



TOWN OF APPLE VALLEY

TOWN COUNCIL STAFF REPORT

To: Honorable Mayor and Town Council **Date:** June 9, 2015
From: Marc Puckett, Assistant Town Manager **Item No:** 11
Subject: REVIEW OF THE FISCAL YEAR 2015-2016 STATEMENT OF INVESTMENT POLICY

T.M. Approval: _____ **Budgeted Item:** Yes No N/A

RECOMMENDED ACTION

Adopt Resolution No. 2015-16 approving the Statement of Investment Policy for Fiscal Year 2015-2016 and delegating the investment activities to the Town Treasurer.

BACKGROUND

The California Government Code Section 53646 requires the Town Treasurer to submit a "Statement of Investment Policy" to the legislative body each fiscal year. Effective January 1, 1996, this Code Section was reinstated and requires annual adoption of the policy statement. This Investment Policy has been designed and developed according to the specific needs of the Town of Apple Valley and complies with the California Government Code, guidelines recommended by the California Municipal Treasurer's Association (CMTA) and guidelines recommended by the Association of Public Treasurers of the United States and Canada (APTUS&C).

Pursuant to the Government Code, the Town Treasurer has the responsibility to submit a quarterly Treasurer's Report to the Town Council regarding the status of receipts, disbursements, cash balances by fund and investment of cash balances within thirty (30) days following the end of the quarter covered by the report. However, the Town's Investment Policy requires that a monthly report be submitted to Town Council within thirty (30) days of the end of the month.

The Finance Department updates cash flow spreadsheets, reviews revenue projections and performs investment functions on a daily basis. The Finance Department analyzes the cash flow requirements of the Town each morning. Idle funds are invested daily to effectively maximize the Town's investment earnings within the parameters outlined in the Town's adopted Investment Policy.

The single most important statutory duty of the Town Treasurer is set forth in California Government Code Section 41001 which provides that the “Treasurer shall receive and safely keep all money coming into the Treasury.” In light of these statutory responsibilities, the California Municipal Treasurer’s Association has established the following guidelines to prudent investment strategy for local treasurers to follow:

Legal Investment Authority: Temporary idle monies are to be invested in accordance with state and local statutes and in compliance with California Government Code Sections 53600 et. seq.

- Safety: It is the primary duty and responsibility of the Treasurer to protect, preserve, and maintain intact cash and investments placed in trust with the Treasurer on behalf of the citizens of the Town of Apple Valley.
- Liquidity: An adequate percentage of the portfolio should be maintained in liquid short-term securities, which can be converted to cash if necessary to meet disbursement requirements.
- Yield: The Treasurer shall obtain the highest possible yield within the parameters of the Town’s authorized investments, provided the criteria for safety and liquidity have been met.

ANALYSIS

The 2014-2015 Investment Policy adopted on June 10, 2014, has been revised to reflect the changes as referenced below:

- Miscellaneous or other “housekeeping” changes such as “date” changes were made to the various sections of the Town’s Investment Policy as noted in the attached red-line copy of the policy statement.

Whenever revisions to the Investment Policy are considered, the proposed revisions are reviewed and discussed by Finance Department staff to ensure compliance with stated investment objectives, the Town’s adopted Investment Policy and State law.

CONCLUSION

The attached proposed Investment Policy has been revised to include the proposed changes referenced above. It is recommended that Town Council adopt the attached Resolution No. 2015-16 approving the attached Investment Policy for Fiscal Year 2015-2016.

Attachments:

- (1) 2014-15 Red Lined Statement of Investment Policy
- (2) 2015-16 Proposed Statement of Investment Policy
 - Investment Guidelines and Strategy
 - Investment Procedures: Internal Controls - Guidelines
 - Cash Controls: Independent Auditors' Procedure
 - Segregation of Treasury Responsibilities
- (3) Glossary
- (4) Resolution No. 2015-16

**TOWN OF APPLE VALLEY
STATEMENT OF INVESTMENT POLICY
20145-156**

I. GENERAL INTRODUCTION

Under the laws of the State of California, it is the responsibility of the Town Treasurer, at the direction of the Town Council, to secure and protect the public funds of the Town, and to establish proper safeguards, controls, and procedures to maintain these funds in a lawful, rational and auspicious manner. Said maintenance shall include the prudent and secure investment of those funds that are deemed temporarily excess, in a manner anticipated to provide additional benefit to the people of the Town of Apple Valley.

This Statement of Investment Policy will be provided annually for the review and approval of the Town Council in an open public meeting. It will be provided to securities dealers, banks, and brokers currently approved for conducting investment transactions with the Town Treasurer's office in the ongoing effort to manage the excess cash portfolio; to other affected persons or entities; and to any member of the electorate wishing to review this document upon request. The Treasurer reserves the right to provide these documents on a cost basis.

II. SCOPE

This Statement of Investment Policy pertains to those temporarily surplus funds under the control of the Treasurer, designated for the daily ongoing operations of the Town; and concerns the deposit, maintenance, safekeeping, and preservation of all such funds, and the investments made with these funds. This Policy does not apply to pension trust funds, deferred compensation funds, and certain other trust or non-operating funds.

III. PURPOSE

The purpose of this Statement of Investment Policy is to provide the Town Council, and those involved in servicing the investment requirements of the Town, and any other interested party, a clear understanding of the regulations and internal guidelines that will be observed in maintaining and investing those pooled funds deemed temporarily excess. This statement is intended to provide guidelines for the prudent investment of the Town's temporary idle cash, and outline the procedures for maximizing the efficiency of the Town's cash management system. The ultimate goal is to enhance the economic status of the Town while safeguarding its assets.

IV. OBJECTIVE

The Town's cash management system is designed to accurately monitor and forecast revenues and expenditures, thus enabling the Town to invest funds to the fullest extent possible. The Town attempts to obtain the highest yield possible only after the criteria established for safety and liquidity have been met.

The Town of Apple Valley operates its pooled idle cash investments with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived. This affords the Town a broad spectrum of investment opportunities as long as the investment is deemed prudent and is allowable under current legislation of the State of California Government Code Section 53600 et seq. and the general laws of the Town of Apple Valley.

The Town of Apple Valley strives to maintain the level of investment of all idle funds as near 100% as possible, through daily and projected cash flow determinations. Idle cash management and investment transactions are the responsibility of the Town Treasurer or his/her designee.

Criteria for selecting investments and the order of priority are:

1. Safety: The safety and risk associated with an investment refers to the potential loss of principal, interest, or a combination of these amounts. The Town only operates in those investments that are considered very safe.
2. Liquidity: This refers to the ability to "cash in" at any moment in time with a minimal chance of losing some portion of principal or interest.
3. Yield: Yield is the potential dollar earnings an investment can provide, and sometimes is referred to as the rate of return.
4. Safekeeping: Securities purchased shall be held in third party safekeeping in the Trust Department of a financial institution, in the Town's name and control. The account established shall be protected from seizure by creditors should the financial institution holding the Town's securities file for bankruptcy protection. The basic premise underlying the Town's investment philosophy is and continues to be, to insure that surplus funds are always safe and available when needed.

V. DELEGATION OF INVESTMENT AUTHORITY

Authority to manage the Town of Apple Valley's investment program is derived from Town of Apple Valley Council Resolution No. 20145-16. Management responsibility for the investment program is hereby delegated for Fiscal Year 20145-156 to the Town Treasurer or his/her designee, who shall establish written procedures for the operation of the investment program consistent with this Investment Policy. Procedures should include references to: safekeeping, repurchase agreements, wire transfer agreements, banking service contracts, and collateral/ depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Town Treasurer or his/her designee. The Town Treasurer or his/her designee shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

VI. STANDARD OF PRUDENCE

The Treasurer shall perform the investment function in conjunction with the “Prudent Man Rule.” This rule states, in principle that whenever investing property for the benefit of others, a trustee shall exercise the judgment and care, under circumstances then prevailing that persons of prudence, discretion, and intelligence, would exercise in the management of their own affairs not in regards to speculation, but in regard to the permanent disposition of their funds, considering the probability of safety of, as well as the probable income from their capital. The Treasurer and his designees are considered to have a fiduciary, trustee, relationship with the public for the public funds and all investment decisions will be made in a manner sustaining this responsibility.

