COUNCIL POLICY 12.7

POLICY TITLE: CITY OF SANTA CRUZ STATEMENT OF INVESTMENT AND PORTFOLIO POLICY

The attached revised Statement of Investment and Portfolio Policy incorporates the most recently published recommendations of the Professional and Technical Committee of the California Municipal Treasurer's Association, the California Association of County Treasurers and Tax Collectors, and the California Society of Municipal Finance Officers.

AUTHORIZATION: Council Policy Manual Update of November 17, 1998; Amended by motion June 24, 2024; Amended by motion March 26, 2024.

City of Santa Cruz

Statement of Investment and
Portfolio Policy

March 26, 2024

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POLICY

It is the policy of the City of Santa Cruz to meet the short and long-term cash flow demands of the City in a manner that will provide for the safety of principal and sufficient liquidity, while providing an investment return. The purpose of this Statement of Investment and Portfolio Policy is to outline a process for the investment of City funds in a prudent manner in order to meet City objectives.

In accordance with Section 53646 of the California Government Code ("Code"), the Director of Finance may annually render to the City Council and the Investment Committee a statement of investment policy, which the City Council shall consider at a public meeting. Any changes in the policy shall also be considered by the City Council at a public meeting.

Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirements of this policy. At maturity or liquidation, such moneys shall be reinvested only as provided by this policy.

SCOPE

This investment policy applies to activities of the City with regard to investing the financial assets of the following reporting entities:

- City of Santa Cruz, which includes the City acting in its capacity as Successor Agency to the former Redevelopment Agency of the City of Santa Cruz
- City of Santa Cruz Public Financing Authority
- Santa Cruz Public Improvement Financing Corporation
- Library Joint Powers Authority

This policy, however, specifically excludes the employees' retirement and deferred compensation funds.

Bond proceeds shall be invested in accordance with the requirements and restrictions outlined in the bond documents and this Statement of Investment and Portfolio Policy.

OBJECTIVES

Funds of the City will be invested in accordance with California Government Code Sections 53600 et. seq. and the Statement of Investment and Portfolio Policy.

The objective of the Investment and Portfolio Policy is to meet the short and long-term cash flow demands of the City. The portfolio will be structured to provide the following (in order of priority):

- Legality
- Safety of Principal
- Liquidity
- Yield
- Local economic benefits generated by investing in local financial institutions

DELEGATION OF AUTHORITY

The Director of Finance, in the capacity of City Treasurer, is designated as the Chief Investment Officer of the City and is responsible for investment decisions and activities, under the direction of the City Manager. The Director of Finance shall develop and maintain written administrative procedures for the operation of the investment program by qualified Finance Department staff, consistent with the Statement of Investment and Portfolio Policy.

No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Director of Finance. The Director of Finance shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

The City may engage the services of an external investment advisor to assist in the management of the City's investment portfolio in a manner consistent with the City's objectives. Such external advisor may be granted discretion to purchase and sell investment securities in accordance with this investment policy. Such advisor must be registered under the Investment Advisers Act of 1940.

INVESTMENT COMMITTEE

There is hereby created an Investment Committee, consisting of the City Manager, the Director of Finance, Assistant Director of Finance, and investment staff. Members of the Investment Committee shall serve without compensation, and shall meet as needed. The Investment Committee shall include in its deliberations such topics as: economic outlook, portfolio diversification, maturity structure, potential risks to the City's funds, authorized depositories, and selection of banks and primary dealers.

PRUDENCE

Persons authorized to make investment decisions on behalf of the City are trustees and, therefore, fiduciaries subject to the prudent investor standard as defined in California Government Code Section 53600.3:

> 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. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law.

Persons authorized to make investment decisions on behalf of the City, acting in accordance with written procedures and the Statement of Investment and Portfolio Policy, and exercising due diligence, shall not be held personally responsible for a specific security's credit risk or market price changes, provided that these deviations are reported in a timely manner and that appropriate action is taken to control adverse developments.

