CITY OF
HAYWARD
HEART OF THE BAY

CITY COUNCIL BUDGET AND FINANCE COMMITTEE SPECIAL MEETING
SEPTEMBER 28, 2011
Conference Room 4B
4:00 PM

CALL TO ORDER

ROLL CALL

PUBLIC COMMENTS: *(The Public Comment section provides an opportunity to address the City Council Committee on items not listed on the agenda. The Committee welcomes your comments and requests that speakers present their remarks in a respectful manner, within established time limits, and focus on issues which directly affect the City or are within the jurisdiction of the City. As the Committee is prohibited by State law from discussing items not listed on the agenda, your item will be taken under consideration and may be referred to staff.)*

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1. FY 2013 & FY 2014 Biennial Budget Calendar; Updated Budget & Finance Committee Schedule for FY 2012

2. General Fund Ten-Year Financial Plan Update

3. Redevelopment Agency Budget Update ***(Oral Report Only)***

4. Annual Review of Statement of Investment Policy
   a. Authorizing the Hayward Public Financing Authority as a Local Agency Investment Funding (LAIF) account

COMMITTEE MEMBER ANNOUNCEMENTS AND REFERRALS

ADJOURNMENT

NEXT REGULAR MEETING – 4:00 PM, WEDNESDAY, OCTOBER 26, 2011

****Materials related to an item on the agenda submitted to the Council after distribution of the agenda packet are available for public inspection in the City Clerk's Office, City Hall, 777 B Street, 4th Floor, Hayward, during normal business hours. An online version of this agenda and staff reports are available on the City's website. All Council Meetings are broadcast simultaneously on the website and on Cable Channel 15, KHRT. ****

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HAYWARD CITY COUNCIL, 777 B STREET, HAYWARD, CA 94541
HTTP://WWW.HAYWARD-CA.GOV

CITY OF
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HEART OF THE BAY

DATE: September 28, 2011

TO: Budget and Finance Committee

FROM: Director of Finance

SUBJECT: FY2013 & FY2014 Biennial Budget Calendar; Updated Budget & Finance Committee Schedule for FY2012

RECOMMENDATION

That the Committee reviews and comments on this report.

DISCUSSION

The City is embarking on the FY2013 & FY2014 Biennial Budget development process. A key element of the process is establishing the Budget Calendar. The comprehensive calendar layers a number of key elements of the budget development process:

1. City Council actions
2. Labor negotiations updates
3. Budget & Finance Committee actions
4. City staff budget development key actions

As the calendar was developed, a special meeting of the Council Budget & Finance Committee on November 16, 2011 has been added for consideration. Attached is a revised Committee Schedule for FY2012 for review.

Prepared and Recommended by: Tracy Vesely, Director of Finance

Approved by:

Fran David, City Manager/Executive Director

Attachments:

Attachment I – FY2013 & FY2014 Biennial Budget Calendar
Attachment II – Updated Budget & Finance Committee Schedule for FY2012

CITY OF HAYWARD
DRAFT FY 2013 and FY 2014 Budget Development Calendar

Key Dates	Acting Body	Actions
7/27/11	Budget & Finance	General Fund 10-year Plan update
September 2011		
12	City Staff	Begin internal budget process
13	City Council	Closed Session: Labor negotiations update
27	City Council	Closed Session: Labor negotiations update
28	Budget & Finance	Draft Budget Calendar, GF 10-year Plan update, Annual Investment Policy Update, RDA Update
29	Labor/Management	Kick-off: Budget calendar, 10-year Plan revenue & expense review, timeline & process
October 2011		
5	Labor/Management	PERS Update
11	City Council	Closed Session: Labor negotiations update
11	City Council	GF 10-Year Plan presentation
13	Labor/Management	GF 10-Year Plan presentation
18	City Staff	Executive Team budget strategy discussion
18	City Council	Closed Session: Labor negotiations update
19	Labor/Management	Benefit trends
26	Budget & Finance	Preliminary FY 2011 year-end analysis, Adopt Budget Calendar
November 2011		
1	City Council	Closed Session: Labor negotiations update
15	City Council	Closed Session: Labor negotiations update
16	Budget & Finance	FY 2013 & FY 2014 budget strategy (special meeting)
18	Labor/Management	Conclusion of Initial labor bargaining - results dictate budget assumptions
30	City Staff	Finalize baseline budget & budget instructions
December 2011		
5	City Staff	Budget Kickoff: Issue Budget Instructions to departments
6	City Council	Closed Session: Labor negotiations update
8	Labor/Management	Town Hall meeting(s)
15	Budget & Finance	Preview of 6/30/11 CAFR w/ external auditor presentation; reserve policy discussion
20	City Council	FY 2011 CAFR presentation/FY 2011 year-end
January 2012		
13	City Staff	DEADLINE: Preliminary department position reductions due to Finance/City Manager
15	City Staff	Begin Master Fee Schedule review with departments
25	Budget & Finance	Review Preliminary FY 2012 Mid-Year; 10-year plan assumptions review
27	City Council	Council biennial budget planning (special meeting - TBD)
31	City Staff	Department operating budget proposals due to Finance/CM
February 2012		
1	Labor/Management	Preliminary staffing impact based on baseline budget
7	City Council	Closed Session: Labor negotiations update
7	City Council	FY 2012 Mid-Year Staff Report & Presentation - 10-Year Plan Update
10	City Staff	Complete review of department budget submittals
13	City Staff	Begin department budget meetings (2/13-3/15)
15	City Staff	Departments submit Master Fee Schedule changes for FY 2013 - begin legal review
21	City Council	Closed Session: Labor negotiations update
22	Budget & Finance	Budget update

CITY OF HAYWARD
DRAFT FY 2013 and FY 2014 Budget Development Calendar

Key Dates	Acting Body	Actions
March 2012		
6	City Council	Closed session: Labor negotiations update
10	City Staff	Labor relations bargaining - input concession assumptions into budget
15	City Staff	Department budget meetings conclude
19	City Staff	Begin building FY 2013 & FY 2014 Biennial Budget document
27	City Council	Closed Session: Labor negotiations update
28	Budget & Finance	Budget update
31	City Staff	DEADLINE: All labor & operating expenditure/revenue data received by Finance
April 2012		
3	City Council	Work Session: CDBG & Social Services funding
6	City Staff	Finalize budget data entry
13	City Staff	Draft of FY 2013 & FY 2014 Operating Budget for CM review
20	City Staff	FY 2013 & FY 2014 Recommended Operating Budget to printers
24	City Council	Public Hearing: Master Fee Schedule
24	City Council	Public Hearing: CDBG & Social Services funding; CDBG budget adoption
25	Budget & Finance	Preview of FY 2013 & 2014 Operating & CIP Budgets
26	Labor/Management	Town Hall meeting(s)
May 2012		
1	City Council	Proposed FY 2013 & FY 2014 Operating Budget - PRESENTED TO CITY COUNCIL
15	City Council	Budget Work Session #1
22	City Council	Budget Work Session #2
23	Budget & Finance	Budget update
29	City Council	Budget Work Session #3 (special?)
June 2012		
12	City Council	Budget -Public Hearing - final Council guidance to City Manager
19	City Council	**Adopt FY 2013 & FY 2014 Biennial Budget**
27	Budget & Finance	Budget update
July 2012		
25	Budget & Finance	Discussion & Analysis of FY 2013 & 2014 Operating Budget Process

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COUNCIL BUDGET AND FINANCE COMMITTEE
PROPOSED REVISED – FY 2012 MEETING SCHEDULE

Meeting Location:	CITY HALL 4TH FLOOR CONFERENCE ROOM 4B 777 B STREET HAYWARD, CALIFORNIA
Meeting Time:	4:00 P. M.
Meeting Dates:	The Council Budget and Finance Committee meets on the fourth Wednesday of the following months: January, April, July and October. Special meetings will be scheduled as determined necessary by the Committee or the City Manager.

DATE	SUGGESTED TOPICS
September 28, 2011 (Special)	General Fund Ten-Year Plan Update FY 2013 & FY 2014 Budget Calendar Annual Investment Policy Renewal Redevelopment Agency Budget Update
October 26, 2011	Preliminary FYE 6/30/2011 Financial Status Further Exploration of a Potential Financing Measure for the City's Critical Facility Needs
November 16, 2011 (Special meeting?)	FY 2013 & FY 2014 Budget Strategy
December 15, 2011 (Special-3rd Thursday)	Preview of 6/30/2011 CAFR with external auditor FY 2011 Year-end
January 25, 2012	Preliminary FY 2012 Mid Year General Fund 10-year assumptions review
February 22, 2012 (Special)	Budget Update
March 28, 2012 (Special)	Budget Update
April 25, 2012	Preview of FY 2013 CIP Budget Preview of FY 2013 and 2014 Operating Budget
May 23, 2012 (Special)	Budget Update
June 27, 2012 (Special)	Budget Update
July 25, 2012	Discussion and Analysis of FY 2013 and 2014 Budget Process

CITY OF
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DATE: September 28, 2011

TO: Budget and Finance Committee

FROM: Finance Director

SUBJECT: General Fund Ten-Year Financial Plan Update

RECOMMENATION

That the Committee reviews and comments on the General Fund Ten-Year Plan Update.

SUMMARY

The General Fund Ten-Year Plan provides the framework for the City's budget planning and decision-making. On July 27, 2011, staff provided the Council Budget and Finance Committee with an update to the Ten-Year Plan that focused on expenditures, inclusive of the FY2012 Adopted Budget changes. As reflected in that update, even with the last round of budget reductions and labor concessions (both one-time and recurring), the City continues to face a significant structural deficit in the General Fund. The deficit is due to the ongoing economic downturn, increased employee services costs, and deferred capital and maintenance needs (fleet, facilities, public safety, and technology).

This report further updates the Ten-Year Plan, with a focus on revised revenue and expenditure projections that are based on new data. Staff will also present the General Fund Ten-Year Plan, to the full City Council on October 11, 2011.

DISCUSSION

The City of Hayward has utilized long-term financial planning to successfully navigate the challenges brought about by the severe downturn in the economy that began in the fall of 2008. These critical tools provide the framework for sound fiscal planning and decision-making, as well as the foundation for negotiations with bargaining units to ensure maintenance of core services and the prudent use of reserves.

This report provides the Committee with:

1. An update to the General Fund Ten-Year Plan, reflecting revised revenue and expenditure projections, and
2. An overview of the major contributing factors to the on-going General Fund deficit.

General Fund Ten-Year Plan Update:
Since the Committee last reviewed the Ten-Year Plan at the end of July, staff has worked to further refine the model. Most importantly, with preliminary FY2011 year-end numbers available for review, as well as additional information from the County Assessor, Auditor-Controller and our sales tax consultant (MuniServices), staff has modified several revenue projections. The plan also updates several expense categories. The Finance Department continues to partner with the Human Resources Department and other City departments to form a General Fund Ten-Year Plan team that formulates and reviews the plan assumptions.

