CITY of CAMPBELL
Finance Department

Notice of Meeting
Finance Sub-Committee

Date: August 5, 2020

Time: 10:00 a.m.

Location: City Hall via telecommunication

This Finance Subcommittee meeting will be conducted via telecommunication and is compliant with provisions of the Brown Act and Executive Order N-29-20 issued by the Governor.

The following Board Members of the Campbell Finance Subcommittee meeting are listed to permit them to appear electronically or telephonically at the Finance Subcommittee meeting on August 5, 2020: Councilmember Rich Waterman, Councilmember Anne Bybee.

Members of the public will not be able to attend meetings at the Campbell City Hall physically. The Finance Subcommittee meeting will be live-streamed YouTube (https://www.youtube.com/user/CityofCampbell).

Those members of the public wishing to participate are asked to register in advance at: https://us02web.zoom.us/webinar/register/WN_WHpQtyDgSu-LMprY9NVnHQ

After registering, you will receive a confirmation email containing information about joining the meeting.

AGENDA

I. Call to Order

II. Review of Investment Policy and Investment Strategy

III. Oral Requests

IV. Adjourn

MEMORANDUM

City of Campbell

Finance Department

To: Finance Sub-Committee Date: August 5, 2020

From: Will Fuentes, Finance Director

Subject: Annual Investment Policy and Investment Strategy Update

A Finance Sub-Committee Meeting has been scheduled for Wednesday, August 5th at 10:00 am via a Zoom virtual meeting to discuss the annual review of the investment policy update.

California Government Code recommends that the City Council review the City's investment policy annually. Our investment policy requires the Finance Sub-Committee to review any proposed changes and make recommendation to the Council accordingly. It also requires the Sub-Committee to review the Investment Strategy annually as well and share a summary of that strategy with Council.

The Investment Policy is updated annually to conform to California Government Code Section 53600 et. seq. Any statutory revisions made during the previous calendar year that impact the City policy are incorporated as necessary. However, staff is not recommending any revisions this fiscal year beyond statutory revisions and there are also no required statutory revisions to make this fiscal year either.

The attached Investment Strategy provides a review of our current strategy with respect to the investment portfolio and recommendations for the upcoming year. Substantive changes are noted in the attachment. Additionally, an economic review of the past year and summary of current economic conditions is provided.

Attachments: Investment Strategy Memorandum
Investment Policy

Distribution:
Rich Waterman, Council Member
Anne Bybee, Council Member
Brian Loventhal, City Manager

MEMORANDUM

CITY OF CAMPBELL

Finance Department

To:	Finance Sub-Committee	**Date:**	August 5, 2020
From:	Will Fuentes, Finance Director		
Subject:	**Investment Strategy for FY 2020-21**		

BACKGROUND

The investment policy establishes procedures and guidelines by which the City's surplus funds can be managed in a prudent and fiscally sound manner. The policy encompasses those funds over which the City exercises fiscal control and prioritizes the objectives of public funds management as safety, liquidity and yield, in that order and consistent with guidance provided by the Government Finance Officers Association (GFOA). It also stipulates allowable and unallowable investment alternatives as well as establishes parameters for selecting broker/dealers and institutions with which the City may do business.

California Government Code Section 53646 (a) (2) recommends that on an annual basis, the City Investment Policy be submitted to its legislative body and any oversight committee for consideration at a public meeting. The Finance Sub-Committee is the oversight committee responsible for review of the Investment Policy. In addition to review of any proposed revisions to the Investment Policy, staff has prepared a report summarizing the past year's economic conditions and the recommended strategy for managing the City's available invested funds.

SUMMARY OF CURRENT STRATEGY AND RECOMMENDATIONS

It is recommended that the City continue to maintain sufficient liquidity to cover daily operating cash flows for a minimum of 3 months to provide a reasonable cushion for fluctuations in the portfolio balance and for unforeseen emergencies. However, due to the added economic uncertainty surrounding COVID-19, staff will also attempt to exceed this target whenever possible and recommends not reinvesting called securities long-term, but rather placing such funds into the highly liquid Local Agency Investment Fund (LAIF). Staff has taken this approach since March 2020 and has reinvested $7.0 million of called US Agency Issues into LAIF so as to enhance the City's liquidity and hedge against uncertainty.

Average monthly disbursements are approximately $6.0 million. Therefore, staff will retain a target of $18.0 million (3 months) in the Local Agency Investment Fund (LAIF), but will again seek to exceed this whenever possible. Staff will also continue to look for longer term fixed income investment opportunities that make sense for Campbell and have individual maturities of no more than 5 years, while maintaining a portfolio weighted average maturity of 3 years or less. As such, staff does not recommend increasing the formal liquidity target past 3 months. This will provide staff with needed flexibility should longer term fixed income opportunities arise which are beneficial to Campbell or the economic impacts of COVID-19 subside quicker than expected.

Please note that as of June 2020, the City had $37.8 million invested in LAIF, with an annual return of 1.47%. Given the current depressed state of fixed income interest rates, LAIF is currently outperforming other longer-term investment classes such as government securities and corporate notes. Thus, staff has taken a short-term investment strategy of accumulating funds in LAIF beyond the target level stated above so as to not only increase liquidity due to COVID-19, but also increase portfolio yield. Liquidity though will be staff's primary concern over the next fiscal year and the investment goals will shift to liquidity, safety, and return, in that order, as opposed to the normal order of safety, liquidity, and return.

Interest rates have decreased this past year as the Federal Reserve has taken a strategy of decreasing the Federal Funds Rate to stimulate the economy and consumer and business borrowing in response to COVID-19. At its July 29, 2020 meeting, the Federal Reserve kept the Federal Funds Rate at 0.25 percent with a target of 0.00 to 0.25 percent. Policymakers reiterated that the Federal Reserve is committed to using its full range of tools to support the US economy and repeated that the COVID-19 pandemic poses considerable risks to the economic outlook over the medium term. Staff believes that the Federal Funds Rate will remain near zero until the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals. This will result in returns less than 1% for the City's fixed income investments, which will likely persist over this fiscal year, but staff will continue to work diligently with the City's broker dealers to find appropriate investment opportunities for Campbell that exceed 1% return.