ETHICS AND CONFLICTS OF INTEREST

The Director of Finance and investment 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. The Director of Finance and investment employees shall disclose any material financial interests in financial institutions that conduct business within this jurisdiction, and they shall further disclose any material personal financial/investment positions that could be related to the performance of the City's portfolio. The Director of Finance and investment employees shall refrain from undertaking personal investment transactions with the same individuals with whom business is conducted on behalf of the City. The Director of Finance and investment employees shall subordinate their personal investment transactions to those of this jurisdiction, particularly with regard to the timing of purchases and sales.

The Director of Finance and the City’s investment employees are required to file an annual Statement of Economic Interests for Designated Employees pursuant to Resolution No. NS-28,266, dated September 28, 2010. During the course of the year, if there is an event subject to disclosure that could impair the ability of the Director of Finance or investment employees to make impartial decisions, the Investment Committee will be notified in writing within ten (10) days of the event.

INTERNAL CONTROLS

The Director of Finance shall establish a system of internal controls, which shall be documented in writing. The internal controls shall be reviewed by the Investment Committee and with the independent external auditor. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City.

SOCIALLY RESPONSIBLE/SUSTAINABLE INVESTMENT PARAMETERS

It is the City's objective to disallow investments in companies whose industry is classified as energy services, oil and gas producers, and refiners and pipelines.
When possible, it is the City's policy to invest in companies that promote the use and production of renewable energy resources and any other socially responsible investments, subject to the prudent investment standard.

COMMUNITY BANKING

In an effort to encourage and support local banking institutions, the City will invest a portion of City funds in qualified community banks, that meet the below criteria.

- The bank must be based in one of the neighboring counties; Santa Cruz, Monterey, San Mateo, Santa Clara, and/or San Benito;
- The bank must provide certification and supporting information that indicates at least 15% of the total bank investment and loan portfolios are invested//made in activities within those county limits;
- To ensure the City of Santa Cruz obtains a competitive rate for investments in the program, any potential investment or proposal must enjoy a rate of return equal to or greater than the Local Agency Investment Fund (LAIF) rate existing at the time of the proposal;
- Participating banks shall provide an annual report, for each year there are active investments and loans, to the City's Investment Committee about their community involvement as of June 30th, due by July 15th.

SALE OF SECURITIES

Securities are purchased with the intent to hold until maturity. Cash will be managed so that the sale of a security will not be required to meet the on-going cash needs of the City. The City may sell a security prior to its maturity (recording a gain or loss) to adjust the portfolio duration or improve the risk structure, liquidity, yield, or return potential of the portfolio in response to market conditions or City needs.

PORTFOLIO DIVERSIFICATION

It is the policy of the City to diversify its investment portfolio. Assets held shall be diversified to eliminate the risk of loss resulting from undue concentration of assets in a specific maturity, a specific issuer, or a specific class of securities.

In establishing specific diversification strategies, the following general policies and constraints shall apply. Portfolio maturities shall be staggered to avoid undue concentration of assets in a specific maturity date. Maturities selected shall provide for stability of income and reasonable liquidity.

- Liquidity shall be assured through practices ensuring that the next accounts payable and payroll dates are covered through maturing investments, revenues, or other liquid sources such as the State Treasurer's Local Agency Investment Fund (LAIF) or a local government investment pool (LGIP).
- Risks of market price volatility shall be controlled through maturity diversification.
- Not more than 5% of the portfolio shall be invested in any one issuer or any one instrument to protect the City from concentration of credit risk, with the following exceptions:

    - U.S. Treasury Obligations
    - Federal agencies or U.S. government-sponsored enterprises
    - Investment pools (including LAIF and LGIPs)

AUTHORIZED INVESTMENTS

The City's investments are governed by Sections 16429.1, 53601, 53635, and 53638 of the California Government Code. Within the investments permitted by Code, the City seeks to further restrict eligible investments to the guidelines listed below. In the event a discrepancy is found between this policy and Code, the more restrictive parameters will take precedence. All percentage holding limits and rating requirements listed in this section apply at the time the security is purchased. A security purchased in accordance with this section shall not have a forward settlement date exceeding 45 days from the time of investment.