VII. AUTHORIZED INVESTMENTS

The California Government Code allows the Town to invest in the following media:

Securities of the U.S. Government, or its government sponsored agencies

Small Business Administration loans

Certificates of deposit, placed with commercial banks and savings and loan companies

Negotiable certificates of deposit

Bankers' acceptances

Commercial paper

Corporate notes and bonds, including medium term notes

State of California Local Agency Investment Fund

Repurchase agreements

Reverse repurchase agreements

Passbook savings account demand deposits

County Treasurer demand deposits

Asset-backed and mortgage-backed securities

Money market mutual funds

As a matter of practice, however, the Town of Apple Valley generally limits its investments to the following vehicles:

U.S. Treasury Bills - Issued weekly with maturity dates up to one year. They are issued and traded on a discount basis with interest figured on a 360-day basis, actual number of days. They are issued in amounts of \$10,000 and up, in multiples of \$5,000. They are a highly liquid security.

U.S. Treasury Notes - Initially issued with two- to ten-year maturities. They are actively traded in a large secondary market and are very liquid. The Treasury may issue Note issues with a minimum of \$1,000; however, the average minimum is \$5,000.

Agency/Government Sponsored Enterprise Issues - Guaranteed directly or indirectly by the United States Government. All agency/GSE obligations qualify as legal investments and are acceptable as security for public deposits.

These securities usually provide higher yields than U.S. Treasury securities with generally all of the same advantages in terms of safety and liquidity. Examples include:

FICBs (Federal Intermediate Credit Bank Debentures) - Loans to lending institutions used to finance the short-term and intermediate needs of farmers, such as seasonal production. These securities are usually issued monthly in minimum denominations of \$3,000 with a nine-month maturity. Interest is payable at maturity and is calculated on a 360-day, 30-day month basis.

FFCBs (Federal Farm Credit Bank) - Debt instruments used to finance the short and intermediate term needs of farmers and the national agricultural industry. They are issued monthly with three- and six-month maturities. The FFCB issues larger issues (one to ten year) on a periodic basis. These issues are highly liquid.

FLBs (Federal Land Bank Bonds) - Long-term mortgage credit provided to farmers by Federal Land Banks. These bonds are issued at irregular times for various maturities ranging from a few months to ten years. The minimum denomination is \$1,000. They carry semi-annual coupons. Interest is calculated on a 360-day, 30-day month basis.

FHLBs (Federal Home Loan Bank Notes and Bonds) - Issued by the Federal Home Loan Bank System to help finance the housing industry. The notes and bonds provide liquidity and home mortgage credit to savings and loan associations, mutual savings banks, cooperative banks, insurance companies, and mortgage-lending institutions. They are issued irregularly for various maturities. The minimum denomination is \$5,000. The notes are issued with maturities of less than one year and interest is paid at maturity. The bonds are issued with various maturities and carry semi-annual coupons. Interest is calculated on a 360-day, 30-day month basis.

FNMA's (Federal National Mortgage Association) - Used to assist the home mortgage market by purchasing mortgages insured by the Federal Housing Administration and the Farmers Home Administration, as well as those guaranteed by the Veterans Administration. They are issued about four times a year for maturities ranging from a few months to eight years. They are issued in minimum denominations of \$10,000. They carry semi-annual coupons. Interest is computed on a 360-day, 30-day month basis.

FHLMCs (Federal Home Loan Mortgage Corporation) - A government-sponsored enterprise established to develop the secondary market for conventional home mortgages. Mortgages are purchased solely from the Federal Home Loan Bank System member lending institutions whose deposits are insured by agencies of the United States Government. They are issued for various maturities and in minimum denominations of \$10,000. Interest is paid semi-annually and is calculated on a 360-day, 30-day month basis.

Other federal agency issues are Small Business Administration notes (SBAs), Government National Mortgage Association notes (GNMAs), and Tennessee Valley Authority notes (TVAs).

As a matter of practice, the Town does not invest in these issues as they do not suit our purposes as well as other investment opportunities available.

The Town limits its investments to no more than 60% of its surplus funds in any one Federal Agency.

Bankers' Acceptances - Short-term credit arrangements to enable businesses to obtain funds to finance commercial transactions. They are time drafts drawn on a bank by an exporter or importer to obtain funds to pay for specific merchandise. By its acceptance, the bank becomes primarily liable for the payment of the draft at its maturity. An acceptance is a high-grade negotiable instrument. Bankers Acceptances can be purchased in various denominations for 30, 60, or 90 days, but no longer than -180 days. The interest is calculated on a 360-day discount basis similar to Treasury Bills. Local agencies may not invest more than 40% of their surplus funds in bankers' acceptances or more than 10% of the agency's surplus funds in bankers' acceptances of any one commercial bank.

Certificates of Deposit - Time deposits of a bank or savings and loan. They are purchased in various denominations with maturities ranging from 30 to 360 days. The interest is calculated on a 360-day, actual-day month basis and is payable monthly.

Negotiable Certificates of Deposit - Unsecured obligations of the financial institution, bank or savings and loan, bought at par value with the promise to pay face value plus accrued interest at maturity. They are high-grade negotiable instruments, paying a higher interest rate than regular certificates of deposit. The primary market issuance is in multiples of \$1,000,000; the secondary market usually trades in denominations of \$500,000, although smaller lots are occasionally available. As a matter of practice, only the ten largest U.S. banks where there is a secondary market established for continued liquidity are considered for investment. The Town's total investment in negotiable certificates of deposit may not exceed 30% of surplus funds.

Commercial Paper - Short-term unsecured promissory notes issued by a corporation to raise working capital. These negotiable instruments are purchased at a discount to par value or at par value with interest bearing.

The Town is permitted by State law to invest in commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by a nationally recognized statistical-rating organization (NRSRO).

Eligible paper is further limited to issuing corporations that are organized and operating within the United States and having total assets in excess of five hundred million dollars (\$500,000,000) and having an "A" or higher rating for the issuer's debt other than commercial paper as rated by an NRSRO. Commercial Paper issued by an Issuer that has a rating of "A" on their debt other than commercial paper but are on credit watch for a possible downgrade by an NRSRO shall not be considered for investment purposes.

Purchases of eligible commercial paper may not exceed 270 days maturity nor represent more than 10% of the outstanding paper of an issuing corporation. Purchases of commercial paper may not exceed 25 percent of the portfolio.

Medium Term Corporate Notes - Unsecured promissory notes issued by a corporation organized and operating in the United States. These are negotiable instruments and are traded

in the secondary market. Medium term corporate notes can be defined as extended maturity commercial paper.

Local agencies are restricted by the Government Code to investments in corporations rated in the top three note categories by Moody's Investors Service, Inc., and/or Standard and Poor's Corporation. For medium-term notes, eligible purchases consist of instruments that have a rating of "A" or better by both Moody's Investors Service, Inc., and Standard and Poor's Corporation. Corporate Notes issued by an issuer that has a rating of "A" but are on credit watch for a possible downgrade by a nationally recognized rating agency shall not be considered for investment purposes. If the security's credit rating falls below an "A" rating by one of these agencies, then awareness is heightened and the security monitored closely to determine if credit risk has been significantly increased. If a security falls below an "A" rating by both rating agencies, then the Town Treasurer or his/her designee will evaluate the need to sell the security prior to maturity. Further restrictions on the purchase of medium term corporate notes are a maximum term of five years to maturity and total investments in medium term corporate notes may not exceed 30% of the local agency's surplus funds or 5% in any one issuer name.

Repurchase Agreements - A repurchase agreement is a short-term investment transaction. Banks buy temporarily idle funds from a customer by selling U.S. Government or other securities with a contractual agreement to repurchase the same securities on a future date. Repurchase agreements are typically for one to ten days in maturity. The customer receives interest from the bank. The interest rate reflects both the prevailing demand for Federal funds and the maturity of the repurchase agreement. Some banks will execute repurchase agreements for a minimum of \$100,000 to \$500,000, but most banks have a minimum of \$1,000,000. The term of a repurchase agreement may not exceed one year. The market value of securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly. Repurchase Agreements can only be executed with financial institutions or broker/dealers that have signed a Master Repurchase Agreement with the Town.

