INVESTMENT POLICY
The City of Eureka
The Eureka Redevelopment Agency
The Eureka Public Financing Authority

Last Adopted May 6, 2008

I. Investment Philosophy

A. Policy

1. This Investment Policy is set forth by the City of Eureka (the City), the Eureka Redevelopment Agency (ERA) and the Eureka Public Financing Authority (EPFA), collectively referred to as the City, for the following purposes:

    a. To establish a clear understanding for the City Council, City management, responsible employees, citizens and third parties of the objectives, policies and guidelines for the investment of City, ERA and EPFA idle and surplus funds;

    b. To offer guidance to investment staff and any external investment advisers on the investment of City, ERA and EPFA funds; and

    c. To establish a basis for evaluating investment results.

2. The City establishes investment policies which meet its current investment goals. The City shall review this policy annually, and may change its policies as its investment objectives change.

B. Objectives

The objectives of this investment policy are, in order of priority:

1. To ensure safety of invested funds;

2. To maintain sufficient liquidity to meet cash flow needs;

3. To attain a "market average rate of return" consistent with the primary objectives of safety and liquidity. The expected rate of return on the City's portfolio is more specifically defined in Section IV; and

4. To assure ongoing compliance with all Federal, State and local laws governing the investment of moneys under the control of the City Treasurer.

C. Prudence

1. The Prudent Investor Standard shall be used by investment officials, and shall be applied in the context of managing an overall portfolio. Investment staff acting in accordance with written procedures and the 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 within 30 days and appropriate action is taken to control adverse developments.

2. **The Prudent Investor Standard:** When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent investor 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. Within the limitations of this section and considering individual investments as part of an overall strategy, a trustee is authorized to acquire investments as authorized by law.

D. Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions.

II. Operational and Procedural matters

A. Scope

This investment policy applies to all financial assets and investment activities of the City, ERA and EPFA with the following exceptions:

1. The City's Deferred Compensation Plan is excluded because it is managed by a third party administrator and invested by individual plan participants; and

2. Proceeds of debt issuance shall be invested in accordance with the general investment philosophy of the City as set forth in this policy; however, such proceeds are invested in accordance with permitted investment provisions of their specific bond indentures.

B. Delegation of Authority

1. Authority to manage the City's investment program is derived from the California Government Code Sections 53600 *et seq.,* Section 607 of the City's Charter, and Section 2-3.106 of the Eureka Municipal Code.

2. The City may 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 objectives. Such external managers may be granted discretion to purchase and sell investment securities in accordance with this Investment Policy. Such managers must be registered under the Investment Advisers Act of 1940.

C. Authorized Financial Dealers and Institutions

1. The City Treasurer shall determine which financial institutions are authorized to provide investment services to the City, ERA and EPFA. Institutions eligible to transact investment business with the City include:

    a. Primary government dealers as designated by the Federal Reserve Bank;

    b. Nationally or state-chartered banks;

    c. The Federal Reserve Bank; and

    d. Direct issuers of securities eligible for purchase by the City.

2. Selection of financial institutions and broker/dealers authorized to engage in transactions with the City shall be at the sole discretion of the City.

3. All financial institutions which desire to become qualified bidders for investment transactions (and which are not dealing only with the investment adviser) must supply the City Treasurer with a statement certifying that the institution has reviewed the California Government Code Section 53600 *et seq*. and the City's Investment Policy and that all securities offered to the City shall comply fully and in every instance with all provisions of the Code and with this Investment Policy.

4. Public deposits shall be made only in qualified public depositories within the State of California as established by State law. Deposits shall be insured by the Federal Deposit Insurance Corporation, or, to the extent the amount exceeds the insured maximum, shall be collateralized with securities in accordance with State law.

5. Selection of broker/dealers used by external investment advisers retained by the City shall be at the sole discretion of the investment advisers, after consultation with the City Treasurer.

D. Delivery vs. payment

All investment transactions of the City shall be conducted using standard delivery-vs.-payment procedures.

E. Safekeeping of securities

To protect against potential losses by collapse of individual securities dealers, and to enhance access to securities, interest payments and maturity proceeds, all securities owned by the City shall be held in safekeeping by a third party bank trust department, acting as agent for the City under the terms of a custody agreement executed by the bank and by the City.

III. Permitted investments and portfolio risk management

A. Authorized Investments

All investments shall be made in accordance with Sections 53600 *et seq.* of the Government Code of California and as described within this Investment Policy. Permitted investments under this policy shall include:

1. Securities issued by the US Treasury

a. a minimum of 10% of the total portfolio shall be invested in US Treasuries at all times
b. there shall be no maximum allowable investment in US Treasury securities

2. Securities issued and fully guaranteed as to payment by an agency of the US Government

a. there shall be no maximum allowable investment in US Government Agency securities
b. provided that no more than 20% of the total portfolio shall be invested in any one Government Agency security

