SUCCESSOR AGENCY TO THE COSTA MESA REDEVELOPMENT AGENCY

STATEMENT OF INVESTMENT POLICY

2014-2015

I. GENERAL INTRODUCTION

Under the laws of the State of California, it is the responsibility of the Successor Agency Treasurer, at the direction of the Successor Agency to the Costa Mesa Redevelopment Agency (Successor Agency), to secure and protect the public funds of the Successor Agency, and to establish proper safeguards, controls, and procedures to maintain these funds in a lawful, rational and auspicious manner. Said maintenance shall include the prudent and secure investment of those funds that are deemed temporarily excess, in a manner anticipated to provide additional benefit to the people of the Successor Agency. The City’s Finance Director serves as the Successor Agency Treasurer.

This Statement of Investment Policy will be provided annually for the review by the Finance Advisory Committee and the approval of the Successor Agency in an open public meeting. It will be provided to securities dealers, banks, and brokers currently approved for conducting investment transactions with the Successor Agency Treasurer’s office in the ongoing effort to manage the excess cash portfolio; to other affected persons or entities; and to any member of the electorate wishing to review this document upon request. The Successor Agency Treasurer reserves the right to provide these documents on a cost basis.

II. SCOPE

This Statement of Investment Policy pertains to those temporarily excess funds under the control of the Successor Agency Treasurer, designated for the daily ongoing operations of the Successor Agency; and concerns the deposit, maintenance, safekeeping, and preservation of all such funds, and the investments made with these funds. This Policy does not apply to pension trust funds, deferred compensation funds, and certain other trust or non-operating funds.

III. PURPOSE

The purpose of this Statement of Investment Policy is to provide the Successor Agency, the Finance Advisory Committee, those involved in servicing the investment requirements of the Successor Agency, and any other interested party, a clear understanding of the regulations and internal guidelines that will be observed in maintaining and investing those pooled funds deemed temporarily excess. This statement is intended to provide guidelines for the prudent investment of the Successor Agency's temporary idle cash, and outline the procedures for maximizing the efficiency of the Successor Agency's cash management system. The ultimate goal of the Investment Policy is to enhance the economic status of the Successor Agency while safeguarding its assets.

IV. OBJECTIVE

The Successor Agency's cash management system is designed to accurately monitor and forecast revenues and expenditures, thus enabling the Successor Agency to invest funds to the fullest extent possible only after the criteria established for safety and liquidity have been met.

The Successor Agency operates its pooled idle cash investments 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.

This affords the Successor Agency a broad spectrum of investment opportunities as long as the investment is deemed prudent and is allowable under current legislation of the State of California Government Code Section 53600 *et seq.* and the general laws of the City of Costa Mesa.

The Successor Agency strives to maintain the level of investment of all idle funds as near 100% as possible, through daily and projected cash flow determinations. Idle cash management and investment transactions are the responsibility of the Successor Agency Treasurer or his/her designee.

Criteria for selecting investments and the order of priority are:

1. Safety: The safety and risk associated with an investment refers to the potential loss of principal, interest, or a combination of these amounts. The Successor Agency only operates in those investments that are considered very safe.

2. Liquidity: This refers to the ability to "cash in" at any moment in time with a minimal chance of losing some portion of principal or interest.

3. Yield: Yield is the potential dollar earnings an investment can provide, and sometimes is referred to as the rate of return.

4. Safekeeping: Securities purchased shall be held in third party safekeeping in the Trust Department of a financial institution, in the Successor Agency's name and control. The account established shall be protected from seizure by creditors should the financial institution holding the Successor Agency's securities file for bankruptcy protection. The basic premise underlying the Successor Agency's investment philosophy is and continues to be, to insure that surplus funds are always safe and available when needed.

V. DELEGATION OF INVESTMENT AUTHORITY

Authority to manage the Successor Agency to the Costa Mesa Redevelopment Agency's investment program is derived from Successor Agency Resolution No. 14-71. Management responsibility for the investment program is hereby delegated for Fiscal Year 2014-2015 to the Successor Agency Treasurer or his/her designee, who shall establish written procedures for the operation of the investment program consistent with this Investment Policy. Procedures should include references to: safekeeping, repurchase agreements, wire transfer agreements, banking service contracts, and collateral/ depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Successor Agency Treasurer or his/her designee. The Successor Agency Treasurer or his/her designee shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

The Successor Agency may engage the services of an external investment manager to assist in the management of the Successor Agency's investment portfolio in a manner consistent with the Successor Agency's objectives. Such an external manager may be granted discretion to purchase and sell investment securities in accordance with this Investment Policy. Such a manager must be registered under the Investment Advisers Act of 1940.

