

Investment Policy

Section 1: Purpose

The purpose of this policy is to create a guide for the investment of City funds and to take advantage of resources not available to the City through the Local Government Investment Pool maintained by the Arizona State Treasurer's Office.

Therefore, it is the investment policy of the City and its Investment Committee to maintain the safety of principal, maintain liquidity to meet cash flow needs and provide competitive investment returns as identified below.

Section 2: Governing Authority

The City invests in conformance with Federal, State and other legal requirements, primarily outlined in A.R.S. §35-323.

Investment Committee

The City may seek to establish an Investment Committee to provide guidance for the investment of the City's funds and achievement of its investment objectives. The Investment Committee shall be made up of the City Manager, Assistant City Manager, and the Chief Financial Officer.

Section 3: Scope

This policy applies to the City's investments with the exception of the City's bond proceeds which are governed by individual indentures.

The City will consolidate cash and reserve balances from all funds to maximize investment earnings and increase efficiencies with investment management pricing, safekeeping costs and administration costs, except for cash in certain restricted and/or trust funds, which are exempted from this policy.

Investment income will be allocated to funds based on their respective participation and in accordance with generally accepted accounting principles.

Investments that need to restrict yield for purposes of the Internal Revenue Service's Arbitrage Bond Regulations will be deposited into a separate account and invested in a manner that meets IRS arbitrage guidelines.

Section 4: Investment Policy Objectives

The primary investment objectives of the City in order of priority are safety, liquidity, and optimal yield as defined below:

1. Safety - Investments shall preserve capital. The objective will be to prudently mitigate credit risk and interest rate risk. It is understood by the City that no investment is completely free of risk.
 - a. Credit Risk – The City will mitigate credit risk, which is defined as the risk of loss due to the failure of the security issuer or backer, by:
 - i. Limiting investments in the portfolio to the asset classes designated as acceptable in A.R.S. §35-323. When possible, analysis of the credit worthiness of debt issuers held in the portfolio should be conducted annually to guard against investing in weak or deteriorating credit situations;
 - ii. Diversifying the investment portfolio to limit potential losses. Specific diversification parameters will be noted in Section 8;
 - iii. Utilizing external research and advice on current global economic condition and impacts on domestic corporate credit quality.

- b. Interest Rate Risk – The City will mitigate interest rate risk, which is defined as the risk that the market value of securities will decline due to increases in market interest rates subsequent to their purchase and prior to their maturity, by:
 - i. Structuring the investment portfolio so that securities mature concurrent with cash requirements for operations, thereby avoiding, as much as possible, the need to sell securities into an adverse market environment prior to maturity;
 - ii. Utilizing external research and advice on current interest rate outlook and global economic condition to optimize portfolio duration strategy.
- 2. Liquidity - The investment portfolio shall remain sufficiently liquid to meet anticipated cash flows by structuring the portfolio so that securities mature concurrent with anticipated cash flow needs (static liquidity). Furthermore, because all cash demands cannot be anticipated, the portfolio should consist of securities with an active secondary market (dynamic liquidity).
- 3. Optimal Yield – The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall generally be held until maturity with the following exceptions:
 - a. A security with declining credit may be sold early to minimize loss of principal.
 - b. A security swap would improve the quality or yield in the portfolio.
 - c. Liquidity needs of the portfolio require that the security be sold.

Section 5: Investment Management Authority

Authority to manage internally or to delegate investment management to an external manager is granted to the City Manager. If all or a portion of the investments are managed externally, the Chief Financial Officer, in conjunction with the Investment Committee, is responsible for:

- 1. Periodic investment portfolio reporting;
- 2. Evaluating the performance of the externally managed portfolio;
- 3. Monitoring manager compliance with the investment policy;
- 4. Conveying investment needs to the external manager;
- 5. Developing investment strategy with the external manager.

