



**CITY COUNCIL AGENDA REPORT**  
**MEETING DATE:** 12/6/2022  
**DEPARTMENT:** Finance

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**SUBJECT:**

STATEMENT OF INVESTMENT POLICY AND INVESTMENT ADVISORY AND MANAGEMENT SERVICES DISCUSSION

**RECOMMENDED ACTION(S):**

1. Provide policy direction to revise the City's Investment Policy to allow all investment opportunities authorized in the Government Code.
  2. Provide policy direction to revise the City's Investment Policy to allow for the use of an investment advisory firm to actively manage the City's Investment Portfolio.
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**EXECUTIVE SUMMARY:**

The City's Statement of Investment Policy ("Policy") requires the City Council to perform an annual review. This review allows the City to adopt proposed revisions to the Policy and incorporate changes in State law. The City's investment policy prioritizes safety and liquidity of funds followed by yield. As of June 30, 2022, the balance of the City's portfolio was approximately \$159 million, and the portfolio is passively managed in liquidity pools such as CAMP, OCIP, and LAIF. These three investment pools are low-yield, high-liquidity investment programs that have been the principal ways through which the City obtains investment income.

Currently, the City's Policy contains more restrictive parameters than the California Government Code allows. This approach was adopted shortly after the Orange County bankruptcy and is reflective of concerns about municipal investments prevalent in the mid-1990s. However, as the City has matured and its investment portfolio has increased, staff believes it is prudent to revise the Policy to access all investment opportunities allowed in the Government Code. In addition, revising the policy to allow the use of a professional investment firm to actively manage the City's portfolio would likely generate greater market yield and return than the City is currently generating via government investment pools.

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## **BACKGROUND:**

The City's Statement of Investment Policy ("Policy") requires the City Council to perform an annual review (Attachment 1). This review allows for proposed revisions to the Policy while emphasizing the Preservation of Principal (Safety), Liquidity, and Return on Investment (Yield) of the City's investment portfolio (in that order), and changes in State law as it relates to investments. The most recent review was conducted on December 21, 2021.

Local agencies are governed by the California Government Code, Sections 5300 et seq. Municipalities are significantly restricted in the types of investment they may purchase and are typically limited to treasury and agency securities, bank certificates of deposit, medium-term corporate notes, the California Asset Management Pool ("CAMP"), a short-term money market portfolio, Orange County Investment Pool ("OCIP"), and the State of California Local Agency Investment Fund ("LAIF"). Currently, the types of investments authorized for purchase by the City, are further restricted in the City's Policy.

In addition to the annual review of the Policy for any proposed revisions, the City Attorney's Office also completes a review of the Policy and notes recent changes in State law. This legal review along with other proposed changes are brought before the City Council for review and adoption.

Per the Policy the City's investment portfolio is managed by the Director of Finance. As of June 30, 2022, the balance of the City's portfolio was approximately \$159 million, and the portfolio is passively managed in liquidity pools such as CAMP, OCIP, and LAIF. These three investment pools are low-yield, high-liquidity investment programs that have been the principal ways through which the City obtains investment income.

Prior to conducting the City's annual review of the City's Policy, staff seeks policy guidance from the City Council regarding a transition from a Policy that is more restrictive than the restrictions of the California Government Code. In addition to a policy discussion, staff also seeks direction to hire an investment advisory firm to provide investment advisory and management services.

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## **DISCUSSION:**

### Policy Considerations

The City's current Policy is reviewed and adopted annually by the City Council. Currently, the Policy omits the mention or use of an investment advisor or advisory firm to assist in managing the City's investments. To hire an investment advisor, the City would need to adapt its Policy to explicitly allow for an

investment advisor to manage the City’s portfolio. Table 1 includes examples of standard language used by other local cities that have adapted their investment policy and have hired an investment advisor to actively manage their portfolios.

*Table 1: Examples of Standard Language Allowing Investment Advisors*

<b>City</b>	<b>Excerpt from Policy</b>
<b>Mission Viejo</b>	The City Council may, upon recommendation of the Investment Advisory Commission, engage the services of one or more external investment managers to assist in the management of the City's investment portfolio in a manner consistent with the City's objectives.
<b>Laguna Niguel</b>	The City Treasurer, with approval from the City Council, may employ the services of professional investment managers to assist in the management of the City's investment portfolio.
<b>Costa Mesa</b>	The City may engage the services of an external investment manager to assist in the management of the City's investment portfolio in a manner consistent with the City's objectives.
<b>Tustin</b>	The Treasurer may engage the services of outside professionals for evaluation and advice regarding the City's investment program. An authorized investment advisor may provide investment management services, which may also include facilitating trade executions under the direction of the Treasurer or designated representative(s). Advisors shall be registered by the Securities & Exchange Commission and licensed to do business in the State of California. Authorized advisors are subject to the provisions of this investment policy and must act in the best interest of the City in the capacity of a fiduciary.

