



CITY OF ANN ARBOR

INVESTMENT POLICY

Council Resolution



City of Ann Arbor, Michigan

Investment Policy

Overview

The City of Ann Arbor, Michigan (“the City”) is a home rule municipality operating under its City Charter and City Code. The City functions under the direction of a City Administrator who is appointed by an eleven-member City Council. The purpose of this Investment Policy is to establish the investment scope, objectives, delegation of authority, standards of prudence, eligible investments and transactions, internal controls, reporting requirements, and safekeeping and custodial procedures necessary for the prudent investment of the funds of the City of Ann Arbor.

This Investment Policy has been adopted by resolution of the City Council of Ann Arbor, Michigan and replaces all previous investment policies or resolutions concerning the cash management or investment of City funds.

The City manages a flexible investment portfolio, which includes general operating funds, bond reserve funds, proceeds from bond sales that will be expended on capital projects as well as various other funds. Because these funds may be required at any time, it is essential that the City maintain strict maturity horizons for the purpose of liquidity control.

Policy

It is the policy of the City of Ann Arbor to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the City and conforming to Michigan Public Act 20 of 1943.

Scope

This Investment Policy applies to all cash and securities of the City except assets of the Pension Fund, Housing Commission, Fifteenth District Court, Elizabeth Dean Fund, Downtown Development Authority and Contractor’s Retainage Fund. The financial assets of the Consolidated Investment Fund, Limited Investment Fund, Capital Projects Funds, Trust and Agency Funds, and any other funds not specifically excluded from the provisions of this Investment Policy are included herein.

In order to effectively make use of the City’s cash resources, all moneys, except cash in certain restricted and special accounts, shall be pooled into one investment account and accounted for separately. The investment income derived from this account shall be

allocated to the various funds based upon each fund's respective participation.

Investment Objectives

The City's funds shall be invested in accordance with all applicable City policies, State statutes, and Federal regulations, and in a manner designed to accomplish the following objectives, which are listed in priority order:

- Safety: Preservation of capital and protection of investment principal
- Liquidity: Maintenance of sufficient liquidity to meet anticipated disbursements and cash flows
- Yield: Attainment of a market rate of return equal to or higher than the performance measure recommended by the Treasurer and approved by the Chief Financial Officer.

Prudence and Indemnification

The standard of prudence to be used in managing the City's assets is the "prudent investor" rule which states, "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."

The City's overall investment program shall be designed and managed with a degree of professionalism that is worthy of the public trust. The City shall recognize that no investment is without risk and that the investment activities of the City are a matter of public record. Accordingly, the City recognizes that occasional measured losses may be desirable in a diversified portfolio and shall be considered within the context of the overall portfolio's return, provided that adequate diversification has been implemented and that the sale of a security before maturity can be in the best long-term interest of the City.

Personnel acting in accordance with this Investment Policy and written procedures and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price change, or other loss in accordance with the City's Indemnification Policy in effect at the time.

Delegation of Authority

The ultimate responsibility and authority for the investment of all City funds resides with the Chief Financial Officer. Acting under the authority of the City Code Chapter 5, 1.103(2), the Chief Financial Officer may delegate the authority to conduct investment transactions and to manage the operation of the investment portfolio to other specifically authorized persons. The Chief Financial Officer, Treasurer, and Deputy Treasurer are authorized to transact investment business on behalf of the City.

Subject to required procurement procedures, the City may engage the support services of outside professionals in regard to its financial program, so long as it can be

demonstrated that these services produce a net financial advantage or necessary financial protection of the City's resources. Such services may include engagement of financial advisors in conjunction with debt issuance, portfolio management, special legal representation, third party custodial services, and appraisals by independent rating services.

Investment Procedures

The Chief Financial Officer shall establish written administrative procedures for the operation of the City's investment program as well as internal controls, which shall include explicit delegation of authority to personnel responsible for investment transactions. The procedures shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, or imprudent actions by employees and officers of the City.