VI. STANDARD OF PRUDENCE

The Successor Agency Treasurer shall perform the investment function in conjunction with the Prudent Investor Standard as set forth in the California Government Code Section 53600.3: "…all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the Successor Agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the Successor Agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law."

VII. AUTHORIZED AND SUITABLE INVESTMENTS

All investments will be made in accordance with Sections 53600 *et seq.* of the Government Code of California and as described within this Investment Policy. Permitted investments under this policy will include:

1. **Municipal Securities.** These include obligations of the City, the state of California, any other state, and any local Agency within the state of California, provided that:

    a. long-term obligations are rated "A" or higher by at least one nationally recognized statistical rating organization.
    b. The maximum maturity is five years.
    c. No more than 5% per issuer.

2. **U.S. Treasury** and other government obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest. There are no limits on the dollar amount or percentage that the Successor Agency may invest in U.S. Treasuries.

3. **Federal Agency** or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. There are no limits on the dollar amount or percentage that the Successor Agency may invest in government-sponsored enterprises.

4. **Banker's acceptances** provided that:

    a. They are issued by institutions with short term debt obligations rated "A-1" or higher, or the equivalent, by at least one nationally recognized statistical-rating organization (NRSRO); and have long-term debt obligations which are rated "A" or higher by at least one nationally recognized statistical rating organization;
    b. The maturity does not exceed 180 days; and,
    c. No more than 40% of the total portfolio may be invested in banker's acceptances and no more than 5% per issuer.

5. **Federally insured time deposits** (Non-negotiable certificates of deposit) in state or federally chartered banks, savings and loans, or credit unions, provided that:

   a. The amount per institution is limited to the maximum covered under federal insurance; and,
   b. The maturity of such deposits does not exceed 5 years.

6. **Time deposits (Non-negotiable certificates of deposit)** in state or federally chartered banks, savings and loans, or credit unions in excess of insured amounts which are fully collateralized with securities in accordance with California law, provided that:

   a. No more than 20% of the portfolio will be invested in a combination of federally insured and collateralized time deposits;
   b. They are issued by institutions which have long-term debt obligations which are rated "A" or higher by at least one nationally recognized statistical rating organization; and/or have short term obligations rated "A-1" or higher, or the equivalent, by at least one nationally recognized statistical rating organization; and,
   c. The maturity of such deposits does not exceed 5 years.

7. **Certificate of Deposit Placement Service (CDARS)**

   a. No more than 30% of the total portfolio may be invested in a combination of certificates of deposit including CDARS.
   b. The maturity of CDARS deposits does not exceed five years.

8. **Negotiable certificates of deposit (NCDs)** provided that:

   a. They are issued by institutions which have long-term obligations which are rated "A" or higher by at least one nationally recognized statistical rating organization; and/or have short term debt obligations rated "A-1" or higher, or the equivalent, by at least one nationally recognized statistical rating organization;
   b. The maturity does not exceed five years; and,
   c. No more than 30% of the total portfolio may be invested in NCDs and no more than 5% per issuer.

9. **Repurchase agreements** collateralized with securities authorized under the Successor Agency's Authorized and Suitable Investments (Section VII) of this policy maintained at a level of at least 102% of the market value of the repurchase agreements, provided that:

   a. The maximum maturity of repurchase agreements will be 1 year;
   b. No more than 30% of the total portfolio may be invested in repurchase agreements;
   c. Securities used as collateral for repurchase agreements will be delivered to the Successor Agency's custodian bank (See Section X); and,
   d. The repurchase agreements are the subject of a master repurchase agreement between the Successor Agency and the provider of the repurchase agreement. The master repurchase agreement will be substantially in the form developed by the Securities Industry and Financial Markets Association (SIFMA).

10. **Commercial paper** provided that:

a. The maturity does not exceed 270 days from the date of purchase;
b. The issuer is a corporation organized and operating in the United States with assets in excess of $500 million;
c. They are issued by institutions whose short term obligations are rated “A-1” or higher, or the equivalent, by at least one nationally recognized statistical rating organization; and whose long-term obligations are rated “A” or higher by at least one nationally recognized statistical rating organization; and,
d. No more than 25% of the portfolio is invested in commercial paper and no more than 5% per issuer.