Were this section does not specify a limitation on the term or remaining maturity at the time of the investment, no investment shall be made in any security, other than a security underlying a repurchase agreement authorized by this section, that at the time of the investment has a term remaining to maturity in excess of five years, unless the legislative body has granted express authority to make that investment either specifically or as a part of an investment program approved by the legislative body no less than three months prior to the investment. For purposes of compliance with this policy, an investment's term or remaining maturity shall be measured from the settlement date to final maturity.

A. Money market accounts deposited with a nationally or state-chartered bank.

B. Municipal Obligations. Bonds issued by the City of Santa Cruz, including bonds payable solely out of the revenues 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.

Bonds, notes, warrants, or other evidences of indebtedness of a local agency within California, including bonds payable solely out of the revenues 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.

Registered state warrants or treasury notes or bonds of California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority of the state.

Registered treasury notes or bonds of any of the other 49 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 states, in addition to California.

Purchases of municipal obligations as described in this subsection shall not exceed five years to maturity. There is no percentage limit in this category.

C. 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. Purchases of this category shall not exceed five years to maturity. There is no percentage limit in this category.

D. Obligations, participations, or other instruments of, or issued by, a Federal agency or a United States government-sponsored enterprise. Purchases of this category shall not exceed five years to maturity. There is no percentage limit in this category. In addition, purchases of callable Federal agency instruments shall not exceed 30% of the fair value of the portfolio. Callable Federal agency instruments will be limited to discrete calls and those that pay 100% of the principal at the redemption date.

E. Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers' acceptances. Purchases of bankers' acceptances may not exceed 180 days' maturity or 40% of the City's portfolio.

F. Non-negotiable and non-transferable certificates of deposit issued by the following types of financial institutions which have branch office locations within Santa Cruz County: 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 a federally licensed or state-licensed branch of a foreign bank. Purchases of non-negotiable and non-transferable certificates of deposit may not exceed 30% of the fair value of the City's portfolio.

G. Repurchase Agreements. The term "repurchase agreement" means a purchase of securities by the City 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 City's third party custodian. Securities for purpose of repurchase mean securities of the same issuer, description, issue date, and maturity.

The City may invest in repurchase agreements with primary dealers of the Federal Reserve with which the City has entered into a Public Securities Association (PSA) master repurchase contract which specifies terms and conditions of repurchase agreements. The market value of securities that underlay a repurchase agreement shall be valued at 102% or greater of the funds borrowed against those securities, and the value shall be adjusted no less than quarterly. Since the market value of the underlying securities is subject to daily market fluctuations, the investments in repurchase agreements shall be in compliance if the value of the underlying securities is brought back up to 102% no later than the next business day.

Securities that can be pledged for collateral shall consist only of investments permitted within this policy with a maximum maturity of five years. If there is a default of the broker, the collateral securities can be sold. Since the securities are valued daily, it is likely that the sale proceeds will equal or exceed the value of the repurchase agreement amount.

Purchases in this category shall not exceed 92 days to maturity and 20% of the fair value of the portfolio.

H. State of California Pool - Local Agency Investment Fund. The City may invest in the Local Agency Investment Fund (LAIF) established by the State Treasurer under California Government Code Section 16429.1 for the benefit of local agencies. LAIF provides daily liquidity; therefore, there is no final stated maturity for this investment category. LAIF establishes a maximum account balance limit.

I. Shares of beneficial interest issued by diversified management companies that (1) invest in U.S. Treasuries, obligations, participations, or other instruments of, or issued by, a federal agency, or a United States government-sponsored enterprise, or repurchase agreements; or (2) are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1, et seq.)

The net asset value of the shares shall be maintained at $1.00 per share. The purchase price of shares of beneficial interest shall not include any commission that the companies may charge.

The management company must comply with the investment restrictions of the Statement of Investment and Portfolio Policy of the City of Santa Cruz and California Government Code Section 53600 et al. The management company shall have attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations.

Purchases in this category shall not exceed 20% of the fair value of the portfolio. Purchases in a single mutual fund may not exceed 10% of the fair value of the portfolio.

