CITY OF DANA POINT
FINANCIAL REVIEW COMMITTEE REPORT

DATE: MAY 22, 2019

TO: MEMBERS OF THE FINANCIAL REVIEW COMMITTEE

FROM: MIKE KILLEBREW, ASSISTANT CITY MANAGER

SUBJECT: ANNUAL REVIEW OF INVESTMENT POLICY

RECOMMENDED ACTION:
That the Financial Review Committee approve the City's Statement of Safekeeping and Investment of Public Funds Policy ("Investment Policy").

BACKGROUND:
State law contained in Government Code Section 53646(a)(2) states that the treasurer of a local government may annually render an investment policy to the legislative body and any oversight committee. The City's Statement of Safekeeping and Investment of Public Funds ("Investment Policy") (Action Document A), was developed in accordance with the Code and incorporates best-practices implemented by other municipal treasury operations. The Investment Policy requires that the City Council approve the Investment Policy annually. In establishing the City's Financial Review Committee (FRC) charter, the City Council requires the FRC to review and make a recommendation in regards to the Investment Policy.

DISCUSSION:
The City contracted with Davis Farr, LLP to perform a review of the Investment Policy. The purpose of the review was to identify any required modifications due to changes in State law governing the investment of public funds, and also to identify any other recommended enhancements to the Investment Policy. The auditor's review (**Supporting C**) suggested a revision to the investment language, which currently limits investment in the State's Local Agency Investment Fund (LAIF) to 50% of the portfolio's market value except for extraordinary circumstances and with City Treasurer approval.

ACTION DOCUMENTS:

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SUPPORTING DOCUMENTS: PAGE

ACTION DOCUMENT A

CITY OF DANA POINT

STATEMENT OF SAFEKEEPING
AND INVESTMENT OF PUBLIC FUNDS

JANUARY 2019

Mark Denny, City Manager/Treasurer

Prepared by the
Department of Administrative Services
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CITY OF DANA POINT

STATEMENT OF SAFEKEEPING AND INVESTMENT OF PUBLIC FUNDS (INVESTMENT POLICY)

JANUARY

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CITY OF DANA POINT

JANUARY 2018

STATEMENT OF SAFEKEEPING AND INVESTMENT OF PUBLIC FUNDS

INTRODUCTION:

The safekeeping of public funds and investment policies and practices of the City of Dana Point ("Investment Policy") are based upon State Law and prudent money management. The primary objectives, in priority order, of the City's investment activities shall be:

1. To provide safekeeping and to protect the principal monies entrusted to this office.

2. To provide sufficient liquidity to meet normal operating and unexpected expenditures.

3. To assure compliance with all Federal, State and Local laws governing the investment of monies under the control of the City Treasurer.

4. To generate a maximum amount of investment income within the parameters of prudent risk management and consistent with the above policies, particularly in regard to the safekeeping of public funds.

The monies entrusted to the City Treasury (referred to as the "Fund" throughout the remainder of this document) will be kept safe, invested, administered and reported in a timely and prudent manner. The Assistant City Manager (Chief Financial Officer or CFO) and staff, by delegation from the City Treasurer, will observe, review and react to changing conditions that affect the Fund. Approval of investment transactions that will affect the Fund are limited to:

- City Manager (City Treasurer)
- Assistant City Manager (Chief Financial Officer or CFO)
- Accounting Supervisor

In addition, the City may, at the City Treasurer's discretion, periodically retain an independent, outside advisor with specific expertise in the investment of municipal funds. The advisor will also be available to provide additional assistance as the need arises.

This policy statement will also address the safekeeping of the Fund and risk management as it is an integral part of the Investment Policy. To concentrate only on maximizing return would be dangerous; therefore, policy issues will be directed toward:

1. Limiting the Fund's exposure to issue and issuer, credit and market risks; and,
2. Determining a minimum credit requirement that firms must have in order to safe keep City money.

I. SCOPE

In accordance with Dana Point Ordinance No. 89-2 and as prescribed by Section 41000 through 41007 of the Government Code of the State, the City Treasurer is responsible for the safekeeping and investing of the Fund.

This Policy shall direct the investment of the Fund, unless specifically exempted by the legislative body. This policy will not direct the investment of funds held on behalf of employees (e.g. in deferred compensation plans), or the investment of bond proceeds which may be specifically governed by specific bond documents and trust indentures.

II. INVESTMENT OBJECTIVES

The primary objectives, in priority order, of the City's investment activities shall be:

A. Safety of Principal

The City's primary objective in managing its investment program is the safety of the Fund's principal. Each investment transaction shall seek to ensure that safety of principal is the foremost objective and that capital losses are to be avoided, whether from securities default, broker-dealer default or erosion of market value. The City shall seek to preserve safety of principal by mitigating credit and interest rate risk.

1. Credit Risk. Credit risk is defined as a) the risk of loss due to failure of the issuer of a security to perform as expected; and, b) risk of loss of value of security resulting from drop in credit quality of issuer. Credit risk shall be mitigated by investing only with issuers whose financial strength and reputation can be verified to be highly rated by nationally known rating agencies and by diversifying the investment portfolio so that the failure of any one issuer would not unduly harm the City's cash flow.

2. Interest Rate Risk. Interest Rate or Market Risk, the risk that changes in interest rates will adversely affect the fair value of an investment. The longer the maturity of an investment, the greater the exposure to interest rate risk. The City shall strive to mitigate market risk by: (a) structuring the portfolio so that securities mature earlier than or concurrent with the

expected timing of major cash outflows, thus eliminating the need to sell securities prior to their maturity; (b) prohibiting the use of leverage and margin accounts; and,
(c) prohibiting the taking of short positions, that is, selling securities which the City does not own. It is explicitly recognized herein, however, that in a diversified portfolio, occasional measured losses are inevitable and must be considered within the context of the overall investment return.

B. Diversification

Safety of principal shall be maximized by diversifying the City's investment portfolio consistent with the specific requirements of Section VII of this policy which lists authorized investments and enumerates the diversification requirements for each.

C. Liquidity

The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated.

To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. In accordance with Government Code Section 53601, the City may not directly invest in securities maturing more than five (5) years from the date of purchase unless previously approved by the City Council in accordance with Section VII. C. of this Investment Policy.

D. Return on Investment or Yield

The City's investment portfolio shall be designed to attain a market-average rate of return through budgetary and economic cycles. The market-average rate of return is defined as the average return of three-month U.S. Treasury bills. Whenever possible, consistent with risk limitations as defined herein, prudent investment principles and consideration of safety of principal as noted above, the Treasurer shall seek to augment returns above the market average rate of return.

III. ETHICS AND CONFLICTS OF INTEREST

City officers and employees involved in the investment process ("Treasury Oversight Staff") shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Treasury Oversight Staff are not permitted to accept any honoraria, gifts or gratuities from advisors, brokers, dealers, bankers, or other persons with whom the treasury does business. Treasury Oversight Staff shall disclose to the City Manager any material financial interests in financial institutions that conduct business within their jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City, consistent with the regulations and filing obligations of the Fair Political Practices Commission and the

City's Conflict of Interest Code.