11. **State of California Local Agency Investment Fund (LAIF)**, provided that:

a. The Successor Agency may invest up to the maximum permitted amount in LAIF; and,
b. LAIF’s investments in instruments prohibited by or not specified in the Successor Agency’s policy do not exclude it from the Successor Agency’s list of allowable investments, provided that the fund’s reports allow the Successor Agency Treasurer to adequately judge the risk inherent in LAIF’s portfolio.

12. **Orange County Treasurer’s Pool** is a special fund in the County Treasury which local agencies may use to deposit funds for investment. The Successor Agency may not invest more than 35% of its surplus money with the Orange County Treasurer’s Pool. The County Treasurer currently charges 8.2 basis points (.082%) to all pool participants for its investment administrative fee. Investment earnings are distributed to the pool participants on a monthly basis, net of the above charges. The earnings are credited to the participant’s accounts on either the last day of the month or the first day of the subsequent month.

13. **Corporate medium term notes (MTNs),** provided that:

a. Such notes have a maximum maturity of five years;
b. Are issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States;
c. Are rated “A” category or better by at least one nationally recognized statistical rating organization; and,
d. Holdings of medium-term notes may not exceed 30% of the portfolio and no more than 5% per issuer.

14. **Mortgage pass-through securities, collateralized mortgage obligations, and asset-backed securities,** provided that such securities:

a. Have a maximum stated final maturity of five years;
b. Be issued by an issuer having an “A” or higher rating for the issuer’s debt as provided by a nationally recognized statistical rating organization;
c. Be rated in a rating category of “AA” or its equivalent or better by a nationally recognized statistical rating organization.
d. Purchase of securities authorized by this subdivision may not exceed 20% of the portfolio.

15. **Money market mutual funds** that are registered with the Securities and Exchange Commission under the Investment Company Act of 1940:

a. Provided that such funds meet either of the following criteria:
   1. Attained the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized statistical rating organizations; or,
   2. Have retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by California Government Code Section 53601 (a through j) and with assets under management in excess of $500 million.

b. Purchase of securities authorized by this subdivision may not exceed 20% of the portfolio.

VIII. INVESTMENT OF BOND PROCEEDS

When investing proceeds from the issuance of bonds, the Successor Agency will follow this Investment Policy when determining allowable investments. Should the trust agreement of a particular bond issue be more restrictive than the Successor Agency's policy on permitted investments, then the trust agreement will take precedence.

IX. SUCCESSOR AGENCY CONSTRAINTS

The Successor Agency Treasurer or his/her designee will evaluate local banks and savings institutions and may invest idle cash funds with such institutions when the criteria for prudent investment previously stated are met. The Successor Agency operates its investment pool according to State and self-imposed constraints. Any investment extending beyond a five-year period requires prior Successor Agency approval. Additionally, a minimum of 20% of the outstanding investments must mature within a one-year time period.

X. SAFEKEEPING AND COLLATERALIZATION

All security transactions, including collateral for repurchase agreements, entered into by the Successor Agency shall be conducted on a delivery-versus-payment (DVP) basis. Securities will be held by a third party custodian designated by the Successor Agency Treasurer or his/her designee.

Collateralization will be required on two types of investments: certificates of deposit and repurchase agreements. In order to anticipate market changes and provide a level of security for all funds, a minimum collateralization level is required.

Surplus funds must be deposited in State or national banks, State or Federal savings and loan associations, or State or Federal credit unions within the State of California. The deposits cannot exceed the amount of the bank's or savings and loan's paid-up capital and surplus.

The bank or savings and loan must secure public funds deposits with eligible securities having a market value of 110% of the total amount of the deposits. State law also allows as an eligible security, first trust deeds having a value of 150% of the total amount of the deposits. A third class of collateral is 105% in the form of a letter of credit drawn on the Federal Home Loan Bank.

The Successor Agency Treasurer or his/her designee may waive security for that portion of a deposit, which is insured pursuant to Federal law. Currently, the first $250,000 of a deposit is federally insured and deposits in excess of $250,000 are collateralized as previously indicated.