J. Local Government Investment Pools (LGIP). Shares of beneficial interest issued by a joint powers authority organized pursuant to California Government Code Section 6509.7 that invests in the securities and obligations authorized in California Government Code Section 53601 subdivisions (a) to (r), inclusive. Each share shall represent an equal proportional interest in the underlying pool of securities owned by the joint powers authority. To be eligible under this section, the joint powers authority issuing the shares shall have retained an investment adviser that meets all of the following criteria:

(1) The adviser is registered or exempt from registration with the Securities and Exchange Commission.

(2) The adviser has not less than five years of experience investing in the securities and obligations authorized in Government Code Section 53601 subdivisions (a) to (q), inclusive.

(3) The adviser has assets under management in excess of five hundred million dollars ($500,000,000).

K. Commercial paper of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph (1) or (2):

(1) The entity meets the following criteria:

(A) Is organized and operating in the United States as a general corporation.

(B) Has total assets in excess of five hundred million dollars ($500,000,000).

(C) Has debt other than commercial paper, if any, that is rated in a rating category of "A" or its equivalent or higher by an NRSRO.

(2) The entity meets the following criteria:

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

(B) Has program wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or a surety bond.

(C) Has commercial paper that is rated "A-1" or higher, or the equivalent, by an NRSRO.

Eligible commercial paper shall have a maximum maturity of 270 days or less. No more than 40% of the fair value of the portfolio shell be in eligible commercial paper.

L. 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 federally licensed or state-licensed branch of a foreign bank. Purchases of negotiable certificates of deposit shall not exceed 30% of the fair value of the portfolio. The legislative body of a local agency and the treasurer or other official of the local agency having legal custody of the moneys are prohibited from investing local agency funds, or funds in the custody of the local agency, in negotiable certificates of deposit issued by a state or federal credit union if a member of the legislative body of the local agency, or a person with investment decision making authority in 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 the supervisory committee of the state or federal credit union issuing the negotiable certificates of deposit.

M. Medium-term notes, defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, 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. Notes eligible for investment under this subdivision shall be rated in a rating category of "A" or its equivalent or better by an NRSRO. Purchases of medium-term notes shall not include other instruments authorized by this section and shall not exceed 30% of the fair value of the portfolio.

N. A mortgage passthrough security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable passthrough certificate, or consumer receivable-backed bond. Securities eligible for investment under this subdivision not issued or guaranteed by an agency or issuer identified in subdivision (C) or (D) of this Policy, the following limitations apply

(1) The security shall be rated in a rating category of "AA" or its equivalent or better by an NRSRO and have a maximum remaining maturity of five years or less.

(2) Purchase of securities authorized by this subdivision shall not exceed 20% of the fair value of the portfolio.

O. Supranational obligations defined as United States 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, with a maximum remaining maturity of five years or less, and eligible for purchase and sale within the United

States. Investments under this subdivision shall be rated in a rating category of "AA" or its equivalent or better by an NRSRO and shall not exceed 30% of the fair value of the portfolio.

Appendix A provides additional information regarding the above investment instruments. Appendix B explains the investment criteria used in the investment decision process. Appendix C provides definitions of investment risks as provided by Statement 40 of the Governmental Accounting Standards Board (GASB).

INELIGIBLE INVESTMENTS

Investments not described herein are ineligible investments. In accordance with Section 53601.6 of the California Government Code, the City shall not invest any funds in inverse floaters, range notes, or mortgage-derived interest only strips. In addition, the City shall not invest any funds in any security that could result in zero interest accrual if held to maturity. The following activities are prohibited by this policy:

- Trading securities for the sole purpose of speculating on the future direction of interest rates.
- Purchasing or selling securities on margin.
- The use of reverse repurchase agreement securities lending or any other form of borrowing or leverage.

COMPETITIVE SELECTION OF INVESTMENT INSTRUMENTS

Whenever possible, a competitive bid process shall be conducted for securities purchased on the secondary market, bankers' acceptances, certificates of deposit, and repurchase agreements.

Bids will be requested from banks, credit unions, and primary dealers that have been approved for investment purposes. The City will accept the bid that provides the highest rate of return within the maturity required and within the parameters of this policy.

Records will be kept of the bids offered, the bids accepted, and a brief explanation of the decision that was made regarding the investment.