Ethics and Conflicts of Interest

All City employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program or which could impair, or create the appearance of an impairment of, their ability to make impartial investment decisions. Employees shall disclose to the Chief Financial Officer any material equity interests in financial institutions that conduct business with the City and they shall subordinate their personal investment transactions to those of the City. Failure to report these relationships may be grounds for discipline, up to and including termination. Employees shall comply with all applicable laws, regulations, professional codes of responsibilities and City policies.

Selection of Banks

The Treasurer shall maintain a list of banks and savings banks authorized to provide depository and other banking services and from which the City may purchase Time Certificates of Deposit. To be authorized, a bank must be eligible to be a depository of funds belonging to the State of Michigan and maintain a principal office or branch office in Michigan. Banks that fail to meet this criteria, or in the judgment of the Treasurer no longer offer adequate safety to the City, will be removed from the list.

Selection of Broker/Dealers

The Treasurer shall maintain a list of broker/dealers authorized to conduct security transactions with the City. To be eligible, a firm must meet at least one of the following criteria:

1. Be recognized as a Primary Dealer by the Federal Reserve Bank of New York or have a primary dealer within their holding company structure; or
2. Report voluntarily to the Federal Reserve Bank of New York; or
3. Qualify under Securities and Exchange Commission (SEC) Rule 15c3-1 (Uniform Net Capital Rule).

In addition, each broker/dealer must complete and annually update a City approved Broker/Dealer Information Request Form, and submit the firm's most recent financial statements.

Broker/dealers will be selected on the basis of their expertise in public cash management and their ability to provide services for the City's account. Approved broker/dealers and firms they represent must be licensed to do business in the State of Michigan and as such are subject to the provisions of Michigan Statutes relating to the investment of public funds.

Per Section 129.96 of Michigan's Act 20 of 1943, before an order to purchase or trade the funds of the City, a financial intermediary, broker, or dealer shall be provided with a copy of this investment policy and shall do both of the following:

- A. Acknowledge receipt of the investment policy.
- B. Agree to comply with the terms of the investment policy regarding the buying or selling of securities.

The City may purchase Commercial Paper from direct issuers even though they are not on the approved broker/dealer list as long as the Commercial Paper meets the criteria outlined in Item 6 of the Authorized Investments and Transactions section of this Investment Policy.

Authorized Investments and Transactions

All investments for the City shall be made in accordance with Michigan State statutes: Act 20 of 1943 as amended, M.C.L. 129.91-129.96, Investment of Surplus Funds of Political Subdivisions, and Act 40 of 1932 as amended, M.C.L. 129.12, Depositories for Public Moneys.

The City has further delineated the types of securities and transactions eligible for use by the City as follows:

1. U.S. Treasury Obligations: United States Treasury Bills, Treasury Notes, Treasury Bonds, and Treasury Strips with maturities not exceeding fifteen years from the date of trade settlement. There is no limit on the percentage of the portfolio that may be invested in these obligations.
2. Federal Agency Securities: Debentures and mortgage-backed securities with a stated final maturity not exceeding ten years from the date of trade settlement. Investments in Federal Agency Securities shall not exceed 10% of the City's investment portfolio.
3. Federal Instrumentality Securities: Debentures, discount notes, step-up and callable securities with a final maturity not exceeding ten years from the date of trade settlement. Investments in Federal Instrumentality Securities shall not exceed 65%

of the City's investment portfolio, and no more than 30% of the City's investment portfolio may be invested in any one issuer of federal instrumentality securities.