<u>The General Fund Deficit</u>
The City has been grappling with its structural deficit for several years. When Council adopted the FY2012 Budget in June 2011, the budget closed a $20.6 million projected gap. Below is a chart that summarizes the initial $20.6 million deficit and the adopted reductions (including the assumed use of $4.2 million of reserves). Unfortunately, since some of the reductions were one-time in nature and the City continues to face slow-growing revenues and increasing costs, the structural deficit remains.

Table 1

$'s in 1000's	June-10 FY 2012 Proposed	March-11 FY2012 Projected	FY 2012 Gap	June-11 FY2012 Adopted	FY2012 Balancing Measures
Resources					
Total Resources	**119,515**	**117,696**	**(1,819)**	**117,740**	**44**
Outlays					
Salary & Benefits	101,449	110,737	(9,288)	100,416	10,321
Overtime	*5,370*	*5,370*	*0*	*3,811*	*1,559*
Charge/(Credit) from other progs	*(5,167)*	*(5,167)*	-	*(5,021)*	*(146)*
Additional Vacancy Savings	*(3,570)*	-	*(3,570)*	*(1,303)*	*1,303*
Employee Commitment Savings		-	-	*(1,671)*	*1,671*
Net Staffing Expense	**98,082**	**110,940**	**(12,858)**	**96,232**	**14,708**
Maintenance & Utilities	2,231	2,231	0	1,017	1,214
Supplies & Services	6,770	6,770	0	7,080	(310)
Internal Service Fees	9,431	9,431	0	9,280	151
Capital	14	14	-	14	0
Net Operating Expense	**18,446**	**18,446**	**0**	**17,391**	**1,055**
Total Expenditure	**116,528**	**129,386**	**(12,858)**	**113,624**	**15,762**
Transfers out	**5,518**	**6,175**	**(657)**	**6,083**	**92**
Total Unfunded		**2,736**	**(2,736)**	**2,246**	**490**
Total Outlays	**122,046**	**138,297**	**(16,251)**	**121,953**	**16,344**
Total Resources Over/(Under) Total Outlays	**(2,531)**	**(20,601)**	**(18,070)**	**(4,212)**	**16,389**

<u>General Fund Ten-Year Plan</u>
Table 2 represents the first five years and the last year (FY2021) of the Ten-Year Plan, and reflects the revised projections. This chart also provides the first glimpse of the FY2011 unaudited actuals (to be further refined and presented to the Committee on October 26, 2011). The plan still reflects a <u>significant structural General Fund gap of $14.2 million in FY2013 that grows to $18.4 million in FY2014</u>. The revised FY2013 projection is $1.5 million lower than the FY2013 $15.7 million deficit represented in the Ten-Year Plan presented in July (due to $801,000 in reduced expenditure projections and $780,000 in increased resources).

However, beyond FY2013, the on-going structural gap widens as a result of slow growing revenues due to a very sluggish economic recovery, the loss of funding from a federal Citizens Oriented

Policing (COPS) grant, increasing employee costs (not all employee concessions were recurring), funding of retiree healthcare, and the funding of deferred capital and maintenance needs.

Table 2

$'s in 1000's	Mid Year Adjusted FY 2011	Year End Preliminary FY 2011	Adopted FY 2012	F - Yr 2 Forecast FY 2013	F - Yr 3 Forecast FY 2014	F - Yr 4 Forecast FY 2015	F - Yr 5 Forecast FY 2016	F - Yr 10 Forecast FY 2021
Resources								
Property Tax	36,261	35,708	36,654	35,977	37,168	37,574	38,323	40,598
Sales Tax	25,258	25,492	23,647	26,059	26,581	27,112	27,654	30,234
UUT	14,510	14,700	14,800	15,170	15,625	16,094	16,577	0
Franchise Fees	8,750	9,091	9,126	9,429	9,664	9,112	8,532	7,463
Other Taxes	8,793	9,163	8,861	9,149	9,559	9,760	10,186	10,521
Charge for Services	7,578	8,850	7,927	8,072	8,219	8,433	8,711	9,405
Other Revenue	3,826	3,483	3,693	3,816	3,944	4,079	4,221	5,044
Intergovernmental	4,082	4,973	4,490	3,149	3,163	3,178	3,194	3,278
Fines and Forfeitures	2,331	2,793	2,410	2,421	2,431	2,442	2,453	2,509
Interest and Rents	570	518	526	395	201	0	0	0
Total Revenue	**111,958**	**114,771**	**112,134**	**113,637**	**116,554**	**117,785**	**119,852**	**109,052**
Transfers in	**7,746**	**17,264**	**5,606**	**5,080**	**5,237**	**5,671**	**5,848**	**6,870**
Total Resources	**119,704**	**132,035**	**117,740**	**118,716**	**121,791**	**123,456**	**125,700**	**115,922**
Outlays								
Salary	101,575	63,431	62,972	65,700	68,243	69,607	70,999	78,385
Overtime	*6,632*	*4,378*	*3,811*	*5,424*	*5,532*	*5,643*	*5,756*	*6,355*
Overtime - Police	*3,817*	-	*1,572*	*2,564*	*2,615*	*2,667*	*2,721*	*3,004*
Overtime - Fire	*2,637*	-	*2,105*	*2,524*	*2,575*	*2,626*	*2,679*	*2,958*
Overtime - Misc	*179*	-	*135*	*335*	*342*	*349*	*356*	*393*
Vacancy Savings	*(3,387)*	-	*(1,303)*	-	-	-	-	-
Medical Benefits		*8,211*	*8,911*	*9,713*	*10,684*	*11,753*	*12,928*	*20,820*
Retiree Medical		*2,141*	*2,560*	*2,659*	*2,763*	*2,871*	*2,985*	*3,632*
Other Benefits		*7,511*	*7,473*	*7,814*	*8,078*	*8,283*	*8,443*	*9,271*
PERS		*16,081*	*18,447*	*20,230*	*22,261*	*23,007*	*23,729*	*26,553*
Charge/(Credit) from other progs	*(4,924)*	*(5,047)*	*(5,021)*	*(5,146)*	*(5,249)*	*(5,354)*	*(5,461)*	*(6,030)*
Furlough Savings	*(4,004)*	-	*(1,617)*	-	-	-	-	-
Net Staffing Expense	**95,892**	**96,706**	**96,232**	**106,393**	**112,311**	**115,810**	**119,377**	**138,988**
Maintenance & Utilities	2,239	1,932	1,017	1,038	1,058	1,080	1,101	1,216
Supplies & Services	7,085	6,511	7,080	7,222	7,367	7,514	7,664	8,462
Internal Service Fees	9,720	9,721	9,280	9,465	9,655	9,848	10,045	11,090
Capital	45	53	14	-	-	-	-	-
Net Operating Expense	**19,089**	**18,216**	**17,391**	**17,725**	**18,080**	**18,441**	**18,810**	**20,768**
Total Expenditure	**114,981**	**114,922**	**113,624**	**124,118**	**130,391**	**134,251**	**138,187**	**159,756**
Transfers out	**6,420**	**6,420**	**8,329**	**6,971**	**7,627**	**7,301**	**7,814**	**9,681**
Additional Personnel Liabilities		-	-	310	310	310	310	310
Future OPEB Obligation				-	-	743	1,515	6,691
RDA Non-liquid Assets		10,438						
Year End Accruals		450						
Critical Unfunded Needs		-	-	590	590	590	590	590
Unfunded Capital Improvement Needs		-	-	910	1,283	585	778	640
Total Unfunded			**-**	**1,810**	**2,183**	**2,228**	**3,193**	**8,231**
Total Outlays	**121,401**	**132,229**	**121,952**	**132,899**	**140,201**	**143,780**	**149,195**	**177,668**
Resources Over/(Under) Outlays	**(1,697)**	**(194)**	**(4,212)**	**(14,183)**	**(18,410)**	**(20,325)**	**(23,495)**	**(61,746)**
Beginning Fund Balance	**36,802**	**36,802**	**35,024**	**28,511**	**14,329**	**(4,081)**	**(24,406)**	**(202,943)**
Change to Reserves/Annual Shortfall	**(1,697)**	**(194)**	**(4,212)**	**(14,183)**	**(18,410)**	**(20,325)**	**(23,495)**	**(61,746)**
Change to Deposits	(81)			-	-	-	-	-
Less Illiquid Fund Balance		**(8,096)**						
Ending Fund Balance	**35,024**	**28,511**	**30,812**	**14,329**	**(4,081)**	**(24,406)**	**(47,901)**	**(264,689)**

FY2011 Unaudited "Preliminary" Actuals & Use of Reserves: A key element of the Ten-Year Plan is the continued review of expenditure and revenue trends based on prior-year actuals. Although the City's outside auditor has not yet finalized the FY2011 actuals, staff does have preliminary numbers to help guide the projections[A]. When City Council adopted the FY2011 budget, the budget projected a $2.16 million deficit and assumed the use of General Fund Reserves to close the gap, even after implementing considerable expenditure reductions.

The FY2011 Mid-Year Update refined these projections and reduced the deficit projection to $1.7 million. With the continued tightening of expenditure controls, and a slightly higher-than-expected overall revenue performance, we ended FY2011 with an estimated $200,000 deficit. While this is a positive step to closing the budget gap, it does not yet represent a balanced budget. It is staff's goal during this budget process to develop a strategy to correct the structural budget deficit for the long-term.

General Fund Reserve

The General Fund Reserve is an essential component of the City's overall fiscal health, providing flexibility to smooth the impacts of economic swings, buffer the loss of state and federal revenues, and sustain the City in the event of a catastrophic natural disaster. Staff's ultimate goal will be to achieve a balanced budget without the need to use any one-time funds from the City's Reserve.

Table 3

$'s in 1000's	**FY 2011 Estimated Ending Balance**	**FY 2011 Actual (EST) Adjustments**	**FY 2011 Preliminary Ending Balance**
Illiquid Fund Balance			
RDA loan	7,725	-	7,725
encumbrances	256	-	256
inventory	15	-	15
prepaid expense	19	-	19
Other Fund Balance Adjustment	-	81	81
Sub-Total Illiquid Fund Balance	**8,015**	**81**	**8,096**
Liquid Fund Balance			
Economic Uncertainty	11,498		11,498
Liquidity	5,749		5,749
Retirement Reserve	-		-
Police Staff (ARRA COPS grant)	1,000		1,000
Contingencies	5,572		5,572
Emergencies	3,000		3,000
Hotel Conference Center	190		190
Change to Reserves	-	1,503	1,503
Sub-Total Liquid Fund Balance	**27,009**	**1,503**	**28,512**

The Reserve is comprised of both liquid and illiquid funds. The chart above summarizes the current composition of the Reserve. During the July Committee meeting, staff presented the requirements of Government Accounting Standards Board Statement 54 (GASB 54) related to how the City reports and defines its reserves. Staff will be working with the Committee over the next year to comply with the provisions of GASB 54 and essentially simplify the current reserve structure.

