DATE: August 16, 2021

AGENDA ITEM # 2

TO: Financial Commission

FROM: Helen Lei, Management Analyst Fellow

SUBJECT: PFM 2nd Quarter Report and Investment Presentation

RECOMMENDATION:

Monique Spyke, Managing Director of PFM Asset Management LLC will provide an overview on the City's investment strategies during the August 2021 Financial Commission meeting.
The Financial Commission to review attached materials including the PFM Annual Presentation, PFM memo, City's Investment Policy, and Item 3. Staff Report Quarterly Investment Report Ended June 30, 2021 to provide general feedback.

BACKGROUND

Financial Commission has an annual goal to review the City's Investment policies and guidelines. The Financial Commission's intention is to use the knowledge of the Investment Policy to better serve the City when providing recommendations for the City's Investment strategy.

DISCUSSION

Monique Spyke, PFM Asset Management LLC, Managing Director, will be providing a presentation on the PFM Quarterly Investment Report ending June 30, 2021.

Attachment 1 is the annual PFM presentation.
Attachment 2 is a memo from Monique Spyke regarding questions Financial Commissioners sent to PFM prior to the meeting.
Attachment 3 is the City's Investment Policy.

ATTACHMENT 1

City of Los Altos

Annual Presentation

for the Fiscal Year Ended June 30, 2021

PFM Asset Management LLC

44 Montgomery St.
3rd Floor
San Francisco, CA 94104

215.567.6100
pfm.com

PFM Overview

PFM is a Leading Investment Advisor

41 years of public sector experience

237 investment professionals

- 29 CFA charterholders
- 23 years average team experience

$170 billion in total assets

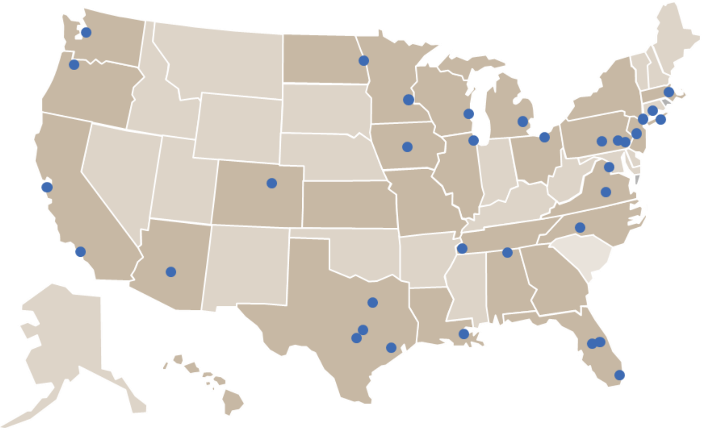
- $125.9 billion in discretionary asset under management
- $44.4 billion in asset under advisement

Fiduciary independence

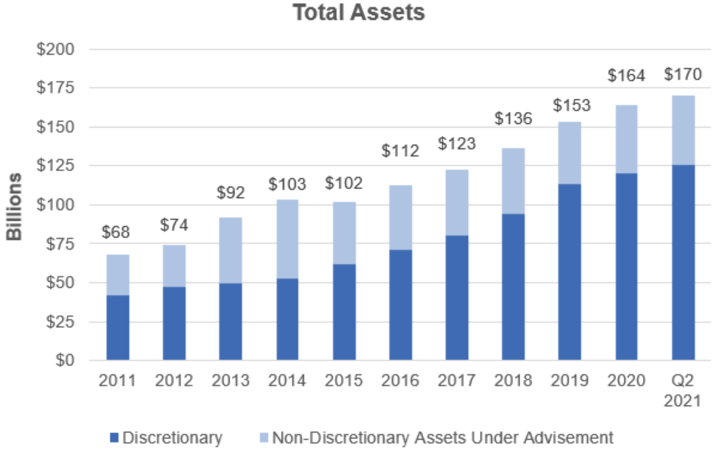
- 100% employee owned
- No custody of assets
- No fees of soft dollars from third parties

All data as of June 30, 2021, unless otherwise noted.

