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| **City of Northfield, Minnesota** | **Policy Number: 6.05** |
| **FINANCE** | **Adopted: 5/20/14: M2014-087** |
| **City Investment Policy** | **Revised:** |

**Item #3**

**CONSENT**

**M2014-087**

City Of Northfield Minnesota

**Date of City Council Meeting: May 20, 2014**

**To:** Mayor and City Council
City Administrator

**From:** Melanie Schlomann, Finance Director

**Subject:** City Investment Policy

**Action Requested:**
The Northfield City Council approves the City Investment Policy

**Summary Report:**
An Investment Policy is being presented for approval. The policy was distributed at the work session on May 13, 2014. The City of Northfield does not currently have a formal investment policy. Minnesota Statute 118A dictates what investments City Government can have in their Investment portfolio. However, 118A does not have any restrictions on Investment sector diversification, or diversification for specific issuers. To help preserve the capital in our investment portfolio, staff is choosing to have a diversified portfolio. The Investment Policy helps put the guidelines in place for diversification.

**Alternative Options:**
Have no formal Investment Policy, continue to default to MN 118A.

**Financial Impacts:**
The Investment Policy is a good guideline for how the City of Northfield should be conducting business with Investment Managers and/or brokers. It also provides language to diversify the portfolio to help with strategies to preserve capital.

**Attachments:**
Northfield Investment Policy

**City of Northfield**
**Investment Policy**

## I. Introduction

The intent of the Investment Policy of the City of Northfield ("City") is to define the parameters within which funds are to be managed. In methods, procedures and practices, the policy formalizes the framework for the City's investment activities that must be exercised to ensure effective and judicious fiscal and investment management of the City's funds. The guidelines are intended to be broad enough to allow the investment officer to function properly within the parameters of responsibility and authority, yet specific enough to adequately safeguard the investment assets.

## II. Governing Authority

The investment program shall be operated in conformance with federal, state, and other legal requirements, including Minnesota Statue 118A which governs the investment of public funds.

## III. Scope

This policy applies to activities of the City with regard to investing the financial assets of all funds. In addition, funds held by trustees or fiscal agents are excluded from these rules; however, all funds are subject to regulations established by the state of Minnesota. The covered funds, and any new funds created by the City, unless specifically exempted by the oversight board and this policy, are defined in the City's Comprehensive Annual Financial Report.

Note that any excluded funds such as employee retirement funds, proceeds from certain bond issues and foundation or endowment assets are covered by separate policies.

Except for funds in certain restricted and special funds, the City can commingle its funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

## IV. General Objectives

The primary objectives, in priority order, of investment activities shall be:

1. *Safety*
Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The goal will be to mitigate credit risk and interest rate risk.

2. *Liquidity*
The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated.

3. *Return*
The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints of safety and liquidity needs.

## V. Standards of Care

1. *Prudence*
The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal liability for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments. The "prudent person" standard states that:

*"Investments shall be made 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."*

2. *Ethics and Conflicts of Interest*
Officers and employees involved in the investment process shall refrain from personal activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. Disclosure shall be made to the governing body. 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 any personal investment transactions with the same individual with whom business is conducted on behalf of the City.

3. *Delegation of Authority and Responsibilities*

**Governing Body**
The City of Northfield will retain ultimate fiduciary responsibility for the portfolios. The governing body will receive monthly reports, designate investment officers and annually review the investment policy making any changes necessary by adoption.

**Investment Officers**
Authority to manage the investment program is granted to the Finance Director ("Investment Officer") as designated by the City of Northfield, City Council.

Responsibility for the operation of the investment program is hereby delegated to the Investment Officer who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this Investment Policy. Officers will prepare monthly investment reports and other special reports as may be deemed necessary.

All participants in the investment process shall seek to act responsibly as custodians of the public trust. No officer or designee may engage in an investment transaction except as provided under the terms of this policy and supporting procedures.