[A] *FY2011 actuals are preliminary numbers and will change as the audit is finalized and all appropriate journal entries are completed.*

The Ten-Year Plan has been including illiquid reserves in its ending fund balance calculation. Although this is technically correct, a truer representation of the tangible assets available to Council would be *cash* ending fund balance. To accomplish this, the Ten-Year Plan backs out $8.1 million in illiquid reserves in the FY2011 Preliminary column (Table 2) in order to present a cash fund balance of $28.5 million. As shown in Table 3, this balance reflects the reduction of $1.5 million in the use of reserves for FY2011 as previously mentioned.

Revised FY 2013 Revenue Forecast:

FY2013 total resource projections are increased by about $781,000 from the FY2013 projections included in the July Ten-Year Plan Update.

FY 2013 Projections ***(in 1,000's)***	**FY 2013 (7/26/11)**	**FY 2013 (9/21/11)**	**Difference**
Program Revenue	112,374	113,734	1,360
Transfers In	5,659	5,080	(579)
Total Resources	$ 118,033	$ 118,814	**$ 781**

While program revenues have actually increased by almost $1.4 million due to sales tax projections, transfers were decreased by $579,000. This reduction was due to the transfer of General Fund maintenance costs to the Gas Tax in the FY2012 budget – and an offset reduction in the transfer from the Gas Tax to the General Fund. Mild growth (1% - 2.5%) for most revenue categories is projected.

Below is a summary of some of the changes to key revenue categories.

- *Property Tax* – FY2013 reflects a net 0.18% reduction over Projected FY2012. This is based on the Assessed Valuation Certificate received by the County Auditor-Controller in August 2011, which indicated a reduction of overall assessed valuation to secured property of 0.25% for FY2012. The projection includes assumed reductions to secured and unsecured property tax revenues, offset by an assumed increased in Airport-related property tax revenues due to an increase of activity at the airport. Staff is hopeful that this represents the "bottom" of the market decline, and out-year projections show modest growth. The FY2014 projection includes an assumed influx of tax revenue from the completion of the CalPine facility.

- *Sales Tax* – For FY2013, staff estimates sales tax revenue to increase 2.2% over the preliminary FY2011 actuals. This reflects modest growth and includes the most recent Sales Tax analysis completed by the City's sales tax consultant, MuniServices. This analysis indicates relatively slow growth for Hayward compared to the Alameda countywide average. The most recent data indicates a growth of 4.4% fiscal year to date. The county average for the same period is growth of 7.9%. The most recent four quarters for Hayward of net cash receipts (October 2010-September 2011) actually indicate a 0.2% decline (compared to a countywide average growth of 7%).

  A number of factors contribute to this statistic, but a significant contributor is the reduction in Hayward's miscellaneous vehicle sales and the impact Gillig Corporation has on City revenues. The FY2011 Mid-Year projections assumed $25.3 million in sales tax revenues – with preliminary actuals at about $25.5 million. Out-year projections assume a very mild economic recovery, with annual growth of 1% - 2%.

Although the Hayward sales tax base is diverse, a variety of factors will likely have a significant long-term impact on future retail sales:

- closure of several auto dealers (and drop in car sales)
- closures of the Mervyn's headquarters and Circuit City
- paralysis in the construction industry
- low consumer confidence combined with increasing unemployment
- threat of closure of many other retailers

- U*tility Users Tax (UUT)* – FY2010 was the first year the City received UUT because the voters approved Measure A in May 2009 and the Ordinance provided for revenue collection to begin in October 2009. FY2011 is the first full twelve-month period for this revenue source. The infusion of this new revenue is a critical element in closing the City's structural budget gap. The Ten-Year Plan reflects the assumed sunset of this revenue in FY2020.

  The FY2013 projections are modified to reflect the level of revenues received in FY2011, with a modest 2.5% growth. (The FY2011 Adjusted Budget assumed $14.5 million, and preliminary actuals show receipt of $14.7 million.)

- *Intergovernmental* – There are two primary changes in this revenue category. The first is the loss of the State Vehicle License Fee revenue effective FY2012. As the 2012 Fiscal Year approached, the Governor signed SB89, which shifted hundreds of millions of Vehicle License Fee revenues to fund state law enforcement grants beginning in FY2012. While the City will see some funding restored in law enforcement grant funding – this is a direct loss to the City's General Fund. The City received $695,000 in VLF funding in FY2011. Anticipating the possible loss of some VLF revenue, the City budgeted $278,000 in FY2012 – which limits our actual budgeted loss for FY2012. This revenue is zeroed out effective FY2012.

  The second change is the conclusion of the Federal ARRA COPS grants effective FY2013 and totaling about $1 million. This grant funds seven police officer positions. The grant requires that the City continue to fund these positions one year following the conclusion of the grant and this funding is designated in the liquid reserve.

- *Fines & Forfeitures* – FY2011 preliminary actuals show a slight increase in revenues attributed to the Red Light Camera Program (up by $200,000 from FY2011 Adjusted). However, the Ten-Year Plan conservatively assumes that this level of revenue will not continue and will level off. Therefore, FY2013 projections are very similar to the original FY2011 Adjusted projections.

Revised FY2013 Expenditure Projections:
The revised Ten-Year Plan projects total outlays for FY2013 of about $132.9 million. This represents an $801,000 reduction from the estimates previously provided to the Committee in July. The FY2013 projections assume all contractually obligated adjustments and include the considerable labor concessions agreed to as part of the FY2012 budget, both one-time and recurring.

FY 2013 Projections *(in 1,000's)*	**FY 2013 (7/26/11)**	**FY 2013 (9/21/11)**	**Difference**
Program Expenditures	124,504	124,118	(386)
Transfers Out	6,896	6,971	75
Unfunded Expenses	2,300	1,810	(490)
Total Outlays	$ 133,700	$ 132,899	**$ (801)**

The notable expenditure variances include:

- *CalPERS Rates* – We see a slight reduction in projected retirement costs effective FY2013 due to revised CalPERS rates received from both the City's CalPERS actuary and the third party actuary, John Bartel. This resulted in a savings across all plans of about $300,000. However, the reduction in rates, a direct result of the CalPERS smoothing methodology, actually results in the gradual growth of the City's unfunded retirement liability.

- *Medical Benefits*: Based on revised costing information, the City has reduced the medical premium costs for FY2013 only – assuming a growth of 9% instead of 10% (savings of about $90,000 in FY2013). Staff is recommending this reduction after completing a ten-year trend analysis of medical rates. However, given current health trends and indicators, staff projects health care costs to grow in double digit figures from FY2013 and on.

- Unfunded Capital Improvement Needs – We have refined our projections with regard to vehicle replacement and maintenance needs and have lowered projections for the FY2013. Please note that this line item fluctuates each year based on the Ten-Year Plan needs. This reduction in FY2013 (only) is $490,000. This funding was originally included in the plan to provide debt service for lease-purchase of fleet vehicles. Now that the plan includes funding to move to a cash purchase internal service fund instead, this is allocation is no longer required.

These reductions are offset by a $71,000 increase to Supplies and Services and other minor cost fluctuations.

Major Contributing Factors to the on-going deficit:

Operating Expense Assumption Changes

1. Employee Contracts – For modeling purposes, a two percent growth factor is applied to wages beginning in FY2014, with the exception of those groups where data is available to support known contractual agreements. The reason for this modest compensation growth, tied to an average Consumer Price Index growth, is based on the fact that labor market conditions continued to remain relatively flat. In addition, the market is also shifting in regards to certain professional and technical areas, forcing the City to adjust salaries and compensation during recruitment in order to remain competitive. Finally, the labor concessions (and lack of concessions) over the last few years have created pressing compaction issues between classes that will need to be addressed in the near future.

   All known information as it relates to labor agreements was included in FY2013 and FY2014 projections, specifically contractually obligated salary increases and the most current CalPERS rate estimates. All employee groups, with the exception of the Fire Department, are contractually due either a Cost of Living Adjustment or market rate increase in FY2013. Staff continues to conduct a thorough Citywide total compensation market comparison to assess competitiveness in the marketplace, anticipated inflation, and the impacts it will have on wages, as well as the impact of continued possible concessions, opening labor contracts, and the City's ability to fund future wage and benefit increases.

2. Retirement Expense – Future pension costs have generally escalated due to: 1) the substantial investment market losses experienced by CalPERS in FY2008; 2) new actuarial studies that change demographic assumptions such as length of life; and 3) reductions in the City's payroll. Rates significantly increased in FY2012, and even with improved CalPERS investment returns in the last two fiscal years, the best case scenario will be continued annual growth in rates (albeit minimal) over the next ten years.

Additional Unfunded Needs Contributing to the On-Going Deficit

1. OPEB Liability - The thirty-year Other Post-Employment Benefits (OPEB) unfunded actuarial liability for retiree healthcare is estimated at $68.4 million as of June 30, 2011. This is an increase of $4 million from 2010. Best practices and projections from the City's last actuarial study for retiree medical costs indicate that the City should contribute an annual amount of nine percent of payroll to fund this liability. It is important to note that current assumptions do not implement the recommended actuarial funding until FY2015. This delay in funding effectively grows the City's unfunded liability and delays our ability to reach the full actuarial Annual Required Contribution (ARC), until FY2021 (Table 2).

   Even with these funding assumptions, the City will remain significantly underfunded in ten years without structural change to retiree health benefits and the unfunded liability will continue to grow if new employees enter the plan under the current structure.

Table 3 – Ten-Year Plan OPEB Funding Assumptions

All $ in Thousands	OPEB Forecast Contributions
FY 2015	$ 743
FY 2016	$ 1,515
FY 2017	$ 2,318
FY 2018	$ 3,153
FY 2019	$ 4,824
FY 2020	$ 6,560
FY 2021	$ 6,691
Total Forecasted Contribution	$ 25,804

2. Worker's Compensation Liability –The City has a comprehensive self-funded Worker's Compensation program. As a self-funded program, the City is responsible for direct costs of wage replacement and medical benefits for employees who are injured in the course of employment. This is different than a fully insured program in that being fully insured, the City would pay monthly premiums based on utilization and the risk associated with large claims is somewhat mitigated.