IV. SAFEKEEPING OF SECURITIES

To protect against potential losses by collapse of individual securities dealers, all securities owned by the City, including collateral on repurchase agreements, shall be held in safekeeping by a third party bank trust department, acting as agent for the City under the terms of a custody agreement executed by the bank and by the City. All security transactions entered into by the City shall be conducted on a delivery-versus- payment basis, i.e., the City's safekeeping agent will only release payment for a security after the security has been properly delivered.

V. REPORTING

The Chief Financial Officer shall render a monthly Treasurer's report to the City Manager and City Council summarizing the:

- type of each investment;
- issuer;
- maturity;
- par amount;
- purchase price;
- current market value;
- dollar amount invested;
- issuing institution;
- selling institution;
- date of maturity;
- amount on deposit;
- yield to maturity;
- description of funds, investments and programs managed by contracted parties (e.g. LAIF, investment pools, and outside money managers) and,
- identify source of the current market values listed in the report.

In addition, there must be a statement about:

- the Fund's ability to meet upcoming six-month cash flow requirements;
- compliance with this investment policy, as directed under the Code; and,
- such additional data as may be required by the City Council.

A recommended, updated Statement of Safekeeping and Investment Policy will be reviewed and approved annually by the City Council.

VI. QUALIFIED FINANCIAL DEALERS AND INSTITUTIONS

The City shall transact business only with qualified banks, savings and loans and investment security dealers as set forth in Government Code Section 53601.5. Investment staff shall investigate the qualifications of financial institutions and dealers that wish to do business with the City in order to determine if they are adequately capitalized, make markets in securities appropriate to the City's needs and are recommended by managers of portfolios similar to the City's. The City is prohibited from engaging any broker, dealer, or security firm within any consecutive 48 month period of them making a campaign contribution exceeding limitations contained in Rule G-37.

Security transactions involving the payment of brokers through the reduction in rate of return, (soft dollars) and directed brokerage arrangements shall be conducted at the lowest responsible transaction cost available and shall contain the specified contract requirements set forth in the California Government Code.

The City shall at least annually send a copy of the current investment policy to all dealers approved to do business with the City. Confirmation of receipt of this policy shall be considered as evidence that the dealer understands the City's investment policies and intends to show the City only appropriate investments.

Annually, in conjunction with the adoption of the investment policy, the City Council shall be provided with a list of dealers currently providing services to the City, and the list shall specify any additions or deletions to that list since the prior investment policy was adopted. The current list is included as the last page of this Investment Policy.

VII. AUTHORIZED INVESTMENTS

Generally, investments shall be made in the context of the "prudent investor" rule, which states:

"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."

A. Types of Authorized Investments

The City is further governed by the California Government Code, Sections 53600 et seq. Within the context of these limitations, the following investments are authorized as further limited herein:

1. U.S. Treasuries: United States Treasury Bills, Bonds and Notes or those for which the full faith and credit of the United States are pledged for payment of principal and interest. There is no limitation as to the percentage of the portfolio which can be invested in this category. Maturity is not to exceed the projected dates of the City's cash needs or five years, whichever is less.

2. U.S. Agencies: Obligations issued by the Government National Mortgage Association (GNMA), the Federal Farm Credit Bank System (FFCB), the Federal Home Loan Bank Board (FHLB), the Federal Home Loan Mortgage Corporation (FHLMC), the Tennessee Valley Authority (TVA) and the Federal National Mortgage Association (FNMA). Although there is no percentage limitation on the dollar amount that can be invested in these issues, the "prudent investor" rule shall apply for a single agency name. Maturity is not to exceed the projected dates of the City's cash needs or five years, whichever is less.

3. Bankers Acceptances: Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as banker's acceptances. Banker's acceptances purchased may not exceed 180 days to maturity or 40% of the market value of the portfolio. No more than 10% of the market value of the portfolio may be invested in banker's acceptances issued by any one bank.

4. Commercial Paper: Commercial paper of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical-rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions:

    i. The entity meets the following criteria:

        a. Is organized and operating in the United States as a general corporation.
        b. Has total assets in excess of five hundred million dollars ($500,000,000).
        c. Has debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.

    Or:

    ii. The entity meets the following criteria:

        a. Is organized within the United States as a special purpose corporation, trust, or limited liability company.

b. Has program-wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or surety bond.
c. Has commercial paper that is rated “A-1” or higher, or the equivalent, by a NRSRO.

Purchases of eligible commercial paper may not exceed 15% of the market value of the portfolio. No more than 10% of the market value of the portfolio may be invested in commercial paper issued by any one corporation. The City may purchase no more than 10% of the outstanding commercial paper of any single issuer. Maturity is not to exceed 270 days.

5. Certificates of Deposit: Negotiable certificates of deposit issued by a nationally or state-chartered Bank or state or federal savings and loan association. Negotiable certificates of deposit (NCDs) differ from other certificates of deposit by their deposit liquidity. They are issued against funds deposited for specified periods of time and earn specified or variable rates of interest. NCDs are traded actively in secondary markets. When feasible, an independent trading service will be used as part of the evaluation process. The financial institution should maintain a rating equivalent to Keefe Bank Watch Service of “A/B” or better. To be eligible for purchase by the City, the NCD must be issued by:

   i. a California bank rated “A/B” or better by the rating service of Keefe, Bruyette and Woods, (Keefe) (or equivalent);
   ii. a major national or regional bank outside of California rated “B” or better by Keefe, (or equivalent);
   iii. a domestic branch of a foreign bank (“Yankee”) rated I for country rating, II or better for peer-group rating and II or better for dollar access by Keefe; or
   iv. a savings and loan association operating in California rated “A/B” or better by Keefe.

   The maturity of bank or savings & loan NCDs shall not exceed two years. Purchases of negotiable certificates of deposit may not exceed 30 percent of the market value of the portfolio.

6. Repurchase Agreements: the City may invest in repurchase agreements with banks and dealers with which the City has entered into a master repurchase agreement which specifies terms and conditions of repurchase agreements:

   i. To the extent required by statute, the City will restrict transactions to primary dealers only. To the extent permitted by law, transactions will be limited to security dealers or financial institutions with a credit rating of “A” or better by a major rating agency.

ii. The market value of securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly. In order to conform with provisions of Federal Bankruptcy Code which provide for the liquidation of securities held as collateral for repurchase agreements, the only securities acceptable as collateral shall be securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States.

iii. No more than 20% of the market value of the portfolio may be invested in repurchase agreements.

iv. The term of repurchase may not exceed one year.

7. Local Agency Investment Fund. The City may invest in the Local Agency Investment Fund (LAIF) established by the State Treasurer for the benefit of local agencies up to the maximum permitted by State law.