Reverse Repurchase Agreements - A reverse repurchase agreement is the opposite of a repurchase agreement. The Town loans a security to a bank in exchange for cash. The Town agrees to pay off the loan with interest on a future date. As this type of investment actually involves a loan arrangement, the Town may not invest more than 10% of its surplus funds in reverse repurchase agreements, and must always match its maturities to the reinvestment. Reverse repurchase agreements may be utilized only when either of the following conditions are met:

1. The security was owned or specifically committed to purchase, by the local agency, prior to December 31, 1994, and was sold using a reverse repurchase agreement on December 31, 1994.
2. The security:
 - a. to be sold has been owned and fully paid for a minimum of 30 days prior to sale; and
 - b. total of all reverse repurchase agreements owned does not exceed 10 percent of the base value of the portfolio; and
 - c. agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement and the final maturity date of the same security.

LAIF (Local Agency Investment Fund) - A special fund in the State Treasury which local agencies may use to deposit funds for investment. There is no minimum investment period and the minimum transaction is \$5,000, in multiples of \$1,000 above that, with a maximum balance of \$40,000,000 for any agency. The Town is restricted to a maximum of fifteen transactions per month. It offers high liquidity because deposits can be converted to cash in 24 hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate share basis determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly. The State retains an amount for reasonable costs of making the investments, not to exceed one-quarter of one percent of the earnings. California Government Code §16429.3 states, in part:

"money placed with the State Treasurer for deposit in the Local Agency Investment Fund by cities, counties, or special districts shall not be subject to impoundment or seizure by any state official or state agency."

Money Market Mutual Funds - Shares of beneficial interest issued by diversified management companies. To be eligible for investment, shares must:

1. attain the highest rating provided by Moody's Investors Service, Inc., which is currently "Aaa," and/or Standard and Poor's Corporation, which is currently "AAA;" and,
2. the investment adviser managing the shares must be registered with the Securities and Exchange Commission with not less than five year's experience investing in instruments authorized under California Government Code §53601 subdivisions (a) to (m) inclusive, and with assets under management in excess of five hundred million dollars (\$500,000,000); and,
3. the purchase price of shares shall not include any commission that these companies may charge; and,
4. investment in shares shall not exceed 20 percent of surplus funds.

However, no more than 10 percent of the Town's surplus funds may be invested in shares of beneficial interest of any one mutual fund. Furthermore, any investment in a money market mutual fund must comply with other self-imposed restrictions as specified in this Investment Policy.

Asset-Backed and Mortgage-Backed Security - Bonds backed by payments from receivables/mortgages having a maximum of five years maturity. These securities must have an "AA" or better rating by Moody's Investors Services, Inc., and/or Standard and Poor's Corporation. No more than 20% of the Town's surplus money may be invested in these securities.

VIII. INVESTMENT OF BOND PROCEEDS

When investing proceeds from the issuance of bonds, the Town of Apple Valley will follow this Investment Policy when determining allowable investments. Should the trust agreement of a particular bond issue be more restrictive than the Town's policy on permitted investments, then the trust agreement will take precedence.

IX. TOWN CONSTRAINTS

The Town Treasurer or his/her designee will evaluate local banks and savings institutions and may invest idle cash funds with such institutions when the criteria for prudent investment previously stated are met. The Town operates its investment pool according to State and self-imposed constraints. It does not buy stocks; it does not speculate; it does not deal in futures or options. Any investment extending beyond a five-year period requires prior Town Council approval. Additionally, a minimum of 20% of the outstanding investments must mature within a one-year time period.

X. SAFEKEEPING AND COLLATERALIZATION

All security transactions, including collateral for repurchase agreements, entered into by the Town shall be conducted on a delivery-versus-payment (DVP) basis. Securities will be held by a third party custodian designated by the Town Treasurer or his/her designee.

Collateralization will be required on two types of investments: certificates of deposit and repurchase (and reverse repurchase) agreements. In order to anticipate market changes and provide a level of security for all funds, a minimum collateralization level is required.

Surplus funds must be deposited in State or national banks, State or Federal savings and loan associations, or State or Federal credit unions within the State of California. The deposits cannot exceed the amount of the bank's or savings and loan's paid-up capital and surplus.

The bank or savings and loan must secure public funds deposits with eligible securities having a market value of 110% of the total amount of the deposits. State law also allows as an eligible security, first trust deeds having a value of 150% of the total amount of the deposits. A third class of collateral is 105% in the form of a letter of credit drawn on the Federal Home Loan Bank.

The Town Treasurer or his/her designee may waive security for that portion of a deposit, which is insured pursuant to Federal law. Currently, the first \$100,000 of a deposit is federally insured. Deposits in excess of \$100,000 are collateralized as previously indicated.

XI. DERIVATIVE INVESTMENTS

A derivative is a generic term often used to categorize a wide variety of financial instruments whose value "depends on" or is "derived from" the value of an underlying asset, reference rate, or index.

Investments in derivative instruments are limited to debt securities that have periodic increases, or step-up interest rate adjustments that provide upward mobility in yield return. Investments in debt securities, which contain a callable feature are also allowable, but must comply with other restrictions as specified in this Investment Policy.

Investments purchased after June 19, 1995, in derivative instruments known as "inverse floaters," "dual index," or "stepped inverse" securities that produce higher than market yields at purchase date (when interest rates are low), but have the possibility of producing low or no coupon rates as market interest rates rise through the life of the instrument are not allowable. Furthermore, investments in range notes or interest-only strips that are derived from a pool of

mortgages are not allowable. However, debt securities that have a floor or a built-in feature that prevents the instrument from potentially returning no yield are allowable.

XII. POLICY COMPLIANCE REGULATIONS

Should the portfolio, for any reason, fall out of compliance with this Investment Policy, immediate liquidation of securities in order to bring the portfolio back into compliance is not required. However, the Treasurer must take action to bring the portfolio into compliance within 12 months from the date the portfolio was determined to be in non-compliance with the provisions of this Investment Policy. Additionally, adequate disclosure as to all instances of noncompliance, and the efforts undertaken to bring the portfolio into compliance, must be made on the monthly Treasurer's Report.

XIII. REPORTING

Under provisions of Section 53646 of the California Government Code, the Treasurer or his/her designee shall render a quarterly investment report to the Town Council, the Town Manager, and the Town Attorney within 30 days following the end of the quarter covered by the report. However, as a matter of practice, a monthly report shall be submitted listing the type of investments, institution, date of maturity, par value, amount of deposit, rate of interest, current market value for all securities, and such other data as may be required by the Town Council on a monthly basis.

XIV. QUALIFIED DEALERS

The Town of Apple Valley shall transact business only with banks, savings and loans, and registered investment securities dealers. The Town will limit the number of broker/dealers authorized to do business with the Town to no more than one (1) broker/dealer for every \$10,000,000 of portfolio size. Each authorized broker/dealer shall be required to annually file a signed certification with the Town Treasurer certifying that they have read and understand the Town's most recently adopted investment policy.

The Town Treasurer or his/her designee will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved broker/dealers who are authorized to provide investment services in the State of California. These may include "primary" and "regional" broker/dealers with offices located in the State of California. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must be approved by and supply the Town Treasurer or his/her designee with a completed broker/dealer questionnaire.

XV. POLICY REVIEW

This Statement of Investment Policy shall be reviewed at least annually to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law, financial and economic trends.

Should conditions change or legislation become effective that behooves subsequent changes or a liberalization of terms within the policy during the next fiscal year, the revised policy will be submitted to Council for adoption of the recommended action.