XI. PORTFOLIO RISK MANAGEMENT

A. Prohibited investment vehicles and practices

1. State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to futures and options, or stocks.

2. In accordance with Government Code Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.

3. Investment in any security that could result in a zero interest accrual if held to maturity is prohibited.

4. Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.

5. Purchasing or selling securities on margin is prohibited.

6. The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited.

7. The purchase of foreign currency denominated securities is prohibited.

B. 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 Successor Agency will mitigate credit risk by adopting the following strategies:

1. The diversification requirements included in Section VII are designed to mitigate credit risk in the portfolio;

2. No more than 5% of the total portfolio may be invested in securities of any single issuer, other than the U.S. Government, its agencies and enterprises;

3. The Successor Agency may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or Successor Agency's risk preferences; and,

4. If securities owned by the Successor Agency are downgraded by either Moody's or S&P to a level below the quality required by this Investment Policy, it will be the Successor Agency's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.

    a. If a security is downgraded, the Successor Agency Treasurer will use discretion in determining whether to sell or hold the security based on its current maturity, the economic outlook for the issuer, and other relevant factors.

    b. If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported monthly to the governing board.

C. <u>Mitigating market risk in the portfolio</u>

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The Successor Agency recognizes that, over time, longer-term portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The Successor Agency will 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 cashflow purposes. The Successor Agency 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 Successor Agency, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

1. The Successor Agency will 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 (does not include "make whole call" securities as defined in the Glossary) in the portfolio will be 20%;

3. The maximum stated final maturity of individual securities in the portfolio will be five years, except as otherwise stated in this policy; and,

4. The duration of the portfolio will at all times be approximately equal to the duration (typically plus or minus 20%) of a Market Benchmark Index selected by the Successor Agency based on the Successor Agency's investment objectives, constraints and risk tolerances. The Successor Agency's current Benchmark will be documented in the investment guidelines.

<u>XII. POLICY COMPLIANCE REGULATIONS</u>

Should the portfolio, for any reason, fall out of compliance with this Investment Policy, immediate liquidation of securities in order to bring the portfolio back into compliance is not required. However, the Treasurer must take action to bring the portfolio into compliance within 12 months from the date the portfolio was determined to be in non-compliance with the provisions of this Investment Policy so long as the action is deemed to be prudent under then current market conditions. Additionally, adequate disclosure as to all instances of noncompliance, and the efforts undertaken to bring the portfolio into compliance, must be made on the monthly Treasurer's Report.

XIII. REPORTING

Under provisions of Section 53646 of the California Government Code, the Successor Agency Treasurer or his/her designee shall render a quarterly investment report to the Successor Agency, the Chief Executive Officer, and the Successor Agency Attorney within 30 days following the end of the quarter covered by the report. However, as a matter of practice, a monthly report shall be submitted listing the type of investments, institution, date of maturity, par value, amount of deposit, rate of interest, current market value for all securities, and such other data as may be required by the Successor Agency Board on a monthly basis. Furthermore, a Finance Advisory Committee comprised of the following individuals will meet quarterly to review the Successor Agency's portfolio and investment strategy.

- Mayor, or his/her designee
- Chief Executive Officer, or his/her designee
- Successor Agency Treasurer
- Assistant Finance Director
- Revenue Supervisor
- Nine Committee Members appointed by City Council who are either residents or conduct business within the City and have experience in banking, securities trading, or financial planning.

Monthly reports

Monthly investment reports will be submitted by the Successor Agency Treasurer or his/her designee to the Successor Agency members and the Finance Advisory Committee. These reports will disclose, at a minimum, the following information about the risk characteristics of the Successor Agency’s portfolio:

1. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate;

2. Monthly transactions for the period;

3. A one-page summary report that shows:

    a. Average maturity of the portfolio and modified duration of the portfolio;
    b. Maturity distribution of the portfolio;
    c. Average portfolio credit quality; and,
    d. 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;

4. A statement of compliance with investment policy, including a schedule of any transactions or holdings which do not comply with this policy or with the California Government Code Section 53600 *et seq*., including a justification for their presence in the portfolio and a timetable for resolution; and,

5. A statement that the Successor Agency has adequate funds to meet its cash flow requirements for the next six months.

XIV. 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 described in the investment procedures manual. These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-1 (uniform net capital rule).