INVESTMENT OBJECTIVES AND OVERVIEW

The City's policy is to invest public funds in a prudent manner, provide for maximum security while meeting daily cash flow needs and comply with applicable statutes. Chief among the objectives outlined in the policy are safety, liquidity and yield, in that specific order and again consistent with GFOA guidance. Within this framework, a number of investment choices are provided to allow flexibility in meeting these objectives. The City continues to take a conservative approach with its investments that is reflected in the current investment policy, but staff will again place a greater emphasis on liquidity this year to hedge against the economic uncertainty surrounding COVID-19.

As a means to implement the policy, it is important to develop a strategy for achieving the stated objectives. Likewise, the strategy should be reviewed periodically to determine whether it needs to be modified in light of changing economic and financial conditions. This document will serve as the City's investment strategy for the next year and will be reviewed annually in conjunction with the review of the City's investment policy or sooner if conditions warrant.

REVIEW OF PAST YEAR

Due to the economic effects of COVID-19, Real gross domestic product (GDP) decreased at an annualized rate of 32.9 percent in the second quarter of 2020, compared to the same quarter in 2019, according to the "advance" estimate released by the Bureau of Economic Analysis (BEA). And in the first quarter of 2020, real GDP decreased by 5.0 percent when compared to the same quarter in 2019. However, despite the contraction in GDP due to COVID-19, the stock market (DJIA), a leading indicator of the economy, has retained most of its value over the past fiscal year and had a price of 25,813 as of June 30, 2020. This is a slight decrease of 3.0% when compared to the ending stock market price of 26,599 as of June 30, 2019. The stock market saw an all-time high of 29,570 on February 12, 2020 before large sectors of the economy shut down due to COVID-19 and public health orders. After that, the stock market contracted sharply to a low of 18,214 on March 23, 2020. However, since that point, due to some reopening of the local, state, and national economy, the stock market has regained much of its value; though still being off the February high.

While the large decrease in GDP is troubling, much of the economic data for June 2020 was positive. Retail sales were stronger than expected in June, industrial production rose more than expected, housing starts continued to rise, consumer prices showed a modest pick-up, US businesses reported an acceleration in activity in the Fed's latest Beige Book[1] report, and new unemployment claims were in line with expectations in June. On a year-over-year basis, retail sales were up 1.1% in June versus down 5.6% in May and down 19.9% in April. On a month-over-month basis, retail sales rose 7.5% in June (much stronger than expected), following an 18.2% increase in May and 14.7% decline in April. Online sales and food and beverage store sales remained quite robust in June, and sales of motor vehicles and auto parts, building materials and garden equipment, sporting goods, and general merchandise were all remarkably positive on a year-over-year basis. Retail sales in other subsectors also improved in June but remain close to prior year levels, including furniture, electronics, health and personal care, and clothing. Meanwhile, restaurant and gas station sales remain deeply in contraction.

The housing sector nationwide has so far proven to be the most resilient sector of the economy during the pandemic. Total housing starts rose 17.3% in June to an annual pace of 1,186,000. Single family starts rose 17.2% to an annualized rate of 831,000, while multi-family starts increased 17.5% to an annualized rate of 355,000. However, housing starts remain below prior-year levels, with single family starts down 3.9% year-over-year, and multi-family starts down 4.1%. Permits edged up 2.1% in June on a month-over-month basis, to an annualized rate of 1,241,000, but were down about 2.5% on a year-over-year basis.

Also due to the economic impacts of COVID-19, unemployment in California rose steeply during the past fiscal year and mainly in the last 4 months of the fiscal year; reaching a high of 16.4% in April 2020. However, the California unemployment rate dropped to 16.3% in May 2020 and to 14.9% in June 2020. The largest increase was seen in the Leisure and Hospitality industries where 292,500 payroll jobs were added when compared to May 2020. Other sectors showing increases include Trade, Transportation, and Utilities (+97,600), Education and Health Services (+84,000), Professional and Business Services (+30,400), Other Services (+27,700), Construction (+26,800), Manufacturing (+23,400), Information (+8,200), and Financial Activities (+4,400). Locally, the County unemployment rate decreased from 11.2% in May 2020 to 10.7% in June 2020 (not seasonally adjusted). This compares to a California unemployment rate of 4.2% and a County unemployment rate of 2.6% in June 2019. Lastly, the unemployment rate in Campbell was 11.2% in April 2020,

[1] ***The Federal Reserve Beige Book*** - Report which is published eight times per year and presents anecdotal information on current economic conditions in each Federal Reserve District through reports from Bank and Branch directors and interviews with key business contacts, economists, market experts, and other sources. The Beige Book summarizes this information by District and sector.

10.3% in May 2020, and 9.5% in June 2020. This compares to 2.3% in June 2019. However, while current unemployment numbers are troubling, unemployment is a lagging indicator of the economy and normally does not cause a recession on its own.

For the fiscal year ended June 30, 2020, the City's average portfolio balance was approximately $37.7 million and the average yield for the fiscal year was 1.98%. This compares to a portfolio balance of $39.7 million and an average yield of 2.08% for fiscal year ended June 30, 2019. Such decreases in yield are due to a rapid decline in fixed income investment rates.

CURRENT MARKET CONDITIONS AND PORTFOLIO BALANCE

Overall, while June retail sales report were encouraging, the outlook for consumer spending is cloudy, given that much of the recent rebound in spending has likely been driven by fiscal stimulus and temporary measures to keep the economy running, including expanded unemployment benefits, and the government's Payroll Protection Program (PPP). The June retail sales report also predates the recent reversal in business reopenings in certain virus hotspots including California and the San Francisco Bay Area. With virus cases surging in many states it is unclear how consumers will respond. The consumer sentiment index fell approximately five points in July and another plunge in consumer sentiment may be on the horizon if the government fails to pass another fiscal relief package.