4. Time Certificates of Deposit with a maturity not exceeding five years, and issued by state or federally chartered banks or savings banks as defined in M.C.L. 129.16, "Depositories for Public Money", that are eligible to be a depository of funds for the State of Michigan, and Certificates of Deposit that are purchased in accordance with M.C.L. 129.91 guidelines. Time Certificates of Deposit may be purchased only from banks that have maintained an average Highline Banking Data Services Rating of 30 or better on a scale of zero to 99, with 99 being the highest quality, for the four most recent reporting quarters. Investments in certificates of deposit shall not exceed 20% of the City's investment portfolio and no more than 5% of the City's investment portfolio may be invested in any one issuer.
5. Obligations of the State of Michigan or any of its political subdivisions with a final maturity not exceeding ten years from the date of trade settlement, that are rated at least AA or the equivalent by at least one NRSRO, and not less by any. Investments in such obligations shall not exceed 10% of the City's investment portfolio and no more than 3% of the City's investment portfolio may be invested in any one issuer. Diversification and credit criteria described for obligations of the State of Michigan are not applicable to issues of the City of Ann Arbor.
6. Prime Commercial Paper with an original maturity of 270 days or less which is rated A-1 or the equivalent at the time of purchase by not less than two NRSROs. If the commercial paper issuer has senior debt outstanding, the senior debt must be rated A+ or the equivalent by not less than two of those rating services. Investments in commercial paper shall not exceed 25% of the City's investment portfolio and no more than 5% of the City's investment portfolio may be invested in any one issuer.
7. Repurchase Agreements with a termination date of 90 days or less collateralized by U.S. Treasury Obligations or Federal Instrumentality Securities listed in 1 and 3 above with maturities not exceeding ten years.

Collateralization: For the purpose of this section, the term "collateral" shall mean "purchased securities" under the terms of the City approved Master Repurchase Agreement. The collateral shall have an original minimum market value (including accrued interest) of 102% of the dollar value of the transaction and the collateral maintenance level shall be 101%. If collateralized value drops below 101 percent, it will immediately be restored to 102%. Collateral shall be held by the City's custodial bank as safekeeping agent, and the market value of the collateral securities shall be marked to the market daily based on that day's bid price. The right of collateral substitution is granted.

Master Repurchase Agreement: Repurchase Agreements shall be entered into only with primary dealers reporting to the Federal Reserve Bank of New York, or with firms that have a primary dealer within their holding company structure or with approved depository banks that have executed an approved Master Repurchase Agreement with the City. Primary dealers approved as Repurchase Agreement counterparties should have a short-term debt rating of at least A-1 or the equivalent and a long-term debt rating of at least A or the equivalent, if rated. The Treasurer shall maintain a copy of the City's approved Master Repurchase Agreement along with a list of the counterparties who have executed a Master Repurchase Agreement with the City.

There is no limit on the percentage of the portfolio that may be invested in repurchase agreements.

8. Money Market Mutual Funds registered under the Investment Company Act of 1940 that are "no-load" (i.e., no commission or fee shall be charged on purchases or sales of shares); have a constant daily net asset value per share of \$1.00; limit assets of the fund to securities authorized in M.C.L. 129.91 as legal investments for a public corporation; have a maximum stated maturity in accordance with Rule 2a-7 of the Investment Company Act of 1940; and are rated either AAAM or the equivalent. The Treasurer shall pre-approve each Money Market Fund before purchase. Investments in money market mutual funds shall not exceed 30% of the City's investment portfolio.
9. Investment Pools organized under Act 367 of 1982, MCL 129.111 to MCL 129.118, Surplus Funds Investment Pool Act, that are "no-load"; have a constant daily net asset value per share of \$1.00; limit assets of the fund to securities authorized in M.C.L. 129.91 as legal investments for a public corporation; and have a maximum stated maturity and weighted average maturity in accordance with Rule 2a-7 of the Investment Company Act of 1940. Investments in investment pools shall not exceed 10% of the City's investment portfolio.

It is the intent of the City that the foregoing list of authorized securities be strictly interpreted. Any deviation from this list must be pre-approved by the Chief Financial Officer in writing.

Securities that have been downgraded to a level that is below the minimum ratings described herein may be sold or held at the City's discretion. The portfolio will be brought back into compliance with Investment Policy guidelines as soon as is practical.

Collateralization of Deposits

The State of Michigan does not require collateralization of all public funds. See Authorized Investments and Transactions, above, for repurchase agreement collateralization requirements.

Safekeeping and Custody

The City Council shall designate one or more financial institutions to provide safekeeping and custodial services for the City. A City approved Safekeeping Agreement shall be executed with each custodian bank prior to utilizing that bank's safekeeping services. To be eligible for designation as the City's safekeeping and custodian bank, a financial institution shall meet the criteria described in the Selection of Banks section of this Investment Policy.

Custodian banks will be selected on the basis of their ability to provide services for the City's account and the competitive pricing of their safekeeping related services.