A. The Successor Agency Finance Director/Treasurer will determine which financial institutions are authorized to provide investment services to the Successor Agency. Institutions eligible to transact investment business with the Successor Agency include:

   1. Primary government dealers as designated by the Federal Reserve Bank and non-primary government dealers;

   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 Successor Agency will be at the sole discretion of the Successor Agency.

C. All financial institutions which desire to become qualified bidders for investment transactions (and which are not dealing only with the investment adviser) must supply the Finance Director/Treasurer with a statement certifying that the institution has reviewed the California Government Code Section 53600 *et seq*. and the Successor Agency's Investment Policy.

D. Selection of broker/dealers used by an external investment adviser retained by the Successor Agency will be at the sole discretion of the investment adviser.

E. Public deposits will be made only in qualified public depositories as established by State law. Deposits will be insured by the Federal Deposit Insurance Corporation, or, to the extent the amount exceeds the insured maximum, will be collateralized in accordance with State law.

XV. POLICY REVIEW

This Statement of Investment Policy shall be reviewed at least annually to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law, financial and economic trends.

Should conditions change or legislation become effective that behooves subsequent changes or a liberalization of terms within the policy during the next fiscal year, the revised policy will be submitted to both the Finance Advisory Committee and Council for adoption of the recommended action.

XVI. INVESTMENT OBJECTIVES (PERFORMANCE STANDARDS AND EVALUATION)

A. **Overall objective:** The investment portfolio will be designed with the overall objective of obtaining a total rate of return throughout economic cycles, commensurate with investment risk constraints and cash flow needs.

B. **Specific objective:** The investment performance objective for the portfolio will be to earn a total rate of return over a market cycle which is approximately equal to the return on the Market Benchmark Index as described in the Successor Agency's investment guidelines.

SUCCESSOR AGENCY TO THE COSTA MESA REDEVELOPMENT AGENCY

INVESTMENT GUIDELINES AND STRATEGY

I. GUIDELINES - Guidelines are established to direct and control activities in such a manner that previously established goals are achieved.

1. Investment Transactions. Investment transactions will be periodically reviewed by the Treasurer or his/her designee.

2. Pooled Cash. Whenever practical, Successor Agency cash is consolidated into one bank account and invested on a pooled concept basis. Interest earnings are allocated quarterly according to month-end cash and investment balances for each fund.

3. Competitive Bids. Purchase and sales of securities are made on the basis of competitive offers and bids when practical.

4. Cash Forecast. The cash flow for the Successor Agency is analyzed with the receipt of revenues and maturity of investments scheduled so that adequate cash will be available to meet disbursement requirements.

5. Investment Limitations. Security purchases and holdings are maintained within statutory limits imposed by the California Government Code. Current limits are:

Bankers' Acceptances	40% Section 53601(g)
Commercial Paper	25% Section 53601(h)
Negotiable Certificates of Deposit	30% Section 53601(i)
Medium Term Notes	30% Section 53601(k)
Money Market Mutual Funds	20% Section 53601(l)
Asset-Backed/Mortgage-Backed Securities	20% Section 53601(o)
Federal Agency restriction	35% per Agency Section VII of Policy
Local Agency Investment Fund	$50,000,000 per Section VII of Policy
Orange County Treasurer's Pool	35% per Section VII of Policy
Portfolio Maturing within one year	20% per Section IX of Policy

6. Liquidity. The marketability of a security is considered at the time of purchase, as the security may have to be sold at a later date to meet unanticipated cash demands.

7. Diversification. The portfolio should consist of a mix of various types of securities, issuers, and maturities.

8. Evaluate Certificates of Deposit
   (a) Certificates of Deposit shall be evaluated in terms of FDIC coverage. For deposits in excess of the FDIC insured maximum, approved collateral at full market value shall be required. (California Government Code Section 53652)
   (b) Negotiable Certificates of Deposit shall be evaluated in terms of the credit worthiness of the issuer, as these deposits are uninsured and uncollateralized promissory notes.

II. STRATEGY - Strategy refers to the ability to manage financial resources in the most advantageous manner.

1. Economic Forecasts. Economic Forecasts are obtained periodically from economists and financial experts through bankers and brokers to assist the Treasurer or his/her designee with the formulation of an investment strategy for the local agency.

2. Implementing Investment Strategy. Investment transactions are executed which conform with anticipated interest rate trends and the current investment strategy plan.

