



**AGENDA ITEM EXECUTIVE SUMMARY**

Agenda Item number: 7.a

Title:

Recommendation to approve the Amended City of St. Charles Corporate Funds Investment Policy

Presenter:

Colleen Lavery

Meeting: Government Operations Committee

Date: June 3, 2019

Proposed Cost: N/A

Budgeted Amount: N/A

Not Budgeted:

The City of St. Charles first implemented a Corporate Funds Investment Policy in December, 1999. The City’s investment policy describes the parameters for investing government funds and identifies the investment objectives, preferences or tolerance for risk, constraints on the investment portfolio, and how the investment program will be managed and monitored. The policy is applicable to the investment activities of all accounting funds of the City except for the St. Charles Police Pension Fund and the St. Charles Firefighters’ Pension Fund.

The investment policy is an important component of an investment program because it establishes guidelines and priorities which enhance the quality of decision making and demonstrates a commitment to the fiduciary care of public funds. One of the elements of the investment policy is that it be reviewed annually and updated when necessary to ensure compliance with state and local laws, regulations, and policies concerning the investment of public funds. In addition, the policy is evaluated to ensure that the City’s investment objectives are being met.

The most recent review resulted in several changes which can be summarized as follows:

1. Added *legal compliance* as a fifth objective and top priority of the investment program.
2. Edited the list of defined terms that are referenced throughout the document.
3. Expanded the safety and custody section by detailing the assets deemed acceptable for collateralization.
4. Identified the Illinois Investment Trust Pool as permissible Local Governmental Investment Pools.
5. Supplemented the investment parameters section to identify permissible investment types, maturity lengths and maximum holdings of an investment type.
6. Removed the attachments section of the document.

Formalizing the revisions made to the Corporate Funds Investment Policy is a housekeeping matter.

**Attachments** *(please list):*

Amended City of St. Charles Investment Policy

**Recommendation/Suggested Action** *(briefly explain):*

Recommendation to Council to approve the Amended City of St. Charles Investment Policy.

# City of St. Charles

## Corporate Funds Investment Policy

### Applicability and Scope

This policy is applicable to those in the Finance Department that are involved in making investment decisions and to those managing the cash flow of funds. This policy includes all funds established by the City of St. Charles. The City will consolidate cash balances from all funds to maximize investment earnings whenever possible. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

### Purpose

In order to ensure that the City of St. Charles maximizes its return on investments while meeting its investment objectives.

### I. Objectives

- A. The primary objectives of investment activities, in order of priority, shall be legal compliance, safety, liquidity, yield, and diversification.
  1. *Legal Compliance* – Investments shall be undertaken in compliance with the applicable provisions of Illinois Compiled Statutes and in accordance with the provisions of this policy.
  2. *Safety and Risk Avoidance* – After ensuring the legality of an investment, the primary objective shall be to preserve investment principal. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the portfolio. The objective will be to mitigate credit risk and interest rate risk.
  3. *Liquidity* - The City's investment portfolio will remain sufficiently liquid to enable the City to meet operating requirements.
  4. *Yield* - The City will seek to maximize its return on investments while remembering its primary objective is risk avoidance. The objective shall be to regularly exceed the average return for six-month treasury bills.
  5. *Diversification* - The City shall diversify its investments to avoid incurring unreasonable risks regarding specific security types and or individual financial institutions.

### II. Definitions

- A. Collateralization - Securities pledged by an institution to cover deposits or investments of the City not covered by the Federal Deposit Insurance Corporation (FDIC) insurance limits (Currently \$250,000).
- B. Government Securities - Direct obligations of the US Treasury backed by the full faith and credit of the US Government or one of its agencies backed by the US Government.
- C. Certificates of Deposit - Obligations of a financial institution insured up to current FDIC insurance limits. \$. Jumbo CD's which are greater than current FDIC insurance limits must be collateralized or insured by a standard insuring agency..
- D. Local Governmental Investment Pool (LGIP) A pool of government investors and

depositors managed so as to attain a higher rate of return by pooling investments. Illinois Funds, the Illinois Investment Trust Pool, and the Illinois Metropolitan Investment Fund (IMET) are popular examples of local governmental investment pools (LGIP's).