The purchase and sale of securities and repurchase agreement transactions shall be settled on a delivery versus payment basis. Ownership of all securities shall be perfected in the name of the City. Sufficient evidence to title shall be consistent with modern investment, banking and commercial practices.

All City owned securities, except Certificates of Deposit, Investment Pools, and Money Market Mutual Funds, will be delivered by either book entry or physical delivery and will be held in third-party safekeeping by a City approved custodian bank, its correspondent bank or the Depository Trust Company (DTC).

All Fed wireable book entry securities shall be held in the Federal Reserve system in a customer account for the custodian bank, which will name the City as "customer."

All DTC eligible securities shall be held in the custodian bank's DTC participant account and the custodian bank shall provide evidence that the securities are held for the City as "customer."

All non-book entry (physical delivery) securities shall be held by the custodian bank or its correspondent bank and the custodian bank shall provide evidence that the securities are held for the City as "customer."

Investment Diversification

It is the intent of the City to diversify the investments within its portfolio to avoid incurring unreasonable risks inherent in over investing in specific instruments, individual financial institutions or maturities. The asset allocation in the portfolio should, however, be flexible depending upon the outlook for the economy, the securities market, and the City's anticipated cash flow needs.

There is no limit on the percentage of the portfolio that may be invested in U.S. Treasury Obligations and Repurchase Agreements. However, no more than 30% of the total portfolio shall be invested in any one issuer of Federal Instrumentality Securities. No more than 5% of the total portfolio shall be invested in any one issuer of commercial paper, or obligations of the State of Michigan or any of its political subdivisions.

No more than 25% of the total portfolio shall be invested in securities with maturities exceeding seven years. No more than 12.5% of the total portfolio shall be invested in

securities with maturities exceeding eleven years.

Other investments shall not exceed the following limits in each of the categories listed below as a percentage of the total portfolio.

- 65% in Federal Instrumentality Securities
- 30% in Money Market Mutual Funds
- 25% in Prime Commercial Paper
- 20% in Time Certificates of Deposit
- 10% in Federal Agency Securities
- 10% in Obligations of the State of Michigan or any of its political subdivisions
- 10% in Investment Pools

Tax funds collected on behalf of taxing authorities and held pending disbursement are not subject to the diversification limits above.

Portfolio Maturities and Liquidity

To the extent possible, the City's investments shall be matched with anticipated cash flow requirements. Unless matched to a specific cash flow liability and approved by the Chief Financial Officer in writing the City will not invest in securities maturing more than fifteen years from the date of trade settlement, and the weighted average final maturity of the portfolio shall not exceed 6.5 years.

The City recognizes that bond proceeds may, from time to time, be subject to provisions of the Tax Reform Act of 1986, Federal Arbitrage Regulations, as amended. Due to the legal complexities of arbitrage law and the necessary immunization of yield levels to correspond to anticipated cash flow schedules, the reinvestment of such debt issuance may, upon the advice of Bond Counsel or financial advisors, deviate from the maturity limitation provisions of this Investment Policy with prior written approval of the Chief Financial Officer. In all cases, however, types of eligible investments will be in compliance with this Investment Policy. This paragraph is only applicable to City funds subject to arbitrage calculations.

Competitive Transactions

Each investment shall be competitively transacted with authorized broker/dealers. At least three broker/dealers shall be contacted for each transaction and their bid and offering prices shall be recorded.

If the City is offered a security for which there is no other readily available competitive offering, then the Treasurer will document quotations for comparable or alternative securities.

Internal Controls

An external auditor shall independently review the City's investment activities on an annual basis. This procedure will assure compliance with policies and procedures.

Performance

The benchmark yield shall be equal to the average yield on the U.S. Treasury Security that most closely corresponds to the portfolio's actual weighted average maturity. When comparing the performance of the City's portfolio, the reported rate of return shall include both average weighted yield and rate of return net of fees.

