

 <p><b>SURPRISE</b> ARIZONA</p>		<p><b>Standard Operating Procedure</b></p> <p><b>INVESTMENTS</b></p>	
<b>PROCESS: Investment Activities With Public Monies</b>			
<b>POLICY REFERENCE:</b> <a href="#">Arizona Revised Statutes (ARS) Title 35; City of Surprise, Arizona Comprehensive Financial Management Policies; Generally Accepted Accounting Principles (GAAP)</a>			
<b>ISSUE DATE:</b> August 26, 2004 Resolution 04-171		<b>LAST AMENDED DATE:</b> June 19, 2018 Resolution 2018-88	<b>EFFECTIVE DATE:</b> July 19, 2018 Resolution 2018-88
<b>FINANCE DIRECTOR APPROVAL:</b>			

**GENERALLY**

The City will consolidate public monies identified for investment from governmental funds, proprietary funds, and internal service funds in order to maximize investment earnings and to increase efficiencies with regard to investment management pricing, safekeeping costs, and administration costs. Funds that are contractually or statutorily restricted from investment activities will be exempted from this policy. Investment income will be allocated to the various funds based on their respective participation of cash balances and in accordance with [Governmental Accounting Standards Board \(GASB\)](#). The investment of public monies is regulated by [Title 35 of Arizona Revised Statutes \(A.R.S.\)](#).

**PURPOSE**

This policy applies to the investment activities of the City of Surprise with the intent to invest public monies in a manner that will maintain the safety of principal, maintain liquidity to meet operating requirements, and provide an industry benchmark yield.

**DEFINITIONS**

*Benchmark*- a comparative base for measuring the performance or risk tolerance of the investment portfolio which should represent a close correlation to the level of risk and the average duration of the portfolio's investments

*Broker*- a third-party who brings buyers and sellers together for a commission

*Certificates of Deposit (CD)* - a marketable receipt for funds deposited in a bank or thrift institution for a specific time period at a stated rate of interest

*Credit Risk*- the risk of loss due to the failure of the security issuer or backer

*Dealer*- as opposed to a broker, a third-party who acts as a principal in all transactions, buying and selling his own account

*Delivery vs. Payment (DVP)* - delivery of securities with an exchange of money for the securities

*Delivery vs. Receipt (DVR)* - delivery of securities with an exchange of a signed receipt for the securities

*Diversification*- dividing investment funds among a variety of securities offering independent returns

*Interest Rate Risk*- the risk that the market value of securities held in the portfolio will decline due to increases in market interest rates subsequent to their purchase

*Investment Advisor*- an investment firm with demonstrated expertise in the management of investment portfolios that acts as a fiduciary for client assets and held to the “Prudent Expert” standard of care; registered with and regulated by the [Securities and Exchange Commission \(SEC\)](#) under the Investment Advisors Act of 1940; and compensated on the basis of assets under management, not transactions

*Liquidity*- an asset that can be converted easily and rapidly into cash without a substantial loss of value

*Market Value*- the price at which a security is trading and could probably be purchased or sold

*Maturity*- the date upon which the principal or stated value of an investment becomes due and payable

*Nationally Recognized Statistical Ratings Organization (NRSRO)* – a national credit rating agency that provides reliable and credible credit ratings that are used by the U.S. government in several regulatory areas, used frequently by investors, and used as benchmarks by federal and state agencies

*Pooled Investment Fund*- the aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment

*Portfolio*- collection of securities held by an investor

*Primary Dealer*- a group of government securities dealers including the SEC, registered securities brokers, dealers, banks, and a few unregulated firms, 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

*Prudent Person Rule*- an investment standard that, depending on the state, requires either a) that a fiduciary, such as a trustee, invest money only in a list of securities selected by the custody state, also known as the “legal list” or b) that the trustee 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 principal

*Public Monies*- money that is generated or levied by a governmental agency to provide goods and services for public purposes

*Safekeeping*- a service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection

[Securities & Exchange Commission \(SEC\)](#) – an agency created by Congress to protect investors in securities transactions by administering securities legislation

[Uniform Net Capital Rule- SEC Rule 15C3-1](#) outlining capital requirements for brokers and dealers

*Yield*- the current rate of return on an investment security generally expressed as a percentage of the security's current price

*Yield to Maturity*- the rate of return yielded by a debt security held to maturity when both interest payments and the investor's potential capital gain or loss are included in the calculation of return

## **POLICIES**

### 1. Investment Management Authority

- a. Authority to manage the investment program of the City is granted to the Finance Director or his/her designee and derived from the [A.R.S. § 35-323](#).

