

City of Richmond

Administrative Manual

SUBJECT: Investment Program Policy

SECTION: Finance

POLICY NUMBER: AP 515

INITIAL DATE PREPARED: November 24, 1999 **LAST DATE REVISED:** November 24, 1999

I. Purpose

- A. To recognize the City of Richmond's Pension Fund Investment Program as containing those appropriate and approved procedures necessary for the approval, and monitoring of the City's Pension Fund Investments. The City's Pension Fund Investment Program includes the General Pension Fund, and the Old and the New Police and Firemen's Pension Funds.
- B. To establish and recognize the City of Richmond's Cash Management Investment Program as containing those appropriate and approved procedures necessary for the creation, approval, and monitoring of the City's Cash Management Investment Program.
- C. To establish the City of Richmond's Cash Management Investment Oversight Committee to improve accountability to the public with respect to City investments.

II. Responsible Officials

- A. The City of Richmond Director of Finance is responsible for the creation, management, and monitoring of the City's Investment Programs, including the City's Pension Fund Investment Program and the City's Cash Management Investment Program.
- B. The City's Pension Fund Investment Program includes the General Pension Fund, and the Old and the New Police and Firemen's Pension Funds. The Pension Fund Investment Program shall be conducted in accordance with the City Charter, Articles XII and XI. The City Charter designates a Pension Board, restrictive investment guidelines, and procedures for planning and monitoring the transactions of the Pension Funds. Current Annual Investment Policy Statements are contained in the following exhibits:

General Pension Fund

Exhibit AP 515-1

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Old Police and Fireman's Pension Fund Exhibit AP 515-2
New Police and Fireman's Pension Fund Exhibit AP 515-3

- C. The City's Cash Management Investment Program shall be created, managed, and monitored by the Director of Finance.
- D. The Director of Finance shall establish a Cash Management Investment Oversight Committee (IOC) confirmed by the City Council. The IOC shall be charged with the following:
 - 1. Oversee the investment and internal accounting, control, procedural and reporting functions of the Director of Finance regarding the City's Cash Management Investment Program, including the Director of Finance's interaction with the Auditor; and
 - 2. Oversee, review and recommend investment guidelines and policy for the Director of Finance and to submit a written quarterly report of its findings; and
 - 3. Notify the City Council should the committee determine any irregularity exists in the Director of Finance's investments.
- E. The Director of Finance may delegate his/her duties to another official in the Department of Finance, but every investment transaction must be reviewed and approved by the Director of Finance. Additionally, 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. Responsibility for the operation of the Cash Management Investment Program is hereby delegated to the Financial Services Division Director, who shall carry out established written procedures and internal controls for the operation of the Cash Management Investment Program. Procedures should include references to: safekeeping, delivery vs payment, investment accounting, repurchase agreements, wire transfer agreements, collateral/depository

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agreements and banking services contracts.

- F. The Director of Finance shall present Annual Policy Statements to the City Council for review and approval at the first City Council meeting in May.
- G. The Director of Finance is responsible for ensuring compliance with the City's investment policies as well as for establishing systems of internal control designed to prevent losses due to fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by City officers and employees. Additionally, the Finance Department is responsible for the physical security of City investments and shall use custodial safekeeping for negotiable and bearer instruments whenever possible.

III. Cash Management Investment Program Objectives

- A. The Cash Management Investment Program is designed to invest, manage and monitor surplus and/or idle cash as determined by the Director of Finance.
- B. The City's primary investment objective is to achieve a reasonable rate of return on public funds while minimizing the potential for capital losses arising from market changes or issuer default. Although the generation of revenues through interest earnings on investments is an appropriate City goal, the primary consideration in the investment of City funds is capital preservation in the overall portfolio. As such, the City's yield objective is to achieve a reasonable rate of return on City investments rather than the maximum generation of income which could expose the City to unacceptable levels of risk.
- C. The Cash Management Investment Program shall adopt prudent investor standards for investing and establish priorities for public investing:
 - 1. **Safety of principal:** Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks

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to ensure the preservation of capital in the overall portfolio. The objective is to mitigate credit risk and interest rate risk summarized as follows:

- a. Credit risk. This is the risk of loss due to the failure of the security issuer or backer. Credit risk may be mitigated by:
 - Limiting investments to the safest types of securities.
 - Pre-qualifying the financial institutions, brokers/dealers, intermediaries, and advisors with which an entity will do business.
 - Diversifying the investment portfolio so that potential losses on individual securities will be minimized.
 - b. Interest rate risk. This is the risk that the market value of securities in the portfolio will fall due to changes in general interest rates. Interest rate risk may be mitigated by:
 - Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity.
 - Investing operating funds primarily in shorter-term securities.
2. **Liquidity to meet the needs of daily cash flow.** The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with

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active secondary or resale markets (dynamic liquidity).