In addition to the restrictions on the overall management of the City’s investments, the current policy also restricts the types of investments that the City may purchase. Through the review of the Investment Policy, staff recommends the City Council revise the policy to allow for the added diversification of investments while still prioritizing the safety of the principal, limiting risk, maintaining appropriate levels of liquidity, and increasing the potential for generating market yield and return in the portfolio. Potential changes include:

- Considering the diversification of investments by adding highly rated, issuers and sectors as permitted by California Government Code,
- Defining a benchmark and duration target to augment the portfolio’s safety,
- Enhancing reporting to include quarterly updates to monitor and evaluate portfolio performance relative to the chosen benchmark(s),

- In addition to allowing the engagement of external investment advisors (as stated above).

To discuss the benefits of diversifying investments, Medium-Term Notes is one example of a type of investment that the City currently does not and cannot purchase due to the current parameters of the Policy. Allowing investments in Medium-Term Notes would provide for diversification in the portfolio and generally carry an acceptable risk-based market yield. Government Codes allow for investments in Medium-Term Notes of a domestic corporation or depository institution with a minimum credit rating of “A” or better, a limit of 30% of the portfolio and 5% in one issuer.

Additionally, aligning the maximum portfolio limits permitted under government code with the Policy would provide increased flexibility in managing the portfolio. Currently federal agency securities are limited to 70% under the Policy, while Government Code does not include a limit.

As with all investment transactions, risk would exist, and the City’s investment strategy and philosophy would help evaluate the potential risks and returns associated with these types of investments. The purpose of these examples is to illustrate examples of investments that the City could allow and add to diversify its portfolio to potentially expand yield while continuing to mitigate risk.

Through the upcoming annual revision of the Policy, staff recommends the City update its Policy and align its requirements with what is permissible by Government Code. In addition to aligning the Policy with Government Code, the City could modernize its requirements to promote the highest standard of education and training among staff and advisors, include industry best practices, and enhance monitoring and reporting.

#### Hiring an Investment Advisory Services Firm

The use of a professional investment advisory firm would complement staff’s ability to deploy an investment strategy by establishing a partnership with a qualified professional consultant. By allowing for the hiring of an investment advisory firm, the City would be able to work with the firm to plan future investment and actively manage the City’s investment portfolio.

The benefits of this proposed transition to an actively managed portfolio managed by a professional investment advisory firm include expanding the size of the City’s investment portfolio, increased access to the depth of knowledge and expertise of an investment advisory firm, and increased time dedicated to managing the City’s investment portfolio. An investment advisory firm would be able to provide day-to-day monitoring of investment yields in the market, rebalance the portfolio’s durations to take advantage of interest rate trends,

provide credit monitoring and analysis, and competitively shop for investments to obtain the best rates. Moreover, a firm would be able to assist in developing and implementing portfolio strategies within the parameters of the City's Investment Policy, provide detailed monthly and quarterly reporting, and ensure the portfolio is compliant with current standards.

At the November 29, 2022, Audit Committee meeting, staff presented this information regarding the potential changes to the Investment Policy and hiring an investment advisory firm for feedback. The Audit Committee's feedback included scheduling a high-level policy discussion for the City Council regarding revising the City's long-time investment practices and expanding investment options while continuing to comply with the Government Code.

### Next Steps

Staff seeks policy direction regarding the potential changes to the Policy discussed in this report that would remove additional restrictions to the management of the City's investment portfolio and allow staff to utilize an investment advisor. Each of the two recommended action items require the City Council to provide policy direction for staff to proceed with the process of drafting a revised and redlined version the Investment Policy and potentially hiring an investment advisory firm.

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### **FISCAL IMPACT:**

There is no fiscal impact associated with the recommended action.

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### **ATTACHMENTS:**

Statement of Investment Policy, Adopted 12-21-2021

Initiated By: Nidia Ruelas, Management Analyst  
Submitted By: Kevin Shirah, Director of Finance/City Treasurer  
Approved By: Debra Rose, City Manager