PFM's 36 Nationwide Offices

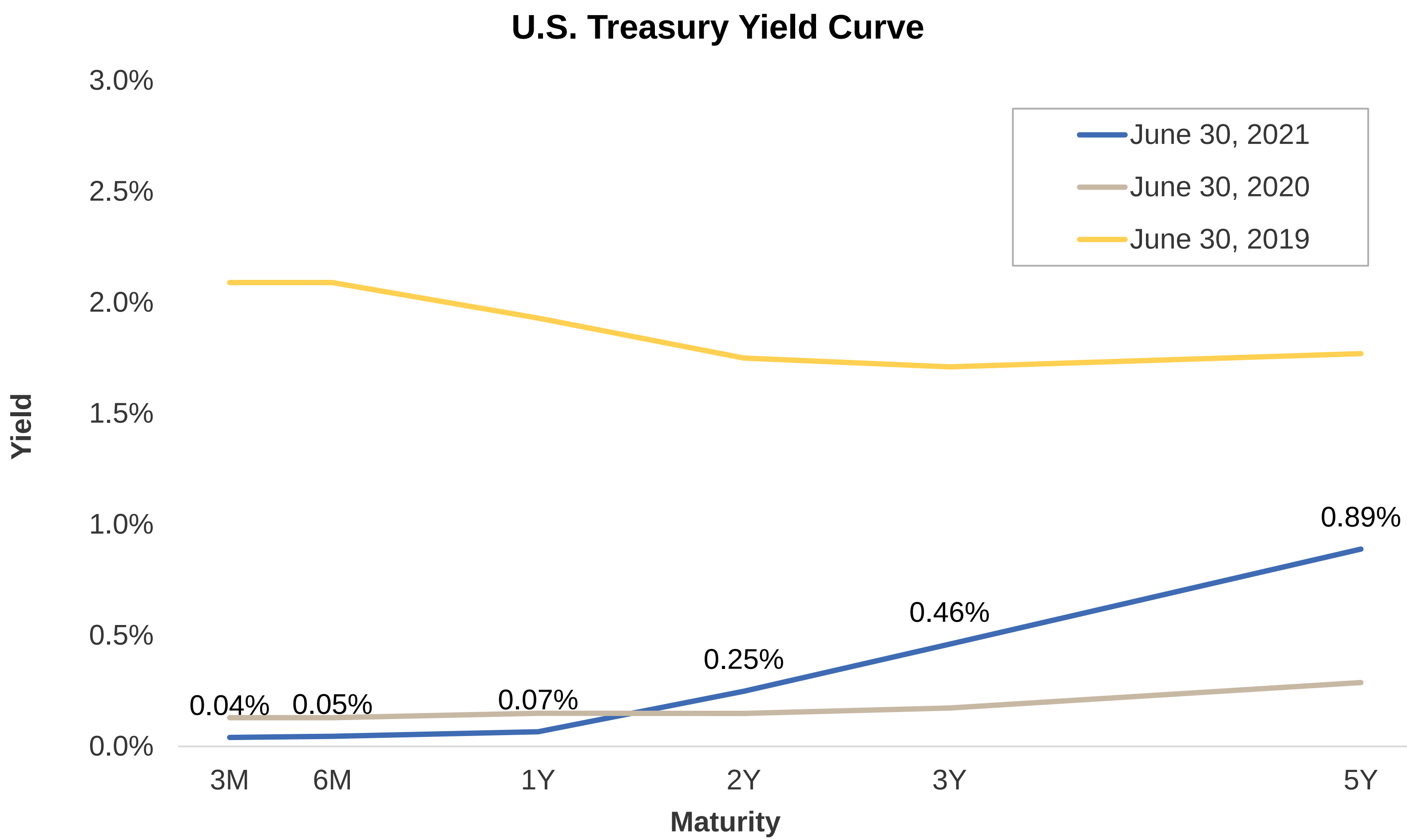


PFM's Assets Under Management and Advisement (in billions)