3. **Yield: The return on funds.** The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of least importance compared to the safety and liquidity objectives described above. The core of investments are limited to relatively low risk securities in anticipation of earning a reasonable return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:
 - A declining credit security could be sold early to minimize loss of principal.
 - A security swap would improve the quality, yield, or target duration in the portfolio.
 - Liquidity needs of the portfolio require that the security be sold.
 - A capital gain would be realized that better positions the overall portfolio in achieving investment policy goals.

IV. Cash Management Investment Program Guidelines and Practices

The Cash Management Investment Program includes the following major guidelines and practices which are to be used in achieving the City's primary investment objective:

- Investment authority and responsibilities
- Capital preservation and risk
- Eligible financial institutions
- Allowable investment vehicles
- Investment maturity

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- Cash management
- Evaluation of investment performance
- Investment reporting
- Investment management program review

These guidelines apply to all cash-related assets included within the scope of the City's audited financial statements and held either directly by the City or held and invested by trustees or fiscal agents. The only exception is funds invested in the City's deferred compensation plan, which are controlled by federal law, specific provisions of the City's adopted plan, and individual employee decisions.

A. Investment Authority and Responsibilities

The Cash Management Investment Program shall comply with State of California Government Code Sections 16481.2, 53601, and 53646 regulating investment practices. It is the policy of the City of Richmond to use the State's provisions for local government investments in developing and implementing the City's investment policies and practices.

As required under Government Code Sections 16481.2 and 53646, the Statement of Investment Policy will be reviewed by the City Council annually. The Cash Management Investment Program will only be formally reviewed by the Council when significant changes in strategies, practices or procedures are proposed. In the interim, the Director of Finance is responsible for keeping the Cash Management Investment Program up-to-date to reflect changes in legislation, organizational structure, Council approved policies and administrative procedures.

B. Capital Preservation and Risk

Some level of risk is inherent in any investment transaction. Losses may be incurred due to issuer default, market price changes, or technical cash flow complications such as investments in non-marketable certificate of deposit. Diversification of the City's

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portfolio by institution, investment vehicle, and maturity term is the primary tool available to the City in minimizing investment risk and capital losses by safeguarding the overall portfolio from any individual loss.

The following sections summarize the City's major portfolio diversification practices and guidelines in determining:

Eligible financial institutions

Investment Vehicles

Investment Maturity

Portfolio limitations included in these guidelines are to be based on the portfolio composition and investment management policy in effect at the time of placement; Investment the actual composition of the City's investments may vary over time from plan limitations due to overall portfolio changes from when the individual placement was made as well as changes in the City's Cash Management Investment Program.

C. Eligible Financial Institutions

1. Portfolio Diversification and Credit-Worthiness Standards

The following general criteria relating to portfolio diversification and credit-worthiness will be used in selecting depositories and broker/dealers (financial institutions) in the placement of City investments:

- a. The financial capacity and credit-worthiness of the financial institution shall be considered prior to the placement of City investments.
- b. Current financial statements shall be maintained for each institution

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in which or through which cash is invested.

- c. No more than 25% of the City's portfolio (exclusive of government agency issues) shall be placed with any financial institution.
- d. No more than 25% of the City's portfolio shall be invested in collateralized certificates of deposit issued by savings and loan institutions.
- e. Certificates of deposit (negotiable and collateralized) placed by the City shall no constitute more than 15% of the total assets of the institution; and negotiable certificates of deposit will only be placed with institutions with total assets in excess of \$200 million and that maintain a ratio of equity to total assets of at least 5%.

2. Certification and Reporting Requirements

The City shall establish a list of qualified securities dealers, AP 515-4, based on a certification submitted by all financial institutions with which the City has an investment relationship. The form for Dealer Questionnaire and Certification is contained in Exhibit AP 515-5. The certification shall state that the institution has reviewed the City's Cash Management Investment Program and that it will:

- a. Exercise due diligence in monitoring the activities of its officers and employees engaged in transaction with the City.
- b. Ensure that all of its officers and employees offering investments to the City are trained in the precautions appropriate to public sector investments.
- c. Submit audited financial statements prepared by an independent

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certified public accountant to the City on an annual basis within 180 days after the end of the institutions fiscal year.