Nevertheless, low mortgage rates remain a strong tailwind for housing demand. Notably, 30-year mortgage rates dropped below 3% in the end of June 2020 to their lowest level ever. Low inventory should also continue to support prices in the near-term and this will continue to benefit Campbell and the San Francisco Bay Area housing market, which typically fares better and rises more quickly than other housing markets nationwide. However, while housing news is positive and will likely remain so, as business reopening activities slow or retreat in response to the surge COVID-19 cases, jobless claims are likely to rise again. Most of these though will likely be temporary job losses as permanent reported job losses are hovering around 2% and are very similar to the "dot-com" crash of 2001.

As of June 30, 2020, the City's investment portfolio was valued at approximately $43.8 million. This was comprised of approximately $37.8 million (86.29%) in LAIF, $4.0 million (9.14%) in US Government Agency securities, and $2.0 million (4.57%) in corporate notes or money market accounts. Almost all these funds are considered "discretionary" investments meaning that the City can invest this amount as it sees fit within the guidelines of the investment policy. With a minimum holdback of at least $18.0 million for cash flow, that leaves up to $25.8 million that can be invested in Agency and other securities (limitation of 75% of portfolio per investment policy). $6.0 million is currently invested outside of LAIF and staff will again seek to maintain its large liquidity position in LAIF throughout the fiscal year to hedge against the economic uncertainty of COVID-19. However, staff will also continue to look for longer term fixed income investment opportunities that make sense for Campbell.

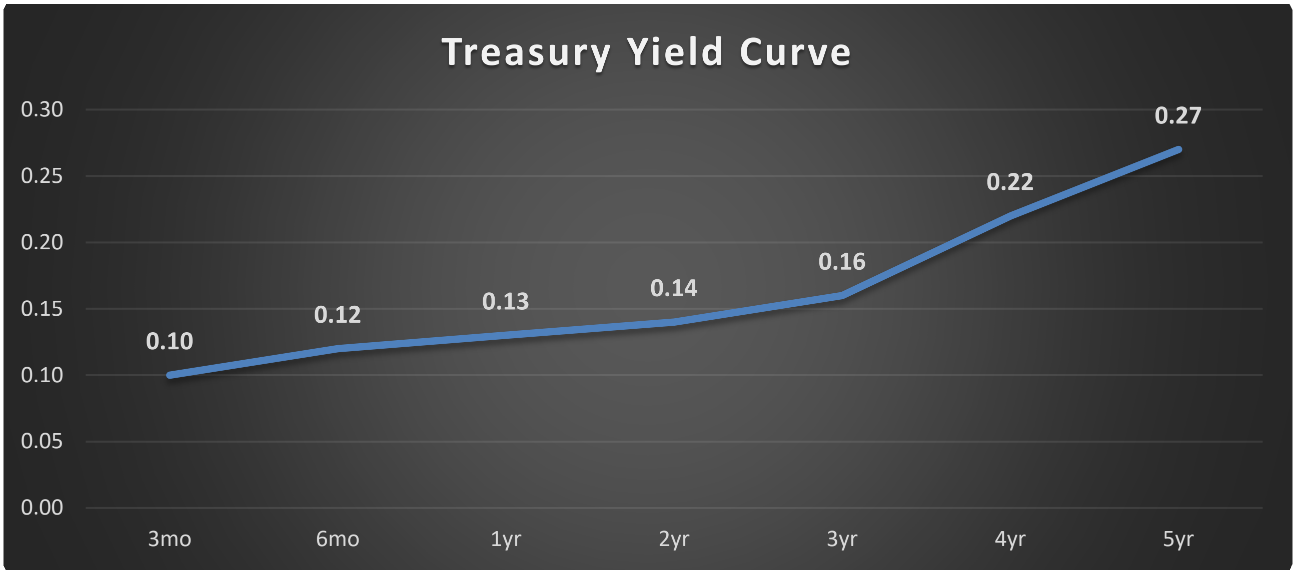
DISCUSSION OF ALLOWABLE INVESTMENTS

The City's investment policy contains a listing of allowable investment instruments along with specified limits and maturities. These include:

- State of California Local Agency Investment Fund (LAIF)
- US Treasury Bills, Notes & Bonds
- US Government Agency Issues (e.g., FNMA & GNMA)
- Corporate Medium-Term Notes
- Banker's Acceptances
- Certificates of Deposit with banks or savings & loan associations
- Repurchase Agreements
- Commercial Paper
- Mutual Funds (allowed by Calif. Gov't Code Sec. 53601(a)-(m))

It is the City's experience that LAIF provides a safe short-term investment vehicle, and the City has utilized it for its primary source of investment earnings for many years. This fund is generally viewed as a conservative and safe investment choice. In fact, the City is not aware of any municipality that has ever experienced a loss of principal in LAIF. One characteristic of LAIF is that, due to its size (combined State Investment Pool assets valued at approximately $101.0 billion as of June 30, 2020) the rate of return will typically lag the current market. Thus, in periods of rising interest rates, LAIF may have a lower return. Conversely, in a declining market, LAIF will provide investors with an above-market return as it does currently. The yield as of June 2019 was approximately 1.47% compared to 2.43% one year ago. LAIF yield is expected to drop to a range of 0.45% to 0.62% by the end of calendar year 2020 due to the overall state of short-term investment rates, but a key benefit of using LAIF is that it again offers a high degree of liquidity whereby funds can generally be requested and received in the same day. Another benefit is that a minimum of staff administrative effort is required, enabling the time to be spent on other departmental priorities.

US Treasuries are considered to be one of the safest investment choices available to municipalities due to their being backed by the full faith and credit of the United States Government. However, because of their popularity and under current market conditions, the rate of return tends to be lower than other types of securities. As of July 28, 2020, the 6-month and 2-year term Treasuries are yielding 0.12% and 0.14%, respectively. The 5-year Treasury has a yield of 0.27%. These rates have decreased significantly from a year ago due to actions by the Federal Reserve to lower the Federal Funds Rate. For reference, please see the treasury yield curve as of July 28, 2020 below. As illustrated, the fixed income market is currently very low with only a slight upward slope in the 3-month to 3-year range and a more pronounced rise in the 3-year to 5-year range.