TOWN OF APPLE VALLEY INVESTMENT GUIDELINES AND STRATEGY

- I. GUIDELINES - Guidelines are established to direct and control activities in such a manner that previously established goals are achieved.
- II. Investment Transaction. Every investment transaction must be authorized and reviewed by the Treasurer or his/her designee.
- III. Pooled Cash. Whenever practical, local agency cash is consolidated into one bank account and invested on a pooled concept basis. Interest earnings are allocated quarterly according to month-end cash and investment balances for each fund.
- IV. Competitive Bids. Purchase and sales of securities are made on the basis of competitive offers and bids when practical.
- V. Cash Forecast. The cash flow for the Town is analyzed with the receipt of revenues and maturity of investments scheduled so that adequate cash will be available to meet disbursement requirements.
- VI. Investment Limitations. Security purchases and holdings are maintained within statutory limits imposed by the California Government Code. Current limits are:
 - Bankers Acceptances 40% Section 53601(f)
 - Commercial Paper 25% Section 53601(g)
 - Negotiable Certificates of Deposit 30% Section 53601(h)
 - Reverse Repurchase Agreements 20% Section 53601(i)
 - Medium Term Notes 30% Section 53601(j)
 - Money Market Mutual Funds 20% Section 53601(k)
 - Asset-Backed/Mortgage-Backed Securities 20% Section 53601(n)
 - Federal Agency restriction 60% per Agency Section VI of Policy
 - Local Agency Investment Fund \$40,000,000 per Section VI of Policy
 - Portfolio Maturing within one year 20% per Section IX of Policy
- VII. Liquidity. The marketability of a security is considered at the time of purchase, as the security may have to be sold at a later date to meet unanticipated cash demands.
- VIII. Diversification. The portfolio should consist of a mix of various types of securities, issuers, and maturities.
- IX. Evaluate Certificates of Deposit
 - (a) Certificates of Deposit shall be evaluated in terms of FDIC coverage. For deposits in excess of the insured maximum of \$100,000, approved collateral at full market value shall be required. (California Government Code Section 53652 and/or 53651(m) and 53651.2(a)(1).
 - (b) Negotiable Certificates of Deposit shall be evaluated in terms of the credit worthiness of the issuer, as these deposits are uninsured and uncollateralized promissory notes.

**TOWN OF APPLE VALLEY
INVESTMENT GUIDELINES AND STRATEGY
(Continued)**

- X. STRATEGY - Strategy refers to the ability to manage financial resources in the most advantageous manner.

- XI. Economic Forecasts. Economic Forecasts are obtained periodically from economists and financial experts through bankers and brokers to assist the Treasurer or his/her designee with the formulation of an investment strategy for the local agency.

- XII. Implementing Investment Strategy. Investment transactions are executed which conform with anticipated interest rate trends and the current investment strategy plan.

- XIII. Rapport. A close working relationship is maintained with large vendors of the city. The objective is to pinpoint when large disbursements will clear the city's bank account. It is essential for good cash control that such large expenditures be anticipated, estimated as to dollar amount, and communicated to the Treasurer or his/her designee for liquidity planning purposes.

- XIV. Preserve Portfolio Value. Field standards are developed in order to maintain earnings near the market and to preserve the value of the portfolio.

**TOWN OF APPLE VALLEY
INVESTMENT PROCEDURES
INTERNAL CONTROL - GUIDELINES**

OBJECTIVES OF INTERNAL CONTROL

Internal control is the plan of organization and all the related systems established by the management's objective of ensuring, as far as practicable:

1. The orderly and efficient conduct of its business, including adherence to management policies.
2. The safeguarding of assets.
3. The prevention or detection of errors and fraud.
4. The accuracy and completeness of the accounting records.
5. The timely preparation of reliable financial information.

LIMITATIONS OF INTERNAL CONTROL

No internal control system, however elaborate, can by itself guarantee the achievement of management's objectives. Internal control can provide only reasonable assurance that the objectives are met, because of its inherent limitations, including:

1. Management's usual requirement that a control be cost-effective.
2. The direction of most controls at recurring, rather than unusual, types of transactions.
3. Human error due to misunderstanding, carelessness, fatigue, or distraction.
4. Potential for collusion that circumvents controls dependent on the segregation of functions.
5. Potential for a person responsible for exercising control abusing that responsibility; a responsible staff member could be in a position to override controls which management has set up.

ELEMENTS OF INTERNAL CONTROL

Elements of a system of internal control are the means by which an organization can satisfy the objectives of internal control. These elements are:

1. **ORGANIZATION**

Specific responsibility for the performance of duties should be assigned and lines of authority and reporting clearly identified and understood.

2. **PERSONNEL**

Personnel should have capabilities commensurate with their responsibilities. Personnel selection and training policies together with the quality and quantity of supervision are thus important.

**TOWN OF APPLE VALLEY
INVESTMENT PROCEDURES
INTERNAL CONTROL - GUIDELINES
(Continued)**

3. SEGREGATION OF FUNCTIONS

Segregation of incompatible functions reduces the risk that a person is in a position both to perpetrate and conceal errors or fraud in the normal course of duty. If two parts of a transaction are handled by different people, collusion is necessary to

conceal errors or fraud. In particular, the functions that should be considered when evaluating segregation of functions are authorization, execution, recording, custody of assets, and performing reconciliations.

4. AUTHORIZATION

All transactions should be authorized by an appropriate responsible individual. The responsibilities and limits of authorization should be clearly delineated. The individual or group authorizing a specific transaction or granting general authority for transactions should be in a position commensurate with the nature and significance of the transactions. Delegation of authority to authorize transactions should be handled very carefully.

5. CONTROLS OVER AN ACCOUNTING SYSTEM

Controls over an accounting system include the procedures, both manual and computerized, carried out independently to ascertain that transactions are complete, valid, authorized, and properly recorded.

TOWN OF APPLE VALLEY CASH CONTROLS

PROCEDURES PERFORMED BY EXTERNAL AUDITORS WITH RESPECT TO CASH RECEIPTS

- A. Town procedures and controls are reviewed. Some of the system strengths are:
1. Receipts are controlled upon receipt by proper registration devices.
 2. Receipts are reconciled on a daily basis.
 3. Amounts are deposited intact.
 4. All bank accounts are authorized by resolution.
 5. Cash counts are done by two or more individuals.
 6. Bank reconciliations are reviewed.
 7. Prompt posting of cash receipt entries in books.
 8. Receipt forms are pre-numbered, accounted for, and physically secured.
 9. Proper approval required for write-off's of customer accounts.
 10. Checks are restrictively endorsed upon receipt or when run through cash register.
 11. Adequate physical security over cash.
 12. Individuals that handle cash do not post to customer account records or process billing statements.
 13. Adequate supervision of Finance Department operations.
- B. Significant revenues are confirmed directly with payer and compared with Town accounting records to make sure amounts are recorded properly.
- C. Cash balances are substantiated by confirming all account balances recorded in the accounting records. Bank reconciliations are reviewed for propriety and recalculated by the auditor. All significant reconciling items on bank reconciliations are verified as valid reconciling items by proving to subsequent bank statements.

**TOWN OF APPLE VALLEY
SEGREGATION OF RESPONSIBILITIES OF
THE TREASURY FUNCTIONS**

<u>Function</u>	<u>Responsibility</u>
1. Authorization of investment transactions: Formal investment policy should be: * Prepared by: * Submitted to: Investment transactions should be approved by:	Town Treasurer Town Council Town Treasurer
2. Execution of investment transactions	Treasurer/ Assistant Director of Finance
3. Investment transactions approved for compliance with Investment policy and/or State law.	Assistant Director of Finance
4. Timely recording of investment transactions: Recording of investment Transactions in the Treasurer's records. Recording of investment transactions in the accounting records	Senior Accountant/Accountant. Senior Accountant/Accountant
5. Verification of investment, i.e., match broker confirmation to Treasurer's records	Assistant Director of Finance
6. Safeguarding of assets and records: Reconciliation of Treasurer's records to the accounting records Reconciliation of Treasurer's records to bank statements and safekeeping records	Senior Accountant/Accountant Senior Accountant/Accountant

**TOWN OF APPLE VALLEY
SEGREGATION OF RESPONSIBILITIES OF
THE TREASURY FUNCTIONS
(Continued)**

<u>Function</u>	<u>Responsibility</u>
6. Safeguarding of Assets and Records (continued): Annual review of (a) financial institution's financial condition, (b) safety, liquidity, and potential yields of investment instruments.	Assistant Director of Finance with Treasurer's approval
7. No less than an annual review of investment portfolio as prepared by Treasurer including: <ul style="list-style-type: none">• Investment types• Purchase Price• Par values• Market values• Maturity dates• Investment yields• Conformance to stated investment policy• Safekeeping reports	External Independent Auditors

The segregation of responsibilities of the Treasury functions as noted herein are intended to enhance the Town's internal controls over cash handling procedures. It should be noted that from time to time, due to the limited size of the Finance department staff, segregation of responsibilities as outlined herein may not be followed in order to fulfill the business needs of the organization.

