



## STAFF REPORT

DATE: April 16, 2019  
CONSENT

**TO:** Honorable Mayor and City Councilmembers  
**FROM:** Sue Iverson – Finance Director  
**AGENDA ITEM:** Investment Policy

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### **BACKGROUND:**

The Investment Policy was last updated in 2014. As part of the 2019 Finance Committee Work Plan, the Finance Committee was to review the Investment Policy. The Finance Committee reviewed this at its April 9, 2019 meeting.

### **ISSUE BEFORE THE CITY COUNCIL:**

- 1) Should the City Council approve the proposed Investment Policy?

### **DISCUSSION:**

The current policy was written in 2014 when the City was just starting to develop and did not have large cash balances. It was written in a different environment from what the City now finds itself. Staff has found the current policy somewhat limiting in being able to diversify and invest in some higher interest investments. State Statute allows cities to invest in securities as referenced in No. 5 - Authorized Investments. The current City policy restricts investing in government bonds for any entity that has a lower bond rating than the City, at the time this was written, the City's bond rating was lower and did allow (at that time) the investment in those rated "A" or above. The higher the bond rating the lower the interest rate, so this policy is now restricting us from diversifying and being able to take advantage of higher yield that are allowable by State Statute.

The new policy incorporates the intent of the old policy and adds some new items, such as, a benchmark and some checks and balances by having the City Administrator or Mayor acknowledge that a transaction was made. The new policy also provides definitions and clarification which is more in line with the recommendations of the Government Finance Officers Association (GFOA).

### **FISCAL IMPACT:**

The City would be able to maximize yield on its investments and add some additional diversification to its portfolio.

### **OPTIONS:**

- 1) Approve the attached Investment Policy.
- 2) Amend and then approve the attached Investment Policy.
- 3) Do not approve the attached Investment Policy.

### **RECOMMENDATION:**

*If removed from consent agenda:*

***Motion to approve the proposed Investment Policy.***

**ATTACHMENTS:**

- 1) Draft Investment Policy
- 2) Current Investment Policy



**CITY OF LAKE ELMO  
COUNTY OF WASHINGTON  
STATE OF MINNESOTA**

**FINANCIAL POLICIES-  
INVESTMENT POLICY**

**1. Purpose**

It is the policy of the City to invest public funds in a manner which maximizes security and provides maximum return in preserving and protecting funds while meeting the daily cash flow demands and conforming to all applicable federal, state and/or local statutes government the investment of public funds.

**2. Standards of Care**

- A. Prudence – The standard of prudence to be used shall be the “prudent person” standard and shall be applied in the context of managing an overall portfolio. Individuals 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.

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.”

- B. Ethics and Conflicts of Interest – 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 shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any person financial/investment positions that could be related to the performance of the investment portfolio. Employees shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the City.

- C. Delegation of Authority – Authority to manage the investment portfolio is granted to the City’s Finance Director, who shall act in accordance with established procedures and internal controls for the operation of the investment portfolio consistent with this investment policy. No person may engage in an investment transaction except as provided under the terms of this policy. The Finance Director shall be responsible for all transactions undertaken and shall establish a system of control. Each transaction will be acknowledged in writing by one of the following officials within 48 hours:
- 1) City Administrator
  - 2) Mayor or Acting Mayor

### 3. Investment Objectives

The City will invest idle funds based on the following objectives:

- A. Safety – The primary objective is the preservation of capital and the safeguarding of public funds by mitigating credit and interest rate risk.
- a. Credit Risk – The City will minimize credit risk, which is the risk of loss due to the failure of the security issuer or backer.
  - b. Interest Rate Risk – The City will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in the market interest rates.
- B. Term – Investments will be scheduled to cover all expenditures. Investments will not be longer than one year for cash flow and all excess funds may be invested for longer than one year, with a maximum term of ten years.
- C. Liquidity – The portfolio shall remain liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands. Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist of securities with active secondary or resale markets. Alternatively, a portion of the portfolio may be placed in money market mutual funds or government investment pools which offer same-day liquidity for short-term funds.
- D. Yield – 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 and liquidity needs. The benchmark to be used will be the 4M Plus Fund annual rate of return. Return on investment is of secondary importance compared to the safety and liquidity objectives. The core of investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall generally be held until maturity.