Section 6: Authorized Financial Institutions, Depositories, and Broker/Dealers

- 1. A list will be maintained of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by creditworthiness (e.g. a minimum capital requirement of \$ 10,000,000 and at least five years of operation). These may include “primary” dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).
- 2. All financial institutions and broker/dealers who desire to become qualified for investment transactions must supply the following as appropriate:
 - a. Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines.
 - b. Proof of certification by the Financial Industry National Regulatory Association (FINRA) (not applicable to Certificate of Deposit counterparties)
 - c. Proof of state registration
 - d. Completed broker/dealer questionnaire (not applicable to Certificate of Deposit counterparties)

- e. Certification of having read and understood and agreeing to comply with the City's investment policy.
 - f. Evidence of adequate insurance coverage.
3. An annual review of the financial condition and registration of all qualified financial institutions and broker/dealers will be conducted by the Chief Financial Officer, in conjunction with the Investment Committee,

Section 7: Portfolio Criteria

Acceptable Asset Classes - Consistent with the City's investment policy objectives and A.R.S. §35-323A, the following investments will be permitted by this policy:

1. Certificates of deposit in eligible depositories.
2. Interest bearing savings accounts in banks and savings and loan institutions doing business in this state whose accounts are insured by federal deposit insurance for their industry, but only if deposits in excess of the insured amount are secured by the eligible depository to the same extent and in the same manner as required under this article.
3. Repurchase agreements with a maximum maturity of one hundred eighty days.
4. The pooled investment funds established by the state treasurer pursuant to A.R.S. § 35-326.
5. Obligations issued or guaranteed by the United States or any of the senior debt of its agencies, sponsored agencies, corporations, sponsored corporations or instrumentalities.
6. Bonds or other evidences of indebtedness of this state or any of its counties, incorporated cities or towns or school districts.
7. Bonds, notes or evidences of indebtedness of any county, municipal district, municipal utility or special taxing district within this state that are payable from revenues, earnings or a special tax specifically pledged for the payment of the principal and interest on the obligations, and for the payment of which a lawful sinking fund or reserve fund has been established and is being maintained, but only if no default in payment on principal or interest on the obligations to be purchased has occurred within five years of the date of investment, or, if such obligations were issued less than five years before the date of investment, no default in payment of principal or interest has occurred on the obligations to be purchased nor any other obligations of the issuer within five years of the investment.
8. Bonds, notes or evidences of indebtedness issued by any county improvement district or municipal improvement district in this state to finance local improvements authorized by law, if the principal and interest of the obligations are payable from assessments on real property within the improvement district. An investment shall not be made if:
 - a. The face value of all such obligations, and similar obligations outstanding, exceeds fifty per cent of the market value of the real property, and if improvements on which the bonds or the assessments for the payment of principal and interest on the bonds are liens inferior only to the liens for general ad valorem taxes.
 - b. A default in payment of principal or interest on the obligations to be purchased has occurred within five years of the date of investment, or, if the obligations were issued less than five years before the date of investment, a default in the payment of principal or interest has occurred on the obligations to be purchased or on any other obligation of the issuer within five years of the investment.
9. Commercial paper of prime quality that is rated within the top 2 ratings by a nationally recognized rating agency. All commercial paper must be issued by corporations organized and doing business in the United States. Bonds, debentures, notes or other evidences of indebtedness that are denominated in United States dollars and that carry at a minimum an "A" or better rating, at the time of purchase, from at least two nationally recognized rating agencies.

10. Negotiable or brokered certificates of deposit issued by a nationally or state chartered bank or savings and loan association.
11. All other investments of operating funds are thereby prohibited from consideration for investment. Furthermore, the City may desire to be more conservative in its investment portfolio and restrict or prohibit certain of the investments listed above.
12. The Chief Financial Officer, in conjunction with the Investment Committee, shall invest trust and restricted funds in accordance with A.R.S. §35-324, A.R.S. §35-328 and the terms of the trust or controlling documents, if any.

Benchmark – The performance of an actively managed portfolio on behalf of the City will be expected to at least match the performance of the Local Government Investment Pool during any one-year period. Occasionally, based on the liquidity needs and the portfolio strategy of the City it may be reasonable and desirable to measure portfolio performance against a total return benchmark. The Chief Financial Officer, in conjunction with the Investment Committee, shall define such a benchmark.

Maturity Parameters:

- a. Operating Funds Maximum Maturity: 5 Years
- b. Maximum Maturity for Repurchase Agreements: 180 Days

Concentration and Diversification – At the time of purchase a maximum of 5% of the market value of the portfolio may be invested in debt issued by any single entity. Debt backed by the United States Treasury or GSE's are exempt from this concentration criterion.