Reporting

The Treasurer shall prepare a quarterly investment report summarizing the investments held by the City and the current market value of those investments. The report shall include a summary of investment earnings and performance results during the period, illustrate the portfolio's adherence to appropriate risk levels utilizing appropriate metrics like maturity or duration depending on the investment strategy of the portfolio, and compare the portfolio's total return versus established investment objectives and goals including performance relative to established benchmark yields. The quarterly investment report shall be submitted in a timely manner to the Chief Financial Officer and to the City Council or its designated financial oversight committee.

The City has established reporting and accounting standards for callable U.S. Instrumentality securities. Callable securities may be retired at the issuer's option prior to the stated maximum maturity. All securities holding reports for the City shall disclose the stated maturity as well as the first call date of each callable security held. For callable securities which are purchased priced to the first call date and have an overwhelming probability of being called on the first call date, weighted average maturity as well as yield shall be calculated using the first call date. Authorized investment personnel may, however, choose to use a further call date or maturity date for reporting purposes when conditions mandate.

Policy Revisions

The Treasurer and Chief Financial Officer shall review this Investment Policy annually, and amend it as conditions warrant, subject to approval by City Council or its designated financial oversight committee.

GLOSSARY

Bankers Acceptance (BA): A draft or bill of exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

Broker: A broker brings buyers and sellers together for a commission paid by the initiator of the transaction or by both sides.

Callable Bond: A bond issue in which all or part of its outstanding principal amount may be redeemed before maturity by the issuer under specified conditions.

Certificate of Deposit: A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs are typically negotiable.

Collateral: Securities or property pledged by a borrower to secure payment.

Commercial Paper: An unsecured promissory note with a fixed maturity of no more than 270 days. Commercial paper is normally sold at a discount from face value.

Dealer: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his/her own account.

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 (also called free). 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.

Discount Securities: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value.

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

Federal Deposit Insurance Corporation (FDIC): A federal agency that insures bank and savings bank deposits.

Federal Funds Rate: The rate of interest at which Fed funds are traded. The Federal Reserve currently pegs this rate through open-market operations.

Fed Wire: A computer system linking member banks and other financial institutions to the Fed, used for making inter-bank payments of Fed funds and for making deliveries of and payments for Treasury, agency and book-entry mortgage backed securities.

Investment Adviser's Act: Legislation passed by Congress in 1940 that requires all investment advisers to register with the Securities and Exchange Commission. The Act is designed to protect the public from fraud or misrepresentation by investment advisers.

Liquidity: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value.

Local Government Investment Pool: A pool of funds authorized under the laws of the State that receives deposits from one or more local units and pays returns based upon each local unit's share of investment in the pool.

Mark-to-market: The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

Market Value: Current market price of a security.

Master Repurchase Agreement: A written contract covering all future transactions between the parties to repurchase or reverse repurchase agreements that establish 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 Mutual Fund: A mutual fund that limits its investments to some or all types of money market instruments.

Net Asset Value: The market value of one share of an investment company, such as a mutual fund.

No Load Fund: A mutual fund that does not levy a sales charge on the purchase or sale of its shares.

NRSRO: Nationally Recognized Statistical Rating Organizations - organizations that issue credit ratings for securities.

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.

Prudent Person Rule: Standard of investing which 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.

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 or the current income return.

Ratings: An evaluation of an issuer of securities by Moody's, Standard & Poor's, Fitch, or other rating services of a security's credit worthiness.

Repurchase Agreements: A transaction whereby a holder of securities sells 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 the agreement, and the terms of the agreement are structured to compensate the buyer. Dealers use repurchase agreements extensively to finance their positions.

Rule 2a-7 of the Investment Company Act of 1940: Applies to all money market mutual funds and mandates such funds to maintain certain standards, including a 13-month maturity limit a 90-day average maturity on investments and maintenance of a constant net asset value of one dollar (\$1.00).

Safekeeping: Holding of assets (e.g., securities) by a financial institution.

Treasury Bills: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Treasury Bills are issued with maturities ranging from a few days to 26 weeks.

Treasury Bonds: Long-term U.S. Treasury securities having initial maturities of more than ten years.

Treasury Notes: Intermediate term coupon bearing U.S. Treasury securities having initial maturities of from one to ten years.

Yield: The rate of annual income return on an investment, expressed as a percentage.