3. Rapport. A close working relationship is maintained with large vendors of the Successor Agency. The objective is to pinpoint when large disbursements will clear the Successor Agency's bank account. It is essential for good cash control that such large expenditures be anticipated, estimated as to dollar amount, and communicated to the Treasurer or his/her designee for liquidity planning purposes.

4. Preserve Portfolio Value. Field standards are developed in order to maintain earnings near the market and to preserve the value of the portfolio.

SUCCESSOR AGENCY TO THE COSTA MESA REDEVELOPMENT AGENCY

INVESTMENT PROCEDURES
INTERNAL CONTROL - GUIDELINES

OBJECTIVES OF INTERNAL CONTROL

Internal control is the plan of organization and all the related systems established by the management's objective of ensuring, as far as practicable:

- The orderly and efficient conduct of its business, including adherence to management policies.
- The safeguarding of assets.
- The prevention or detection of errors and fraud.
- The accuracy and completeness of the accounting records.
- The timely preparation of reliable financial information.

LIMITATIONS OF INTERNAL CONTROL

No internal control system, however elaborate, can by itself guarantee the achievement of management's objectives. Internal control can provide only reasonable assurance that the objectives are met, because of its inherent limitations, including:

- Management's usual requirement that a control be cost-effective.
- The direction of most controls at recurring, rather than unusual, types of transactions.
- Human error due to misunderstanding, carelessness, fatigue, or distraction.
- Potential for collusion that circumvents controls dependent on the segregation of functions.
- Potential for a person responsible for exercising control abusing that responsibility; a responsible staff member could be in a position to override controls which management has set up.

INVESTMENT PROCEDURES
INTERNAL CONTROL - GUIDELINES
(Continued)

ELEMENTS OF INTERNAL CONTROL

Elements of a system of internal control are the means by which an organization can satisfy the objectives of internal control. These elements are:

1. ORGANIZATION
   Specific responsibility for the performance of duties should be assigned and lines of authority and reporting clearly identified and understood.

2. PERSONNEL
   Personnel should have capabilities commensurate with their responsibilities. Personnel selection and training policies together with the quality and quantity of supervision are thus important.

3. SEGREGATION OF FUNCTIONS
   Segregation of incompatible functions reduces the risk that a person is in a position both to perpetrate and conceal errors or fraud in the normal course of duty. If two parts of a transaction are handled by different people, collusion is necessary to conceal errors or fraud. In particular, the functions that should be considered when evaluating segregation of functions are authorization, execution, recording, custody of assets, and performing reconciliations.

4. AUTHORIZATION
   All transactions should be authorized by an appropriate responsible individual. The responsibilities and limits of authorization should be clearly delineated. The individual or group authorizing a specific transaction or granting general authority for transactions should be in a position commensurate with the nature and significance of the transactions. Delegation of authority to authorize transactions should be handled very carefully.

5. CONTROLS OVER AN ACCOUNTING SYSTEM
   Controls over an accounting system include the procedures, both manual and computerized, carried out independently to ascertain that transactions are complete, valid, authorized, and properly recorded.

SUCCESSOR AGENCY TO THE COSTA MESA REDEVELOPMENT AGENCY

CASH CONTROLS

PROCEDURES PERFORMED BY EXTERNAL AUDITORS WITH RESPECT TO CASH RECEIPTS

A. Successor Agency procedures and controls are reviewed. Some of the system strengths are:

1. Receipts are controlled upon receipt by proper registration devices.
2. Receipts are reconciled on a daily basis.
3. Amounts are deposited intact.
4. All bank accounts are authorized by the Successor Agency.
5. Cash counts are done by two or more individuals.
6. Bank reconciliations are reviewed.
7. Prompt posting of cash receipt entries in books.
8. Receipt forms are prenumbered, accounted for, and physically secured.
9. Proper approval required for write-off's of customer accounts.
10. Checks are restrictively endorsed upon receipt or when run through cash register.
11. Adequate physical security over cash.
12. Individuals that handle cash do not post to customer account records or process billing statements.
13. Adequate supervision of Finance Department operations.

B. Significant revenues are confirmed directly with payor and compared with Successor Agency books to make sure amounts are recorded properly.

C. Cash balances are substantiated by confirming all account balances recorded in books. Bank reconciliations are reviewed for propriety and recalculated by the auditor. All significant reconciling items on bank reconciliations are verified as valid reconciling items by proving to subsequent bank statements.