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3. **Banker's acceptances** provided that:

   a. They are issued by institutions the short term obligations of which are rated a minimum of P1 by Moody's or A1 by S&P; or, if the short term obligations are unrated, the long-term obligations of which are rated a minimum of A by Moody's and S&P;

   b. The maturity does not exceed 180 days; and

   c. No more than 40% of the total portfolio may be invested in banker's acceptances;

4. **Federally insured time deposits** (Non-negotiable certificates of deposit) in California banks with a maximum maturity of 180 days;

5. **Time deposits (Non-negotiable certificates of deposit)** in California banks in excess of insured amounts which are fully collateralized with securities in accordance with California law, provided that:

   a. No more than 20% of the portfolio shall be invested in a combination of federally insured and collateralized time deposits;

   b. They are issued by institutions which have long term debt rated "A" or higher by S&P or "A2" or higher by Moody's; and/or have short term debt rated at least A1 by S&P or P1 by Moody's; and

   c. The maturity of such deposits does not exceed 180 days;

6. **Negotiable certificates of deposit (NCDs)** provided that:

   a. They are issued by institutions which have long term debt rated "A" or higher by S&P and Moody's; and/or have short term debt rated at least A1 by S&P or P1 by Moody's;

   b. The maturity does not exceed two years; and

   c. No more than 30% of the total portfolio may be invested in NCDs;

7. **Repurchase agreements** collateralized with securities authorized under Sections III(A1-2) of this policy maintained at a level of at least 102% of the market value of the repurchase agreements, provided that:

a. The maximum maturity of repurchase agreements shall be 30 days;

b. No more than 10% of the portfolio shall be invested in repurchase agreements;

c. Securities used as collateral for repurchase agreements, shall be delivered to the City's custodian bank, except that securities used as collateral for the one to seven day repurchase agreements with the City's depository bank may be held in safekeeping by the depository bank's trust department in the name of the City, as evidenced by appropriate receipts of trust (See Section II E); and

d. The repurchase agreements are the subject of a master repurchase agreement between the City and the provider of the repurchase agreement. The master repurchase agreement shall be substantially in the form developed by the Public Securities Association;

8. **Commercial paper** provided that:

   a. The maturity does not exceed 270 days from the date of purchase;

   b. The issuer is a corporation organized and operating in the United States with assets in excess of $500 million;

   c. The paper is rated a minimum of P1 by Moody's Investor Services (Moody's) and A1 by Standard & Poor's Inc. (S&P); and

   d. No more than 25% of the portfolio is invested in commercial paper;

9. **State of California Local Agency Investment Fund (LAIF)**, provided that

   a. The City, ERA and EPFA may invest up to the maximum permitted amount in LAIF; and

   b. LAIF's investments in instruments prohibited by or not specified in the City's policy do not exclude it from the City's list of allowable investments, provided that the fund's reports allow the City Treasurer to adequately judge the risk inherent in LAIF's portfolio;

10. **Corporate medium term notes,** provided that:

a. Such notes have a maximum maturity of five years;

b. are 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;

c. are rated in a rating category of "A" or its equivalent or better by Moody's and S&P; and

d. holdings of medium-term notes may not exceed 30 percent of the portfolio;

11. Mortgage pass-through securities and asset-backed securities, provided that:

a. such securities shall have a maximum stated final maturity of five years;

b. shall be rated AAA by S&P or Aaa by Moody's; and

c. purchase of securities authorized by this subdivision may not exceed 20 percent of the portfolio.

12. Money market mutual funds, provided that such funds

a. Are registered with the Securities and Exchange Commission and are rated AAA by S&P or Aaa by Moody's; and

b. Have retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by California Government Code Section 53601 (a through j) and with assets under management in excess of $500 million.

B. Prohibited investment vehicles and practices

1. State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to, mutual funds (other than government money market funds as described in Section III A(12), unregulated and/or unrated investment pools or trusts, collateralized mortgage obligations and futures and options.

2. In accordance with Government Code Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.

3. Investment in any security that could result in a zero interest accrual if held to maturity is prohibited.

4. Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.

5. Purchasing or selling securities on margin is prohibited.

6. The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited.

C. Mitigating credit risk in the portfolio

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

1. The diversification requirements included in Section III (A) are designed to mitigate credit risk in the portfolio;

2. No more than 5% of the total portfolio may be invested in securities of any single issuer, other than the US Government, its agencies and instrumentalities;

3. The City may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or the City's risk preferences; and

4. If securities owned by the City are downgraded by either Moody's or S&P to a level below the quality required by this Investment Policy, it shall 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.

    a. If a security is downgraded two grades below the level required by the City, the security shall be sold immediately.

    b. If a security is downgraded one grade below the level required by this policy, the City Treasurer will use discretion in determining whether to sell or hold the security based on its current maturity, the loss in value, the economic outlook for the issuer, and other relevant factors.

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

D. Mitigating market risk in the portfolio

Market risk is the risk that the portfolio will decline in value (or will not optimize its value) due to changes in the general level of interest rates. The City recognizes that, over time, longer term portfolios achieve higher returns. On the other hand, longer term portfolios have higher volatility of return. The City shall mitigate market risk by providing adequate liquidity for short term cash needs, and by making some longer term investments only with funds which are not needed for current cashflow purposes. The City further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The City, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

1. The maximum stated final maturity of individual securities in the portfolio shall be five years, with the average maturity no greater than 3 years.