US Agency issues also provide a safe and acceptable rate of return and are still considered a safe investment choice (AAA rated). Agencies can be "callable" meaning they can be redeemed by the issuer prior to maturity or "non-callable (bullet)" meaning they cannot be redeemed prior to maturity. Agencies also issue "discount notes" which have shorter term issues, generally less than 18 months, in which the note is bought at a deep discount and redeemed for face value at maturity. The City has historically purchased primarily callable structured rate agencies to maximize its yields and minimize interest rate risk in the future. As of June 30, 2019, the City held $4.0 million in US Agency issues and earned an annual interest rate of 2.01%. Additionally, as of June 30, 2019, the City held $2.0 million in non-callable Corporate Certificates of Deposit (CDs) and earned an annual interest rate of 2.01%.

With respect to the upcoming year, it is anticipated that investments outside of LAIF will continue to be made primarily in callable agency securities with some rate protection and an average term of two to four years. Staff will also evaluate other types of investments allowed by policy that may have yields in excess of LAIF and agency issues, such as short-term commercial paper, corporate notes rated AA or higher, and non-callable agency issues, or that lock in an acceptable rate of return for a longer period of time than LAIF. However, due to the economic uncertainty surrounding COVID-19, staff's primary goal will be to enhance liquidity.

RECOMMENDATION

It is recommended that the Finance sub-Committee approve the proposed strategy.

Distribution:
Rich Waterman, Council Member
Anne Bybee, Council Member
Brian Loventhal, City Manager

I. PURPOSE

It is the policy of the City of Campbell to invest public funds in a prudent manner which conforms to all statutes governing the investment of public funds while providing security and meeting the daily cash flow needs of the City.

The purpose of this document is to identify the policies guiding prudent investment of the City's temporarily idle funds and to establish guidelines and objectives for suitable investments including delegation of authority, prudence, monitoring and reporting, policy review, diversification, eligible securities, safekeeping, collateralization, selection of financial institutions and broker/dealers, glossary of terms, and forms utilized.

II. SCOPE

A. This investment policy shall apply to all financial assets, investment activities, and debt issues of the City of Campbell including the following fund types:

1. General Fund
2. Special Revenue Funds
3. Debt Service Funds
4. Capital Projects Funds
5. Internal Service Funds
6. Trust and Agency Funds

B. The policy does not cover funds held by the Public Employees Retirement System nor funds of the Deferred Compensation program.

III. OBJECTIVES

A. It is the objective of this policy to provide a system which will monitor and forecast revenues and expenditures so that the City can invest temporarily idle funds to the fullest extent possible. The temporarily idle funds shall be invested in accordance with provisions of California Government Code Section 53600 et. seq.

B. The City adheres to conservative investment philosophies including investment of all idle cash, preservation of principal at the risk of yield, maintenance of adequate liquidity to meet anticipated cash flow needs and diversification to avoid the risks inherent in over investing in any one asset class.

C. This policy specifically prohibits trading securities for the sole purpose of speculating on the future direction of interest rates. It further prohibits reverse repurchase agreements, use of derivative products, and/or leveraging of the portfolio.

D. The City shall ensure the safety of invested funds by limiting credit and interest rate risks. The three primary objectives of the City's Investment Policy in order of priority are:

1. Safety: Safety of principal is the foremost objective of the City of Campbell. Safety and the minimizing of risk associated with investing refer to attempts to reduce the potential for loss of principal, interest or a combination of the two. The City ensures safety of its invested idle funds and limits credit and interest rate risks by following these guidelines (all of which are detailed within the body of the Investment Policy):

a. Investing only in those instruments that are generally accepted as safe investment vehicles for local government as authorized by this Policy,

b. Carefully reviewing the qualifications and financial strength of financial institutions and broker/dealers prior to conducting business with them,

c. Diversifying the investment portfolio as prescribed within this Policy,

d. Structuring the portfolio such that securities mature to meet the City's cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to their maturation,

e. Limiting the final maturity of purchased securities to five years; limiting the weighted average maturity of the portfolio to three years, and

f. Ensuring the physical security or safekeeping of the City's investments.

2. Liquidity: Liquidity is the second most important objective of the City's Policy. Liquidity refers to the ability to convert an investment to cash promptly without loss of principal and minimal loss of interest. For example, this is accomplished by investing either in the Local Agency Investment Fund (LAIF) with same day availability, or investing in securities with active secondary or resale markets.

3. Yield: Yield on the City's portfolio is last in rank among investment objectives. Investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed.

IV. STRUCTURE AND RESPONSIBILITY

A. DELEGATION OF AUTHORITY:

1. The City Council assumes direction over the City’s investments, and assigns management responsibility for the investment program to the Finance Director, who shall serve as Chief Fiscal Officer, and have legal custody of funds. The Finance Director may provide for delegation of his/her responsibilities to other persons under his/her control responsible for investment transactions, including designation of certain portions of the investment portfolio related to debt financing to be administered by professional portfolio administrators, i.e. California Arbitrage Management Program (C.A.M.P.) or such other designated administrators approved by the Finance Sub-Committee.

B. POLICY REVIEW:

1. This Investment Policy shall be reviewed and approved annually as recommended by California Government Code Section 53600 et. seq.

C. RESPONSIBILITIES:

1. **Responsibilities of the City Council:** The City Council consists of a Mayor and four Council members and is the policy setting board for the City of Campbell. The City Council has considered and adopted a written Investment Policy for the City of Campbell. Pursuant to the City's Financial Policies, the City Council shall on an annual basis, approve necessary changes to the Investment Policy as recommended by the Finance Sub-Committee. On a quarterly basis, the City Council shall receive, review and accept the Quarterly Investment Report submitted by the Finance Department.