#### 4. Pooling of Funds

The City will consolidate (pool) cash and reserves balances from all funds, except for those legally restricted by statutes, to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration.

#### 5. Authorized Investments

The City of Lake Elmo will invest only in securities authorized by Minnesota Statute §118A.04 and §118A.05.

1. 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, excluding mortgage-backed securities defined as “high risk” (as defined below) or in certificates of deposit secured by letters of credit issued by Federal Home Loan Banks.

High risk mortgage-backed securities are as follows:

- A) interest – only or principal – only mortgage-backed securities,
  - B) 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.
2. Obligations of the United States or its agencies under a repurchase agreement if the margin agreement under the repurchase agreement is 101 percent and with any of the following institutions:
    - A) a bank qualified as depository of public funds,
    - B) any national or state bank in the United States which is a member of the Federal Reserve System and whose combined capital and surplus equals or exceeds \$10,000,000,
    - C) a primary reporting dealer in the United States government securities to the Federal Reserve Bank of New York,
    - D) a securities broker/dealer having its principal executive office in Minnesota, licensed pursuant to Minnesota Statutes Chapter 80A, or an affiliate of it, regulated by the Securities and Exchange Commission and maintaining a combined capital and surplus of \$10,000,000 or more, exclusive of subordinated debt.

3. State and local government obligation as follows:
  - A) an obligation of the State of Minnesota or any of its municipalities:
    - a) that have taxing power, and
    - b) are rated “A” or better by a national bond rating service.
  - B) obligation of other state and local governments:
    - a) that have taxing power, and
    - b) are rated “A” or better by a national bond rating service.
  - C) general obligations of the Minnesota Housing Finance Agency that are rated “A” or better by a national bond rating service.
  - D) general obligations of housing finance agencies of other states, provided:
    - a) they include a moral obligation of the state, and
    - b) they are rated “A” or better by a national bond rating service,
  - E) general revenue obligation of any agency or authority of the State of Minnesota other than those found in C or D above (Housing Finance Agency) that are rated “AA” or better by a national bond rating service.
4. Certificates of deposit at state and federally chartered banks and savings and loan associations. All investments made under this subsection shall be limited to the amount of Federal Deposit Insurance Corporation or the manner set forth in Minnesota statute §118A.05. The certificate of deposit should be in the form of a discounted security maturing in the amount not to exceed the insurance coverage or in the amount so that at any time the face amount together with any accrued interest does not exceed the insurance coverage.
5. Banker’s Acceptances of United States Corporation or their Canadian subsidiaries that are rated “A1” by Moody’s Investors Service and/or P1 by Standard and Poor’s Corporation and matures in 270 days or less. Banker’s Acceptances can only be purchased if the yield is greater than the United States Treasury obligations or Federal Agency issues.
6. Commercial Paper issued by United States corporations or their Canadian subsidiaries that are rated “A1” by Moody’s Investors Service and/or “P1” by Standard and Poor’s Corporation and matures in 270 days or less.
7. Money Market Funds consisting of United States Treasury Obligations and/or Federal Agency Issues and/or re-purchase agreements as long as it is rated AAA by two rating agencies (FDIC, SIPC, FSLC, or NRSRO).
8. The City will not purchase securities that are considered highly sensitive. A highly sensitive investment is a debt instrument with contract terms that make the investment’s fair value highly sensitive to interest rate changes. Examples include range notes and index amortizing notes, variable-rate investments with coupon multipliers, and coupons that vary inversely with a benchmark index.
9. The City will not purchase securities that could expose the City to foreign currency risk.

10. The City will not purchase derivatives.

## 6. Safekeeping and Custody

Investments may be held in safekeeping with:

1. Any Federal Reserve Bank,
2. Any bank authorized under the laws of the United States or any state to exercise corporate trust powers, including but not limited to the bank from which the investment is purchased,
3. A primary reporting dealer in the United States government securities to the Federal Reserve Bank of New York, or
4. A securities broker-dealer having its principal executive office in Minnesota, Licensed pursuant to Minnesota Statutes Chapter 80A, or an affiliate of it, regulated by the securities and exchange commission and maintaining a combined capital and surplus of \$10,000,000 or more, exclusive of subordinated debt.