Safekeeping and Custody:

- a. *Delivery vs. Payment* - All trades of marketable securities will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in an eligible financial institution prior to the release of funds.
- b. *Safekeeping* - Securities will be held by a custodian selected by the City and evidenced by custodial reports. The safekeeping institution shall annually provide a copy of their most recent report on internal controls (Statement of Auditing Standards No. 70, or SAS 70).

Section 8: Reporting

1. The Chief Financial Officer shall report investment activity to the Council at least quarterly. The purpose of the report is to enable the City to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report should include:
 2. A list of individual securities held at the end of the reporting period;
 - a. The realized and unrealized gains or losses in the portfolio;
 - b. The maturity date of each security held in the portfolio;
 - c. The book value and market value of each security in the portfolio;
 - d. The percentage of the total portfolio market value that each security represents;
 - e. The yield to maturity of the portfolio and of each security held in the portfolio;
 - f. The periodic interest earnings of each security held in the portfolio;
 - g. The credit quality of each security held in the portfolio;
 - h. The weighted average maturity of the portfolio;
 - i. A periodic summary of portfolio transactions, including fees incurred for external management and custody services.
3. Custodian Reconciliation – The report of investment holdings shall be reconciled within 30 days of the close of each month to the custodian bank. Discrepancies shall be reported to the Chief Financial Officer.

Section 9: Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activities that could conflict with the proper execution and management of the investment program or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose, within sixty (60) days, any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of the City.

Section 10: Investment Policy Guideline Glossary

1. U.S. Treasury Bills, Notes and Bonds: U.S. government guaranteed securities. Represent the most liquid and creditworthy security in the domestic market.
2. U.S. Federal Agency Securities: Debt obligations issued by agencies of the U.S. government such as the Federal National Mortgage Association (FNMA) and the Federal Farm Credit Bank (FFCB). While not explicitly guaranteed by the government, the securities are generally traded with an "implied" guarantee.
3. Repurchase Agreements: Standardized, simultaneous purchase and sale of the same security by approved brokers/dealers. Repurchase Agreements are, in effect, short-term (overnight) loans collateralized by securities. Two types of collateral are authorized: U.S. Treasury securities and U.S. Government Agency securities.
4. Commercial Paper: An unsecured promissory note (maturities 1-270 days) issued by banks, corporations, public entities and finance companies.
5. Corporate Notes and Bonds: Corporate debt instrument. Maturities range from nine months to 30 years.
6. Floating Rate Securities: Corporate or Federal Agency debt in which the periodic coupon is reset based upon a formula stated at the time of issue.
7. Municipal Obligations: Taxable or tax-exempt municipal securities typically secured by general governmental funds from tax revenue or a municipally operated enterprise.
8. Certificates of Deposit: A marketable receipt for funds deposited in a bank or thrift institution for a specific time period at a stated rate of interest.
9. Funds Maximum Maturity: The longest acceptable time to maturity that any one security in the portfolio may have at the time of purchase.
10. Maximum Maturity for Repurchase Agreements: The longest acceptable time to maturity that any one repurchase agreement in the portfolio may have at the time of purchase.
11. Portfolio Duration Target: Duration is the weighted average maturity of a portfolio's cash flows, where the present values of the cash flows serve as the weights. Thus, portfolio duration target is a pre-determined duration at which a portfolio is expected to be maintained.
12. Portfolio Duration Range: An acceptable range in which the actual portfolio duration can deviate from the Portfolio Duration Target.
13. Prudence: The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidity and the sale of

securities are carried out in accordance with the terms of this policy. The "prudent person" standard states that, "Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived." *Source :GFOA Sample Investment Policy*

14. Delegation of Authority: Authority to manage the investment program is granted to the Chief Financial Officer or his designee and derived from the following: A.R.S. §§35-321, 35 323. Responsibility for the operation of the investment program is hereby delegated to the investment officer, who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures should include references to: safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements and collateral/depository agreements. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the investment officer. The investment officer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials. *Source: GFOA Sample Investment Policy*
15. Weighted Average Maturity: The weighted average time until all securities in a portfolio mature.