QUALIFIED BANKS, CREDIT UNIONS, AND PRIMARY DEALERS

The City shall transact business only with banks, credit unions, or primary dealers. The purchase of any investment, other than those purchased directly from the issuer, shall be purchased either from a National or State-Chartered Bank or a brokerage firm designated as a Primary Dealer by the Federal Reserve Bank of New York.

The City shall maintain a listing of banks, credit unions, and primary dealers that are approved by the Investment Committee to submit quotations and transact business with the

City. All banks, credit unions, and primary dealers which desire to become qualified bidders for investment transactions must provide current audited financial statements with an unqualified opinion from an independent auditor. In addition, primary dealers must maintain a minimum capital adequacy ratio of liquid capital to measured risk that meets or exceeds 125% as required by the Federal Reserve Bank of New York. Banks must meet the regulatory minimums of a well-capitalized bank as defined by the Federal Deposit Insurance Corporation Improvement Act. Credit unions must meet the regulatory minimums of a well-capitalized credit union as defined by the Federal Credit Union Act. The listing of banks, credit unions, and primary dealers shall be reviewed periodically, and the most recent audited financial statement for each institution will be reviewed to insure that it is in compliance with the standards of the investment policy.

Only those banks, credit unions, and primary dealers on the approved list are entitled to submit quotations and transact business with the City. Any bank, credit union, or primary dealer failing to meet the capitalization standards and to maintain an unqualified opinion from an independent auditor will be deleted from the approved list. If a bank, credit union, or primary dealer places the City's investments at risk, removal from the approved list will be immediate.

Before transacting business with the City, each bank or primary dealer shall submit a certification. The document will certify that the officer of the bank or the primary dealer has reviewed the investment policies and objectives and agrees to disclose potential conflicts or risks to public funds that might arise out of business transactions between the bank or primary dealer and the City. All banks, credit unions, and primary dealers shall agree to undertake reasonable efforts to preclude imprudent transactions involving the City’s funds.

A minimum number of two and a maximum number of three banks or primary dealers will be approved for conducting investment transactions with the City of Santa Cruz, except that no such limit shall apply to certificate of deposit transactions.

A request for proposals (RFP) for investment services shall be conducted periodically by the Investment Committee. Each bank or primary dealer responding to the RFP must submit a “Request for Information” form. The banks and primary dealers selected by the Investment Committee to provide services must sign an agreement for securities services and a statement of work.

If the City engages a professional investment advisor, the investment advisor shall use their own list of approved broker/dealers.

SAFEKEEPING OF SECURITIES AND COLLATERAL REQUIREMENTS

Pursuant to California Government Code Section 53601, securities purchased in a negotiable, bearer, registered, or nonregistered format, shall be delivered to the City, including those purchased for the City by financial advisors, consultants, or managers using the City's funds, by book entry, physical delivery, or a third party custodial agreement. The transfer of securities to the counterparty bank's customer book entry account may be used for book entry delivery. For purposes of this section, "counterparty" means the other party to the transaction. A counterparty bank's trust department or separate safekeeping department may be used for the physical delivery of the security if the security is held in the name of the City of Santa Cruz.

A third party custodian under the terms of a PSA master repurchase agreement will hold collateral for repurchase agreements. All securities will be received and delivered using standard delivery versus payment procedures, which ensures that securities are deposited with the third party custodian prior to the release of funds. A third party custodian as evidenced by safekeeping receipts will hold securities. Investments in the Local Agency Investment Fund (LAIF), an LGIP, or mutual funds are undeliverable and are not subject to delivery or third party safekeeping.

California Government Code Sections 53651 through 53667 require depositories to maintain certain types and levels of collateral for public funds above federal insurance limits. The collateral requirements apply to both active deposits (checking and savings accounts) and inactive deposits (non-negotiable time certificates of deposit).

Collateral is also required for repurchase agreements. The collateral level is valued daily and must be maintained at a level of 102% or greater for the life of the repurchase agreement.

REPORTING REQUIREMENTS

Under the provision of Section 53646 of the California Government Code, the Director of Finance, may render a report to the City Council and City Manager containing detailed information on all unrestricted moneys, securities, and investments of the City.

The report shall be submitted monthly and provided to the City Council and City Manager within 45 days following the end of the month.