   As a result of being self-funded, there is a continued unfunded liability for the City's Worker's Compensation Fund. Actuarial recommendations indicate the reserve balance should be 70% of the estimated future liability. The concepts of this fund are similar to the other future benefit obligations. Currently, we operate in a "pay as you go" framework as it relates to funding injuries of current employees and on-going claims of past employees and retirees. In order to build the current reserve balance to the 70% standard, an annual contribution of $310,000 is recommended. The assumptions have not changed from the last update and funding of this program began in FY2012. Staff is in the process of conducting an overall programmatic assessment of this large cost center and continuous improvement efforts are underway, including refinement of recommendations as it relates to on-going funding and risk management.

Critical Unfunded Needs

1. Fire Station 7 Replacement – Replacement of the temporary facility continues to be a top priority as a critical infrastructure liability for the City. Currently, the estimated expense for this facility is $6.7 million, which would be financed over twenty to thirty years. There are still options that may lower the overall expense and more comprehensive financing options need to be explored. Staff is also reviewing the estimated cost for the project. Until these are examined in October, the original assumption has remained unchanged.

2. ERP System – The FY2012 Adopted Budget includes $1 million in funding for the new ERP system. While the City is still in the evaluation phase of the RFP process, our initial project estimates indicate total funding required between $4 million - $6 million. Currently, the model does not reflect additional appropriations for the implementation phases of the ERP.

Unfunded Capital Needs

In addition to the operational expenditures, additional liabilities, and critical unfunded needs, there is a laundry list of unfunded capital needs throughout the City, in which the General Fund portion is estimated at $10.5 million over a ten-year period. This does not include the $100-$150 million necessary for major facility replacements. Unfunded capital needs include:

1. Fleet – The City vehicle fleet program has been underfunded and therefore regular replacements of vehicles have been delayed. Due to the lack of funding, only the most critical vehicles have been replaced, and these have been financed using long-term capital leases, adding a significant financing component to the overall costs. The Ten-Year Plan assumes the City will move toward establishing an internal service fund for vehicle replacement and return to paying cash for future replacements – a far less expensive method of procurement for regular fleet purchases.

2. Public Safety – The public safety unfunded needs total $3.2 million over the Ten-Year period. Included in this list of unfunded needs are the replacement of fire breathing apparatus, all police and fire interoperability emergency radio equipment, and related infrastructure. Full participation in the EBRCSA system, is not yet reflected in this total.

3. Technology Services – The Ten-Year Plan model includes funding for minimum upgrades to desktop computers and software. Included in this list of unfunded needs are replacement of public safety mobile data units, network servers, specialized printers, audio visual equipment, and the VOIP phone system.

4. Major Facility Replacements – In addition to the above stated needs, there are several City facilities that require replacement including the main library, police facility, and animal control facility. The cost for replacement of these major facilities is estimated to be between $100 and $150 million. In addition, almost all fire stations are in need of rehabilitation and upgrade. These costs are not included in the Ten-Year model presented with this report because the City would most likely seek voter approval of a facilities bond to fund some or all of these major projects and therefore the direct cost to the General Fund would be minimal.

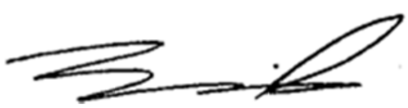
NEXT STEPS

The budget process will begin earlier than normal for the FY2013 and FY2014 budget cycle – with the informal kickoff being the September 28, 2011 Budget and Finance Committee meeting. Specific to the Ten-Year Plan, there will be one additional scheduled update (after this update) during the course of FY2012. That will be held during the Mid-Year Budget review on February 7, 2012. At that time, staff will have final CalPERS rates and the CAFR/audit will be complete, thus allowing the plan to be updated with final audited numbers for FY2011 and reasonable mid-year projections for FY2012. These mid-year numbers will be used as the basis for preparing the next biennial budget for FY2013 and FY2014.

The internal Budget Team will continue to work with the Ten-Year Plan Team to identify balancing options to close the projected two-year budget deficit. As displayed in the FY2013 & FY2014 Budget Calendar, staff will be engaging City Council and the Council Budget and Finance Committee in continued budget discussions for the next nine months. In addition, we will participate in a collaborative and transparent process with City labor unions, City employees and Hayward residents throughout the budget process.

Prepared and Recommended by: Tracy Vesely, Finance Director

Approved by:



Fran David, City Manager

Attachments: None

CITY OF
HAYWARD
HEART OF THE BAY

DATE: September 28, 2011

TO: Budget and Finance Committee

FROM: Director of Finance

SUBJECT: Annual Review of Statement of Investment Policy

RECOMMENDATION

That the Committee recommends approval of the FY 2012 Statement of Investment Policy and establishment of an additional Local Agency Investment Account (LAIF) for the Hayward Public Financing Authority to the City Council.

BACKGROUND

The City's Statement of Investment Policy (Policy) is required to be reviewed annually by the Investment Advisory Committee and, thereafter be reviewed and approved by the City Council at a public meeting. The Statement of Investment Policy was reviewed by the Investment Advisory Committee on August 8, 2011, and is being brought to the Budget and Finance Committee for review on September 28, 2011.

DISCUSSION

The purpose of this Investment Policy is to establish cash management and investment guidelines for the Finance Director, who is responsible for the stewardship of the City of Hayward's Investment Program. Each transaction and the entire portfolio must comply with California Government (Code) Sections 53600 and 53635 et seq. (these sections specify the types of investment vehicles a city can utilize) and the City's Policy. This Policy conforms to customary standards of prudent investment management. Should the provisions of the Government Code change from those contained herein; such provisions will be considered incorporated in the City's Policy.

In managing the City of Hayward's Investment Portfolio, the City's primary objectives are safety, liquidity and yield.

1. Safety - Safety of principal is the foremost objective of the City, followed by liquidity and yield. Each investment transaction shall seek to first ensure that capital losses are avoided, whether losses are from securities defaults or erosion of market value.

2. Liquidity - The City's investment portfolio will remain sufficiently liquid to enable the City to

meet all operating requirements that might be reasonably anticipated. This need for investment liquidity may be tempered to the extent that the City is able to issue short-term notes to meet its operating requirements.

3. Yield - The investment portfolio shall be managed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the City's investment risk constraints and cash flow requirements, and state and local law, ordinances or resolutions that restrict the placement of short-term funds. Investment decisions should not incur unreasonable investment risks in order to obtain current investment income.

Staff recommends that the Committee recommend Council approval of the revised FY2012 Statement of Investment Policy. The policy contains one substantive change since last adopted by City Council on September 14, 2010: updated language to Section IV (Delegation of Authority) to allow the Finance Director, upon authorization by the City Council, to engage an external investment management firm to assist with the City's portfolio investments.

Staff also recommends that the Committee recommend to City Council the authority for the Finance Director to create a Local Agency Investment Fund (LAIF) account for the Hayward Public Financing Authority.

<u>Establish Authority for External Investment Management Firm</u>

Currently, the Finance Director is responsible for the direct investment of City funds. While the Finance Director will continue to be the responsible officer of the City regarding the City's portfolio, staff would like to consider hiring an external investment management firm to assist with the portfolio management. As staffing resources have decreased, and the responsibilities of Finance Directors have broadened, many municipalities are increasingly seeking assistance with their portfolio management. The Investment Advisory Committee has considered this issue and supports creating the authority within the Investment Policy to hire an external investment management firm, and supports the Finance Director in seeking assistance from such a firm.

The Government Finance Officers Association (GFOA) recognizes that many local governments use the services of investment management firms and offers best practice guidelines in the selection of such firms. The City will conduct the appropriate bidding/contracting process in conformance with GFOA recommended standards.

The City's external auditor, Maze & Associates, is in the process of conducting the audit of the City's financial statements for the period ending June 30, 2011. As part of their preliminary review, the auditor provided an Accounting Issues Memo. This memo identifies that the City does not have a balanced investment portfolio, and cites the cause for this condition as the lack of an official Investment Manager. The auditor recommends that the City consider hiring a third party Investment Manager to better manage and diversify the investment portfolio.

Given that the City currently has a large amount of its pooled cash in LAIF, the earnings are relatively low. With the assistance of an Investment Manager, staff hopes to increase earnings by a minimum of 1%. This increase should adequately cover the cost of the Investment Manager.

The Investment Advisory Committee reviewed and approved in concept this recommendation at its August 8, 2011 meeting. The Committee meets again on September 27, 2011 and will formally make a recommendation on this item.

<u>Hayward Public Financing Authority LAIF Account</u>
LAIF has a maximum deposit cap of $50 million per agency account. Currently, the City of Hayward has three general accounts: City of Hayward, the Hayward Housing Authority, and the Hayward Redevelopment Agency. Given the status of the California Redevelopment Agency's, the City of Hayward has discontinued use of the Hayward Redevelopment Agency LAIF account. The remaining two accounts are at the maximum deposit amount. From time to time, the City's cash flow requires additional short-term investment accounts. Creating an additional LAIF account under the Hayward Public Financing Authority provides the flexibility for managing the City's liquidity and cash flow.

It is not the intent of staff to invest the maximum amount in all three accounts (total of $150 million). Instead, staff will pursue a diversified portfolio that conforms to the City's Investment Policy. The third active LAIF account will simply be available as needed for cash flow purposes.

The Investment Advisory Committee reviewed and approved this recommendation at its August 8, 2011 meeting.

<u>Next Steps</u>
As required under Government Code Sections 16481.2 and 53646, the Statement of Investment Policy must be reviewed and approved by the Council annually at a public meeting. Upon review and approval of this report by the Budget and Finance Committee, staff will present the Change of Statement of Investment Policy, Annual Delegation of Authority, and Annual Report to the full Council on October 11, 2011.

Prepared and Recommended by: Tracy Vesely, Director of Finance

Approved by:

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Fran David, City Manager

Attachment:
Attachment I – Draft - FY2012 Statement of Investment Policy

CITY OF
HAYWARD
HEART OF THE BAY

FY 2012
Statement of Investment Policy

Finance Department
Director of Finance, Tracy Vesely
Policy Recommended Changes: September 28, 2011

Policy last amended: September 14, 2010

Table of Contents

I. Introduction

The purpose of this document is to identify various policies and procedures that enhance opportunities for a prudent and systematic investment policy and to organize and formalize investment-related activities. Activities that comprise good cash management include accurate cash projections, the expeditious collection of revenue, the control of disbursements, cost-effective banking relations, and arranging for a short-term borrowing program that coordinates working capital requirements and investment opportunities.

A. **Included** – Funds included in this policy are described in the City's annual financial report, and include: General Fund, Special Revenue Funds, Capital Projects Funds, Enterprise Funds, Internal Service Funds, Fiduciary Funds, Redevelopment Agency Funds, and Housing Finance Agency Funds. The investment policy applies to all transactions involving the financial assets and related activity of the foregoing funds.