2. **Responsibilities of the Finance Sub-Committee:** The Finance Sub-Committee consists of two Council members, the City Manager, the Finance Director, and the Finance Manager. On an annual basis, this Sub-Committee shall review necessary revisions to the established Investment Policy of the City of Campbell and make a recommendation to the City Council accordingly. No less than once per fiscal year, the City's investment strategy will be reviewed by the Finance Sub-Committee. A summary of the investment strategy will be shared with the City Council at that time. Should market activity encourage revisions in the City's strategy, the Finance Sub-Committee shall be advised accordingly.

3. **Responsibilities of the City Manager:** The City Manager is responsible for directing and supervising the Finance Director. He/she has the responsibility of keeping the City Council fully advised as to the financial condition of the City.

   a. **Wire Transfer Authority:** The City Manager has unlimited wire transfer authority for a single transaction. Such a transaction requires joint review, approval and verification in advance by the City Manager and Finance Director. The transaction shall be highlighted in the Quarterly Investment Report to Council.

4. **Responsibilities of the Finance Director:** The Finance Director is appointed by the City Manager and serves as Chief Fiscal Officer. He/she is subject to the direction and supervision of the City Manager. The Finance Director is charged with the responsibility for the conduct of all Finance Department functions including the custody and investment of City funds, and investment of those funds in accordance with principles of sound treasury management and in accordance with applicable laws and policies. Refer to "Delegation of Authority" for additional information pertaining to delegation of investment responsibilities.

a. **Wire Transfer Authority:** The Finance Director has wire transfer authority not to exceed $5,000,000 for a single transaction. Such a transaction shall be reviewed, approved and verified in advance by the City Manager. The transaction shall be highlighted in the Quarterly Investment Report to Council.

5. **Responsibilities of the Finance Manager:** The Finance Manager is appointed by the Finance Director and serves as the Investment Manager for the City pursuant to specific delegation authority provided by this Investment Policy. He/she is subject to the direction and supervision of the Finance Director and is charged with the responsibility and conduct of the day-to-day accounting and cash management functions of the City. This includes the custody and investment of City funds, and investment of those funds in accordance with principles of sound treasury management and in accordance with applicable laws and policies. Refer to "Delegation of Authority" for additional information pertaining to delegation of investment responsibilities.

Implementation and maintenance of the Investment Policy are the responsibility of this individual. On an annual basis, the Finance Manager shall present to the Finance Sub-Committee, recommended changes to the City's Investment Policy. On a quarterly basis, the Finance Manager shall present to the City Council, via the City Manager, a Quarterly Investment Report. Refer to "Monitoring and Reporting" for additional information.

a. **Wire Transfer Authority:** The Finance Manager has wire transfer authority not to exceed $3,000,000 for a single investment transaction. Such a transaction shall be reviewed, approved and verified in advance by the Finance Director, and shall be reported in the Quarterly Investment Report to Council.

6. **Responsibilities of the Accountant and Sr. Accountant:** The Accountant is appointed by the Finance Director and is subject to the direction and supervision of the Finance Manager. The Accountant carries out the specific instructions provided by the Finance Manager regarding the purchase and sale of securities in accordance with principles of sound treasury management and in accordance with applicable laws and policies. Accounting for the various investment transactions is the responsibility of the Accountant.

a. **Wire Transfer Authority:** The Accountant and Senior Accountant have wire transfer authority not to exceed $2,100,000 for a single investment transaction. The standard operating procedure is that all cash and investment wire transfers made by the Accountant and Senior Accountant are reviewed, approved and verified in advance by the Finance Manager, and are reported in the Quarterly Investment Report to Council.

D. Prudence:

1. It is the understanding of the individuals holding positions with investment responsibilities that the "prudent investor" rule applies. This means that investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital and income to be derived.

2. The City's overall investment program shall be designed and managed with a degree of professionalism that is worthy of the public trust. The City recognizes that no investment is totally riskless and that the investment activities of the City are a matter of public record. Accordingly, while the intent of the City is to hold purchased securities to maturity, the City recognizes that occasional measured losses may be advisable in a diversified portfolio and shall be considered within the context of the overall portfolio's return, provided that (a) adequate diversification has been implemented, (b) the sale of a security is in the best long-term interest of the City and (c) the City Manager approves in writing.

E. Ethics and Conflicts of Interest:

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

F. Conflict with State Statutes or Regulations

1. Any conflict between the City of Campbell Investment Policy and Government Code Section 53600 et seq, shall be interpreted in favor of the Government Code.

V. AUTHORIZED SECURITIES AND TRANSACTIONS

All investments and deposits of the City shall be made in accordance with California Government Code Sections 16429.1, 53600-53609 and 53630-53686, except that pursuant to California Government Code Section 5903(e), proceeds of bonds and any moneys set aside or pledged to secure payment of the bonds may be invested in securities or obligations described in the ordinance, resolution, indenture, agreement, or other instrument providing for the issuance of the bonds. Any revisions or extensions of these code sections will be assumed to be part of this Policy immediately upon being enacted. However, in the event that amendments to these sections conflict with this Policy and past City investment practices, the City may delay adherence to the new requirements when it is deemed in the best interest of the City to do so. Percentage holdings limits listed in this section apply at the time the security is purchased.

The City has further restricted the eligible types of securities and transactions to the following:

1. United States Treasury bills, notes, bonds, or strips with a final maturity not exceeding five years from the date of purchase.

2. Federal Agency debentures and mortgage-backed securities with a final maturity not exceeding five years from the date of purchase issued by the Government National

Mortgage Association (GNMA). The aggregate investment in Federal Agency obligations shall not exceed 75% of the City's total portfolio.

3. Federal Instrumentality (government sponsored enterprise) debentures, discount notes, callable and step-up securities, with a final maturity not exceeding five years from the date of purchase, issued by the following only: Federal Home Loan Banks (FHLB), Federal National Mortgage Association (FNMA), Federal Farm Credit Banks (FFCB) and Federal Home Loan Mortgage Corporation (FHLMC). The aggregate investment in Federal Instrumentality obligations shall not exceed 75% of the City's total portfolio.