3. Individual Placement of Investments

Individual placement of investments with eligible financial institutions shall be based on the following practices and procedures:

- a. Investments shall be placed with institutions selected by the Director of Finance after considering the established list of qualified Primary Dealers in U.S. Government Securities. A copy of this list is included in Exhibit AP 515-4. The performance of the selected institutions shall be continually monitored and a new institution selected if determined to be in the best interest of the City. The formal selection process regarding eligible institutions shall be conducted every two years.
- b. Investments shall only be placed with financial institutions maintaining offices within the State of California.
- c. Except for repurchase agreements and placements with the State's local agency investment pool (LAIF), investments shall be awarded based on competitive bids. Documentation relating to investment quotas shall be maintained by the Finance Department for six months.
- d. Within the context of the City's policies regarding competitive and portfolio limitations, investments shall be distributed as evenly as possible between financial institutions.
- e. Negotiable investments shall not be purchased or sold from the institution which provides custodial safekeeping for City investments.

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4. Individual Placement of Deposits

Individual placement of negotiable, collateralized, and other time certificates of deposit with eligible financial institutions shall be based on the following practices and procedures:

- a. Deposits shall only be placed with financial institutions maintaining offices within the City of Richmond.
- b. Unless collateralized by eligible securities as provided in Sections 53651 and 53652 of the Government Code, the maximum amount of Certificates of Deposit to be placed with any single institution is \$100,000.
- c. Reasonable efforts will be made to place deposits of less than \$100,000 with each eligible institution. Any deposits in excess of this amount shall be awarded on competitive bids. Documentation relating to rate quotes shall be maintained by the Finance Department for six months.
- d. Within the context of the City's policies regarding competitive bidding and portfolio limitations, deposits shall be distributed as evenly as possible between financial institutions.

5. Controls

The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgements by management. Accordingly, the Director of Finance shall establish a process for annual independent review by an external auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

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- a. **Separation of transaction authority from accounting and record keeping.** By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.
- b. **Custodial safekeeping.** Securities purchased from any bank or dealer including appropriate collateral (as defined by State Law) shall be placed with an independent third party for custodial safekeeping.
- c. **Avoidance of physical delivery securities.** Book entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.
- d. **Delivery vs payment.** All trades applicable will be executed by delivery vs payment (DVP). This ensures that securities are deposited in the eligible financial institution prior to the release of funds. Securities will be held by a third party custodian as evidenced by safekeeping receipts.
- e. **Clear delegation of authority to subordinate staff members.** Subordinate staff members must have a clear understanding of their authority and responsibility to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.
- f. **Written confirmation of telephone transactions for investments and wire transfers.** Due to the potential for error and improprieties arising from telephone transactions, all telephone transactions should be supported by written communications and approved by the

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appropriate person. Written communications may be via fax if on letterhead and the safekeeping institution has a list of authorized signatures.

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

6. Evaluation of Investment Officer Actions

- a. The standard of prudence to be used by investment officials shall be the “prudent person” standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and this Cash Management Investment Program, and exercising due diligence shall be relieved of personal responsibility for an individual security’s credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of the Program.
- b. Investments shall be made with judgement and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.
- c. Officers and employees involved in the investment process shall refrain from person business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in

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financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of their entity.

D. Allowable Investment Vehicles

1. State of California Limitations

As provided in Sections 53601, 53635, and 16429.1 of the Government Code, the State of California limits the investment vehicles available to local agencies as summarized by the following:

a. Government Agency Issues

As authorized in Government Code Sections 53601(a) through (e), this category includes a wide variety of government securities. There are no portfolio limitations on the amount; however, the maturity term for these investment vehicles may not exceed five years unless approved by the Council. As discussed below, special authority is granted to the Director of Finance to invest proceeds from debt issues (reserve funds) for a period not to exceed the term of the debt. These securities include the following:

- Local government bonds or other indebtedness
- State bonds or other indebtedness
- U.S. Treasury notes or other indebtedness secured by the full faith and credit of the federal government

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- Other federal agency securities such as issues by the Government National Mortgage Association (GNMA's), Federal National Mortgage Association (FNMA's), and Small Business Administration.

b. Banker's Acceptances

As provided in Government Code Section 53601(f), 40% of the City's portfolio may be invested in Banker's Acceptances that are eligible for purchase by the Federal Reserve System, although no more than 30% of the portfolio may be invested in Banker's Acceptances with any one commercial bank. Additionally, the maturity period cannot exceed 270 days; however, Banker's Acceptances are seldom marketed with maturities in excess of 180 days.