8. Time Deposits. The City may invest in nonnegotiable time deposits collateralized in accordance with the California Government Code in those banks and savings and loan associations which meet the requirements for investment in negotiable certificates of deposit. Since time deposits are not liquid, no more than 15% of the market value of the portfolio may be invested in this category. The issuer firm should have been in existence for at least five years.

   The City may waive the first $250,000 of collateral security for such deposits if the institution is insured pursuant to federal law. In order to secure the uninsured portions of such deposits, an institution shall maintain collateral and interest of at least 10% in excess of the total amount deposited. Real estate mortgages may not be accepted as collateral. The maximum term for deposits shall be one year.

   In general, the issuer must have a minimum 6% net worth to assets ratio or the minimum ratio established by the Controller of the Currency. The issuer's operation must have been profitable during their last reporting period. In order to secure the interest earnings of time deposits, the interest earnings must be collateralized.

9. Money Market Funds. The City may invest only in money market funds investing solely in U.S. treasuries, obligations of the U.S. Treasury and repurchase agreements relating to such treasury obligations. To be eligible, these companies must have an investment advisor who is registered with the SEC with not less than five years of experience investing in instruments authorized by Government Code Sections 53601 and 53635.

   The fund must have the highest ranking available as evaluated by not less than two nationally recognized rating agencies and have assets under management in excess of $500 million. The purchase price of shares of money market funds shall not exceed 20% of the market value of the portfolio. No more than 10% of the City's investment portfolio may be invested in shares of beneficial interest of any one money market fund of this type. At least annually, the City shall review the fund for continuing compliance with the requirements set forth in this section.

10. Monies Held by Trustee or Fiscal Agent. Notwithstanding anything to the contrary contained in this section, Section 53635 or any other provision of law, monies held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness or obligations under a lease, installment sale or other agreement of a local agency or certificates of participation in those bonds, indebtedness or lease installment sale or other agreements may be invested in accordance with the statutory provisions governing the issuance of those bonds, indebtedness or lease installment sale or other agreement or to the extent not consistent therewith if there are no specific statutory provisions in accordance with the ordinance, resolution, indenture or agreement of the local agency providing for the issuance.

B. Types of Unauthorized Investments

The following instruments are not to be used for investments: reverse repurchase agreements, mutual funds (excluding Money Market Funds as listed in Section VII.A.), zero coupon bonds, mortgage backed securities, common stocks and corporate notes and bonds, inverse floaters, range notes, interest only strips derived from collateralized mortgage obligations (CMOs) and any security that could result in zero or negative interest accrual if held to maturity, except as these instruments may be utilized by agencies such as the State of California Local Agency Investment Fund which this policy specifically names as an "authorized investment".

C. Limitations By Type of Investment

Where this section specifies a percentage limitation for a particular category of investment, that percentage is applicable only at the date of purchase. Where this section does not specify a limitation on the term or remaining maturity at the time of the investment, no investment shall be made in any security that at the time of the investment has a term remaining to maturity in excess of five years, unless the City Council has granted express authority to make that 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.

VIII. PURCHASE OF SECURITIES

To assure all securities are purchased at a competitive market price, the City will obtain at least three offers, one of which will be obtained from a primary dealer.

IX. COSTS INCURRED IN THE INVESTING, DEPOSITING, BANKING, AUDITING, REPORTING, HANDLING AND MANAGING OF FUNDS

All authorized costs incurred in the investing, depositing, banking, auditing, reporting, handling, and managing of funds invested by the City shall be borne solely by the General Fund and shall not be allocated to other funds.

X. SWAPPING OF SECURITIES

A swap is the movement from one security to another and may be done for a variety of reasons, such as to increase yield, lengthen or shorten maturities, to take a profit or to increase investment quality. The purchase transaction and the sale transaction must each be recorded separately and any losses or gains on the sale must be recorded.

XI. PORTFOLIO ADJUSTMENTS

Should an investment percentage-of-portfolio limitation be exceeded due to an incident such as fluctuation in portfolio size, the affected securities may be held to maturity to avoid losses. When no loss is indicated, the Treasurer shall consider reconstructing the portfolio basing decisions in part on the expected length of time the portfolio will be unbalanced.

XII. INTERNAL CONTROL AND REVIEW

Internal controls shall be established and maintained to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, or imprudent actions by employees and officers of the City. Controls deemed most important include: separation of duties, separation of transaction authority from accounting and record keeping, custodial safekeeping, clear delegation of authority, specific limitations regarding securities losses and remedial action, control over wire transfers, minimizing the number of authorized investment officials, and documentation of transactions and strategies.

This investment policy shall be reviewed at least annually to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends. The Financial Review Committee shall meet at least annually to review the City's portfolio. The City Council shall be responsible for maintaining guidance over this investment policy to insure that the City can adapt readily to changing market conditions and shall approve any modification to the investment policy prior to implementation.

In the event the portfolio or individual investments are deemed to be out of compliance with either statute or the investment policy, the following procedures shall be followed:

A. In the event that an owned security becomes non-compliant with the investment policy, such as due to a change in credit rating or a change in the investment policy as it relates to authorized investments, a determination shall be made as to whether the security can be sold prior to maturity without the City sustaining a loss of principal or interest. If such a sale is possible, the City Treasurer shall authorize such a sale. If such a sale is not possible, and it is determined that the security must be held to maturity, then the Financial Review Committee shall be convened to authorize holding the security until it matures. If it is determined that a loss will or may be sustained in either case (sale prior to maturity or holding to maturity), then a report shall be delivered to the City Council from the City Treasurer with a recommendation as to the appropriate action.

B. In the event that, as a result of a change in its fair market value, any investment exceeds the allowable maximum percentage for that investment type, a determination shall be made as to whether the security can be sold prior to maturity without the City sustaining a loss of principal or interest. If such a sale is possible, the City Treasurer shall authorize such a sale. If such a sale is not possible, and it is determined that the security must be held to maturity, then the Financial Review Committee shall be convened to authorize holding the security until it matures. If it is determined that a loss will or may be sustained in either case (sale prior to maturity or holding to maturity), then a report shall be delivered to the City Council from the City Treasurer with a recommendation as to the appropriate action.

C. In the event of any other economic event occurring that significantly impacts, or threatens to impact, the value of the City's investment portfolio or its investment strategies, the Financial Review Committee shall be convened to develop recommendations, if any, for further actions by the City Council.

STATE LAW

The legislated authority of the fund is covered in sections 53601 et.seq, of the Government Code. It is the policy of the City Treasurer to comply with the State laws governing the Fund.

GLOSSARY OF TERMS

ACCRUED INTEREST: Coupon interest accumulated on a bond or note since the last interest payment or, for a new issue, from the dated date to the date of delivery.

AGENCIES: Federal agency securities and/or Government-sponsored enterprises.

ASKED: The price at which securities are offered.

BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution, as well as the issuer, guarantees payment of the bill.

BANK DEPOSITS: To deposit collateral in the form of currency that may be in the form of demand accounts (checking) or investments in accounts that have a fixed term and negotiated rate of interest.