4. Repurchase Agreements with a final termination date not exceeding one year collateralized by U.S. Treasury obligations, Federal Agency securities, or Federal Instrumentality securities listed in items 1, 2 and 3 above with the maturity of the collateral not exceeding five years. For the purpose of this section, the term collateral shall mean purchased securities under the terms of the City's approved Master Repurchase Agreement. The purchased securities shall have a minimum market value including accrued interest of 102% of the dollar value of the transaction. Collateral shall be held in the City's custodian bank, as safekeeping agent, and the market value of the collateral securities shall be marked-to-the-market daily. The aggregate investment in repurchase agreements shall not exceed 10% of the City's total portfolio.

   Repurchase Agreements shall be entered into only with broker/dealers that have executed a City approved Master Repurchase Agreement with the City. Repurchase counterparties shall be recognized as Primary Dealers with the Federal Reserve Bank of New York, or shall have a primary dealer within their holding company structure. Broker/dealers approved as Repurchase Agreement counterparties shall have a short-term credit rating of at least A-1 or the equivalent and a long-term credit rating of at least A or the equivalent. The Finance Director shall maintain a copy of the City's approved Master Repurchase Agreement along with a list of the broker/dealers that have executed a Master Repurchase Agreement with the City.

5. Prime Commercial Paper with a maturity not exceeding 270 days from the date of purchase with the highest ranking or of the highest letter and number rating as provided for by a NRSRO. The entity that issues the commercial paper shall meet all of the following conditions in either sub-paragraph a. or sub-paragraph b. below:

   a. The entity shall (1) be organized and operating in the United States as a general corporation, (2) have total assets in excess of five hundred million dollars ($500,000,000) and (3) have debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.
   b. The entity shall (1) be organized within the United States as a special purpose corporation, trust, or limited liability company, (2) have program wide credit enhancements, including, but not limited to, over collateralization, letters of credit or surety bond and (3) have commercial paper that is rated "A-1" or higher, or the equivalent, by a NRSRO.

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

6. Eligible Bankers Acceptances rated at least A-1 by Standard & Poor's, P-1 by Moody's, or F1 by Fitch at the time of purchase by each service that rates the commercial paper, with a maturity not exceeding 180 days from the date of purchase, issued by a state or national bank that has combined capital and surplus of at least $250 million, whose deposits are insured by the FDIC, and whose senior long-term debt is rated at least A by Standard & Poor's, A2 by Moody's or A by Fitch at the time of purchase. No more than 10% of the City's total portfolio may be invested in banker's acceptances of any one issuer, and the aggregate investment in banker's acceptances shall not exceed 30% of the City's total portfolio.

7. Medium Term Notes issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States, with a final maturity not exceeding five years from the date of purchase, and rated at least AA by Standard & Poor's, Aa2 by Moody's or AA by Fitch. The aggregate investment in medium term notes shall not exceed 30% of the City's total portfolio.

8. Non-negotiable Time Certificates of Deposit and savings deposits with a maturity not exceeding five years, in state or nationally chartered banks or savings and loans with a California branch office that are insured by the FDIC. Time Certificates of Deposit exceeding the FDIC insured amount must be secured pursuant to California Government Code Section 53652. No more than $1 million may be invested in non-negotiable time certificates of deposit of any one issuer and the aggregate amount invested in non-negotiable time certificates of deposit shall not exceed 25% of the City's total portfolio.

9. Certificates of Deposit at commercial bank, savings bank, or savings and loan association that uses a private sector entity (Certificate of Deposit Account Registry Service) that assists in the placement of certificates of deposit, provided that the purchase of certificates of deposit do not, in total, exceed 30% of the City's funds that may be invested for this purpose. The City shall choose a nationally or state chartered commercial bank in California as the "selected" depository institution to invest the funds. The selected depository institution may submit the funds to a CDARS for the benefit of the City's account. The full amount of the principal and interest that may be accrued during the maximum term of each certificate shall be insured by the FDIC.

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

11. Mutual Funds registered under the Investment Company Act of 1940 that (1) are "no-load" (meaning no commission or fee shall be charged on purchases or sales of shares); (2) invest only in the securities and obligations authorized in this policy and (3) have a rating of AAAm by Standard and Poor's, Aaa by Moody's or AAA/V1+ by Fitch. No more than 10% of the City's total portfolio may be invested in mutual funds of any one issuer, and the aggregate investment in mutual funds shall not exceed 15% of the City's total portfolio.

12. Money Market Mutual Funds registered under the Investment Company Act of 1940 that (1) are "no-load" (meaning no commission or fee shall be charged on purchases or sales

of shares); (2) have a constant daily net asset value per share of $1.00; (3) invest only in the securities and obligations authorized in this policy and (4) have a rating of at least two of the following: AAA by Standard and Poor's, Aaa by Moody's or AAA/V1+ by Fitch. No more than 10% of the City's total portfolio may be invested in money market funds of any one issuer, and the aggregate investment in money market funds shall not exceed 15% of the total portfolio.

13. Municipal and State Obligations with a minimum long-term rating of A/A-1 or higher by Standard and Poor's and not exceeding 10% of the portfolio:

(a) Bonds Issued by the Local Agency (City of Campbell) including bonds payable solely out of the revenue from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the local agency.)

(b) State Obligations including registered treasury notes or bonds of this State and any of the other 49 states in addition to California, including bonds payable solely out of the revenue from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of the any of the other 49 United States, in addition to California.

(c) California Local Agency obligations including bonds, notes, warrants, or other evidence of indebtedness of any local agency within this state, including bonds payable solely out of the revenue from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the any of the local agency.

14. Asset-Backed, Mortgage-Backed, Mortgage Pass-Through Securities, and Collateralized Mortgage Obligations from Issuers Not Defined in Sections 1, 2, and 4 of the Authorized Investments Section of This Policy, provided that:

(a) The securities are rated in a rating category of "AA" or its equivalent or better by a NRSRO.
(b) No more than 20% of the total portfolio may be invested in these securities.
(c) No more than 5% of the portfolio may be invested in any single Asset-Backed or Commercial Mortgage security issuer.
(d) The maximum legal final maturity does not exceed five (5) years.