B. **Excluded** – The following funds are excluded from the policy: Deferred Compensation Fund assets and investments, whereas investments of these monies are directed by each employee in accordance with the rules of the Deferred Compensation Plan of the City; and employer and employee deposits into both the PARS and PERS Fund.

C. **Other excluded funds** - 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 the City, or certificates of participation in those bonds, indebtedness, or lease installment sale, or other agreements may be invested in accordance with the ordinance, resolution, indenture or agreement approved by the City Council which govern the issuance of those bonds, or lease installment sale, or other agreement, rather than this Statement of Investment Policy.

II. Policy

It is the policy of the City of Hayward to invest public funds not required for immediate day-to-day operations in safe, liquid and medium term investments. These investments shall yield an acceptable return while conforming to all California statutes. Investments are intended to achieve a reasonable rate of return on public funds while minimizing the potential for capital losses arising from market changes or issuer default.

Although the generating revenues through interest earnings on investments is an appropriate City goal, the primary consideration in the investment of City funds is capital preservation in the overall portfolio. As such, the City's yield objective is to achieve a reasonable rate of return on City investments rather than the maximum generation of income, which could expose the City to unacceptable levels of risk.

In managing the City of Hayward's Investment Portfolio, the City's primary objectives are safety, liquidity and yield.

1. **Safety** of principal is the foremost objective of the City, followed by liquidity and yield. Each investment transaction shall seek to first ensure that capital losses are avoided, whether they are from securities defaults or erosion of market value.

2. **Liquidity** - The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements that might be reasonably anticipated. This need for investment liquidity may be tempered to the extent that the City is able to issue short-term notes to meet its operating requirements.

3. **Yield** - The investment portfolio shall be managed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the City's investment risk constraints and cash flow requirements, and state and local law, ordinances or resolutions that restrict the placement of short-term funds. Investment decisions should not incur unreasonable investment risks in order to obtain current investment income.

4. **Goal Yield** - The investment portfolio shall be managed with the objective of regularly exceeding by 50 basis points, the average of three-month and six-month U.S. Treasury Bill rates for the equivalent period. These indices are considered benchmarks for risk-less investment transactions and therefore comprise a minimum standard for the portfolio's rate of return. The investment program shall seek to augment returns above this threshold, consistent with risk limitations identified herein and prudent investment principles.

5. **Diversification** - The City's investment portfolio will be diversified to avoid incurring unreasonable and avoidable risks associated with concentrating investments in specific security types or in individual financial institutions.

While the City will not make investments for the purpose of trading or speculation as the dominant criterion, the Finance Director shall seek to enhance total portfolio return by means of active portfolio management. The prohibition of speculative investments precludes pursuit of gain or profit through unusual risk and precludes investments primarily directed at gains or profits from conjectural fluctuations in market prices. However, as long as the original investments can be justified by their ordinary earning power, trading in response to changes in market value or market direction is a requirement of active portfolio management.

III. Use of State Investment Guidelines

Government Code Sections 16481.2, 53601, 53607, 53635, and 53646 of the State of California regulate the investment practices. It is the policy of the City of Hayward to use the State's provisions for local government investments as the base for developing and implementing the City's investment policies and practices.

IV. Delegation of Authority

In accordance with Section 53607 of the California Government Code, the responsibility for conducting the City's investment program is delegated to the Finance Director, who has established written procedures for the operation of the investment program, consistent with this investment policy, which also govern delegation of authority for all investment activities. The authority to invest City Funds rests with the Finance Director and his/her designated staff. The Finance Director has further authority, with consent of the City Council, engage the services of one or more external investment managers to assist in the management of the City's investment portfolio in a manner consistent with the City's Investment Policy. Such managers must be registered under the Investment Advisors Act of 1940.

V. Investment Advisory Committee

The City Manager will appoint an Investment Advisory Committee (IAC) for the purpose of overseeing the implementation of the City's investment program and assuring it is consistent with the investment policy as approved by the Council. The IAC shall consist of the Assistant City Manager, Finance Director, City Attorney, a representative of California State University, East Bay, a member of the financial community, and two department heads chosen by the City Manager.

The IAC shall meet at least quarterly to determine general strategies and to monitor results. The committee shall include in its deliberations such topics as: economic outlook, portfolio diversification and maturity structure, potential risks to the City's funds, approval of authorized financial institutions, and the goal rate of return on the investment portfolio. Written investment procedures must be approved by the IAC.

VI. Investment Policy Adoption

The City's investment policy shall be formally reviewed and approved by the Investment Advisory Committee, not more than 120 days after the beginning of each fiscal year; and, thereafter shall be reviewed and approved by the City Council at a public meeting.

As required under Government Code Sections 16481.2 and 53646, the Council will review the Statement of Investment Policy annually.

VII. Reporting

The following investment activity reports will be completed.

A. Quarterly

Within 30 days of the end of each quarter, the Finance Director shall submit a quarterly investment report to the City Manager, City Council, and Investment Advisory Committee, as required by California Government Code 53607.

The text of report shall highlight key aspects of information contained in the investment report schedules, and inform readers of economic conditions affecting the portfolio. The report will present recent investment performance and future investment strategy; disclose any perceived threats to portfolio quality, security or liquidity; compare the average portfolio investment yield with the portfolio goal yield.

Graphs, charts or schedules of the report shall itemize investment purchases, sales and maturities and indicate their effect on portfolio value. The report will itemize all investments and deposits in the portfolio by investment or deposit category, providing essential identifying characteristics for each investment or deposit; indicate the percentage of the portfolio represented by each investment and by each investment category; show all par values, market values and costs at time of purchase, together with each item's coupon or discount rate. The report will show the average earning rate for the portfolio, indicate distribution of the portfolio by category; and provide other relevant detail to accomplish disclosure of investment activity and portfolio status.

B. Monthly

Within 30 days of the end of each month, the Finance Director shall submit an investment summary to the City Council Budget & Finance Committee, City Manager, and Investment Advisory Committee. For those months where a quarterly investment report is published, the quarterly investment report will serve as both the monthly investment summary and the quarterly investment report.

The investment summary will report key aspects of the investment portfolio, to include information about the type of each investment instrument, issuer, par and dollar amount, purchases, sales, gains and losses, maturity dates, credit ratings, and the percentage of the portfolio by each type of investment.

C. Annual

Within 90 days of the fiscal year end, the Finance Director shall present a comprehensive annual report on the investment program and investment activity. This report shall be presented to the Investment Advisory Committee. The annual report shall include twelve-month comparisons of return, shall suggest policies and improvements that might enhance the investment program, and include an investment plan for the ensuing fiscal year. In conjunction with its review of the annual investment report, the Investment Advisory Committee shall review and reaffirm the Statement of Investment Policy of the City, whether or not specific policy modifications are suggested as part of the annual report.

Following the annual review of the Statement of Investment Policy by the Investment Advisory Committee, the Investment Policy shall be submitted to the City Council together with any changes recommended by the Investment Advisory Committee. The City Council shall consider any such recommended changes and annually reaffirm the Statement of Investment Policy at a public meeting of the City Council.

D. Other Reporting

The City shall comply with such requirements which may be enacted by amendment to the government code relating to investment practices which provide for transmitting to state agencies copies of annual reports and the Statement of Investment Policy.

VIII. Investment Instruments

A summary and description of authorized investment instruments is below.

INVESTMENT INSTRUMENT SUMMARY Security Type	Maximum Maturity	Min Credit Quality	Authorized Investment Limit	Per Issuer Limit
A. US Treasury Notes/Bills	4 Years	None	100%	100%
B. US Agencies – Fully Backed	4 Years	None	100%	100%
B. US Agencies – Sponsored	4 Years	None	50%	20%
C. Banker's Acceptance (BA)	180 days	A-1/P-1	40%	30%
D. Commercial Paper	270 days	A-1/P-1	15%	10%
E. Negotiable Certificates of Deposit	4 Years	A to AA	30%	20%
F. Repurchase Agreements	1 Year	None	25%	20%
F. Reverse Repurchase Agreement	92 Days	None	20%	20%
G. Medium Term Notes (MTN)	2-4 Years	A to AA	30%	20%
H. Mutual Funds	Limited to bond proceeds only.			
I. Money Market Fund	2 Years	AAA	20%	10%
J. Asset-backed Corporate Notes	4 Years	AA	20%	20%
K. County Treasurer Pool	None	None	15%	20%
L. LAIF (1)	None	None	$150 M	N/A
M. Certificates of Deposit	4 Years	None	25%	20%

The following sections describe individual investment types. The sections specify a percentage limitation for a particular category of investment, that percentage is applicable only at the date of purchase. A later increase or decrease in a percentage resulting from a change in values or assets shall not constitute a violation of that restriction. If subsequent to purchase, securities are downgraded below the minimum acceptable rating level, the securities shall be reviewed for possible sale within a reasonable amount of time after the downgrade (GC 53601.7 d).

Note (1): This Policy was amended in October 2010 to increase the authorized investment limit for LAIF from $120 million to $150 million, to agree with the increase in the maximum LAIF account balances set by the State (LAIF Board).

A. United States Treasury Notes, Bonds, Bills, or Certificates of Indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

Description: Treasury securities are government bonds issued by the United States Department of the Treasury through the Bureau of the Public Debt. They are the debt financing instruments of the U.S. Federal government, and are often referred to simply as Treasuries. There are four types of treasury securities: Treasury bills, Treasury notes, Treasury bonds, and Savings bonds. All of the Treasury securities (besides savings bonds) are very liquid and are heavily traded on the secondary market.

U.S. Treasury Securities	City Of Hayward	CA Govt Code 53601 (b)
Maximum Maturity	4 years	5 years
Credit Rating Limit	None	None
Authorized Investment Limit	100%	None
Per Issuer Limit	100%	None
Other Requirement	None	

B. Federal Agency or United States Government-Sponsored Enterprise (GSE) Obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises.

Description: The term "agency issues" is used to describe debt issues by Federal agencies in the United States. These special federal agencies are often created to channel credit to specific sectors of the economy (Freddie Mac for housing development for example). Although the federal government does not explicitly insure this debt, it is assumed that the government will step forth if the agency nears default.

The government-sponsored enterprises (GSEs) are a group of financial services corporations created by the United States Congress. Their function is to reduce interest rates for specific borrowing sectors of the economy, farmers, and homeowners. The mortgage-borrowing segment is by far the largest of the borrowing segments that the GSEs operate in.

i. U.S. Agencies (fully backed)	City Of Hayward	CA Govt Code 53601 (e)
Maximum Maturity	4 years	5 years
Credit Rating Limit	None	None
Authorized Investment Limit	100%	None
Per Issuer Limit	100%	None
Other Requirement	None	
ii. U.S. Agencies	**City Of Hayward**	**CA Govt Code 53601 (e)**

(Government Sponsored Enterprise (GSE))		
Maximum Maturity	4 years	5 years
Credit Rating Limit	None	None
Authorized Investment Limit	50%	None
Per Issuer Limit	20%	None
Other Requirement	None	

C. Prime Banker's Acceptances (BA) otherwise known as bills of exchange or time drafts that are drawn on and accepted by a commercial bank.