**TOWN OF APPLE VALLEY
STATEMENT OF INVESTMENT POLICY
2015-16**

I. GENERAL INTRODUCTION

Under the laws of the State of California, it is the responsibility of the Town Treasurer, at the direction of the Town Council, to secure and protect the public funds of the Town, and to establish proper safeguards, controls, and procedures to maintain these funds in a lawful, rational and auspicious manner. Said maintenance shall include the prudent and secure investment of those funds that are deemed temporarily excess, in a manner anticipated to provide additional benefit to the people of the Town of Apple Valley.

This Statement of Investment Policy will be provided annually for the review and approval of the Town Council in an open public meeting. It will be provided to securities dealers, banks, and brokers currently approved for conducting investment transactions with the Town Treasurer's office in the ongoing effort to manage the excess cash portfolio; to other affected persons or entities; and to any member of the electorate wishing to review this document upon request. The Treasurer reserves the right to provide these documents on a cost basis.

II. SCOPE

This Statement of Investment Policy pertains to those temporarily surplus funds under the control of the Treasurer, designated for the daily ongoing operations of the Town; and concerns the deposit, maintenance, safekeeping, and preservation of all such funds, and the investments made with these funds. This Policy does not apply to pension trust funds, deferred compensation funds, and certain other trust or non-operating funds.

III. PURPOSE

The purpose of this Statement of Investment Policy is to provide the Town Council, and those involved in servicing the investment requirements of the Town, and any other interested party, a clear understanding of the regulations and internal guidelines that will be observed in maintaining and investing those pooled funds deemed temporarily excess. This statement is intended to provide guidelines for the prudent investment of the Town's temporary idle cash, and outline the procedures for maximizing the efficiency of the Town's cash management system. The ultimate goal is to enhance the economic status of the Town while safeguarding its assets.

IV. OBJECTIVE

The Town's cash management system is designed to accurately monitor and forecast revenues and expenditures, thus enabling the Town to invest funds to the fullest extent possible. The Town attempts to obtain the highest yield possible only after the criteria established for safety and liquidity have been met.

The Town of Apple Valley operates its pooled idle cash investments with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived. This affords the Town a broad spectrum of investment opportunities as long as the investment is deemed prudent and is allowable under current legislation of the State of California Government Code Section 53600 et seq. and the general laws of the Town of Apple Valley.

The Town of Apple Valley strives to maintain the level of investment of all idle funds as near 100% as possible, through daily and projected cash flow determinations. Idle cash management and investment transactions are the responsibility of the Town Treasurer or his/her designee.

Criteria for selecting investments and the order of priority are:

5. Safety: The safety and risk associated with an investment refers to the potential loss of principal, interest, or a combination of these amounts. The Town only operates in those investments that are considered very safe.
6. Liquidity: This refers to the ability to "cash in" at any moment in time with a minimal chance of losing some portion of principal or interest.
7. Yield: Yield is the potential dollar earnings an investment can provide, and sometimes is referred to as the rate of return.
8. Safekeeping: Securities purchased shall be held in third party safekeeping in the Trust Department of a financial institution, in the Town's name and control. The account established shall be protected from seizure by creditors should the financial institution holding the Town's securities file for bankruptcy protection. The basic premise underlying the Town's investment philosophy is and continues to be, to insure that surplus funds are always safe and available when needed.

V. DELEGATION OF INVESTMENT AUTHORITY

Authority to manage the Town of Apple Valley's investment program is derived from Town of Apple Valley Council Resolution No. 2015-16 Management responsibility for the investment program is hereby delegated for Fiscal Year 2015-2016 to the Town Treasurer or his/her designee, who shall establish written procedures for the operation of the investment program consistent with this Investment Policy. Procedures should include references to: safekeeping, repurchase agreements, wire transfer agreements, banking service contracts, and collateral/depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Town Treasurer or his/her designee. The Town Treasurer or his/her designee shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

VI. STANDARD OF PRUDENCE

The Treasurer shall perform the investment function in conjunction with the “Prudent Man Rule.” This rule states, in principle that whenever investing property for the benefit of others, a trustee shall exercise the judgment and care, under circumstances then prevailing that persons of prudence, discretion, and intelligence, would exercise in the management of their own affairs not in regards to speculation, but in regard to the permanent disposition of their funds, considering the probability of safety of, as well as the probable income from their capital. The Treasurer and his designees are considered to have a fiduciary, trustee, relationship with the public for the public funds and all investment decisions will be made in a manner sustaining this responsibility.

VII. AUTHORIZED INVESTMENTS

The California Government Code allows the Town to invest in the following media:

Securities of the U.S. Government, or its government sponsored agencies

Small Business Administration loans

Certificates of deposit, placed with commercial banks and savings and loan companies

Negotiable certificates of deposit

Bankers' acceptances

Commercial paper

Corporate notes and bonds, including medium term notes

State of California Local Agency Investment Fund

Repurchase agreements

Reverse repurchase agreements

Passbook savings account demand deposits

County Treasurer demand deposits

Asset-backed and mortgage-backed securities

Money market mutual funds

As a matter of practice, however, the Town of Apple Valley generally limits its investments to the following vehicles:

U.S. Treasury Bills - Issued weekly with maturity dates up to one year. They are issued and traded on a discount basis with interest figured on a 360-day basis, actual number of days. They are issued in amounts of \$10,000 and up, in multiples of \$5,000. They are a highly liquid security.

U.S. Treasury Notes - Initially issued with two- to ten-year maturities. They are actively traded in a large secondary market and are very liquid. The Treasury may issue Note issues with a minimum of \$1,000; however, the average minimum is \$5,000.

Agency/Government Sponsored Enterprise Issues - Guaranteed directly or indirectly by the United States Government. All agency/GSE obligations qualify as legal investments and are acceptable as security for public deposits.

These securities usually provide higher yields than U.S. Treasury securities with generally all of the same advantages in terms of safety and liquidity. Examples include:

FICBs (Federal Intermediate Credit Bank Debentures) - Loans to lending institutions used to finance the short-term and intermediate needs of farmers, such as seasonal production. These securities are usually issued monthly in minimum denominations of \$3,000 with a nine-month maturity. Interest is payable at maturity and is calculated on a 360-day, 30-day month basis.

FFCBs (Federal Farm Credit Bank) - Debt instruments used to finance the short and intermediate term needs of farmers and the national agricultural industry. They are issued monthly with three- and six-month maturities. The FFCB issues larger issues (one to ten year) on a periodic basis. These issues are highly liquid.

FLBs (Federal Land Bank Bonds) - Long-term mortgage credit provided to farmers by Federal Land Banks. These bonds are issued at irregular times for various maturities ranging from a few months to ten years. The minimum denomination is \$1,000. They carry semi-annual coupons. Interest is calculated on a 360-day, 30-day month basis.

FHLBs (Federal Home Loan Bank Notes and Bonds) - Issued by the Federal Home Loan Bank System to help finance the housing industry. The notes and bonds provide liquidity and home mortgage credit to savings and loan associations, mutual savings banks, cooperative banks, insurance companies, and mortgage-lending institutions. They are issued irregularly for various maturities. The minimum denomination is \$5,000. The notes are issued with maturities of less than one year and interest is paid at maturity. The bonds are issued with various maturities and carry semi-annual coupons. Interest is calculated on a 360-day, 30-day month basis.

FNMA's (Federal National Mortgage Association) - Used to assist the home mortgage market by purchasing mortgages insured by the Federal Housing Administration and the Farmers Home Administration, as well as those guaranteed by the Veterans Administration. They are issued about four times a year for maturities ranging from a few months to eight years. They are issued in minimum denominations of \$10,000. They carry semi-annual coupons. Interest is computed on a 360-day, 30-day month basis.

FHLMCs (Federal Home Loan Mortgage Corporation) - A government-sponsored enterprise established to develop the secondary market for conventional home mortgages. Mortgages are purchased solely from the Federal Home Loan Bank System member lending institutions whose deposits are insured by agencies of the United States Government. They are issued for various maturities and in minimum denominations of \$10,000. Interest is paid semi-annually and is calculated on a 360-day, 30-day month basis.

Other federal agency issues are Small Business Administration notes (SBAs), Government National Mortgage Association notes (GNMAs), and Tennessee Valley Authority notes (TVAs).