15. Supranationals, provided that:

(a) Issues are US dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank.
(b) The securities are rated in a rating category of "AA" or its equivalent or better by a NRSRO.
(c) No more than 30% of the total portfolio may be invested in these securities.
(d) No more than 10% of the portfolio may be invested in any single issuer.
(e) The maximum maturity does not exceed five (5) years.

Note: Per state statute, the maximum combination of Mutual Funds and Money Market Mutual Funds is 20% of the portfolio.

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

VI. PORTFOLIO MATURITIES AND LIQUIDITY

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities. The City will not invest in securities maturing more than five years from the date of purchase, unless the City Council has granted authority to make such an investment at least three months prior to the date of investment. The weighted average final maturity of the City's portfolio shall at no time exceed 3 years.

VII. MONITORING AND REPORTING

A. The Finance Director shall routinely monitor the contents of the portfolio and shall file with the City Council the Finance Manager's Investment Report at the first regularly scheduled City Council meeting after 30 days from the end of the quarter. The reports shall be prepared and submitted in accordance with California Government Code Section 53646 and shall include the following on all invested monies:

- Type of Investment and Issuer
- Beginning Balances
- Purchases During Quarter
- Maturities or Sales During the Quarter
- Ending Balances
- Maturity Date
- Weighted Average Final Maturity
- Call Provisions (if any)
- Interest Rate
- Weighted Average Yield
- Face Value or Purchase Cost
- Market Value including source
- Interest Earned During Quarter
- Interest Earned to Maturity
- Cash Flow Projection for the Following Quarter
- Summary of Cash Invested to Total Cash Balances
- Comparative Statistics by Fiscal Year
- Reconciliation of Cash & Investments to General Ledger Balances
- Investments under the Management of Contracted Parties
- Statement of Compliance with the Investment Policy
- Statement of Ability to Meet Obligations of Next Six Months

B. Each time an investment transaction is made, an "Investment Transaction Record" form shall be prepared by the Accountant and approved by the Finance Manager. Copies of the form are to be distributed to the City Manager, and Finance Director.

VIII. SELECTION OF BROKER/DEALERS

The City shall transact business with securities broker/dealers after careful review of their qualifications and creditworthiness. In selecting broker /dealers, the Finance Director or designated staff member shall select broker/dealers representing primary dealers in government securities that have established offices and order desks within the State of California, or with such firms that have a primary dealer within their holding company structure. Exceptions to this rule will be made only upon the joint written authorization of the Finance Director and City Manager. Staff shall investigate broker/dealers wishing to do business with the City to determine if they are adequately capitalized, are reputable, have pending legal action against the firm or the individual broker, have established offices and order desks within the State of California, and make markets in the securities appropriate to the City's needs.

Before accepting funds or engaging in investment transactions with the City, the supervising officer at each authorized broker/dealer shall submit and annually update a City approved Broker/Dealer Information Request form that includes the firm's most recent audited financial statement. The Finance Director, or his or her designee, shall maintain a list of approved broker/dealers. Broker/dealers shall attest in writing that they have received and reviewed a copy of this Investment Policy, and that they will comply with it and disclose potential conflicts or risks to public funds that might arise out of business transactions between the firm and the City of Campbell.

IX. SAFEKEEPING AND COLLATERALIZATION

A. **Safekeeping:**

1. The City shall contract with a bank or banks for the safekeeping of securities which are owned by the City as a part of the investment portfolio. Staff shall periodically review the performance and pricing of the third-party, safekeeping agent services.

2. All investment securities (except the collateral for certificates of deposit in banks, and/or savings and loans) purchased by the City shall be held in third-party safekeeping by an institution designated as primary agent. The primary agent shall issue a safekeeping receipt to the City listing the specific instrument, rate, maturity and other pertinent information, and shall provide monthly reports of activity and ending balances for all securities held on behalf of the City.

B. **Collateralization:**

1. Deposit-type securities (i.e. certificates of deposit) shall be collateralized through the State of California collateral pool requirements for any amount exceeding FDIC coverage in accordance with California Government Code Section 53652 and/or 53651(m) (1). Collateral for certificates of deposit shall be held in a trust company located in California, the trust department of a bank located in California or the Federal Home Loan Bank of San Francisco.

2. Other securities shall be collateralized by the actual security held in third-party safekeeping by the primary agent.

X. DIVERSIFICATION AND ELIGIBLE SECURITIES

The City will diversify investment instruments to avoid incurring unreasonable risks in overinvesting in specific instruments, individual financial institutions or maturities. The following portfolio maximums shall apply:

If the credit ratings of any security owned by the City are downgraded to a level below the quality required by this investment policy, it will be the City's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.

If a security is downgraded, the Finance Director will use discretion in determining whether to sell or hold the security based on its current maturity, the economic outlook for the issuer, and other relevant factors.

If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported quarterly to the City Council.