Description - A short-term credit investment created by a non-financial firm and guaranteed by a bank. Acceptances are traded at a discount from face value on the secondary market. Banker's acceptances are very similar to T-bills and are often used in money market funds.

Banker's Acceptances	City Of Hayward	CA Govt Code 53601 (f), 53601.7
Maximum Maturity	Less than 180 days	Less than 180 days
Credit Rating Limit	A-1/P-1/F-1	A-1/P-1/F-1
Authorized Investment Limit	40%	40%
Per Issuer Limit	30%	30%
Other Requirement	• BAs which are eligible for purchase by the Federal Reserve System. • BAs that are issued by the top 50 banks in the world or any qualified depository in the State of California with a 4.5 percent equity to asset ratio.	

D. Commercial Paper (CP) of "prime" quality.

Description - An unsecured promissory note with a fixed maturity. Short-term corporate IOUs, are generally due in less than a year and sold at a discount from face value.

Commercial Paper	City Of Hayward	CA Govt Code 53601 (g) 53635
Maximum Maturity	270 days or less	270 days or less
Credit Rating Limit	Highest letter and numerical rating as provided for by Moody's or Standard and Poor's rating services. (A-1/P-1/F-1)	A-1/P-1/F-1
Authorized Investment Limit	15%	25%
Per Issuer Limit	10%	10%
Other City Requirement	The entity that issues CP shall meet all of the following conditions in either paragraph 1 or 2. 1. The entity meets the following criteria: o Is organized and operating in the United States as a general corporation. o Has total assets in excess of five hundred million dollars ($500,000,000). o Has debt other than commercial paper, if any, that is rated "A" or higher by a nationally recognized statistical-rating organization (NRSRO). 2. The entity meets the following criteria: o Is organized within the United States as a special purpose corporation, trust, or limited liability company. o Has program-wide credit enhancements including, but not limited to, over-collateralization, letters of credit, or surety bond. o Has commercial paper that is rated "A-1" or higher, or the equivalent, by a nationally recognized statistical-rating organization (NRSRO).	

E. Negotiable Certificates of Deposit issued by a nationally or state-chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a state-licensed branch of a foreign bank.

Description - A CD with a very large denomination, usually $1 million or more. These are usually bought by institutional investors who are interested in low-risk investments. Negotiable certificates of deposit are usually in bearer form, and have secondary markets that are highly liquid.

Negotiable CD	City Of Hayward				CA Govt Code 53601 (h)
Maximum Maturity	6 mo to 1 year	1 -2 Years	2-3 Years	3-4 Years	5 Years
Credit Rating Limit	Min A-2/ P-2 rating	Min A rating	Min A+ rating	Min AA rating	Rated at least A-1/P-1/F-1 for short term, and A for long-term
Authorized Investment Limit	30%				30%
Per Issuer Limit	20%				None
Other Requirement	None				

F. Repurchase Agreements or Reverse Repurchase Agreements
Description - purchase of portfolio securities by an investor with a simultaneous agreement to resell the securities back to the seller on a specific future date, at the original purchase price, plus a negotiated interest payment. This transaction should be secured or made safe with collateralization.

Repurchase agreement means a purchase of securities by the local agency pursuant to an agreement by which the counterparty seller will repurchase the securities on or before a specified date and for a specified amount and the counterparty will deliver the underlying securities to the local agency by book entry, physical delivery, or by third-party custodial agreement. The transfer of underlying securities to the counterparty bank's customer book-entry account may be used for book-entry delivery.

Repurchase Agreement	City Of Hayward	CA Govt Code 53601 (i)
Maximum Maturity	1 Year	1 Year
Credit Rating Limit	Depends on underlying asset.	Rated at least A-1/P-1/F-1 for short term, and A for long-term
Authorized Investment Limit	20%	20%
Per Issuer Limit	20%	None
Other Requirement	• Securities purchased under the repurchase agreement shall be limited to the securities and qualifications listed in this policy, under Section VIII, Investment Instruments. • Investments in repurchase agreements may be made, on any investment authorized in this section, when the term of the agreement does not exceed one year. • Securities shall be marked-to-market daily, and shall be maintained at a value equal to or greater than the cash investment. • 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. • At the time of purchase the market value of the securities shall be in excess of the cash investment. • A third-party custodian or safekeeping agent shall hold all securities purchased under a repurchase agreement. Transfer of underlying securities to a counterparty bank's customer book entry account may be used for book entry delivery, and a counterparty bank's trust department or safekeeping department may also be used for physical delivery of the underlying security. • The seller of repurchase securities shall not be entitled to substitute securities, except as authorized by the City. New or substitute securities should be reasonably identical to the original securities in terms of maturity, yield, quality, and liquidity. • "Retail" repurchase agreements shall not be authorized for purchase. • As soon as possible a master repurchase agreement shall be executed between the City and all trading partners.	

Reverse repurchase agreement means a sale of securities by the local agency pursuant to an agreement by which the local agency will repurchase the securities on or before a specified date and includes other comparable agreements.

Reverse Repurchase Agreement	City Of Hayward	CA Govt Code 53601 (i)
Maximum Maturity	92 days	1 year
Credit Rating Limit	Rated at least A-1/P-1/F-1 for short term, and A for long-term. See limits for individual investment securities.	Rated at least A-1/P-1/F-1 for short term, and A for long-term
Authorized Investment Limit	20%	20%
Per Issuer Limit	20%	None
Other Requirement	• The security to be sold on reverse repurchase agreement or securities lending agreement has been owned and fully paid for by the local agency for a minimum of 30 days prior to sale. • The total of all reverse repurchase agreements and securities lending agreements on investments owned by the local agency does not exceed 20 percent of the base value of the portfolio. • The agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security. • Funds obtained or funds within the pool of an equivalent amount to that obtained from selling a security to a counterparty by way of a reverse repurchase agreement or securities lending agreement shall not be used to purchase another security with a maturity longer than 92 days from the initial settlement date of the reverse repurchase agreement or securities lending agreement, unless the reverse repurchase agreement or securities lending agreement includes • A written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity date of the same security. • Investments in reverse repurchase agreements, securities lending agreements, or similar investments in which the local agency sells securities prior to purchase with a simultaneous agreement to repurchase the security may only be made upon prior approval of the governing body of the local agency and shall only be made with primary dealers of the Federal Reserve Bank of New York or with a nationally or state-chartered bank that has or has had a significant banking relationship with a local agency.	

G. Medium-Term Notes (MTN)

Description - Corporate promissory notes of 9-month to 15-year duration sold through dealers on a continuously offered basis. Like certificates of deposit, MTNs can be either collateralized or unsecured. Issuers include banks and savings and loans, insurance companies and corporations.

Medium Term Corporate	City Of Hayward			CA Govt Code 53601 (j)
Maximum Maturity	1 day to two years	Two to three years	Three to four years	5 Years
Credit Rating Limit	Minimum A rating	Minimum A+ rating	Minimum AA rating	A
Authorized Investment Limit	30%			30%
Per Issuer Limit	20%			N/A
Other Requirement	• Securities must be issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States.			

H. Mutual Funds

Description - A mutual fund is simply a financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective. The mutual fund will have a fund manager who is responsible for investing the pooled money into specific securities (usually stocks or bonds). When you invest in a mutual fund, you are buying shares (or portions) of the mutual fund and become a shareholder of the fund.

Mutual Funds	City of Hayward	CA Govt Code 53601 (k), 53601.7
Maximum Maturity	180 days or less	None
Credit Rating Limit	The funds must be rated in the highest category of Moody's or Standard and Poor's, or must be administered by a domestic bank with long-term debt rated in one of the top two categories of Moody's or Standard and Poor's.	Rated at least A-1/P-1/F-1 for short term, and A for long-term
Authorized Investment Limit	20%	20%
Per Issuer Limit	10%	10%
Other Requirement	• Eligible for purchase, provided that use of mutual funds shall be **limited to bond proceeds** for which the City Treasurer finds a mutual fund's accounting methods particularly suited to the accounting requirements of the bond issue and helpful with arbitrage calculations.	

I. Money Market Funds

Description: Money market securities are essentially IOUs issued by governments, financial institutions and large corporations. These instruments are very liquid and considered extraordinarily safe. Because they are extremely conservative, money market securities offer significantly lower returns than most other securities.

Money Market Funds	City of Hayward	CA Govt Code 53601 (k)
Maximum Maturity	2 Years	None
Credit Rating Limit	AAA by two NRSROs.	Highest ranking by two NRSROs.
Authorized Investment Limit	20%	20%
Per Issuer Limit	10%	N/A
Other Requirement	• Attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations (NRSRO) or retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than ten years' experience managing money market mutual funds with assets under management in excess of one billion dollars ($1,000,000,000). • The purchase price of shares of beneficial interest purchased shall not include any commission that the companies may charge. • The City shall invest only in Money Market Funds that have a policy of maintaining a constant daily net asset value per share of $1.00.	

A thorough investigation of any money market fund or investment pool is required prior to investing, as well as on an ongoing basis. The following information should be obtained and analyzed:

(i) A description of eligible investment securities.
(ii) A written statement of investment policies and objectives.
(iii) A description of interest calculation and their distribution, and the treatment of gains and losses.
(iv) A description of how the securities are safeguarded and how often the securities are priced and the program audited.
(v) Information about the size and frequency of deposits and withdrawals allowed, and how much notice is needed for withdrawals.
(vi) A schedule for receiving statements and portfolio listings.
(vii) A fee schedule, as well as how and when the fees are assessed.
(viii) The rating of the pool/fund.
(ix) Information about investment advisers, including registration with the Securities and Exchange Commission, length of experience and total assets under management.

J. Asset-Backed Corporate Notes

Description: Asset-backed securities are bonds backed by a pool of physical or financial assets that cannot easily be traded in their existing form. By pooling together a large portfolio of these illiquid assets they can be converted into instruments that may be offered and sold more freely in the capital markets. A financial security backed by a loan, lease or receivables against assets other than real estate and mortgage backed securities.