**Investment Adviser**
The City may 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 entity's objectives. Such external managers may be granted discretion to purchase and sell investment securities in accordance with this Investment Policy. Such managers must be registered under the Investment Advisers Act of 1940.

## VI. Authorized Financial Institutions, Depositories, and Broker/Dealers

1. *Authorized Financial Institutions, Depositories, and Broker/Dealers*
A list will be maintained of financial institutions and depositories authorized to provide investment services. In addition, a list will be maintained of approved security broker/dealers selected by conducting a process of due diligence. For the purpose of this section, the term "broker" means a broker-dealer, broker, or agent of a government entity, who transfers, purchases, sells, or obtains securities for, or on behalf of, a government entity. These may include primary dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

The investment officer shall determine which financial institutions are authorized to provide investment services to the City. Institutions eligible to transact investment business with the City may include:

1. Primary government dealers as designated by the Federal Reserve Bank;
2. Nationally or state-chartered banks;
3. The Federal Reserve Bank; and,
4. Direct issuers of securities eligible for purchase.

B. Selection of financial institutions and broker/dealers authorized to engage in transactions with the City shall be at the sole discretion of the City of Northfield.

C. All broker/dealers who desire to become qualified for investment transactions must supply the following (as appropriate):

1. Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines
2. Proof of FINRA certification
3. Evidence of adequate insurance coverage
4. Prior to completing an initial transaction with a broker, a government entity shall provide annually to the broker a written statement of investment restrictions which shall include a provision that all future investments are to be made in accordance with Minnesota Statutes governing the investment of public funds.
5. A broker must acknowledge annually receipt of the statement of investment restrictions in writing and agree to handle the government entity's account in accordance with these restrictions. A government entity may not enter into a transaction with a broker until the broker has provided this written agreement to the government entity.

D. All financial institutions who desire to become depositories must supply the following (as appropriate):

1. Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines
2. Proof of state registration
3. Evidence of adequate insurance coverage

E. A periodic review of the financial condition and registration of all qualified financial institutions and broker/dealers will be conducted by the investment officer.

F. If the City hires an investment adviser to provide investment management services, and the investment adviser maintains a list of approved Brokers/Dealers that is adhered to for investment transactions, the City may adopt that investment adviser's list as it may be amended periodically. The investment manager must provide evidence of a formalized process for approval and ongoing monitoring of its approved Broker/Dealers; a process that at a minimum is equally as rigorous as the requirements detailed in this section.

*2. Minority, Emerging and Community Financial Institutions*
From time to time, the investment officer may choose to invest in instruments offered by minority, emerging and community financial institutions. All terms and relationships will be fully disclosed prior to purchase and will be reported to the appropriate entity on a consistent basis and should be consistent with state or local law.

*3. Competitive Transactions*

A. The investment officer shall obtain competitive bid information on all purchases of investment instruments purchased on the secondary market. A competitive bid can be executed through a bidding process involving at least three separate brokers/financial institutions or through the use of a nationally recognized trading platform.

B. If the Entity is offered a security for which there is no readily available competitive offering on the same specific issue, then the Investment Officer shall document quotations for comparable or alternative securities. When purchasing original issue instrumentality securities, no competitive offerings will be required as all dealers in the selling group offer those securities as the same original issue price.

C. If the City hires an investment adviser to provide investment management services, the adviser must provide documentation of competitive pricing execution on each transaction. The investment adviser will retain documentation and provide upon request.

## VII. Safekeeping and Custody

*1. Delivery vs. Payment*
All trades of marketable securities will be executed (cleared and settled) on a delivery vs. payment (DVP) basis to ensure that securities are deposited in the City's safekeeping institution prior to the release of funds.

*2. Third-Party Safekeeping*
Securities will be held by an independent third-party safekeeping institution selected by the City. All securities will be evidenced by safekeeping receipts in the City's name. The safekeeping institution shall annually provide a copy of its most recent report on internal controls - Service Organization Control Reports (formerly 70, or SAS 70) prepared in accordance with the Statement on Standards for Attestation Engagements (SSAE) No. 16 (effective June 15, 2011).