As a matter of practice, the Town does not invest in these issues as they do not suit our purposes as well as other investment opportunities available.

The Town limits its investments to no more than 60% of its surplus funds in any one Federal Agency.

Bankers' Acceptances - Short-term credit arrangements to enable businesses to obtain funds to finance commercial transactions. They are time drafts drawn on a bank by an exporter or importer to obtain funds to pay for specific merchandise. By its acceptance, the bank becomes primarily liable for the payment of the draft at its maturity. An acceptance is a high-grade negotiable instrument. Bankers Acceptances can be purchased in various denominations for 30, 60, or 90 days, but no longer than -180 days. The interest is calculated on a 360-day discount basis similar to Treasury Bills. Local agencies may not invest more than 40% of their surplus funds in bankers' acceptances or more than 10% of the agency's surplus funds in bankers' acceptances of any one commercial bank.

Certificates of Deposit - Time deposits of a bank or savings and loan. They are purchased in various denominations with maturities ranging from 30 to 360 days. The interest is calculated on a 360-day, actual-day month basis and is payable monthly.

Negotiable Certificates of Deposit - Unsecured obligations of the financial institution, bank or savings and loan, bought at par value with the promise to pay face value plus accrued interest at maturity. They are high-grade negotiable instruments, paying a higher interest rate than regular certificates of deposit. The primary market issuance is in multiples of \$1,000,000; the secondary market usually trades in denominations of \$500,000, although smaller lots are occasionally available. As a matter of practice, only the ten largest U.S. banks where there is a secondary market established for continued liquidity are considered for investment. The Town's total investment in negotiable certificates of deposit may not exceed 30% of surplus funds.

Commercial Paper - Short-term unsecured promissory notes issued by a corporation to raise working capital. These negotiable instruments are purchased at a discount to par value or at par value with interest bearing.

The Town is permitted by State law to invest in commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating as provided for by a nationally recognized statistical-rating organization (NRSRO).

Eligible paper is further limited to issuing corporations that are organized and operating within the United States and having total assets in excess of five hundred million dollars (\$500,000,000) and having an "A" or higher rating for the issuer's debt other than commercial paper as rated by an NRSRO. Commercial Paper issued by an Issuer that has a rating of "A" on their debt other than commercial paper but are on credit watch for a possible downgrade by an NRSRO shall not be considered for investment purposes.

Purchases of eligible commercial paper may not exceed 270 days maturity nor represent more than 10% of the outstanding paper of an issuing corporation. Purchases of commercial paper may not exceed 25 percent of the portfolio.

Medium Term Corporate Notes - Unsecured promissory notes issued by a corporation organized and operating in the United States. These are negotiable instruments and are traded

in the secondary market. Medium term corporate notes can be defined as extended maturity commercial paper.

Local agencies are restricted by the Government Code to investments in corporations rated in the top three note categories by Moody's Investors Service, Inc., and/or Standard and Poor's Corporation. For medium-term notes, eligible purchases consist of instruments that have a rating of "A" or better by both Moody's Investors Service, Inc., and Standard and Poor's Corporation. Corporate Notes issued by an issuer that has a rating of "A" but are on credit watch for a possible downgrade by a nationally recognized rating agency shall not be considered for investment purposes. If the security's credit rating falls below an "A" rating by one of these agencies, then awareness is heightened and the security monitored closely to determine if credit risk has been significantly increased. If a security falls below an "A" rating by both rating agencies, then the Town Treasurer or his/her designee will evaluate the need to sell the security prior to maturity. Further restrictions on the purchase of medium term corporate notes are a maximum term of five years to maturity and total investments in medium term corporate notes may not exceed 30% of the local agency's surplus funds or 5% in any one issuer name.

Repurchase Agreements - A repurchase agreement is a short-term investment transaction. Banks buy temporarily idle funds from a customer by selling U.S. Government or other securities with a contractual agreement to repurchase the same securities on a future date. Repurchase agreements are typically for one to ten days in maturity. The customer receives interest from the bank. The interest rate reflects both the prevailing demand for Federal funds and the maturity of the repurchase agreement. Some banks will execute repurchase agreements for a minimum of \$100,000 to \$500,000, but most banks have a minimum of \$1,000,000. The term of a repurchase agreement may not exceed one year. The market value of securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly. Repurchase Agreements can only be executed with financial institutions or broker/dealers that have signed a Master Repurchase Agreement with the Town.

Reverse Repurchase Agreements - A reverse repurchase agreement is the opposite of a repurchase agreement. The Town loans a security to a bank in exchange for cash. The Town agrees to pay off the loan with interest on a future date. As this type of investment actually involves a loan arrangement, the Town may not invest more than 10% of its surplus funds in reverse repurchase agreements, and must always match its maturities to the reinvestment. Reverse repurchase agreements may be utilized only when either of the following conditions are met:

3. The security was owned or specifically committed to purchase, by the local agency, prior to December 31, 1994, and was sold using a reverse repurchase agreement on December 31, 1994.
4. The security:
 - a. to be sold has been owned and fully paid for a minimum of 30 days prior to sale; and
 - b. total of all reverse repurchase agreements owned does not exceed 10 percent of the base value of the portfolio; and
 - c. agreement does not exceed a term of 92 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement and the final maturity date of the same security.

LAIF (Local Agency Investment Fund) - A special fund in the State Treasury which local agencies may use to deposit funds for investment. There is no minimum investment period and the minimum transaction is \$5,000, in multiples of \$1,000 above that, with a maximum balance of \$40,000,000 for any agency. The Town is restricted to a maximum of fifteen transactions per month. It offers high liquidity because deposits can be converted to cash in 24 hours and no interest is lost. All interest is distributed to those agencies participating on a proportionate share basis determined by the amounts deposited and the length of time they are deposited. Interest is paid quarterly. The State retains an amount for reasonable costs of making the investments, not to exceed one-quarter of one percent of the earnings. California Government Code §16429.3 states, in part:

"money placed with the State Treasurer for deposit in the Local Agency Investment Fund by cities, counties, or special districts shall not be subject to impoundment or seizure by any state official or state agency."

Money Market Mutual Funds - Shares of beneficial interest issued by diversified management companies. To be eligible for investment, shares must:

5. attain the highest rating provided by Moody's Investors Service, Inc., which is currently "Aaa," and/or Standard and Poor's Corporation, which is currently "AAA;" and,
6. the investment adviser managing the shares must be registered with the Securities and Exchange Commission with not less than five year's experience investing in instruments authorized under California Government Code §53601 subdivisions (a) to (m) inclusive, and with assets under management in excess of five hundred million dollars (\$500,000,000); and,
7. the purchase price of shares shall not include any commission that these companies may charge; and,
8. investment in shares shall not exceed 20 percent of surplus funds.

However, no more than 10 percent of the Town's surplus funds may be invested in shares of beneficial interest of any one mutual fund. Furthermore, any investment in a money market mutual fund must comply with other self-imposed restrictions as specified in this Investment Policy.

Asset-Backed and Mortgage-Backed Security - Bonds backed by payments from receivables/mortgages having a maximum of five years maturity. These securities must have an "AA" or better rating by Moody's Investors Services, Inc., and/or Standard and Poor's Corporation. No more than 20% of the Town's surplus money may be invested in these securities.

VIII. INVESTMENT OF BOND PROCEEDS

When investing proceeds from the issuance of bonds, the Town of Apple Valley will follow this Investment Policy when determining allowable investments. Should the trust agreement of a particular bond issue be more restrictive than the Town's policy on permitted investments, then the trust agreement will take precedence.

IX. TOWN CONSTRAINTS

The Town Treasurer or his/her designee will evaluate local banks and savings institutions and may invest idle cash funds with such institutions when the criteria for prudent investment previously stated are met. The Town operates its investment pool according to State and self-imposed constraints. It does not buy stocks; it does not speculate; it does not deal in futures or options. Any investment extending beyond a five-year period requires prior Town Council approval. Additionally, a minimum of 20% of the outstanding investments must mature within a one-year time period.

X. SAFEKEEPING AND COLLATERALIZATION

All security transactions, including collateral for repurchase agreements, entered into by the Town shall be conducted on a delivery-versus-payment (DVP) basis. Securities will be held by a third party custodian designated by the Town Treasurer or his/her designee.