### 2. Delegation of Authority

- a. The Finance Director shall have responsibility for the operation of the investment program and shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this Investment Policy. No person may engage in investment transactions except as provided under the terms of this policy and the procedures established by the Finance Director.
- b. The Finance Director has the authority to manage internally or to delegate the management of the investment program to an investment advisor. If authority to manage all or a part of the investment program of the City is delegated to an investment advisor, the Finance Director is responsible for:
  - i. Periodic investment portfolio reporting
  - ii. Evaluating the performance of the externally managed portfolio
  - iii. Monitoring the investment advisor's compliance with the City's Investment Policy
  - iv. Conveying the investment needs of the City to the investment advisor

- v. Developing investment strategy with the investment advisor

## 2. Investment Policy Adoption

- a. The City's Investment Policy shall be adopted by City Council. The Policy shall be reviewed on an annual basis by the Finance Director when applicable, and any modifications made must be approved and adopted by the City Council.

## 3. Internal Control

- a. The Finance Director shall establish internal controls that are designed to prevent losses due to fraud, negligence, third-party misrepresentation, and other foreseeable circumstances that may arise in the operations of the investment function. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that a) the cost of a control should not exceed the benefits likely to be derived and b) the valuation of costs and benefits requires estimates and judgments by management.
- b. The internal controls shall address the following points:
  - i. Control of collusion
  - ii. Segregation of duties
  - iii. Custodial safekeeping
  - iv. Delegation of authority
  - v. Documented confirmation of transactions for investments and wire transfers

## 4. Prudence

- a. The standard of prudence to be used by investment officials shall be the "uniform prudent act" standard and shall be applied in the context of managing an overall portfolio. The Finance Director, 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 sale of securities are carried out in accordance with the terms of the City's Investment Policy.

## 5. Investment Policy Objectives

- a. The primary objectives, in priority order, of investment activities shall be safety, liquidity, and yield.
  - i. Safety
    - a. Investments shall be undertaken in a manner that seeks to ensure the preservation of principal in the overall portfolio. The objective will be to prudently mitigate credit risk and interest rate risk.
    - b. Credit risk can be mitigated by diversification of the investment portfolio.

- c. Interest rate risk can be mitigated by structuring the investment portfolio so that securities mature concurrently with the anticipated cash flow requirements for ongoing operations, thereby avoiding, as much as possible, the need to sell securities into an adverse market environment prior to maturity, and utilizing external research and advice regarding the current interest rate outlook and global economic condition to optimize portfolio duration strategy.
  - ii. Liquidity
    - a. The investment portfolio shall remain sufficiently liquid to meet anticipated cash flow requirements. This is to be accomplished by structuring the portfolio so that securities mature concurrently with anticipated cash flow needs.
  - iii. Yield
    - a. The investment portfolio shall be designed to optimize the yield the City obtains from the portfolio taking into account the criteria of the City's Investment Policy, the liquidity needs of the City, and the current interest rate outlook/economic condition while remaining compliant with the policy.
- 6. Authorized and Eligible Investments for Public Monies
  - a. Consistent with the City's [Policy Section 5 Investment Policy Objectives](#) and [A.R.S. § 35-323 \(A\)](#), only the following investments will be permitted:
    - i. Certificates of deposit in eligible depositories - 50% sector limit, must be insured or fully collateralized.
    - ii. Interest bearing savings accounts in banks and savings and loan institutions doing business in the State of Arizona whose accounts are insured by federal deposit insurance for their industry, but only if deposits in excess of the insured amount are secured by the eligible depository to the same extent and in the same manner as required under [A.R.S. § 35-323 \(A\)](#).
    - iii. The pooled investment funds established by the State Treasurer pursuant to [A.R.S. § 35-326](#).
    - iv. Obligations issued or guaranteed by the United States or any of the senior debt of its agencies, sponsored agencies, corporations, sponsored corporations, or instrumentalities.
    - v. Bonds or other evidences of indebtedness of the State of Arizona or any of its counties, incorporated cities, towns, school districts, or special taxing districts, including registered warrants, substitute checks, and electronic funds transfers that bear interest pursuant to section [A.R.S. § 11-635](#). - 40% sector limit, 5% issuer limit.
    - vi. Bonds, notes, or evidences of indebtedness of any county, municipal district, municipal utility, or special taxing district within the State of Arizona that are

payable from revenues, earnings, or a special tax specifically pledged for the payment of the principal and interest on the obligations, and for the payment of which a lawful sinking fund or reserve fund has been established and is being maintained, but only if no default in payment on principal or interest on the obligations to be purchased has occurred within five years of the date of investment, or, if such obligations were issued less than five years before the date of investment, no default in payment of principal or interest has occurred on the obligations to be purchased nor any other obligations of the issuer within five years of the investment. Investments in this category must be rated "A" or the equivalent or better by a NRSRO - 40% sector limit, 5% issuer limit.