BASIS POINTS: Refers to the yield on bonds. Each percentage point of yield in bonds equals 100 basis points (1/100% or 0.01%). If a bond yield changes from 5.25% to 5.39%, that is a rate of 14 basis points.

BENCHMARK: A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

BID: The price asked by a seller of securities.

BOOK VALUE: The value at which an asset is carried on a balance sheet.

BOND: A financial obligation for which an issuer promises to pay the bondholder a specified stream of future cash flows, including periodic interest payments and a principal repayment.

BROKER: A person or firm that acts as an intermediary by purchasing and selling securities for others rather than for its own account. A broker brings buyers and sellers together for a commission.

CALLABLE SECURITIES: An investment security that contains an option allowing the issuer to retire the security prior to its final maturity date.

CASH FLOW: A comparison of cash receipts (revenues) to required payments (expenses).

CERTIFICATES OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property, which a borrower pledges to secure repayment of a loan and/or security. Also refers to securities pledged by a bank to secure deposits of public monies.

COMMERCIAL PAPER: Unsecured, short-term promissory notes issued by corporations to finance accounts receivable and inventories. It is usually issued at a discount reflecting prevailing market interest rates. Maturities range from 2 days up to 270 days.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the City of Dana Point. It includes combined entity-wide and fund financial statements prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

COUPON: The annual rate of interest that a bond's issuer promises to pay the bondholders on the bond's face value; a certificate attached to a bond evidencing interest due on a payment date.

CREDIT RATING: Various alphabetical and numerical designations used by institutional investors, Wall Street underwriters, and commercial rating companies to give relative indications of bond and note creditworthiness.

- Standard & Poors and Fitch Ratings use the same system, starting with their highest rating of AAA, AA, A, BBB, BB, B, CCC, CC, C, and D for Default; while,
- Moody's Investors Service uses Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C, and D.

Each of the services use pluses (+), minuses (-), or numerical modifiers to indicate steps within each category. The top four letter categories are considered "investment grade" ratings.

CREDIT RISK: The chance that an issuer will be unable to make scheduled payments of interest and principal on an outstanding obligation. Another concern for investors is that the market's perception of a corporation's credit will cause the market value of a security to fall, even if default is not expected.

CUSIP NUMBER: The Committee on Uniform Security Information Procedures (CUSIP) Number refers to a security's identification number assigned to each publicly traded security by the CUSIP Service Bureau operated by Standard & Poors for the American Bankers Association (ABA). The CUSIP Number is a nine-character identifier unique to the issuer, the specific issue and maturity, if applicable (the first six characters identifying the issuer, the next two identifying the security and the last digit providing a check digit to validate the accuracy of the preceding CUSIP Number).

CUSTODIAN: A bank or other financial institution that keeps custody of stock certificates and other assets.

DEALER: A dealer, as opposed to a broker, is someone who acts as a principal in all transactions, including underwriting, buying, and selling securities, including from his/her own account.

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

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

DISCOUNT: The difference between the par value of a security and the cost of the security, when the cost is below par. Par, also referred to as the "face amount" of a security, is the principal value stated on the face of the security. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g., U.S. Treasury Bills.

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent returns.

FEDERAL CREDIT AGENCIES: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g., Savings & Loans, small businesses, students, farm cooperatives, and exporters.

FEDERAL FARM CREDIT BANK SYSTEM: Agency of the Federal government set up to supply credit to farmers.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposit accounts, including checking and savings accounts, money market deposit accounts and certificates of deposit up to $250,000. The coverage amount will be lowered to $100,000 per deposit on January 1, 2010. FDIC insurance does not cover other financial products and services that insured banks may offer, such as stocks, bonds, mutual fund shares, life insurance policies and annuities.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks) which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private shareholder-owned corporation. On September 6, 2008, and in response to the meltdown of the financial markets, the Federal Housing Finance Agency (FHFA) appointed FHFA as conservator of Fannie Mae. In addition, the U.S. Department of the Treasury agreed to provide up to $100 billion of capital as needed to ensure the company continues to provide liquidity to the housing and mortgage markets. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

FIDUCIARY: An individual who holds something in trust for another and bears liability for its safekeeping.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA OR GINNIE MAE): Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. A security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FMHA mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL AGENCY INVESTMENT FUND (LAIF): A voluntary investment fund open to government entities in California that is managed by the State Treasurer's Office.

MARKET RISK: The chance that the value of a security will decline as interest rates rise. In general, as interest rates fall, prices of fixed income securities rise. Similarly, as interest rates rise, prices fall.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold at a particular point in time.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase-reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date on which the principal or stated value of an investment becomes due and payable.

MEDIUM-TERM NOTES: Corporate or depository institution debt securities meeting certain minimum quality standards (as specified in the Government Code) with a remaining maturity of five years or less.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

MONEY MARKET MUTUAL FUNDS (MMF's): MMF's are mutual funds that invest exclusively in short-term money market instruments. MMF's seek the preservation of capital as a primary goal while maintaining a high degree of liquidity and providing income representative of the market for short term investments.

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer). See Asked and Bid.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

PAR AMOUNT OR PAR VALUE: The principal amount of a note or bond which must be paid at maturity. Par, also referred to as the "face amount" of a security, is the principal value stated on the face of the security. A par bond is one sold at a price of 100 percent of its principal amount.

PORTFOLIO: Collection of securities held by an investor.

PREMIUM: Premium means the difference between the par value of a security and the cost of the security, when the cost is above par. Investors pay a premium to purchase a security when the return to the investor (yield) is lower than the stated coupon (interest rate) on the investment.

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

PRUDENT INVESTOR STANDARD OR RULE: A standard of conduct where a person acts with care, skill, prudence, and diligence when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing funds. The test of whether the standard is being met is if a prudent person acting in such a situation would engage in similar conduct to ensure that investments safeguard principal and maintain liquidity.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.

REPURCHASE AGREEMENT (RP OR REPO): An agreement of one party (for example, a financial institution) to sell securities to a second party (such as a local government) and simultaneous agreement by the first party to repurchase the securities at a specified price from the second party on demand or at a specified date.

RISK: The uncertainty of maintaining the principal or interest associated with an investment due to a variety of factors.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES & EXCHANGE COMMISSION (SEC): Agency created by Congress to protect investors in securities transactions by administering securities legislation**.**

TREASURY BILLS: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

TREASURY BONDS: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

WEIGHTED AVERAGE MATURITY: The average maturity of all the securities that comprise a portfolio, typically expressed in days or years.

YIELD: The current rate of return on an investment security generally expressed as a percentage of the securities current price.