SUCCESSOR AGENCY TO THE COSTA MESA REDEVELOPMENT AGENCY

SEGREGATION OF RESPONSIBILITIES OF THE TREASURY FUNCTIONS

	Function	Responsibility
1.	Authorization of investment transactions:	
	Formal investment policy should be:	
	* Prepared by:	Successor Agency Treasurer
	* Submitted to:	Successor Agency
	Investment transactions should be approved by	Successor Agency Treasurer and/or External Investment Manager
2.	Execution of investment transactions	Assistant Finance Director and/or Revenue Supervisor and/or External Investment Manager
3.	Investment transactions approved for compliance with investment policy and/or State law	Assistant Finance Director and/or External Investment Manager
4.	Timely recording of investment transactions:	
	Recording of investment transactions in the Treasurer's records	Revenue Supervisor
	Recording of investment transactions in the accounting records	Accounting Supervisor and/or Accountant
5.	Verification of investment, i.e., match broker confirmation to Treasurer's records	Assistant Finance Director and/or Revenue Supervisor and/or External Investment Manager
6.	Safeguarding of assets and records:	
	Reconciliation of Treasurer's records to the accounting records	Revenue Supervisor
	Reconciliation of Treasurer's records to bank statements and safekeeping records	Accounting Supervisor and/or Accountant

SUCCESSOR AGENCY TO THE COSTA MESA REDEVELOPMENT AGENCY

SEGREGATION OF RESPONSIBILITIES OF THE TREASURY FUNCTIONS (Continued)

Function		Responsibility
6.	Safeguarding of Assets and Records (continued):	
	Annual review of (a) financial institution's financial condition, (b) safety, liquidity, and potential yields of investment instruments.	Assistant Finance Director with Successor Agency Treasurer's approval
7.	No less than an annual review of investment portfolio as prepared by Treasurer including: • Investment types • Purchase Price • Par values • Market values • Maturity dates • Investment yields • Conformance to stated investment policy • Safekeeping reports	External Independent Auditors
8.	Periodic review of investment portfolio and strategies.	Finance Advisory Committee

GLOSSARY

(**Note**: Entities are encouraged to include a glossary as part of the investment policy. All words of a technical nature should be included. Following is an example of common treasury terminology.)

AGENCIES: Federal agency securities and/or Government - sponsored enterprises.

ASKED: The price at which securities are offered.

BANKERS' ACCEPTANCE (BA): a draft or bill or exchange accepted by a bank or trust company.

BID: The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See Offer.

BROKER: A broker brings buyers and sellers together for a commission..

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secured deposits of public monies.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the City of Costa Mesa. It includes five combined statements for each individual fund and group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. A certificate attached to a bond evidencing interest due on a payment date. DEALER: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling

DEBENTURE: A bond secured only by the general credit of the issuer.

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

DERIVATIVES: (1) Financial instrument whose return profile is linked to, or derived from, the movement of one or more underlying index or security, and may include a leveraging factor, or (2) financial contracts based upon notional amounts whose value is derived from an underlying index or security (interest rates, foreign exchanges, equities or commodities).

DISCOUNT: The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Non-interest bearing money market instruments that are issued a discount and redeemed at maturity for full face value, *e.g.*, U.S. Treasury Bills.

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent returns.

FEDERAL CREDIT AGENCIES: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, *e.g.*, S&L's, small business firms, students, farmers, farm cooperatives, and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FIDC): A federal agency that insures bank deposits, currently up to $250,000 per deposit.

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks) which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae): Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FmHA mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL GOVERNMENT INVESTMENT POOL (LGIP): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase – reverse repurchase agreements that established each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date upon which the principal or stated value of an investment becomes due and payable.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked and Bid.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers 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. Primary dealers include Securities and Exchange Commission (SEC) - registered securities broker-dealers, banks, and a few unregulated firms.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond the current income return.

REPURCHASE AGREEMENT (RP OR REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money, that is, increasing bank reserves.

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.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES & EXCHANGE COMMISSION: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

SEC RULE 15C3-1: See Uniform Net Capital Rule.

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations which have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

TREASURY BILLS: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

TREASURY BONDS: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

YIELD: The rate of annual income return on an investment, expressed as a percentage. (a) **INCOME YIELD** is obtained by dividing the current dollar income by the current market price for the security. (b) **NET YIELD** or **YIELD TO MATURITY** is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.