*3. Internal Controls*
Management shall establish a system of internal controls, which shall be documented in writing. The internal controls shall be reviewed by the investment committee, where present, and with the independent auditor. The controls shall be designed to prevent the loss of public funds arising from fraud, employee error, and misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees and officers of the City.

## VIII. Suitable and Authorized Investments

1. *Investment Types and Credit Guidelines*
The City will be permitted by this policy to invest public funds in those security types that are

permitted by Minnesota Statute 118A.04 which include, but are not limited to:

- Governmental Bonds, notes, bills, mortgages and other securities, which are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress; excluded from this section are "high-risk mortgage backed securities" which are defined by statute as:
  1. interest-only or principal-only mortgage backed securities; and
  2. any mortgage derivative security that:
     a. has an expected average life greater than ten years;
     b. has an expected average life that:
        i. will extend by more than four years as the result of an immediate and sustained parallel shift in the yield curve of plus 300 basis points; or
        ii. will shorten by more than six years as the result of an immediate and sustained parallel shift in the yield curve of minus 300 basis points; or
     c. will have an estimated change in price of more than 17 percent as the result of an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points

- Any security which is a general obligation of any state or local government with taxing powers which is rated in the three highest ratings categories (generally referred to as "A or better") by a Nationally Recognized Statistical Rating Organization ("NRSRO"), or any security which is a revenue obligation of any state or local government with taxing powers which is rated in the two highest ratings categories (generally referred to as "AA or better") by a NRSRO

- General Obligations of the Minnesota housing finance agency which is a moral obligation of the state of Minnesota and is rated in the three highest ratings categories by a NRSRO

- Commercial Paper issued by United States corporations or their Canadian subsidiaries that is rated in the highest ratings category by two NRSROs and matures in 270 days or less

- Time deposits that are fully insured by the Federal Deposit Insurance Corporation or bankers acceptances of United States banks

- General obligation temporary bonds of the same governmental entity issued under section 429.091, subdivision 7, 469.178, subdivision 5, or 475.61, subdivision 6 of Minnesota Statutes

- SEC registered money market mutual funds; and

- Local government investment pools.

2. *Debt Service Funds*

Funds held in a debt service fund may be used to purchase any obligation, whether general or special, of an issue which is payable from the funds, at such price, which may include a premium, as shall be agreed to by the holder, or may be used to redeem any obligation of such an issue prior to maturity in accordance with its terms. The securities representing any such investment may be sold by the governmental entity at any time, but the money so received remains part of the fund until used for the purpose for which the fund was created. Any obligations held in a debt service fund from which it is payable may be canceled at any time unless otherwise provided in a resolution or other instrument securing obligations payable from the fund.

**IMPORTANT NOTE:** If the credit rating of a security is subsequently downgraded below the minimum rating level for a new investment of that security, the Investment Officer shall evaluate the downgrade on a case-by-case basis in order to determine if the security should be held or sold. The Investment Officer will apply the general objectives of safety, liquidity, yield and legality to make the decision.

3. *Collateralization*
Where allowed or required by state law, full collateralization will be required on all demand deposit accounts, including checking accounts and negotiable (as authorized by respective state statutes) and non-negotiable certificates of deposit.

**Authorized Collateral**

Acceptable collateral for bank deposits and repurchase agreements shall include only:

- Obligations of the U.S. Government, its agencies and GSEs, including mortgage backed securities
- Obligations of any state, city, county or authority rated at least AA by two nationally recognized statistical rating organizations.