Collateralization will be required on two types of investments: certificates of deposit and repurchase (and reverse repurchase) agreements. In order to anticipate market changes and provide a level of security for all funds, a minimum collateralization level is required.

Surplus funds must be deposited in State or national banks, State or Federal savings and loan associations, or State or Federal credit unions within the State of California. The deposits cannot exceed the amount of the bank's or savings and loan's paid-up capital and surplus.

The bank or savings and loan must secure public funds deposits with eligible securities having a market value of 110% of the total amount of the deposits. State law also allows as an eligible security, first trust deeds having a value of 150% of the total amount of the deposits. A third class of collateral is 105% in the form of a letter of credit drawn on the Federal Home Loan Bank.

The Town Treasurer or his/her designee may waive security for that portion of a deposit, which is insured pursuant to Federal law. Currently, the first \$100,000 of a deposit is federally insured. Deposits in excess of \$100,000 are collateralized as previously indicated.

XI. DERIVATIVE INVESTMENTS

A derivative is a generic term often used to categorize a wide variety of financial instruments whose value "depends on" or is "derived from" the value of an underlying asset, reference rate, or index.

Investments in derivative instruments are limited to debt securities that have periodic increases, or step-up interest rate adjustments that provide upward mobility in yield return. Investments in debt securities, which contain a callable feature are also allowable, but must comply with other restrictions as specified in this Investment Policy.

Investments purchased after June 19, 1995, in derivative instruments known as "inverse floaters," "dual index," or "stepped inverse" securities that produce higher than market yields at purchase date (when interest rates are low), but have the possibility of producing low or no coupon rates as market interest rates rise through the life of the instrument are not allowable. Furthermore, investments in range notes or interest-only strips that are derived from a pool of

mortgages are not allowable. However, debt securities that have a floor or a built-in feature that prevents the instrument from potentially returning no yield are allowable.

XII. POLICY COMPLIANCE REGULATIONS

Should the portfolio, for any reason, fall out of compliance with this Investment Policy, immediate liquidation of securities in order to bring the portfolio back into compliance is not required. However, the Treasurer must take action to bring the portfolio into compliance within 12 months from the date the portfolio was determined to be in non-compliance with the provisions of this Investment Policy. Additionally, adequate disclosure as to all instances of noncompliance, and the efforts undertaken to bring the portfolio into compliance, must be made on the monthly Treasurer's Report.

XIII. REPORTING

Under provisions of Section 53646 of the California Government Code, the Treasurer or his/her designee shall render a quarterly investment report to the Town Council, the Town Manager, and the Town Attorney within 30 days following the end of the quarter covered by the report. However, as a matter of practice, a monthly report shall be submitted listing the type of investments, institution, date of maturity, par value, amount of deposit, rate of interest, current market value for all securities, and such other data as may be required by the Town Council on a monthly basis.

XIV. QUALIFIED DEALERS

The Town of Apple Valley shall transact business only with banks, savings and loans, and registered investment securities dealers. The Town will limit the number of broker/dealers authorized to do business with the Town to no more than one (1) broker/dealer for every \$10,000,000 of portfolio size. Each authorized broker/dealer shall be required to annually file a signed certification with the Town Treasurer certifying that they have read and understand the Town's most recently adopted investment policy.

The Town Treasurer or his/her designee will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved broker/dealers who are authorized to provide investment services in the State of California. These may include "primary" and "regional" broker/dealers with offices located in the State of California. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must be approved by and supply the Town Treasurer or his/her designee with a completed broker/dealer questionnaire.

XV. POLICY REVIEW

This Statement of Investment Policy shall be reviewed at least annually to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law, financial and economic trends.

Should conditions change or legislation become effective that behooves subsequent changes or a liberalization of terms within the policy during the next fiscal year, the revised policy will be submitted to Council for adoption of the recommended action.

TOWN OF APPLE VALLEY INVESTMENT GUIDELINES AND STRATEGY

- I. GUIDELINES - Guidelines are established to direct and control activities in such a manner that previously established goals are achieved.
- II. Investment Transaction. Every investment transaction must be authorized and reviewed by the Treasurer or his/her designee.
- III. Pooled Cash. Whenever practical, local agency cash is consolidated into one bank account and invested on a pooled concept basis. Interest earnings are allocated quarterly according to month-end cash and investment balances for each fund.
- IV. Competitive Bids. Purchase and sales of securities are made on the basis of competitive offers and bids when practical.
- V. Cash Forecast. The cash flow for the Town is analyzed with the receipt of revenues and maturity of investments scheduled so that adequate cash will be available to meet disbursement requirements.
- VI. Investment Limitations. Security purchases and holdings are maintained within statutory limits imposed by the California Government Code. Current limits are:
 - Bankers Acceptances 40% Section 53601(f)
 - Commercial Paper 25% Section 53601(g)
 - Negotiable Certificates of Deposit 30% Section 53601(h)
 - Reverse Repurchase Agreements 20% Section 53601(i)
 - Medium Term Notes 30% Section 53601(j)
 - Money Market Mutual Funds 20% Section 53601(k)
 - Asset-Backed/Mortgage-Backed Securities 20% Section 53601(n)
 - Federal Agency restriction 60% per Agency Section VI of Policy
 - Local Agency Investment Fund \$40,000,000 per Section VI of Policy
 - Portfolio Maturing within one year 20% per Section IX of Policy
- VII. Liquidity. The marketability of a security is considered at the time of purchase, as the security may have to be sold at a later date to meet unanticipated cash demands.
- VIII. Diversification. The portfolio should consist of a mix of various types of securities, issuers, and maturities.
- IX. Evaluate Certificates of Deposit
 - (a) Certificates of Deposit shall be evaluated in terms of FDIC coverage. For deposits in excess of the insured maximum of \$100,000, approved collateral at full market value shall be required. (California Government Code Section 53652 and/or 53651(m) and 53651.2(a)(1).
 - (b) Negotiable Certificates of Deposit shall be evaluated in terms of the credit worthiness of the issuer, as these deposits are uninsured and uncollateralized promissory notes.

**TOWN OF APPLE VALLEY
INVESTMENT GUIDELINES AND STRATEGY
(Continued)**

- X. STRATEGY - Strategy refers to the ability to manage financial resources in the most advantageous manner.
- XI. Economic Forecasts. Economic Forecasts are obtained periodically from economists and financial experts through bankers and brokers to assist the Treasurer or his/her designee with the formulation of an investment strategy for the local agency.
- XII. Implementing Investment Strategy. Investment transactions are executed which conform with anticipated interest rate trends and the current investment strategy plan.
- XIII. Rapport. A close working relationship is maintained with large vendors of the city. The objective is to pinpoint when large disbursements will clear the city's bank account. It is essential for good cash control that such large expenditures be anticipated, estimated as to dollar amount, and communicated to the Treasurer or his/her designee for liquidity planning purposes.
- XIV. Preserve Portfolio Value. Field standards are developed in order to maintain earnings near the market and to preserve the value of the portfolio.

TOWN OF APPLE VALLEY INVESTMENT PROCEDURES INTERNAL CONTROL - GUIDELINES

OBJECTIVES OF INTERNAL CONTROL

Internal control is the plan of organization and all the related systems established by the management's objective of ensuring, as far as practicable:

1. The orderly and efficient conduct of its business, including adherence to management policies.
2. The safeguarding of assets.
3. The prevention or detection of errors and fraud.
4. The accuracy and completeness of the accounting records.
5. The timely preparation of reliable financial information.

LIMITATIONS OF INTERNAL CONTROL

No internal control system, however elaborate, can by itself guarantee the achievement of management's objectives. Internal control can provide only reasonable assurance that the objectives are met, because of its inherent limitations, including:

1. Management's usual requirement that a control be cost-effective.
2. The direction of most controls at recurring, rather than unusual, types of transactions.
3. Human error due to misunderstanding, carelessness, fatigue, or distraction.
4. Potential for collusion that circumvents controls dependent on the segregation of functions.
5. Potential for a person responsible for exercising control abusing that responsibility; a responsible staff member could be in a position to override controls which management has set up.

