chandler Asset Management will refrain from making any direct investments in issuers whose primary business revenue is derived from the exploration, extraction, and processing of fossil fuels.

This directive is in effect as of the date of this memo and will remain in effect until it is replaced by a revised directive.

Respectfully,



Nadine Atieh Hade  
Administrative Services Director  
City of San Rafael, California