Asset-backed Corporate Notes	City Of Hayward		CA Govt Code 53601 (n)
Maximum Maturity	Bullet maturity = 4 years	Stated final maturity = 5 years	5 years
Credit Rating Limit	Issuer Rating of A or better.	Security Rating of AB themselves, AA or better.	AA
Authorized Investment Limit	20 % for AB securities alone.	40% for total of MTN and AB securities.	20%
Per Issuer Limit	10%		None
Other Requirement	• Mortgage-backed corporate notes shall <u>not</u> be invested in.		

K. County Agency Investment Fund;

County Agency Pool	City Of Hayward	CA Govt Code 53684
Maximum Maturity	N/A	N/A
Credit Rating Limit	Not rated	N/A
Authorized Investment Limit	15%	N/A
Per Issuer Limit	10%	N/A
Other Requirement	N/A	

L. State of California Local Agency Investment Fund (LAIF) –

Description: This is the fund in which the State of California pools its investments and the investments of California public agencies, which participate in LAIF An agency participates by depositing funds in the State pool.

LAIF	City Of Hayward	CA Govt Code 16429.1
Maximum Maturity	None	None
Credit Rating Limit	None	None
Authorized Investment Limit	$100 Million	None
Per Issuer Limit	None	None
Other Requirement	• The current limit on any one City investment in this fund for the number of transactions (deposits or withdrawals) is limited to 15 per month. • The City maintains a total of three LAIF investments (up to $50 million each). • The City's participation in LAIF shall conform to State Regulation. • In general, it is the City's intention to use investment in LAIF as a temporary repository for short-term funds needed for liquidity purposes. • The Finance Director shall maintain on file appropriate information concerning LAIF's current investment policies, practices and performance. • The Finance Director shall maintain LAIF's requirements for participation, including, but not limited to, limitations on deposits or withdrawals and the composition of the portfolio.	

M. Certificates of Deposit

Description: A time deposit with a specific maturity evidenced by a certificate.

Certificates of Deposit	City Of Hayward	CA Govt Code 53601 (m)
Maximum Maturity	4 Year	5 Years
Credit Rating Limit	Rated at least A-1/P-1/F-1 for short term, and A for long-term	Rated at least A-1/P-1/F-1 for short term, and A for long-term
Authorized Investment Limit	25%	None
Per Issuer Limit	20%	None
Other Requirement	• In accordance with California statutes, City deposits including collateralized certificates of deposit shall not exceed the total paid-up capital (to include capital notes and debentures) and surplus of any depository bank, or the total of the net worth of any savings and loan association. • The money shall be deposited in any bank, savings association or federal association, state or federal credit union, or federally insured industrial loan company with the objective of realizing maximum return, consistent with prudent financial management, except that money shall not be deposited in any state or federal credit union if a member of the legislative body of a local agency, or any person with investment decision making authority of the administrative office, manager's office, budget office, auditor-controller's office, or treasurer's office of the local agency, also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or supervisory committee, of the state or federal credit union.	

IX. Prohibited Investments

Consistent with California Government Code 53601.6, inverse floaters, range notes, mortgage derived interest-only strips, or any security that could result in zero interest accrual if held to maturity are specifically prohibited, except to the extent that they are shares of diversified management companies registered under the Investment Company Act of 1940. The City shall not purchase any security rated A-1 and or A+ or below if that security has been placed on "credit watch" for a possible downgrade by either Moody's Investor Services or Standard and Poor's. Investments not specifically approved by this policy are prohibited.

X. Internal Controls

The Finance Director shall establish a system of internal controls. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, and misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City. Controls deemed most important include:

- **Clearly delegating authority to subordinate staff members.** Subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.

- **Custodial safekeeping.** Securities purchased from any bank or dealer including appropriate collateral (as defined by State Law) shall be placed with an independent third party for custodial safekeeping.

- **Separating transaction authority from accounting and record keeping.** By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.

- **Delivery versus payment.** All trades where applicable will be executed by delivery vs. payment (DVP). This ensures that securities are deposited in the eligible financial institution before the release of funds. A third party custodian as evidenced by safekeeping receipts will hold securities.

- **Avoiding physical delivery securities.** Book entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.

- **Confirming telephone transactions for investments and wire transfers in writing.** Due to the potential for error and improprieties arising from telephone transactions, all telephone transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and the safekeeping institution has a list of authorized signatures.

- **Developing wire transfer agreements with the lead bank or third party custodian.** This agreement should outline the various controls, security provisions, and delineate responsibilities of each party making and receiving wire transfers.

XI. Evaluation of Investment Officer Actions

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

The City adheres to the guidance provided by the prudent investor standard which obligates a fiduciary to ensure that investments shall be made with the exercise of that degree of judgment and care, under circumstances then prevailing, which a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. Investment officers acting in accordance with written procedures and the statement 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 plan.

When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency.

XII. Bond Proceeds

The investment of bond proceeds will be made in accordance with applicable bond indentures.

XIII. Credit Downgrade

In the event that a financial institution or depository receives a Standard and Poor's, Moody's, Fitch or Keefe rating equal to or lower than Standard and Poor's rating of BBB, the Finance Director promptly shall make and implement an informed decision on whether to sell, withdraw from deposit or retain any security or deposit in the City portfolio issued or held by such affected financial institution or depository. The Finance Director may consult the Investment Advisory Committee on the action to be taken and shall advise its Chairman and Members of the final disposition of the matter either by memorandum or at the next Investment Advisory Committee meeting. If the meeting is scheduled more than a month after action is taken, the communication of disposition will be by memorandum.

XIV. Rating Agency Changes

In the event a security held by the City is the subject of a rate drop which brings it below accepted minimums specified herein, or the security is placed on negative credit watch, where downgrade could result in a rate drop below acceptable levels, the investment advisor who purchased the security will immediately notify the Finance Director of that fact.

The course of action to be followed will then be decided on a case by case basis, considering such factors as the reason for the rate drop, prognosis for recovery or further drop, and market price of the security. The City Council will be advised of the situation and intended course of action by e-mail or fax.

XV. Banks and Security Dealer Selection

The Investment Advisory Committee shall approve all financial institutions from which securities are purchased or sold.

In selecting financial institutions for the deposit or investment of City funds, the Finance Director shall consider the creditworthiness of institutions. The Finance Director shall continue to monitor financial institutions' credit characteristics and financial history throughout the period in which City funds are deposited or invested.

Only primary government securities dealers that report to the New York Federal Reserve shall be used for the purchase of repurchase agreements. (It is acknowledged that inclusion on the primary dealer listing of the Federal Reserve Bank of New York is not a guarantee of creditworthiness.)

Effective October 14, 1987, the City shall be prohibited from investing funds with any person who is knowingly or intentionally engaged in the development or production of nuclear weapons. Person is defined as any person, Private Corporation, institution or other entity, which is within the jurisdiction of the City of Hayward.

XVI. Maturity and Diversification

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity).

It is City policy to diversify the investment portfolio in order to reduce the risk of loss resulting from over concentration of assets in a specific maturity, a specific issuer, or a specific class of securities. The following strategies and constraints shall apply:

1. **Maintains Liquidity** - Concern for liquidity shall be insured through practices that

include covering the next vendor disbursement date and payroll date through maturing investments of U.S. Treasury bills.

2. **Staggered Maturities** - Portfolio maturities shall be staggered in a way that avoids undue concentration of assets in a specific maturity sector. Maturities shall be selected which provide for stability of income and reasonable liquidity.

3. **Maturity Diversification -** Risks of market price volatility shall be controlled through maturity diversification such that aggregate price losses on instruments with maturities exceeding one year shall not be greater than coupon interest and investment income received from the balance of the portfolio.

4. **Specific Diversification Limitations –** The City shall not invest in instruments whose maturities exceed four years at the time of purchase. Instruments with maturities greater than two years shall be limited to (1) U.S. Treasury and agency obligations; (2) medium term notes rated "A" or its equivalent or better by at least one of the four national rating services identified above; (3) certificates of deposit rated "A", its equivalent or better by at least one of the four national rating services identified above; and (4) asset-backed notes as regards the "bullet" maturity, provided the "stated final" maturity is not more than five years. The average maturity of the City's short-term portfolio shall not exceed one year.

   It is the intent that investments shall be managed in such a way that any market price losses resulting from interest-rate volatility would be offset by coupon income and current income received from the balance of the portfolio during a twelve-month period.

5. **Specific diversification limitation shall be imposed on the portfolio as follows:**

   a. No more than 40% of the portfolio may be invested beyond twelve months, and the average maturity of the portfolio shall not exceed 400 calendar days.

6. **The maximum percentage of the total portfolio that shall be placed at any one time in each of the categories of investment is summarized below.**

Security Type	Maximum Allowable Portfolio Percentage						
	100%	50%	40%	30%	25%	20%	15%
US Treasury Notes/Bills							
US Agencies – Fully Backed							
US Agencies – Government Sponsored Entities (GSE)							
LAIF							
Fully collateralized certificates of deposit	✓						

Fully collateralized medium term notes	✓						
Banker's Acceptance (BA)							
Negotiable Certificates of Deposit (NCD)				✓			
Medium Term Notes (MTN) (30 % alone, and no more than 40% when combined with AB category)				✓			
Asset-backed (AB) Securities (20% alone and no more than 40% when combined with the MTN category)						✓	
County Treasurer Pool							✓
Commercial Paper (CP)							✓

In accordance with California statutes, City deposits including collateralized certificates of deposit shall not exceed the total paid-up capital (to include capital notes and debentures) and surplus of any depository bank, or the total of the net worth of any savings and loan association.

XVII. Risk Tolerance

The City recognizes that investment risks can result from issuer defaults, market price changes or various technical complications leading to temporary illiquidity. Portfolio diversification is employed as a way to control risk. Investment managers are expected to display prudence in the selection of securities, as a way to minimize default risk. No individual investment transaction shall be undertaken which jeopardizes the total capital position of the overall portfolio.

The Finance Director shall periodically establish guidelines and strategies to control risks of default, market price changes and illiquidity. All investment reports shall specifically address whether current investment results have been affected by any of the foregoing risks, and shall explain what actions investment officials have taken to control or correct for such risks.

In addition to these general policy considerations, the following specific policies will be strictly observed:

1. All investment funds will be placed directly with qualified financial institutions. The City will not deposit or invest funds through third parties or money brokers.

2. All transactions will be executed on a delivery versus payment basis.

3. The City will not enter into reverse repurchase agreements other than for cash flow requirements; nor shall it trade in options on future contracts unless, upon recommendation by the Investment Advisory Committee, such transactions are specifically authorized by the City Council.