ELEMENTS OF INTERNAL CONTROL

Elements of a system of internal control are the means by which an organization can satisfy the objectives of internal control. These elements are:

1. ORGANIZATION

Specific responsibility for the performance of duties should be assigned and lines of authority and reporting clearly identified and understood.

2. PERSONNEL

Personnel should have capabilities commensurate with their responsibilities. Personnel selection and training policies together with the quality and quantity of supervision are thus important.

**TOWN OF APPLE VALLEY
INVESTMENT PROCEDURES
INTERNAL CONTROL - GUIDELINES
(Continued)**

3. SEGREGATION OF FUNCTIONS

Segregation of incompatible functions reduces the risk that a person is in a position both to perpetrate and conceal errors or fraud in the normal course of duty. If two parts of a transaction are handled by different people, collusion is necessary to

conceal errors or fraud. In particular, the functions that should be considered when evaluating segregation of functions are authorization, execution, recording, custody of assets, and performing reconciliations.

4. AUTHORIZATION

All transactions should be authorized by an appropriate responsible individual. The responsibilities and limits of authorization should be clearly delineated. The individual or group authorizing a specific transaction or granting general authority for transactions should be in a position commensurate with the nature and significance of the transactions. Delegation of authority to authorize transactions should be handled very carefully.

5. CONTROLS OVER AN ACCOUNTING SYSTEM

Controls over an accounting system include the procedures, both manual and computerized, carried out independently to ascertain that transactions are complete, valid, authorized, and properly recorded.

TOWN OF APPLE VALLEY CASH CONTROLS

PROCEDURES PERFORMED BY EXTERNAL AUDITORS WITH RESPECT TO CASH RECEIPTS

- A. Town procedures and controls are reviewed. Some of the system strengths are:
5. Receipts are controlled upon receipt by proper registration devices.
 6. Receipts are reconciled on a daily basis.
 7. Amounts are deposited intact.
 8. All bank accounts are authorized by resolution.
 5. Cash counts are done by two or more individuals.
 6. Bank reconciliations are reviewed.
 7. Prompt posting of cash receipt entries in books.
 8. Receipt forms are pre-numbered, accounted for, and physically secured.
 9. Proper approval required for write-off's of customer accounts.
 10. Checks are restrictively endorsed upon receipt or when run through cash register.
 11. Adequate physical security over cash.
 12. Individuals that handle cash do not post to customer account records or process billing statements.
 13. Adequate supervision of Finance Department operations.
- B. Significant revenues are confirmed directly with payer and compared with Town accounting records to make sure amounts are recorded properly.
- C. Cash balances are substantiated by confirming all account balances recorded in the accounting records. Bank reconciliations are reviewed for propriety and recalculated by the auditor. All significant reconciling items on bank reconciliations are verified as valid reconciling items by proving to subsequent bank statements.

**TOWN OF APPLE VALLEY
SEGREGATION OF RESPONSIBILITIES OF
THE TREASURY FUNCTIONS**

<u>Function</u>	<u>Responsibility</u>
1. Authorization of investment transactions: Formal investment policy should be: * Prepared by: * Submitted to: Investment transactions should be approved by:	Town Treasurer Town Council Town Treasurer
2. Execution of investment transactions	Treasurer/ Assistant Director of Finance
3. Investment transactions approved for compliance with Investment policy and/or State law.	Assistant Director of Finance
4. Timely recording of investment transactions: Recording of investment Transactions in the Treasurer's records. Recording of investment transactions in the accounting records	Senior Accountant/Accountant. Senior Accountant/Accountant
5. Verification of investment, i.e., match broker confirmation to Treasurer's records	Assistant Director of Finance
6. Safeguarding of assets and records: Reconciliation of Treasurer's records to the accounting records Reconciliation of Treasurer's records to bank statements and safekeeping records	Senior Accountant/Accountant Senior Accountant/Accountant

**TOWN OF APPLE VALLEY
SEGREGATION OF RESPONSIBILITIES OF
THE TREASURY FUNCTIONS
(Continued)**

<u>Function</u>	<u>Responsibility</u>
6. Safeguarding of Assets and Records (continued): Annual review of (a) financial institution's financial condition, (b) safety, liquidity, and potential yields of investment instruments.	Assistant Director of Finance with Treasurer's approval
7. No less than an annual review of investment portfolio as prepared by Treasurer including: <ul style="list-style-type: none">• Investment types• Purchase Price• Par values• Market values• Maturity dates• Investment yields• Conformance to stated investment policy• Safekeeping reports	External Independent Auditors

The segregation of responsibilities of the Treasury functions as noted herein are intended to enhance the Town's internal controls over cash handling procedures. It should be noted that from time to time, due to the limited size of the Finance department staff, segregation of responsibilities as outlined herein may not be followed in order to fulfill the business needs of the organization.

2015-2016

INVESTMENT POLICY

GLOSSARY

AGENCIES. Federal agency securities and/or government-sponsored enterprises.

ASKED: The price at which securities are offered.

BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

BENCHMARK: A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

BID: The price offered by a buyer of securities. See Offer.

BROKER: A broker brings buyers and sellers together for a commission.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

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

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the Town of Apple Valley. It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date. **DEALER:** A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

DEBENTURE: A bond secured only by the general credit of the issuer.

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of signed receipt for the securities.

DERIVATIVES: (1) Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying index or security, and may include a leveraging factor, or (2) financial contracts based upon notional amounts whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities or commodities).

DISCOUNT: The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e. g., U. S. Treasury Bills.

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

FEDERAL CREDIT AGENCIES: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g., S & L's, small business firms, students, farmers, farm cooperatives, and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to \$250,000 per deposit.

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks), which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of

adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D. C., 12 regional banks and about 5,700 commercial banks that are members of the system.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae): securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U. S. Government. Ginnie Mae securities are backed by the FHA, VA or FmHa mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL GOVERNMENT INVESTMENT POOL (LGIP): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

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

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase – reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date upon which the principal or stated value of an investment becomes due and payable.

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

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked and Bid.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

PRUDENT PERSON RULE: An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state-the do-called legal list. In other states, the trustee may invest in a security if it is one, which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond the current income return.

REPURCHASE AGREEMENT (RP OR REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money that is, increasing bank reserves.

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

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

SECURITIES AND EXCHANGE COMMISSION: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

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

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations, which have imbedded options (E.G., call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

TREASURY BILLS: A non-interest bearing discount security issued by the U. S. treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

TREASURY BONDS: Long-term coupon-bearing U. S. Treasury securities issued as direct obligations of the U. S. Government and having initial maturities of more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U. S. Treasury securities issued as direct obligations of the U. S. Government and having initial maturities from two to ten years.

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

YIELD: The rate of annual income return on an investment, expressed as a percentage. (a) **INCOME YIELD** is obtained by dividing the current dollar income by the current market price for the security. (b) **NET YIELD** or **YIELD TO MATURITY** is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

RESOLUTION NO. 2015-16

A RESOLUTION OF THE TOWN COUNCIL OF THE TOWN OF APPLE VALLEY, CALIFORNIA, ADOPTING THE TOWN OF APPLE VALLEY INVESTMENT POLICY

THE TOWN COUNCIL OF THE TOWN OF APPLE VALLEY DOES HEREBY RESOLVE AS FOLLOWS:

WHEREAS, in accordance with Section 53607 of the Government Code of the State of California, the Town Treasurer is hereby authorized (a) to invest such portion of any sinking fund of, or idle money in, the Town Treasury, not required for the immediate necessities of the Town as is deemed wise or expedient, in securities in which this Council is authorized to invest such sums by the provisions of State Government Code Section 53601 and Section 53635, limited by the Town's Investment Policy; and (b) to sell, or exchange for other eligible securities, and reinvest the proceeds of the securities purchased. The Town Treasurer shall make a monthly report of such transactions to this Council.

NOW, THEREFORE, BE IT RESOLVED that the Town Council of the Town of Apple Valley has adopted the 2015-2016 Statement of Investment Policy as set forth in the attached document. The Town Clerk shall certify to the passage and adoption of this resolution, and it shall thereupon be in full force and effect.

APPROVED AND ADOPTED by the Town Council of the Town of Apple Valley, this 9th day of June 2015.

Larry Cusack, Mayor

ATTEST:

La Vonda M-Pearson, Town Clerk