- E. Commercial Paper - Direct obligations of US corporations.
- F. Delivery vs. Payment (DVP) - A method of buying a security which insures delivery of the security by not allowing payment without obtaining possession of the exact security instructed to be purchased.
- G. Book Entry - Most securities are not physical. They are "book entry" at the Federal Reserve, which means they are recorded but are not actually a "physical certificate."
- H. Third Party Safekeeping - A method of holding securities by a party other than the parties involved in the transaction so as to ensure the safety of the investments.
- I. Offer - This is the term used when one wants to "Buy" a security.
- J. Bid - Solicitation for the "sale" of a security.
- K. Long Bond - The 30 year Treasury bond that causes interest rates to fluctuate up or down depending on its price. The yield moves in the opposite direction of its price, therefore, if the price is up yields go down and if the price is down yields go up.
- L. Basis Point - .01 percent (.0001).
- M. Dollar Price - The decimal equivalent of the total dollar amount of an investment.
- N. Interfund Sale - The sale of an investment or portion thereof, from one fund to another based on the City's cumulative cash flow needs.
- O. Effective Interest - The method used to value investments based on amortizing the premium or discount of the investment.
- P. Book Value - The "value" of an investment based on the cost of the investment amortized to the current date.
- Q. Market Value - The "value" of an investment based on the price one would receive from the market if they were to sell the investment that day. The difference between book and market value would constitute an unrealized gain or loss.

### **III. Standards of Care**

- A. At all times the individual maintaining the investments shall follow the "prudent person rule." This rule obligates the individual making investments to exercise the degree of judgement and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived. Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this policy.
- B. In addition to the prohibitions contained in the Public Funds Investment Act, officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the City of St. Charles.

- C. Authority to manage the investment program is granted to the Director of Finance. Responsibility for the operation of the investment program is hereby delegated to the Director of Finance, who shall act in accordance with established written procedures and internal controls for the operation of the investment program established within this policy. No person may engage in an investment transaction except as provided under the terms of this policy and under the direction of the Director of Finance. The Director of Finance shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinates.

#### **IV. Safekeeping and Custody**

- A. It shall be the policy of the City to require that funds on deposit in excess of FDIC limits, or investments not guaranteed by the United States of America or any agency of the United States of America be secured by some form of collateral. The City will accept any of the following assets as collateral:
1. Negotiable obligations of the United States Government.
  2. Negotiable obligations including FHLB letters of credit of any agency or instrumentality of the United States Government guaranteed by the full faith and credit of the United States Government.
  3. Negotiable obligations of the State of Illinois, or of any county, city, town or municipal corporation of this State or any other political subdivision of this State which are rated A or better by Moody's or Standard and Poors rating thereof.
  4. Negotiable obligations of any State of the United States, or any municipal or other political subdivision thereof which are rated A or better by Moody's or Standard and Poors rating thereof.

The amount of collateral provided will not be less than 105% of the fair market value of the net amount of public funds secured. Pledged collateral will be held in third party safekeeping as evidenced by a safekeeping agreement. The City shall require monthly reports that include the market value of securities pledged in the City's name.

- B. The Director of Finance is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of the control should not exceed the benefits derived and (2) the valuation of costs and benefits require estimates and judgements by management. To assure compliance with such policies and procedures, the internal control structure shall be reviewed annually by an external auditor in conjunction with the annual examination of the financial statement of the City.
- C. All trades where applicable will be executed by delivery vs. payment (dvp) to ensure that securities are deposited in an eligible financial institution prior to the release of funds. Securities will be held by a third party custodian as evidenced by safekeeping receipts.
- D. The actual delivery of an investment depends on the settlement that is decided on at the time of the trade.
1. Cash Settlement - trade settles the same day
  2. Regular Settlement (Reg) - trade settles the next banking day
  3. Corporate – trade settles 3 banking days later

4. New Issue – trade settles the day the issue is done – these trades can transact as much as one month before actual settlement

## **V. Suitable and Authorized Investments**

- A. The City of St. Charles can invest in any type of security allowed by law as set out in the Illinois Compiled Statutes. However, the City chooses to impose some additional restrictions on derivative types of securities. The term derivative is a broad term and cannot be easily defined. Technically the term includes any security that derives its value from an underlying factor such as securities, currencies or interest rates. The City does allow investment in derivatives but not those that are considered "high risk". These high-risk securities include, but are not limited to, floating rate securities, interest only strips, principal only strips, forwards, futures, currency and interest rate swaps, options, and reverse repurchase agreements. Collateralized Mortgage Obligations (CMO's) are derivatives. The City does allow investment in CMO's, however, the maximum final maturity cannot go beyond 5 years, regardless of what the average life or duration is.
- B. The following investments are permitted:
  1. U.S. Government Securities including bonds, notes, bills, strips, and debentures backed by the full faith and credit of the US Government or its Agencies, which have a liquid market with a readily determinable value.  
Short term (less than 360 days) discount obligations of the Federal National Mortgage Association.  
Interest bearing time deposits that are fully insured or collateralized.
  2. Debt of states, municipalities, and their political subdivisions
  3. Illinois Funds Investment Pool, IMET, the Illinois Investment Trust Pool and other local government investment pools.
  4. Short term obligations of US corporations (commercial paper) with assets exceeding \$500,000,000 if (a) such obligations are rated at the time of purchase within the three highest classifications (such as A1P1, A2D2, A3P3) established by at least two standard rating services and which mature not later than 180 days from the date of purchase, (b) and no more than 25% of all funds are invested in such obligations at any time and (c) such purchases do not exceed 10% of the corporation's outstanding obligations.
  5. Money market mutual funds regulated by the Securities and Exchange Commission and as authorized under Illinois Compiled Statutes.