4. A competitive bid process, utilizing financial institutions deemed eligible by the Investment Advisory Committee, will be used to place investment purchases. Based on annual evaluation, securities dealers, banks and other financial

institutions will be dropped or continued on the eligibility list. The following criteria will be used in the evaluation:

a. number of transactions competitively won
b. prompt and accurate confirmation of transactions
c. efficient securities delivery
d. accurate market information account servicing

5. The Finance Director shall designate an official to manage investments and designate a second official to perform investment management during absences of the primary designee. The Finance Director shall insure that competent investment management is maintained and shall insure that, if both designated investment officials are replaced or are simultaneously absent, any temporary replacement(s) shall be closely supervised, indoctrinated in the requirements of this Statement of Investment Policy, and given written investment procedures regulating the authority to invest in maturities beyond six months by means of appropriate controls and restraining requirements.

6. In order to assist in identifying "qualified financial institutions," the Finance Director shall forward copies of the City's Investment Policy to those financial institutions with which the City is interested in doing business and require written acknowledgement of the Policy.

XVIII. Safekeeping and Custody

To protect against potential fraud and embezzlement, the assets of the City shall be secured through third-party custody and safekeeping procedures.

The investment official shall be bonded to protect the public against possible embezzlement and malfeasance. An independent auditor shall review safekeeping procedures annually. The auditor may conduct surprise audits of safekeeping and custodial procedures.

All cash and securities in the City's portfolio, shall be held in safekeeping in the City's name 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 the City.

All securities will be received and delivered using standard delivery versus payment (DVP) procedures; the City's safekeeping agent will only release payment for a security after the security has been properly delivered. The only exception to the foregoing shall be depository accounts and securities purchases made with: (i) local government investment pools; and, (ii) money market mutual funds, since the purchased securities are not deliverable.

Appendix A

Comparison and Interpretation of Credit Ratings [1]

Long Term Debt Ratings

Rating Interpretation	Moody's	Standard & Poor's	Fitch
Best-quality grade	Aaa	AAA	AAA
High-quality grade	Aa1 Aa2 Aa3	AA+ AA AA-	AA+ AA AA-
Upper Medium Grade	A1 A2 A3	A+ A A-	A+ A A-
Medium Grade	Baa1 Baa2 Baa3	BBB+ BBB BBB-	BBB+ BBB BBB-
Speculative Grade	Ba1 Ba2 Ba3	BB+ BB BB-	BB+ BB BB-
Low Grade	B1 B2 B3	B+ B B-	B+ B B-
Poor Grade to Default	Caa	CCC+	CCC
In Poor Standing	- -	CCC CCC-	- -
Highly Speculative Default	Ca C	CC -	CC -
Default	- - -	- - D	DDD DD D

Short Term/Commercial Paper Investment Grade Ratings

Rating Interpretation	Moody's	Standard & Poor's	Fitch
Superior Capacity	P-1	A-1+/A-1	F1+/F1
Strong Capacity	P-2	A-2	F2
Acceptable Capacity	P-3	A-3	F3

[1] These are general credit rating guidelines and are for information only.

Appendix B
Glossary

BANKER'S ACCEPTANCE: A money market instrument created to facilitate international trade transactions. This instrument is highly liquid and safe because the risk of the trade transaction is transferred to the bank that "accepts" the obligation to pay the investor.

BANK DEPOSITS: 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.

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 at which a buyer offers to buy a security.

BOND: A bond is essentially a loan made by an investor to a division of the government, a government agency, or a corporation. The bond is a promissory note to repay the loan in full at the end of a fixed time period. The date on which the principal must be repaid is the called the maturity date, or maturity. In addition, the issuer of the bond, that is, the agency or corporation receiving the loan proceeds and issuing the promissory note, agrees to make regular payments of interest at a rate initially stated on the bond. Bonds are rated according to many factors, including cost, degree of risk, and rate of income.

BROKER: A broker brings buyers and sellers together for a transaction for which the broker receives a commission. Brokers generally do not hold inventory or make a market for securities.

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION (CDIAC): CDIAC provides information, education and technical assistance on public debt and investments to local public agencies and other public finance professionals.

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

CALIFORNIA LOCAL AGENCY OBLIGATIONS: See Local Agency Bonds.

CAPITAL GAIN: The amount by which an asset's selling price exceeds its initial purchase price.

CAPITAL LOSS: The decrease in the value of an investment or asset below its initial purchase price.

CD (CERTIFICATE OF DEPOSIT): A CD is a note issued by a bank for a savings deposit that an individual agrees to leave invested in the bank for a certain term. At the end of this term, on the maturity date, the principal may either be paid to the individual or rolled over into another CD. Interest rates on CDs between banks are competitive. Monies deposited into a CD are insured by the bank, thus they are a low-risk investment. Maturities may be as short as a few weeks or as long as several years. Most banks set heavy penalties for premature withdrawal of monies from a CD. Large-denomination CD's are typically negotiable.

CFA INSTITUTE: CFA Institute is the global, not-for-profit association of investment professionals that awards the CFA (Chartered Financial Analyst®) designation. The Institute promotes the highest ethical standards and offers a range of educational opportunities online and around the world.

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

COLLATERALIZATION: Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

COMMERCIAL PAPER: The short-term unsecured debt of corporations or companies.

CONVEXITY: Measures the rate of change in a bond's sensitivity to interest rate moves. It's the rate of change in a bond's duration (price volatility).

COUNTY POOLS: See County Pooled Investment Fund.

COUNTY POOLED INVESTMENT FUNDS: The aggregate of all funds from public agencies placed in the custody of the county treasurer or chief finance officer for investment and reinvestment.

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date.

CREDIT RISK: The likelihood that an issuer will be unable to make scheduled payments of interest and principal on an outstanding obligation.

CUSTODIAN: An agent such as a broker or a bank that stores a customer's investments for safekeeping. The custodian does not have fiduciary responsibilities.

DEALER: A dealer, as opposed to a broker, acts as a principal in security transactions, selling securities from, and buying securities for his/her own position.

DEFAULT: To default is to fail to repay principal or make timely interest payments on a bond or other debt investment security. Also, a default is a breach of or failure to fulfill the terms of a note or contract.

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

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

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

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

FLOATING RATE INVESTMENTS: Notes whose interest rate is adjusted according to the interest rates of other financial instruments. These instruments provide protection against rising interest rates, but pay lower yield than fixed rate notes.

FUTURES: Commodities, which are sold to be delivered at a future date.

INVERSE FLOATING RATE INVESTMENTS: Variable-rate notes (such as inverse floating rate notes) whose coupon and value increase as interest rates decrease.

INTEREST ONLY STRIPs: Securities with cash flow based entirely on the monthly interest payments received from a mortgage pool.

INVESTMENT PROGRAM: The process of modern portfolio management. The process includes establishing investment policy, analysis of the economic and capital markets environment, portfolio monitoring and rebalancing, and measuring performance.

LOCAL AGENCY BONDS: These bonds are issued by a county, city, city and county, including a chartered city or county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation.

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

LIQUIDITY: The ease with which investments can be converted to cash at their present market value. Liquidity is significantly affected by the number of buyers and sellers trading a given security and the number of units of the security available for trading.

MARKET RISK: Market risk is the risk that investments will change in value based on changes in general market prices.

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

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase–reverse repurchase agreements that establish 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 upon which the principal or stated value of an investment becomes due and payable.

MEDIUM TERM NOTES (MTN): Unsecured, investment-grade senior debt securities of major corporations that are sold either on a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

MODERN PORTFOLIO THEORY: overall investment strategy that seeks to construct an optimal portfolio by considering the relationship between risk and return. This theory recommends that the risk of a particular investment should not be looked at on a standalone basis, but rather in relation to how that particular investment's price varies in relation to the variation in price of the market portfolio. The theory goes on to state that given an investor's preferred level of risk, a particular portfolio can be constructed that maximizes expected return for that level of risk.

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

MORTGAGE BACKED SECURITIES: A debt instrument with a pool of real estate loans as the underlying collateral. The mortgage payments of the real estate assets are used to pay interest and principal on the bonds.

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

MUTUAL FUNDS: An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. **Money market mutual funds** invest exclusively in short term (one day to one year) debt obligations such as Treasury bills, certificates of deposit, and commercial paper. The principal objective is the preservation of capital and generation of current income.

OFFER: The price asked by a seller of securities. See Asked and Bid.

OPTION: A contract that provides the right, but not the obligation, to buy or to sell a specific amount of a specific security within a predetermined time period. A call option provides the right to buy the underlying security. A put option provides the right to sell the underlying security. The seller of the contracts is called the writer.

PORTFOLIO: Collection of securities held by an investor.

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.

PRINCIPAL ONLY STRIPs: Securities with cash flow based entirely on the monthly principal payments received from a mortgage pool.

RANGE NOTES: A range note is a bond that pays interest if a specified interest rate remains above or below a certain level and/or remains within a certain range.

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 the current income return.

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

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

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

SECURITIES AND EXCHANGE COMMISSION (SEC): A federal government agency comprised of five commissioners appointed by the President and approved by the Senate. The SEC was established to protect the individual investor from fraud and malpractice in the marketplace. The Commission oversees and regulates the activities of registered investment advisers, stock and bond markets, broker/dealers, and mutual funds.

SEC RULE 15C3-1: See Uniform Net Capital Rule.

STATE OBLIGATIONS: Registered treasury notes or bonds of any of the other 49 United States in addition to California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 United States, in addition to California.

STRIPs: Bonds, usually issued by the U.S. Treasury, whose two components, interest and repayment of principal, are separated and sold individually as zero-coupon bonds. Strips are an acronym for Separate Trading of Registered Interest and Principal of Securities.

TRUSTEE: An individual or organization, which holds or manages and invests assets for the benefit of another. The trustee is legally obliged to make all trust-related decisions with the trustee's interests in mind, and may be liable for damages in the event of not doing so.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

U.S. AGENCY OBLIGATIONS: Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments. The obligations are issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. Issuers include, Fannie Mae, Farmer Mac, Federal Farm Credit Banks, Freddie Mac, Federal Home Loan Banks, Financing Corporation, Tennessee Valley Authority, Resolution Trust Funding Corporation, World Bank, Inter-American Development Bank and PEFCO.

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

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

Treasury Notes: All securities issued with initial maturities of two to ten years are called Treasury Notes (T-notes), and pay interest semi-annually.

Treasury Bonds: All securities issued with initial maturities greater than ten years are called Treasury Bonds (T-bonds). Like Treasury Notes, they pay interest semi-annually.

YIELD: The rate of annual income return on an investment, expressed as a percentage. Yield does not include capital gains. (a) **INCOME YIELD** is obtained by dividing the current dollar income by the current market price for the security. (b) **NET YIELD** or **YIELD TO MATURITY** is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

ZERO-COUPON BOND: A bond on which interest is not payable until maturity (or earlier redemption), but compounds periodically to accumulate to a stated maturity amount. Zero-coupon bonds are typically issued at a discount and repaid at par upon maturity.