The City's ownership of all securities in which the fund is invested should be evidenced by written acknowledgments identifying the securities by:

- A. The names of issuers,
- B. The maturity dates,
- C. The interest rates,
- D. Any serial numbers or cusips.

The City shall not invest in securities that are both uninsured and not registered in the name of the City and are held by either:

- A. The counterparty or
- B. The counterparty's trust department or agent, but not in the name of the City.

The Finance Director shall establish a system of internal controls, which shall be reviewed with the independent auditor of the City. 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.

## 7. Concentration of Credit Risk

No more than 5% of the overall portfolio may be invested in the securities of a single issuer, except for the securities of the U.S. Government, or a maximum of 25% with any individual counter party in an external investment pool.

## 8. Investment Depositories and Authorized Dealers

Annually, the City Council will designate by resolution depositories, broker dealers and financial institutions authorized to provide banking and investment services to the City. Prior to completing an initial transaction each year with a broker/dealer, the City shall provide to the broker/dealer a copy of the City's Investment Policy and a copy of the Notification to Broker and Certification by Broker as required by Minnesota Statutes Chapter 80A. The broker/dealer must sign and return the Notification to Broker and Certification by Broker and agree to handle the City's account in accordance with the City's Investment Policy and provide a copy of their broker's insurance coverage for their firm.

**9. Investment Earnings**

Interest earnings, market value adjustments and interest accruals will be allocated at the end of the fiscal year based on the average cash balances during the fiscal year.

**10. Reporting and Review**

A listing of the City's investment portfolio shall be included in the financial report to the Finance Committee and the City Council at the end of each fiscal quarter. The list should include date of purchase and maturity, type of investment, firm invested at, yield, interest rate, and comparison to the benchmark set forth in this policy.

**11. Exemption**

Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirement of this policy. Upon maturity, if funds are re-invested the new securities must conform to this policy.

**12. Review and Approval**

The investment policy shall be formally approved and adopted by resolution the City Council and any future changes to the policy must be approved by the City Council.

Approval by the City Council the \_\_\_\_ Day of \_\_\_\_\_, 2019.

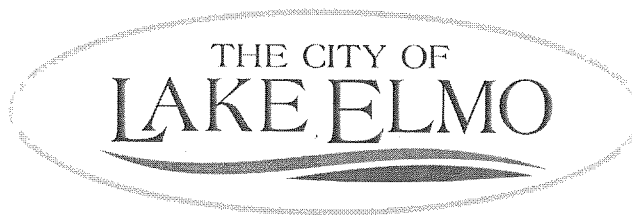
\_\_\_\_\_  
Michael Pearson, Mayor

\_\_\_\_\_  
Date

\_\_\_\_\_  
Julie Johnson, City Clerk

\_\_\_\_\_  
Date





## **Investment Policy**

### **1. Purpose and Scope**

- a. The purpose of this policy is to establish specific guidelines which the City of Lake Elmo will use in the investment of City funds. The fundamental objectives for the investment of City funds include protection of principal, liquidity and an acceptable rate of return on all funds under the scope of this policy.
- b. This policy applies to the investment of all funds controlled by the City of Lake Elmo, excluding the investment of employees' retirement funds.
- c. Pooling of funds: Except for cash in certain restricted and special funds, the City will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Each individual fund cash balance will continue to be reported separately in the general ledger system. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

### **2. Objectives**

- a. The three main objectives of all investment activity are protection of principal (capital), liquidity and optimization of return with safety of capital being the primary objective.
- b. Investments will be undertaken in a manner which seeks to ensure the preservation of capital in the overall portfolio. Both credit and interest rate risk will be mitigated.
  - i. The City will minimize credit risk, which is the risk of loss due to the failure of the security issuer or backer, by limiting investments to those types outlined in this policy.
  - ii. The City will also minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changing market rates. Extended maturities may be utilized to take advantage of higher yields; however no more than 25% of total investments should extend beyond 5 years and in no circumstance should any extend beyond 10 years.
- c. The City will practice a buy and hold investing philosophy. Once an investment is purchased, it will be held until maturity. In the unlikely circumstance that unanticipated cash demand may require it an investment may be sold to cover immediate cash needs. This action must be approved by the City Council. In order to facilitate such a transaction, the majority of securities within the portfolio should have active secondary or resale markets.