Brokers Used for Investment Activity

JP Morgan

UBS Financial Services

Stifel Investment Services

Wedbush Securities

SUPPORTING DOCUMENT B

CITY OF DANA POINT

STATEMENT OF SAFEKEEPING AND INVESTMENT OF PUBLIC FUNDS

JANUARY ~~2018~~2019

Mark Denny, City Manager/Treasurer

Prepared by the
Department of Administrative Services
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CITY OF DANA POINT

STATEMENT OF SAFEKEEPING AND INVESTMENT OF PUBLIC FUNDS (INVESTMENT POLICY)

JANUARY ~~2018~~2019

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CITY OF DANA POINT

JANUARY 2018

STATEMENT OF SAFEKEEPING AND INVESTMENT OF PUBLIC FUNDS

INTRODUCTION:

The safekeeping of public funds and investment policies and practices of the City of Dana Point ("Investment Policy") are based upon State Law and prudent money management. The primary objectives, in priority order, of the City's investment activities shall be:

1. To provide safekeeping and to protect the principal monies entrusted to this office.
2. To provide sufficient liquidity to meet normal operating and unexpected expenditures.
3. To assure compliance with all Federal, State and Local laws governing the investment of monies under the control of the City Treasurer.
4. To generate a maximum amount of investment income within the parameters of prudent risk management and consistent with the above policies, particularly in regard to the safekeeping of public funds.

The monies entrusted to the City Treasury (referred to as the "Fund" throughout the remainder of this document) will be kept safe, invested, administered and reported in a timely and prudent manner. The Assistant City Manager (Chief Financial Officer or CFO) and staff, by delegation from the City Treasurer, will observe, review and react to changing conditions that affect the Fund. Approval of investment transactions that will affect the Fund are limited to:

- City Manager (City Treasurer)
- Assistant City Manager (Chief Financial Officer or CFO)
- Accounting Supervisor

In addition, the City may, at the City Treasurer's discretion, periodically retain an independent, outside advisor with specific expertise in the investment of municipal funds. The advisor will also be available to provide additional assistance as the need arises.

This policy statement will also address the safekeeping of the Fund and risk management as it is an integral part of the Investment Policy. To concentrate only on maximizing return would be dangerous; therefore, policy issues will be directed toward:

1. Limiting the Fund's exposure to issue and issuer, credit and market risks; and,
2. Determining a minimum credit requirement that firms must have in order to safe keep City money.

I. SCOPE

In accordance with Dana Point Ordinance No. 89-2 and as prescribed by Section 41000 through 41007 of the Government Code of the State, the City Treasurer is responsible for the safekeeping and investing of the Fund.

This Policy shall direct the investment of the Fund, unless specifically exempted by the legislative body. This policy will not direct the investment of funds held on behalf of employees (e.g. in deferred compensation plans), or the investment of bond proceeds which may be specifically governed by specific bond documents and trust indentures.

II. INVESTMENT OBJECTIVES

The primary objectives, in priority order, of the City's investment activities shall be:

A. Safety of Principal

The City's primary objective in managing its investment program is the safety of the Fund's principal. Each investment transaction shall seek to ensure that safety of principal is the foremost objective and that capital losses are to be avoided, whether from securities default, broker-dealer default or erosion of market value. The City shall seek to preserve safety of principal by mitigating credit and interest rate risk.

1. Credit Risk. Credit risk is defined as a) the risk of loss due to failure of the issuer of a security to perform as expected; and, b) risk of loss of value of security resulting from drop in credit quality of issuer. Credit risk shall be mitigated by investing only with issuers whose financial strength and reputation can be verified to be highly rated by nationally known rating agencies and by diversifying the investment portfolio so that the failure of any one issuer would not unduly harm the City's cash flow.

2. Interest Rate Risk. Interest Rate or Market Risk, the risk that changes in interest rates will adversely affect the fair value of an investment. The longer the maturity of an investment, the greater the exposure to interest rate risk. The City shall strive to mitigate market risk by: (a) structuring the portfolio so that securities mature earlier than or concurrent with the

expected timing of major cash outflows, thus eliminating the need to sell securities prior to their maturity; (b) prohibiting the use of leverage and margin accounts; and,
(c) prohibiting the taking of short positions, that is, selling securities which the City does not own. It is explicitly recognized herein, however, that in a diversified portfolio, occasional measured losses are inevitable and must be considered within the context of the overall investment return.

B. Diversification

Safety of principal shall be maximized by diversifying the City's investment portfolio consistent with the specific requirements of Section VII of this policy which lists authorized investments and enumerates the diversification requirements for each.

C. Liquidity

The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated.

To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. In accordance with Government Code Section 53601, the City may not directly invest in securities maturing more than five (5) years from the date of purchase unless previously approved by the City Council in accordance with Section VII. C. of this Investment Policy.

D. Return on Investment or Yield

The City's investment portfolio shall be designed to attain a market-average rate of return through budgetary and economic cycles. The market-average rate of return is defined as the average return of three-month U.S. Treasury bills. Whenever possible, consistent with risk limitations as defined herein, prudent investment principles and consideration of safety of principal as noted above, the Treasurer shall seek to augment returns above the market average rate of return.

III. ETHICS AND CONFLICTS OF INTEREST

City officers and employees involved in the investment process ("Treasury Oversight Staff") shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Treasury Oversight Staff are not permitted to accept any honoraria, gifts or gratuities from advisors, brokers, dealers, bankers, or other persons with whom the treasury does business. Treasury Oversight Staff shall disclose to the City Manager any material financial interests in financial institutions that conduct business within their jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City, consistent with the regulations and filing obligations of the Fair Political Practices Commission and the

City's Conflict of Interest Code.

IV. SAFEKEEPING OF SECURITIES

To protect against potential losses by collapse of individual securities dealers, all securities owned by the City, including collateral on repurchase agreements, shall be held in safekeeping by a third party bank trust department, acting as agent for the City under the terms of a custody agreement executed by the bank and by the City. All security transactions entered into by the City shall be conducted on a delivery-versus- payment basis, i.e., the City's safekeeping agent will only release payment for a security after the security has been properly delivered.

V. REPORTING

The Chief Financial Officer shall render a monthly Treasurer's report to the City Manager and City Council summarizing the:

- type of each investment;
- issuer;
- maturity;
- par amount;
- purchase price;
- current market value;
- dollar amount invested;
- issuing institution;
- selling institution;
- date of maturity;
- amount on deposit;
- yield to maturity;
- description of funds, investments and programs managed by contracted parties (e.g. LAIF, investment pools, and outside money managers) and,
- identify source of the current market values listed in the report.

In addition, there must be a statement about:

- the Fund's ability to meet upcoming six-month cash flow requirements;
- compliance with this investment policy, as directed under the Code; and,
- such additional data as may be required by the City Council.

A recommended, updated Statement of Safekeeping and Investment Policy will be reviewed and approved annually by the City Council.

VI. QUALIFIED FINANCIAL DEALERS AND INSTITUTIONS

The City shall transact business only with qualified banks, savings and loans and investment security dealers as set forth in Government Code Section 53601.5. Investment staff shall investigate the qualifications of financial institutions and dealers that wish to do business with the City in order to determine if they are adequately capitalized, make markets in securities appropriate to the City's needs and are recommended by managers of portfolios similar to the City's. The City is prohibited from engaging any broker, dealer, or security firm within any consecutive 48 month period of them making a campaign contribution exceeding limitations contained in Rule G-37.