c. Commercial Paper

As authorized in Government Code Section 53601(g), 15% of the City's portfolio may be invested in "prime" commercial paper as rated by Moody's or Standard and Poor', with maturities not to exceed 180 days. This percentage may be increased to 30% if the dollar weighted average maturity does not exceed 31 days. There are a number of other qualifications regarding investments in commercial paper based on the financial strength of the corporation and the size of the investment.

d. Negotiable Certificates of Deposit

As authorized in Government Code Section 53601(h), the City may invest 30% of its portfolio in negotiable certificates of deposit issued

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by commercial banks. The maturity period for this investment vehicle may not exceed five years unless approved by the Council.

e. **Repurchase and Reverse Repurchase Agreements**

As authorized in Government Code Section 53601(I), repurchase agreements are agreements between the local agency and seller for the purchase of government securities to be resold at a specific date and for a specific amount. Repurchase agreements are generally used for short term investments varying from one day to two weeks. The legal limitation on the maturity period for a repurchase agreement is for one year with the required market value underlying the agreement at 102% of the funds borrowed with the value adjusted quarterly. Reverse repurchase agreements are agreements between the local agency and buyer for the sale of government securities to be repurchased at a specific date and for a specific amount. As provided in Government Code Section 53635(I), reverse repurchase agreements require the prior approval of the Council. Repurchase agreements and reverse repurchase agreements can only be made with primary dealers of the Federal Reserve Bank of New York. There are no portfolio limitations on the amount for these investment vehicles.

f. **Corporate Notes and Diversified Management Companies (Mutual Funds)**

As authorized in Government Code Sections 53601(k) and (l), local agencies may invest in corporate notes issued by corporations organized and operating in the United States with a maximum maturity period of five years in an amount not to exceed 15% of the agency's portfolio. Local agencies are also authorized to invest in shares of beneficial interest issued by diversified management companies (DMC's) as defined in Section 23701(m) of the Revenue

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and Taxation Code in an amount not to exceed 15% of the agencies portfolio. There are a number of other qualification and restrictions regarding allowable investments in corporate notes and share of beneficial interest issued by DMC's.

g. **Financial Futures and Financial Option Contracts**

As authorized in Government Code Section 53601.1, local agencies may invest in financial futures or option contracts in any of the above investment categories subject to the same overall portfolio limitations.

h. **Time Certificates of Deposit**

As authorized in Government Code Section 53635, Certificates of Deposit are fixed term investments which are required to be collateralized 110% by eligible pooled securities. The pool is administered by the State, and is composed of a wide variety of government securities, including those indicated (except municipal bonds), as well as promissory notes secured by first mortgages on improved residential property located in the State. There are no portfolio limits on the amount, however, the maturity period for this investment vehicle may not exceed five years unless approved by the Council.

i. **Local Agency Investment Fund**

As authorized in Government Code Section 16429.1, local agencies may invest in the Local Agency Investment Fund (LAIF), a money market fund which allows local agencies to pool their investment resources. Current policies of LAIF set minimum and maximum amounts of monies that may be invested as well as maximum

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numbers of transactions that are allowed per month.

2. City Policies

a. Policy

The Director of Finance is authorized to invest in any of the investment vehicles allowed by Sections 53601, 53635 and 16429.1 of the Government Code with the exception of financial futures or option contracts. Exclusion of these vehicles is consistent with the City's overall objective of achieving reasonable yields on public funds while minimizing risk and capital losses. Although the potential exists for greater interest yields with these vehicles, it is believed that the potential level of risk exceeds their benefits except in very limited circumstances. Accordingly, Council approval is required on a case-by-case basis for any investments in financial futures or option contracts.

b. Term

Reserve funds from the proceeds of debt issues may be invested by the Director of Finance in government agency securities with terms exceeding five (5) years if the maturity of such investments are made to coincide as nearly as practicable with the life of the debt issue. In all other cases, Council approval to make investments with terms in excess of 5 years is required on a case-by-case basis.

c. Deferred Compensation

These policies do not apply to deferred compensation plans. Individual investment policies are adopted by each deferred compensation plan and approved independently by Council. Further,

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individual investments are directed solely by the employee.