### **3. Delegation of Authority**

- a. Management of the City's investment portfolio is delegated by the City Council to the Finance Director. The Finance Director shall establish procedures for the operation of the investment program consistent with this policy, shall be responsible for all transactions undertaken and shall establish a system of internal controls designed to prevent loss from fraud and employee error.

#### **4. Prudence**

- a. Investment personnel acting in accordance with this policy and with Minnesota Statutes 118A.01 – 118A.06 and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes provided that reasonable action is taken to control adverse developments and unexpected deviations are reported in a timely manner.
- b. Employees involved in the investment process shall refrain from personal business activity which would conflict with the proper execution of the investment program or which could impair their ability to make impartial investment decisions.

#### **5. Authorized Investments**

- a. Consistent with Minnesota Statutes Section 118A.04, the following is a listing of the instruments the City will be authorized to invest in:
  1. U.S. Treasury obligations which carry the full faith and credit guarantee of the United States government and are considered to be the most secure instruments available
  2. U.S. government agencies which are created and supervised by the federal government
  3. Certificates of Deposit (CD) which are negotiable or non-negotiable instruments issued by commercial banks and insured up to \$250,000 each by the Federal Deposit Insurance Corporation (FDIC)
  4. Commercial paper, rated in the highest tier (A1, P1) by a nationally recognized rating agency and maturing in 270 days or less
  5. General Obligations of the State of Minnesota or any of its municipalities. Municipalities should have a bond rating equal to or better than the City of Lake Elmo's bond rating.
  6. Repurchase agreements whose underlying purchased securities consist of the aforementioned instruments
  7. Money market mutual funds which invest in authorized instruments according to Minnesota Statutes 118A.05
- b. The City will not invest in:
  1. Reverse repurchase agreements;
  2. Mortgage-Back securities
  3. Future contracts
  4. Options
  5. Guaranteed investment contracts
  6. Derivatives
  7. Equities
  8. Alternative Investments

#### **6. Authorized Financial Institutions, Depositories & Broker/Dealers**

- a. The City of Lake Elmo will maintain a list of financial institutions, depositories and broker/dealers authorized to provide investment services to the City. This list will be provided to the City Council annually at the second Council meeting in January. Institutions will meet the following criteria:
  1. Minimum capital requirement \$10,000,000 and at least five years of operations and/or "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule)
  2. Located in the State of Minnesota
- b. An annual review of the financial condition and registration of all qualified financial institutions and broker/dealers may be conducted by the Finance Director. Information requested may include the following: audited financial statements, proof of National Association of Securities Dealers (NASD) certification, and proof of state registration.

- c. All brokers will provide to the City of Lake Elmo annually a Broker/Dealer Certification form as required by law, outlining their intention to do business with the City in accordance with Minnesota Statutes and the City's investment policy. All financial institutions shall agree to undertake reasonable efforts to preclude imprudent transactions involving City funds.
- d. Whenever possible using a local community bank is advised.

**7. Diversification**


- a. It is the policy of the City of Lake Elmo to diversify its investment portfolio by type, maturity of investment purchased and brokerages holding those investments. This will eliminate risk of loss resulting from over concentration of assets in a specific maturity, issuer or class of securities.
- b. Portfolio maturities will be staggered and maturities selected will provide for stability of income and liquidity.
- c. Primary guidance in the diversification will be the annual cash flow requirements of the City.

**8. Reporting**

- a. The Finance Director will provide at a minimum a Quarterly Investment Portfolio Performance report to the Finance Committee. This report will provide the current status of the City's investment portfolio. As a guideline the investment report should include the following information:
  - i. Type of investment
  - ii. Financial institution involved in the transaction
  - iii. Yield
  - iv. Purchase date and Maturity date
  - v. Amount invested
- b. An annual report on the investment portfolio performance will be available within 30 days subsequent to fiscal year end. The report will include the annual activity of the above data, return on investment, gains or losses due to marking the portfolio to market value and the percentage breakdown of investments by type and maturity.

Approved by City Council  
Date:

ATTEST:

  
Mike Pearson, Mayor