Security transactions involving the payment of brokers through the reduction in rate of return, (soft dollars) and directed brokerage arrangements shall be conducted at the lowest responsible transaction cost available and shall contain the specified contract requirements set forth in the California Government Code.

The City shall at least annually send a copy of the current investment policy to all dealers approved to do business with the City. Confirmation of receipt of this policy shall be considered as evidence that the dealer understands the City's investment policies and intends to show the City only appropriate investments.

Annually, in conjunction with the adoption of the investment policy, the City Council shall be provided with a list of dealers currently providing services to the City, and the list shall specify any additions or deletions to that list since the prior investment policy was adopted. The current list is included as the last page of this Investment Policy.

VII. AUTHORIZED INVESTMENTS

Generally, investments shall be made in the context of the "prudent investor" rule, which states:

"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."

A. Types of Authorized Investments

The City is further governed by the California Government Code, Sections 53600 et seq. Within the context of these limitations, the following investments are authorized as further limited herein:

1. U.S. Treasuries: United States Treasury Bills, Bonds and Notes or those for which the full faith and credit of the United States are pledged for payment of principal and interest. There is no limitation as to the percentage of the portfolio which can be invested in this category. Maturity is not to exceed the projected dates of the City's cash needs or five years, whichever is less.

2. U.S. Agencies: Obligations issued by the Government National Mortgage Association (GNMA), the Federal Farm Credit Bank System (FFCB), the Federal Home Loan Bank Board (FHLB), the Federal Home Loan Mortgage Corporation (FHLMC), the Tennessee Valley Authority (TVA) and the Federal National Mortgage Association (FNMA). Although there is no percentage limitation on the dollar amount that can be invested in these issues, the "prudent investor" rule shall apply for a single agency name. Maturity is not to exceed the projected dates of the City's cash needs or five years, whichever is less.

3. Bankers Acceptances: Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as banker's acceptances. Banker's acceptances purchased may not exceed 180 days to maturity or 40% of the market value of the portfolio. No more than 10% of the market value of the portfolio may be invested in banker's acceptances issued by any one bank.

4. Commercial Paper: Commercial paper of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical-rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions:
   i. The entity meets the following criteria:
      a. Is organized and operating in the United States as a general corporation.
      b. Has total assets in excess of five hundred million dollars ($500,000,000).
      c. Has debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.

   Or:

   ii. The entity meets the following criteria:
      a. Is organized within the United States as a special purpose corporation, trust, or limited liability company.

b. Has program-wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or surety bond.
c. Has commercial paper that is rated "A-1" or higher, or the equivalent, by a NRSRO.

Purchases of eligible commercial paper may not exceed 15% of the market value of the portfolio. No more than 10% of the market value of the portfolio may be invested in commercial paper issued by any one corporation. The City may purchase no more than 10% of the outstanding commercial paper of any single issuer. Maturity is not to exceed 270 days.

5. Certificates of Deposit: Negotiable certificates of deposit issued by a nationally or state-chartered Bank or state or federal savings and loan association. Negotiable certificates of deposit (NCDs) differ from other certificates of deposit by their deposit liquidity. They are issued against funds deposited for specified periods of time and earn specified or variable rates of interest. NCDs are traded actively in secondary markets. When feasible, an independent trading service will be used as part of the evaluation process. The financial institution should maintain a rating equivalent to Keefe Bank Watch Service of "A/B" or better. To be eligible for purchase by the City, the NCD must be issued by:

   i. a California bank rated "A/B" or better by the rating service of Keefe, Bruyette and Woods, (Keefe) (or equivalent);
   ii. a major national or regional bank outside of California rated "B" or better by Keefe, (or equivalent);
   iii. a domestic branch of a foreign bank ("Yankee") rated I for country rating, II or better for peer-group rating and II or better for dollar access by Keefe; or
   iv. a savings and loan association operating in California rated "A/B" or better by Keefe.

The maturity of bank or savings & loan NCDs shall not exceed two years. Purchases of negotiable certificates of deposit may not exceed 30 percent of the market value of the portfolio.

6. Repurchase Agreements: the City may invest in repurchase agreements with banks and dealers with which the City has entered into a master repurchase agreement which specifies terms and conditions of repurchase agreements:

   i. To the extent required by statute, the City will restrict transactions to primary dealers only. To the extent permitted by law, transactions will be limited to security dealers or financial institutions with a credit rating of "A" or better by a major rating agency.

ii. The market value of securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly. In order to conform with provisions of Federal Bankruptcy Code which provide for the liquidation of securities held as collateral for repurchase agreements, the only securities acceptable as collateral shall be securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States.

iii. No more than 20% of the market value of the portfolio may be invested in repurchase agreements.

iv. The term of repurchase may not exceed one year.

7. Local Agency Investment Fund. The City may invest in the Local Agency Investment Fund (LAIF) established by the State Treasurer for the benefit of local agencies up to the maximum permitted by State law. ~~However, the City shall not invest more than 50% of the market value of the portfolio in LAIF or in any other single investment pool which may be authorized by this policy.~~

~~At the discretion of the City Treasurer, the 50% maximum investment ceiling in LAIF may be exceeded under extraordinary circumstances, but not for more than one-hundred twenty (120) days.~~

8. Time Deposits. The City may invest in nonnegotiable time deposits collateralized in accordance with the California Government Code in those banks and savings and loan associations which meet the requirements for investment in negotiable certificates of deposit. Since time deposits are not liquid, no more than 15% of the market value of the portfolio may be invested in this category. The issuer firm should have been in existence for at least five years.

The City may waive the first $250,000 of collateral security for such deposits if the institution is insured pursuant to federal law. In order to secure the uninsured portions of such deposits, an institution shall maintain collateral and interest of at least 10% in excess of the total amount deposited. Real estate mortgages may not be accepted as collateral. The maximum term for deposits shall be one year.

In general, the issuer must have a minimum 6% net worth to assets ratio or the minimum ratio established by the Controller of the Currency. The issuer's operation must have been profitable during their last reporting period. In order to secure the interest earnings of time deposits, the interest earnings must be collateralized.

9. Money Market Funds. The City may invest only in money market funds investing solely in U.S. treasuries, obligations of the U.S. Treasury and repurchase agreements relating to such treasury obligations. To be eligible, these companies must have an investment advisor who is registered with the SEC with not less than five years of experience investing in instruments authorized by Government Code Sections 53601 and 53635.

   The fund must have the highest ranking available as evaluated by not less than two nationally recognized rating agencies and have assets under management in excess of $500 million. The purchase price of shares of money market funds shall not exceed 20% of the market value of the portfolio. No more than 10% of the City's investment portfolio may be invested in shares of beneficial interest of any one money market fund of this type. At least annually, the City shall review the fund for continuing compliance with the requirements set forth in this section.