2. The City shall maintain a minimum of three months of budgeted operating expenditures in short term investments; and

IV. Specific objectives and expectations

A. Overall objective. The investment portfolio shall be designed with the overall objective of obtaining a total rate of return throughout economic cycles, commensurate with investment risk constraints and cash flow needs.

B. Specific objective. The investment performance objective for the portfolio shall be to earn a total rate of return over a market cycle which is approximately equal to the return on the Benchmark Index. The Merrill Lynch US Treasuries 1-3 years Index.

V. Reporting, disclosure and program evaluation

A. Quarterly reports

Quarterly investment reports shall be submitted by the City Treasurer to the City Council. These reports shall disclose, at a minimum, the following information about the risk characteristics of the City's portfolio:

1. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate;

2. A one-page summary report which shows:

    a. Average maturity of the portfolio and modified duration of the portfolio;

    b. Maturity distribution of the portfolio;

    c. Average portfolio credit quality; and

    d. Time-weighted total rate of return for the portfolio for the prior three months, twelve months, year to date, and since inception compared to the Benchmark Index returns for the same periods;

3. A statement of compliance with investment policy, including a schedule of any transactions or holdings which do not comply with this policy or with the California Government Code, including a justification for their presence in the portfolio and a timetable for resolution; an

4. A statement that the City has adequate funds to meet its cash flow requirements for the next six months.

B. Semi-Annual reports

The City Treasurer is responsible for submitting a copy of the quarterly investment report, as submitted to the City Council, to the California Debt and Investment Advisory Commission (CDIAC) twice a year. The second quarter report, for the period ending June 30, shall be submitted no later than the end of August. The fourth quarter report, for the period ending December 31, shall be submitted no later than the end of February.

C. Annual reports

1. The investment policy shall be reviewed and adopted at least annually within 90 days of the end of the calendar year to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.

2. A comprehensive annual report shall be presented in conjunction with the investment policy review. This report shall include comparisons of the City's return to the Benchmark Index return, shall suggest policies and improvements that might enhance the investment program, and shall include an investment plan for the coming year.

3. A copy of the investment policy shall be submitted to the California Debt and Investment Advisory Commission (CDIAC) each calendar year and within 60 days of any amendment to the investment policy.

D. Internal controls

The City Treasurer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the entity are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. Internal controls shall be in writing and shall address the following points: control of collusion, separation of transaction authority from accounting and record keeping, safekeeping of assets and written confirmation of telephone transactions for investments and wire transfers.

E. Annual audit

The City Treasurer shall establish an annual process of independent review by the City's external auditor to assure compliance with internal controls. Such audit will include tests deemed appropriate by the auditor.

F. Special audits

The City Council may at any time order an audit of the investment portfolio and/or the City Treasurer's investment practices.

GLOSSARY OF INVESTMENT TERMS

Banker's acceptance. A high quality, short term money market instrument used to finance international trade. There has never been an instance of a failure to pay a banker's acceptance in full at its maturity date.

Benchmark. A segment of the securities market with characteristics similar to the subject portfolio. It is used to compare portfolio performance to the performance of the appropriate segment of the market.

California Debt and Investment Advisory Commission (CDIAC). An agency providing information, education and technical assistance on public debt and investments to local public agencies and other public finance professionals. Created in 1981 by state legislation, the Commission serves as the state's clearinghouse for public debt issuance information.

Commercial paper. Short term, negotiable unsecured promissory notes of corporations.

Delivery vs. payment. A procedure whereby delivery of securities sold is made to the buying customer's bank in exchange for payment, usually in the form of cash.

Duration. See modified duration.

Local agency investment fund (LAIF). A pooled investment vehicle for local agencies in California sponsored by the State of California and administered by the State Treasurer.

Market cycle. A market cycle is defined as a period of time which includes a minimum of two consecutive quarters of falling interest rates followed by a minimum of two consecutive quarters of rising interest rates.

Modified duration. A measure of exposure to market risk of a security or a portfolio. It is the percent change in the price of a security (portfolio) for a 100 basis point change in the security's (portfolio's) yield.

Money market mutual fund. A mutual fund which invests in short term money market instruments only, and which has as an investment objective

Negotiable certificate of deposit. A large denomination certificate of deposit which can be sold in the open market prior to maturity.

Repurchase agreement. An investment transaction wherein an investors agrees to purchase securities at an agreed upon price, and simultaneously agrees to sell the securities back to the contraparty on an agreed upon future date at an agreed upon price.

Time certificate of deposit. A non-negotiable certificate of deposit which cannot be sold prior to maturity.

Time-weighted total rate of return. A measurement of portfolio return which eliminates the effect of the timing of contributions to and withdrawals from the fund. It measures the internal rate of return which equates the period-ending market value of the portfolio with its period-beginning market value, with adjustments for cash contributions to and withdrawals from the portfolio.