E. Investment Maturity

In addition to the risks associated with the credit-worthiness of the financial institution and the security of the investment vehicle, the maturity period of investments is also a significant consideration in the management of the City's portfolio. In order to minimize the impact of market risk, it is intended that all investments will be held until maturity. Under this practice, long-term investments (over one year) will be limited to 30% of the total portfolio. In implementing this policy, the following guidelines will be used:

1. Projected cash flow requirements are the primary factor to be used in determining investment maturity terms. After cash flow needs have been met, yield considerations will be the next factor used in determining maturity terms, with the expectation that longer maturity periods will generally yield greater returns on investments.
2. Investments may be sold prior to maturity for cash flow or appreciation purposes; however, no investment shall be made based solely on yields resulting from anticipated capital gains.
3. Investments longer than one year may be made if consistent with the City's cash flow needs and related intent of holding until maturity.

In accordance with the guidelines above, the following targets will be used in guiding the maturity mix of the overall portfolio exclusive of longer-term investments of debt service reserves:

Within 1 month	10%
Within 1 month to 1 year	60%
Within 1 to 5 years	20%

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Greater than 5 years	<u>10%</u>
TOTAL	100%

F. Cash Management

To achieve a reasonable return on public funds, the following cash management practices will be followed:

1. Maintain maximum investment of all City funds not required to meet immediate cash flow needs while maintaining adequate compensating balances as required under the City's banking services agreement.
2. Pool resources available for investment from all City-administered funds, with interest earnings allocated to each of the funds in accordance with generally accepted accounting principles.
3. Maximize the City's cash flow through the immediate deposit of all cash receipts, use of direct deposits and wire transfers when available, and appropriate timing of payments to vendors.
4. Maximize the cash flow information available through the use of only one operating bank account.

G. Evaluation of Investment Performance

As indicated earlier, it is the City's primary investment objective to achieve a reasonable rate of return on public funds while minimizing risks and preserving capital. In evaluating the performance of the City's portfolio in achieving this objective, it is expected that yields on City investments will regularly meet or exceed the average return on three month U.S. Treasury Bills.

H. Investment Reporting

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1. Consistent with Sections 16481.2 and 53646 of the Government Code, the Finance Department shall submit an annual Statement of Investment Policy to the Council for consideration at the first public meeting in May. A copy of the current Statement of Cash Management Investment Policy is contained in Exhibit AP515-6. This statement will generally be reviewed by the Council in conjunction with the Financial Plan review and approval process. In accordance with this statement of investment policy, the Director of Finance is responsible for developing and maintaining this investment program.
2. In addition to the submittal of an annual Statement of Cash Management Investment Policy and the preparation of an Investment Management Program, the Finance Department shall provide the Council, City Manager, and Department Directors with a monthly investment report providing the following information for each investment or security:
 - a. Issuer or broker/dealer (financial institution)
 - b. Type of investment
 - c. Certificate or other reference number if applicable
 - d. Percentage yield on an annualized basis
 - e. Purchase Date
 - f. Maturity date for each investment and the weighted average maturity of all the investments within the portfolio
 - g. Current book value
 - h. Current market value

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- i. Total cost and market value, including source of this valuation, of the City's portfolio
 - j. A description of the compliance with the Statement of Investment Policy
 - k. Information demonstrating that the City's expenditure requirements can be met in the following six months
 - l. Other information regarding the City's portfolio as appropriate.
3. The monthly Investment Report shall include all investments as of the end of the month from all funds held in the City's portfolio, including funds held and invested by trustees exclusive of deferred compensation plan funds; and shall be issued within 30 days after the end of the monthly reporting period. The most recent Monthly Investment Report is included in Exhibit AP 515-7.

I. Investment Management Program Review

1. The Finance Department shall review the City's Statement of Investment Policy and Cash Management Investment Program on an ongoing basis to ensure its continued value in administering the City's portfolio. Additionally, the City shall form an Investment Oversight Committee whose membership shall consist of the City Manager, Assistant City Manager, Finance Director, Financial Services Division Director, and the City's Independent Certified Public Accountant. The Investment Oversight Committee is responsible for:
 - a. Reviewing the City's portfolio at least quarterly to determine compliance with the Cash Management Investment Program; and
 - b. Reviewing and making recommendations as appropriate regarding the

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City's Annual Cash Management Investment Policy at least annually.

2. It is important to note the distinction between the committee's oversight responsibility in ensuring compliance with the policies and overall framework established in this Program, and the responsibility of the Finance Director in managing the City's investment portfolio in accordance with this Program.

This distinction between management and oversight is especially important to make as it applies to the role of the City's independent auditors on this committee. The committee's oversight function is consistent with the scope of the auditor's engagement duties, which includes reviewing for compliance with City financial policies and procedures, and for making recommendations for improvements in the City's fiscal operations. However, in this oversight context, they retain their independence from responsibility for managing any aspects of the City's operations; this responsibility lies solely with the City's elected leadership and staff.