10. Monies Held by Trustee or Fiscal Agent. Notwithstanding anything to the contrary contained in this section, Section 53635 or any other provision of law, monies held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness or obligations under a lease, installment sale or other agreement of a local agency or certificates of participation in those bonds, indebtedness or lease installment sale or other agreements may be invested in accordance with the statutory provisions governing the issuance of those bonds, indebtedness or lease installment sale or other agreement or to the extent not consistent therewith if there are no specific statutory provisions in accordance with the ordinance, resolution, indenture or agreement of the local agency providing for the issuance.

B. Types of Unauthorized Investments

The following instruments are not to be used for investments: reverse repurchase agreements, mutual funds (excluding Money Market Funds as listed in Section VII.A.), zero coupon bonds, mortgage backed securities, common stocks and corporate notes and bonds, inverse floaters, range notes, interest only strips derived from collateralized mortgage obligations (CMOs) and any security that could result in zero or negative interest accrual if held to maturity, except as these instruments may be utilized by agencies such as the State of California Local Agency Investment Fund which this policy specifically names as an "authorized investment".

C. Limitations By Type of Investment

Where this section specifies a percentage limitation for a particular category of investment, that percentage is applicable only at the date of purchase. Where this section does not specify a limitation on the term or remaining maturity at the time of the investment, no investment shall be made in any security that at the time of the investment has a term remaining to maturity in excess of five years, unless the City Council has granted express authority to make that 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.

VIII. PURCHASE OF SECURITIES

To assure all securities are purchased at a competitive market price, the City will obtain at least three offers, one of which will be obtained from a primary dealer.

IX. COSTS INCURRED IN THE INVESTING, DEPOSITING, BANKING, AUDITING, REPORTING, HANDLING AND MANAGING OF FUNDS

All authorized costs incurred in the investing, depositing, banking, auditing, reporting, handling, and managing of funds invested by the City shall be borne solely by the General Fund and shall not be allocated to other funds.

X. SWAPPING OF SECURITIES

A swap is the movement from one security to another and may be done for a variety of reasons, such as to increase yield, lengthen or shorten maturities, to take a profit or to increase investment quality. The purchase transaction and the sale transaction must each be recorded separately and any losses or gains on the sale must be recorded.

XI. PORTFOLIO ADJUSTMENTS

Should an investment percentage-of-portfolio limitation be exceeded due to an incident such as fluctuation in portfolio size, the affected securities may be held to maturity to avoid losses. When no loss is indicated, the Treasurer shall consider reconstructing the portfolio basing decisions in part on the expected length of time the portfolio will be unbalanced.

XII. INTERNAL CONTROL AND REVIEW

Internal controls shall be established and maintained to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, or imprudent actions by employees and officers of the City. Controls deemed most important include: separation of duties, separation of transaction authority from accounting and record keeping, custodial safekeeping, clear delegation of authority, specific limitations regarding securities losses and remedial action, control over wire transfers, minimizing the number of authorized investment officials, and documentation of transactions and strategies.

This investment policy shall be reviewed at least annually to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends. The Financial Review Committee shall meet at least annually to review the City's portfolio. The City Council shall be responsible for maintaining guidance over this investment policy to insure that the City can adapt readily to changing market conditions and shall approve any modification to the investment policy prior to implementation.

In the event the portfolio or individual investments are deemed to be out of compliance with either statute or the investment policy, the following procedures shall be followed:

A. In the event that an owned security becomes non-compliant with the investment policy, such as due to a change in credit rating or a change in the investment policy as it relates to authorized investments, a determination shall be made as to whether the security can be sold prior to maturity without the City sustaining a loss of principal or interest. If such a sale is possible, the City Treasurer shall authorize such a sale. If such a sale is not possible, and it is determined that the security must be held to maturity, then the Financial Review Committee shall be convened to authorize holding the security until it matures. If it is determined that a loss will or may be sustained in either case (sale prior to maturity or holding to maturity), then a report shall be delivered to the City Council from the City Treasurer with a recommendation as to the appropriate action.

B. In the event that, as a result of a change in its fair market value, any investment exceeds the allowable maximum percentage for that investment type, a determination shall be made as to whether the security can be sold prior to maturity without the City sustaining a loss of principal or interest. If such a sale is possible, the City Treasurer shall authorize such a sale. If such a sale is not possible, and it is determined that the security must be held to maturity, then the Financial Review Committee shall be convened to authorize holding the security until it matures. If it is determined that a loss will or may be sustained in either case (sale prior to maturity or holding to maturity), then a report shall be delivered to the City Council from the City Treasurer with a recommendation as to the appropriate action.

C. In the event of any other economic event occurring that significantly impacts, or threatens to impact, the value of the City's investment portfolio or its investment strategies, the Financial Review Committee shall be convened to develop recommendations, if any, for further actions by the City Council.

STATE LAW

The legislated authority of the fund is covered in sections 53601 et.seq, of the Government Code. It is the policy of the City Treasurer to comply with the State laws governing the Fund.

GLOSSARY OF TERMS

ACCRUED INTEREST: Coupon interest accumulated on a bond or note since the last interest payment or, for a new issue, from the dated date to the date of delivery.

AGENCIES: Federal agency securities and/or Government-sponsored enterprises.

ASKED: The price at which securities are offered.

BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution, as well as the issuer, guarantees payment of the bill.

BANK DEPOSITS: To deposit collateral in the form of currency that may be in the form of demand accounts (checking) or investments in accounts that have a fixed term and negotiated rate of interest.

BASIS POINTS: Refers to the yield on bonds. Each percentage point of yield in bonds equals 100 basis points (1/100% or 0.01%). If a bond yield changes from 5.25% to 5.39%, that is a rate of 14 basis points.

BENCHMARK: A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

BID: The price asked by a seller of securities.

BOOK VALUE: The value at which an asset is carried on a balance sheet.

BOND: A financial obligation for which an issuer promises to pay the bondholder a specified stream of future cash flows, including periodic interest payments and a principal repayment.

BROKER: A person or firm that acts as an intermediary by purchasing and selling securities for others rather than for its own account. A broker brings buyers and sellers together for a commission.

CALLABLE SECURITIES: An investment security that contains an option allowing the issuer to retire the security prior to its final maturity date.

CASH FLOW: A comparison of cash receipts (revenues) to required payments (expenses).

CERTIFICATES OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property, which a borrower pledges to secure repayment of a loan and/or security. Also refers to securities pledged by a bank to secure deposits of public monies.

COMMERCIAL PAPER: Unsecured, short-term promissory notes issued by corporations to finance accounts receivable and inventories. It is usually issued at a discount reflecting prevailing market interest rates. Maturities range from 2 days up to 270 days.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the City of Dana Point. It includes combined entity-wide and fund financial statements prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

COUPON: The annual rate of interest that a bond's issuer promises to pay the bondholders on the bond's face value; a certificate attached to a bond evidencing interest due on a payment date.