The report will contain the following information on the funds that are subject to this investment policy:

- the type of investment
- name of issuer
- date of maturity
- par and cost of each investment
- the market value and source of the valuation
- the weighted average maturity of the investments
- description of any funds, investments, or programs, that are under the management of contracted parties, including lending programs

- a statement of compliance with the investment and portfolio policy
- interest rate and yield

In addition to the above report, on a quarterly basis, the Director of Finance will submit a narrative report on the activities and investment strategy related to management of the pooled portfolio to the City Council and City Manager.

The Director of Finance will also render a quarterly report pertaining to unpooled moneys, securities, and investments from bond proceeds that are held by trustees. The report will be submitted to the City Manager and the City Council within 45 days following the end of the quarter covered by the report.

COMPLIANCE

The Director of Finance shall insure that all banks and primary dealers are in compliance with the applicable provisions of the Americans with Disabilities Act of 1990 and shall be an equal opportunity employer as defined by Title VII of the Civil Rights Act of 1964, the California Fair Employment and Housing Act of 1980, and the City of Santa Cruz Resolution NS-20,137 and Ordinance 92-11. As such, the banks and primary dealers shall not discriminate against any person on the basis of race, religious creed, color, national origin, ancestry, disability, medical condition, marital status, age, sex, sexual orientation, height, weight or physical characteristics with respect to hiring, application for employment, tenure or terms and conditions of employment.

APPENDIX A
EXPLANATION OF ALLOWABLE INVESTMENTS

Federal Agency or a United States Government Sponsored Enterprise:

Obligations issued by banks for cooperatives, federal land banks, federal intermediate credit banks, federal home loan banks, the Federal Home Loan Bank Board, the Tennessee Valley Authority, or in obligations, participations, or other instruments of, or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association, or in guaranteed portions of Small Business Administration notes, or in obligations, participations, or other instruments of, or issued by, a federal agency or a United States government-sponsored enterprise.

Federal agency obligations include the following securities:

Banks for Cooperatives
Federal Land Banks (FLB)
Federal Intermediate Credit Banks (FICB)
Federal Home Loan Banks (FHLB)
Tennessee Valley Authority (TVA)
Federal National Mortgage Association (FNMA)
Small Business Administration (SBA)
Federal Farm Credit Banks (FFCB)
Government National Mortgage Association (GNMA)
Federal Home Loan Mortgage Corporation (FHLMC)

Callable Federal Agencies:

A security is said to be callable when the issuer has the option to repay part or all of the issue early by paying some specified redemption price to the bondholders. A discrete call can be redeemed early only on certain dates. For example, a bond may be called quarterly, semi-annually, or annually. A continuous call may be redeemed early at any date, providing the issuer gives the bondholders five to ten days' notice.

Certificates of Deposit:

A certificate of deposit (CD) is a receipt for funds deposited in 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 a federally licensed or state-licensed branch of a foreign bank for a specified period of time at a specified rate of interest. The first $250,000 of a CD is guaranteed by the Federal Deposit Insurance Corporation (FDIC) if the deposit is with a bank or savings association; or by the National Credit Union Administration (NCUA) if the deposit is with a credit union. A CD with a face value in excess of federal insurance limits must be collateralized pursuant to California Government Code Sections 53651 to 53667.

Bankers' Acceptance:

A bankers' acceptance is a negotiable time draft or bill of exchange drawn on and accepted by a commercial bank. Acceptance of the draft irrevocably obligates the bank to pay the bearer the face amount of the draft at maturity. Bankers' acceptances are usually created to finance the import and export of goods, the shipment of goods within the United States, and the storage of readily marketable staple commodities. In addition to the guarantee by the accepting bank, the transaction is identified with a specific commodity. Warehouse receipts verify that the pledged commodities exist, and, by definition, these commodities are readily marketable. The sale of the underlying goods generates the necessary funds to liquidate the indebtedness.

Bankers' acceptances enjoy marketability since the Federal Reserve Bank is authorized to buy and sell prime bankers' acceptances with maturities of up to nine months. The Federal Reserve Bank enters into repurchase agreements in the normal course of open market operations with bankers' acceptance dealers.