## IX. Investment Parameters

1. *Mitigating Credit Risk in the Portfolio*

Credit risk is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt. The City shall mitigate credit risk by adopting the following:

*Diversification*
It is the policy of the City to diversify its investment portfolios. To minimize risk of loss resulting from the over-concentration of assets in a specific maturity, issuer, or class of securities, assets in all City funds shall be diversified by maturity, issuer, and class of security. Diversification strategies shall be determined and revised periodically by the investment officer for all funds.

| Sector | Maximum % | Issuer Max % | Minimum Credit | Maximum Maturity[1] |
|---|---|---|---|---|
| U.S. Treasury Obligations | 100% | 100% | N/A | 10 Years |
| Federal Agencies | 100% | 50% | N/A | 10 Years |
| Federal Instrumentalities | 75% | 50% | Highest two rating categories | 10 Years |
| Federal Agency MBS | 40% | 50% | N/A | 10 Years[2] |
| Commercial Paper | 30% | 5% | Highest rating category | 270 Days |
| Municipal Obligations | 30% | 5% | Highest three rating categories | 10 Years |
| SEC Money Market Funds | 100% | 50% | N/A | N/A |
| LGIP | 100% | 50% | N/A | N/A |

[1]Maturity restrictions may not apply to Project Funds or Debt Service Funds as such investments should be made to coincide as nearly as practicable with the expected use of funds

[2]As calculated using Weighted Average Life (WAL)

2. *Mitigating Market Risk in the Portfolio*

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The City recognizes that, over time, longer-term/core portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The City shall mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes. The City further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The City, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

1. The City shall maintain a minimum of three months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements;
2. The maximum percent of callable securities in the portfolio shall be 15%;
3. Longer term/Core funds will be the defined as the funds in excess of liquidity requirements.
4. The duration of the portfolio shall at all times be approximately equal to the duration (plus or minus
5. 20%) of a Market Benchmark(s) Index selected by the City based on its investment objectives, constraints and risk tolerances. The City's current Benchmark(s) are documented in Section X of this Investment Policy.

Due to fluctuations in the aggregate surplus funds balance, parameters outlined in this section may be exceeded at a point in time subsequent to the purchase of a particular investment type. Securities need not be liquidated to realign the portfolio; however, consideration should be given to this matter when future purchases are made to ensure that appropriate diversification is maintained.

**X Performance Standards/ Evaluation**

The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should achieve a total return (which considers both income and market appreciation/depreciation) during a market/economic (generally considered five years) that exceeds that of the BofA Merrill Lynch 1-3yr U.S. Treasury Index. The BofA Merrill Lynch 1-3yr U.S. Treasury Index represents U.S. Treasury securities maturing over one year, but less than three years and is an appropriate benchmark based on the objectives of the City.

## XI. Reporting/Disclosure

1. *Methods*
The investment officer shall prepare an investment report at least quarterly, including a management summary that provides an analysis of the status of the current investment portfolio and the individual transactions executed over the last quarter. This management summary will be prepared in a manner which will allow the City to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report should be provided to the entity's chief administrative officer, and the legislative body. The report will include, at a minimum, the following:

a. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate;
b. Average maturity of the portfolio and modified duration of the portfolio;
c. Maturity distribution of the portfolio;
d. Average portfolio credit quality; and,
e. Time-weighted total rate of return for the portfolio for the prior one month, three months, twelve months, year to date, and since inception compared to the Benchmark Index returns for the same periods;
f. Average weighted yield to maturity of portfolio on investments as compared to applicable Benchmarks
g. Distribution by type of investment.

*Annual reports*

1. The investment policy shall be reviewed at least annually within 120 days of the end of the fiscal year to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.

2. A comprehensive annual report shall be presented in conjunction with the investment policy review. This report shall include comparisons of City's return to the Benchmark Index return, shall suggest policies and improvements that might enhance the investment program, and shall include an investment plan for the coming year.

## XIII. Policy Considerations

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

*2. Amendments*
This policy shall be reviewed on an annual basis. Any changes must be approved by the investment officer and any other appropriate authority, as well as the individuals charged with maintaining internal controls.

## XIV Approval of Investment Policy

The investment policy and any modifications to that policy shall be formally approved and adopted by the governing body of the City.