- vii. Bonds, notes, or evidences of indebtedness issued by any county improvement district or municipal improvement district in the State of Arizona to finance local improvements authorized by law, if the principal and interest of the obligations are payable from assessments on real property within the improvement district. Investments in this category must be rated "A" or the equivalent or better by a NRSRO - 40% sector limit, 5% issuer limit. An investment shall not be made if:
  - a. The face value of all such obligations, and similar obligations outstanding, exceeds 50% of the market value of the real property, and if improvements on which the bonds or the assessments for the payment of principal and interest on the bonds are liens inferior only to the liens for general ad valorem taxes.
  - b. A default in payment of principal or interest on the obligations to be purchased has occurred within five years of the date of investment, or, if the obligations were issued less than five years before the date of investment, a default in the payment of principal or interest has occurred on the obligations to be purchased or on any other obligation of the issuer within five years of the investment.

b. Investment Rating Downgrade

- i. The City may be invested in a security whose rating is downgraded by a NRSRO. In the event of a downgrade, the designated investment advisor shall report the downgrade to the Finance Director. In the event of a downgrade below the minimum credit rating criteria permitted by this Investment Policy, the designated investment advisor shall immediately report the downgrade, sell the investment and reinvest proceeds upon approval of Finance Director.

c. Portfolio Management

- i. Following the primary objective of this policy, investments shall be actively managed to take advantage of market opportunities. In so doing, negotiable securities may be sold prior to their maturity to provide liquid funds as needed for cash flow purposes, to enhance portfolio returns, or to restructure maturities to increase yield and/or reduce risk.

d. Concentration and Diversification

- i. Any percentage sector limitation for a particular category of investment in this section is applicable only on the date of purchase of the investment. Credit criteria listed in this section refer to the credit of the issuing organization at the time the security is purchased.
- ii. It is the policy of the City to diversify its investment portfolios. The investments shall be diversified to eliminate the risk of loss resulting from over concentration of assets in a specific maturity, issuer, or class of securities.

7. Safekeeping and Custody

a. Delivery vs. Payment

- i. 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.

b. Third Party Safekeeping

- i. 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 name of the City of Surprise.

8. Ethics and Conflicts of Interest

- a. City employees involved in the investment process shall refrain from personal business activities that could conflict with the proper execution and management of the investment program or which could impair his/her ability to make impartial investment decisions. Employees and investment officials shall disclose, within sixty (60) days, any material interests in financial institutions with which they conduct business. They shall further disclose any large 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 which business is conducted on behalf of the City.

9. Authorized Brokers/Dealers

- a. The City or the City's investment advisor will maintain a list of approved security broker/dealers selected by conducting a process of due diligence. These may include "primary" dealers or regional dealers that qualify under [Securities and Exchange Commission \(SEC\) Rule 15C3-1 \(Uniform Net Capital Rule\)](#).
- b. If the City maintains a list, all broker/dealers who desire to become qualified for investment transactions must supply the following:
  - i. Audited financial statements demonstrating compliance with state and federal capital adequacy guidelines

- ii. Proof of [Financial Industry Regulatory Authority \(FINRA\)](#) certification
  - iii. Proof of state registration
  - iv. Completed broker/dealer questionnaire
  - v. Certification of having read and understood and agreeing to comply with the City's Investment Policy.
  - vi. Evidence of adequate insurance coverage
- c. A periodic review of the financial condition and registration of all the City's qualified broker/dealers will be conducted by the Finance Director. If the City uses an investment advisor, the Finance Director may request to periodically review the advisor's approved broker/dealer list.

#### 10. Reporting of Managed Securities

- a. The Finance Director or his/her designee shall publish a quarterly investment report on the City's public website for the governing body of the City to review. The report should include:
- i. A list of individual securities held at the end of the reporting period
  - ii. The realized and unrealized gains or losses in the portfolio
  - iii. The duration of the portfolio
  - iv. The maturity date and market value of each security held in the portfolio
  - v. The yield to maturity of the portfolio and of each security held in the portfolio
  - vi. The periodic interest earnings of each security held in the portfolio
  - vii. The credit quality of each security held in the portfolio