Bankers' acceptances are sold at a discount from par. An acceptance is tied to a specific loan transaction; therefore, the amount and maturity of the acceptance is fixed.

Local Agency Investment Fund Demand Deposit:

The Local Agency Investment Fund (LAIF) was established by the State to enable treasurers to place funds in a pool for investments. LAIF is particularly beneficial for local jurisdictions with small portfolios due to LAIF’s policy of establishing a maximum account balance. The City uses this fund for short-term investments, liquidity, and yield when rates are declining.

Repurchase Agreements:

A repurchase agreement (REPO) is not a security, but a contractual arrangement between a financial institution or dealer and an investor. Usually, amounts are $500,000 or more, but some repurchase agreements can be smaller.

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.

Negotiable Certificates of Deposit:

Generally, short-term debt instrument that usually pays interest and is issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. The majority of negotiable CDs mature within six months while the average maturity is two weeks. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor). Negotiable CDs are insured by FDIC up to $250,000, but they are not collateralized beyond that amount.

Commercial Paper:

An unsecured short-term promissory note issued by corporations or municipalities, with maturities ranging from 2 to 270 days.

Medium Term Notes:

Corporate and depository institution debt securities with a maximum remaining maturity of five years or less, 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.

Supranational Institutions:

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 Inter-American Development Bank (IADB).

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)).

APPENDIX B
INVESTMENT CRITERIA

SAFETY OF PRINCIPAL

Investments of the City of Santa Cruz shall be undertaken in a manner that seeks to ensure the preservation of capital and to minimize capital losses. Losses may occur due to the default of a financial institution or the issuer of a security (credit risk), or the erosion of the market value of securities due to declining interest rates (interest rate risk). The City shall seek to ensure the safety of principal by mitigating the two types of risk in order of importance: credit risk and interest rate risk.

LIQUIDITY

Liquidity refers to the availability of cash to meet the operating requirements of the City. The portfolio will be structured so that securities mature concurrent with cash needs to meet anticipated demands. In addition, the portfolio will maintain a liquidity buffer so that unanticipated cash needs can be met. The buffer will be held in the Local Agency Investment Fund (LAIF) or and LGIP or any money market accounts allowed by this policy.

All investments purchased shall have daily liquidity or a final stated maturity date, upon which the full principal value of the security will be received.

RETURN ON INVESTMENT

The portfolio shall be designed to attain a return on investments through budgetary and economic cycles, taking into account safety of principal and liquidity needs of the City. Return on investment is of least importance compared to the safety and liquidity objectives described above. The core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk assumed.

APPENDIX C
TYPES OF INVESTMENT RISK

Concentration of Credit Risk

The risk of loss attributed to the magnitude of a government's investment in a single issuer. The portfolio will be diversified so that the failure of any one issuer will not unduly harm the City's cash flow.

Credit Risk

The risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit risk is further defined as the risk of loss due to the failure of an issuer of a security or a financial institution. Purchasing U.S. Treasuries or Federal Agencies will lessen this type of risk. Evaluating and pre-qualifying banks, primary dealers, intermediaries, and advisors with whom the City does business will also reduce credit risk.

Custodial Credit Risk

The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party.

The City protects deposits from custodial credit risk by requiring depositories to comply with the collateral requirements of California Government Code Sections 53651 through 53667. In addition, the City protects investments from custodial credit risk by holding investments in the City's name at a bank's trust department (safekeeping bank), except in the case of investments held for the City's benefit by trustees in accordance with City bond issues.

Foreign Currency Risk

The risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The City does not invest in foreign securities.

Interest Rate Risk

The risk that changes in interest rates will adversely affect the market value of an investment. Interest rate risk may be reduced by investing primarily in shorter-term securities with the weighted average maturity of the portfolio not to exceed three (3) years as of the date of the monthly report.

Reinvestment Risk

The risk that coupon payments and redemptions of principal will be reinvested at lower rates of return.

Weighted Average Maturity

A weighted average maturity measure expresses investment time horizons – the time when investments become due and payable – in years or months, weighted to reflect the dollar size of individual investments within an investment type.