CREDIT RATING: Various alphabetical and numerical designations used by institutional investors, Wall Street underwriters, and commercial rating companies to give relative indications of bond and note creditworthiness.

- Standard & Poors and Fitch Ratings use the same system, starting with their highest rating of AAA, AA, A, BBB, BB, B, CCC, CC, C, and D for Default; while,
- Moody's Investors Service uses Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C, and D.

Each of the services use pluses (+), minuses (-), or numerical modifiers to indicate steps within each category. The top four letter categories are considered "investment grade" ratings.

CREDIT RISK: The chance that an issuer will be unable to make scheduled payments of interest and principal on an outstanding obligation. Another concern for investors is that the market's perception of a corporation's credit will cause the market value of a security to fall, even if default is not expected.

CUSIP NUMBER: The Committee on Uniform Security Information Procedures (CUSIP) Number refers to a security's identification number assigned to each publicly traded security by the CUSIP Service Bureau operated by Standard & Poors for the American Bankers Association (ABA). The CUSIP Number is a nine-character identifier unique to the issuer, the specific issue and maturity, if applicable (the first six characters identifying the issuer, the next two identifying the security and the last digit providing a check digit to validate the accuracy of the preceding CUSIP Number).

CUSTODIAN: A bank or other financial institution that keeps custody of stock certificates and other assets.

DEALER: A dealer, as opposed to a broker, is someone who acts as a principal in all transactions, including underwriting, buying, and selling securities, including from his/her own account.

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

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

DISCOUNT: The difference between the par value of a security and the cost of the security, when the cost is below par. Par, also referred to as the "face amount" of a security, is the principal value stated on the face of the security. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g., U.S. Treasury Bills.

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent returns.

FEDERAL CREDIT AGENCIES: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g., Savings & Loans, small businesses, students, farm cooperatives, and exporters.

FEDERAL FARM CREDIT BANK SYSTEM: Agency of the Federal government set up to supply credit to farmers.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposit accounts, including checking and savings accounts, money market deposit accounts and certificates of deposit up to $250,000. The coverage amount will be lowered to $100,000 per deposit on January 1, 2010. FDIC insurance does not cover other financial products and services that insured banks may offer, such as stocks, bonds, mutual fund shares, life insurance policies and annuities.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks) which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private shareholder-owned corporation. On September 6, 2008, and in response to the meltdown of the financial markets, the Federal Housing Finance Agency (FHFA) appointed FHFA as conservator of Fannie Mae. In addition, the U.S. Department of the Treasury agreed to provide up to $100 billion of capital as needed to ensure the company continues to provide liquidity to the housing and mortgage markets. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

FIDUCIARY: An individual who holds something in trust for another and bears liability for its safekeeping.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA OR GINNIE MAE): Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. A security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FMHA mortgages. The term “pass-throughs” is often used to describe Ginnie Maes.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL AGENCY INVESTMENT FUND (LAIF): A voluntary investment fund open to government entities in California that is managed by the State Treasurer’s Office.

MARKET RISK: The chance that the value of a security will decline as interest rates rise. In general, as interest rates fall, prices of fixed income securities rise. Similarly, as interest rates rise, prices fall.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold at a particular point in time.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase-reverse repurchase agreements that establishes each party’s rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date on which the principal or stated value of an investment becomes due and payable.

MEDIUM-TERM NOTES: Corporate or depository institution debt securities meeting certain minimum quality standards (as specified in the Government Code) with a remaining maturity of five years or less.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

MONEY MARKET MUTUAL FUNDS (MMF's): MMF's are mutual funds that invest exclusively in short-term money market instruments. MMF's seek the preservation of capital as a primary goal while maintaining a high degree of liquidity and providing income representative of the market for short term investments.

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer). See Asked and Bid.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

PAR AMOUNT OR PAR VALUE: The principal amount of a note or bond which must be paid at maturity. Par, also referred to as the "face amount" of a security, is the principal value stated on the face of the security. A par bond is one sold at a price of 100 percent of its principal amount.

PORTFOLIO: Collection of securities held by an investor.

PREMIUM: Premium means the difference between the par value of a security and the cost of the security, when the cost is above par. Investors pay a premium to purchase a security when the return to the investor (yield) is lower than the stated coupon (interest rate) on the investment.

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

PRUDENT INVESTOR STANDARD OR RULE: A standard of conduct where a person acts with care, skill, prudence, and diligence when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing funds. The test of whether the standard is being met is if a prudent person acting in such a situation would engage in similar conduct to ensure that investments safeguard principal and maintain liquidity.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.

REPURCHASE AGREEMENT (RP OR REPO): An agreement of one party (for example, a financial institution) to sell securities to a second party (such as a local government) and simultaneous agreement by the first party to repurchase the securities at a specified price from the second party on demand or at a specified date.

RISK: The uncertainty of maintaining the principal or interest associated with an investment due to a variety of factors.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES & EXCHANGE COMMISSION (SEC): Agency created by Congress to protect investors in securities transactions by administering securities legislation**.**

TREASURY BILLS: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

TREASURY BONDS: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

WEIGHTED AVERAGE MATURITY: The average maturity of all the securities that comprise a portfolio, typically expressed in days or years.

YIELD: The current rate of return on an investment security generally expressed as a percentage of the securities current price.

Brokers Used for Investment Activity

~~Morgan Stanley~~

JP Morgan

UBS Financial Services

Stifel Investment Services

Wedbush Securities

SUPPORTING DOCUMENT C

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To the City Council
of the City of Dana Point

INDEPENDENT ACCOUNTANT'S REPORT
ON APPLYING AGREED-UPON PROCEDURES

City of Dana Point

We have performed the procedures enumerated below, which were agreed to by the City of Dana Point ("the City"), on reviewing the City's processes over investments. The City's management is responsible for maintaining the accounting records and other documentation to support the information reported on those records. The sufficiency of these procedures is solely the responsibility of the City's management. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which the report has been requested or for any other purpose.

The procedures performed and the results of those procedures are as follows:

1. We inspected evidence that the annual investment policy was rendered and adopted by the City Council.

   Results: No exceptions were noted as a result of our procedures.

2. We determined if each of the specific requirements of the City's Investment Policy complies with applicable sections of the California government code.

   Results: No exceptions were noted as a result of our procedures with respect to the California government code. However, the City's Investment Policy states "the City shall not invest more than 50% of the market value of the portfolio in LAIF or in any other single investment pool which may be authorized by this policy. At the discretion of the City Treasurer, the 50% maximum investment ceiling in LAIF may be exceeded under extraordinary circumstances, but not for more than one-hundred twenty (120) days." At June 30, 2018, the City's investment in LAIF comprised 57% of total cash and investments. We noted no other exceptions to the City's Investment Policy.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on the accounting records. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the City Council and management of the City of Dana point and is not intended to be, and should not be, used by anyone other than those specified parties.

Davis Farr LLP

Irvine, California
January 4, 2019