## **VI. Investment Parameters**

- A. In order to reduce the risk of default City shall always have third party safekeeping of collateral. The investment portfolio shall be diversified in order to limit its exposure to market and credit risk. The following parameters shall be followed.
  1. U.S. Government Securities including bonds, notes, bills, strips, and debentures backed by the full faith and credit of the US Government or its Agencies, which have a liquid market with a readily determinable value shall be permitted in any amount. However, care should be taken to vary the investments in other ways such as differing securities, agency types, maturities etc. provided the diversification otherwise fits into the parameters of this policy.
  2. Commercial paper shall not exceed 25% of the of the investment portfolio.
  3. Investments to be used for purposes of trading for capital gain shall not exceed 9% of the portfolio.

4. Investments will have varied maturities.
  5. When investing in state or municipal securities, the City shall limit its investments so that no more than 10% of its investment portfolio shall be invested in one issuer.
  6. Investments in local governmental investment pools shall be permitted in any amount provided that the local governmental investment pool in question adheres to the same guidelines as the City's general investment policy.
  7. Investments in customized managed accounts offered by financial institutions and entities offering Local Governmental Investment Pools, provided such customized managed accounts are in accordance with the provisions of this policy and Illinois Compiled Statutes.
- B. To the extent possible, the City shall attempt to match investments with anticipated cash flow requirements. Unless matched to a specific cash flow or part of the 9% allowed for investing for capital gain, the City will not directly invest in securities maturing more than five (5) years from the date of purchase or in accordance with State statutes. Reserve funds and other funds with longer-term horizons may be invested in securities exceeding five (5) years if the maturity of such investments is made to coincide as nearly practicable with the expected use of funds.
- C. A list of financial dealers and institutions authorized to provide investment services will be maintained.

## **VII. Reporting**

- A. The Director of Finance or a designee shall prepare an investment report at least quarterly, including a succinct management summary that provides a clear picture of the status of the current investment portfolio and transactions made. This summary will be prepared in a manner that will allow the entity to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report will be presented to the City Council and will include the following:
1. A listing of individual securities held at the end of the reporting period by maturity date.
  2. Realized and unrealized gains or losses resulting from appreciation or depreciation by listing the cost and market value of securities over one-year duration that are not intended to be held to maturity (in accordance with GASB requirements).
  3. Average weighted yield to maturity of the portfolio as compared to applicable benchmarks.
  4. Percentage of the portfolio by investment type.
- B. The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should obtain a market average rate of return during a market/economic environment of stable interest rates. The City shall compare its return to the average return on the six-month Treasury bill and the average six-month certificate of deposit.
- C. The market value of the portfolio shall be calculated on an annual basis and a statement of the market value of the portfolio shall be issued. This will ensure the review of the investment portfolio in terms of value and price volatility. These reports will represent paper gains and losses only. It will be the City's policy to hold an investment until

maturity unless a sale is required to meet unanticipated expenses or would be beneficial to the City for the purpose of capital gain.

#### **VIII. Policy Considerations**

- A. Any investment purchased before the date of the implementation of this policy that is not within the parameters of this policy shall be exempted from the requirements of this policy and will be held to maturity or to the time that it is deemed appropriate to sell the investment. At that time such monies will be reinvested only as provided by this policy.
- B. This policy shall be reviewed on an annual basis. The Director of Finance must approve any changes and if deemed significant, then approval will be made by the City Council.
- C. In the event of any conflict between this policy and the Illinois Compiled Statutes or case decisions of the State of Illinois, then the statutes and case law shall control.

#### **IX. Accounting for Investments**

- A. All investments are recorded at Par. Amortization of the discount or premium is recorded using the effective interest method.
- B. Investments will be marked to market on an annual basis.
- C. Any gains or losses are recorded based on the amortized value of the investment.
- D. Interfund sales are allowed when a fund has a negative cash balance in excess of 45 days. Price will be based on book value at the time of the transfer.