Authorized Securities and Transactions Maximum Portfolio

CA. Gov't. Code Section	Authorized Investment	Maximum Maturity	Authorized Investment Limits - % of Portfolio	Credit Rating Limit
53601 (a)	City of Campbell Local Agency Bonds	5 years	None/10% Per Issuer	A/A-1 or Higher
53601 (c)	State Obligations	5 years	None/10% Per Issuer	A/A-1 or Higher
53601 (e)	California Local Agencies	5 years	None/10% Per Issuer	A/A-1 or Higher
53601(b)	United States Treasuries	5 years	None	None
53601(e)	Federal Agency Securities	5 years	75%	None
53601(e)	Federal Instrumentality	5 years	75%	None
53691(i)	Repurchase Agreements	1 year	10%	A-1/A
53601(g)	Prime Commercial Paper	270 days	25% 10% Per Issuer	A/A-1 or higher
53601(f)	Eligible Bankers Acceptances	180 days	10% per issuer/30% Aggregate	A-1/P-1/F-1
53601(j)	Medium Term Notes	5 years	30%	AA/Aa2/AA
53601(n)	Non-negotiable Certificates of Deposit	5 years	25% $1 million per issuer	-

CA. Gov't. Code Section	Authorized Investment	Maximum Maturity	Authorized Investment Limits - % of Portfolio	Credit Rating Limit
53601.8 (a)-(h)	Certificates of Deposit through Account Registry Services	5 years	7.5% Aggregate Maximum Up to the FDIC Insured Limit Per Issuer	-
16429.1	State of California LAIF	18 Months-Avg	None	-
53601(k)	*Mutual Funds	None	15%	AAAm/Aaa/AAAV1+
53601(k)	*Money Market Mutual Funds	None	15%	AAAm/Aaa/AAAV1+
53601(o)	Asset-Backed, Mortgage-Backed, Mortgage Pass-Through Securities, and Collateralized Mortgage Obligations	5 years	20%	AA or higher
53601(q)	Supranationals	5 years	30%	AA or higher
	*Combined total not to exceed 20% per State		20%	

EXHIBIT A

GLOSSARY OF ELIGIBLE INVESTMENTS

Local Agency Investment Fund (L.A.I.F.). The L.A.I.F. was established by the state of California to enable treasurers to place funds in a pool for investments. There currently is a limitation of $65 million per agency subject to a maximum of 15 total transactions per month. The City of Campbell uses this fund when interest rates are declining as well as for short-term investments and liquidity.

U.S. Treasury Bills. Commonly referred to as T-Bills, these are short-term marketable securities sold as obligations of the U.S. Government. T-Bills do not accrue interest but are sold at a discount to pay face value at maturity.

U.S. Treasury Notes. These are marketable, interest-bearing securities sold as obligations of the U.S. Government with original maturities of one to ten years. Interest is paid semi-annually.

U.S. Treasury Bonds. These are the same as U.S. Treasury Notes except they have original maturities of ten years or longer.

U.S. Government Agency Issues. Are securities that are unconditionally backed by the full faith and credit of the United States, including: Government National Mortgage Association (GNMA), Farmers Home Administration (FmHA),Small Business Administration (SBA), General Services Administration (GSA), Federal Housing Administration (FHA) and Housing and Urban Development (HUD).

U.S. Government Instrumentality Issues. Are government sponsored enterprises that are backed by the creditworthiness of the issuing agency, not the full faith and credit of the U.S. government. They do carry an implied guarantee of government assistance to the organization should it encounter financial difficulties. Issuers include: Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB), Federal Farm Credit Banks (FFCB) and Federal Home Loan Mortgage Corporation (FHLMC).

Asset Backed Securities. - Securities that are supported by pools of assets, such as installment loans or leases, or by pools of revolving lines of credits. Asset-backed securities are structured as trusts in order to perfect a security interest in the underlying assets.

Banker's Acceptance. This is a negotiable time draft (bill of exchange) with a maturity of six months or less drawn on and accepted by a commercial bank. Banker's Acceptances are usually created to finance the import and export of goods, the shipment of goods within the United States and storage of readily marketable commodities. Per State Law, cities may not invest more than 30% of idle cash in Banker's Acceptances.

Certificate of Deposit (CD's). - is a receipt for funds deposited in a bank or savings and loan association for a specified period of time at a specified rate of interest. The first $250,000 of a certificate of deposit is guaranteed by the Federal Deposit Insurance Corporation (FDIC). CD's with a face value in excess of $250,000 can be collateralized by Treasury Department Securities, which must be at least 110% of the face value of the CD's, in excess of the first $250,000, or by first mortgage loans which must be at least 150% of the face value of the CD balance in excess of the first $250,000.

Repurchase Agreements (REPOS). - is a contractual arrangement between a financial institution, or dealer, and an investor. This agreement normally can run for one or more days. The investor puts up his funds for a certain number of days at a stated yield. In return, he takes a given block of securities as collateral. At maturity, the securities are repurchased and the funds repaid plus interest.

Commercial Paper. - Notes are unsecured promissory notes of industrial corporations, utilities and bank holding companies. State law limits a city to investments in United States corporations having assets in excess of five hundred million dollars with an "A" or higher rating. Per State law, cities may not invest more than 25% of idle cash in commercial paper.

Medium Term Notes. - are corporate or depository institution debt securities meeting certain minimum quality standards (as specified in the California Government Code) with a remaining maturity of five years or less.

Money Market Mutual Fund. - Mutual funds that invest solely in money market instruments (short-term debt instruments, such as Treasury bills, commercial paper, bankers' acceptances, repos and federal funds).

Mortgage Backed Securities. - Mortgage-backed securities (MBS) are created when a mortgagee or a purchaser of residential real estate mortgages creates a pool of mortgages and markets undivided interests or participations in the pool. MBS owners receive a prorata share of the interest and principal cash flows (net of fees) that are “passed through” from the pool of mortgages. MBS are complex securities whose cash flow is determined by the characteristics of the mortgages that are pooled together. Investors in MBS face prepayment risk associated with the option of the underlying mortgagors to pre-pay or payoff their mortgage. Most MBS are issued and/or guaranteed by federal agencies and instrumentalities (e.g., Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), and Federal Home Loan Mortgage Corporation (FHLMC)).

Mortgage Pass-Through Obligations. - Securities that are created when residential mortgages (or other mortgages) are pooled together and undivided interests or participations in the stream of revenues associated with the mortgages are sold.

Mutual Fund. - An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. Mutual funds are regulated by the Investment Company Act of 1940 and must abide by strict Securities and Exchange Commission (SEC) disclosure guidelines.

Supranationals. - International institutions formed by two or more governments that transcend boundaries to pursue mutually beneficial economic or social goals. There are three supranational institutions that issue obligations that are eligible investments for California local agencies: the International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), and InterAmerican Development Bank (IADB).