Performance Overview

Interest Rate Environment

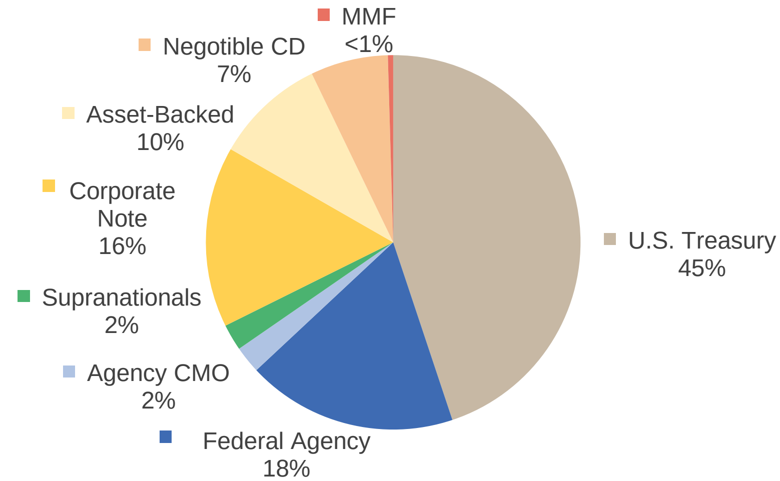


Source: Bloomberg, as of June 30, 2021.

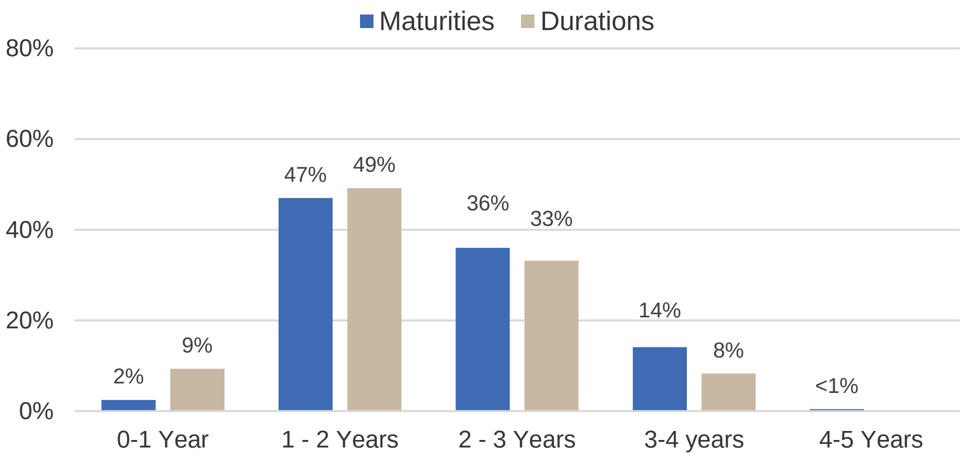
Portfolio Overview as of June 30, 2021

Portfolio Statistics as of June 30, 2021	
Market Value	$54,962,204
Duration	1.86 years
Yield at Cost*	0.94%

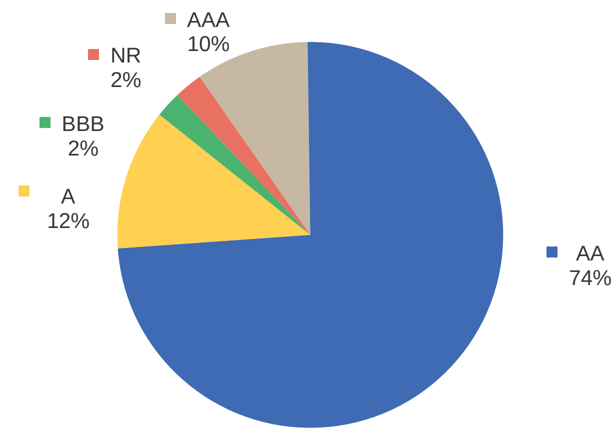
Sector Allocation



Maturity/Duration Distribution



Credit Quality*



**Ratings are Standard and Poor's. Securities rated BBB by Standard and Poor's include corporate notes rated A- or better by Moody's and Fitch. Securities rated NR by Standard and Poor's include asset-backed securities rated AAA by Moody's and Fitch.*

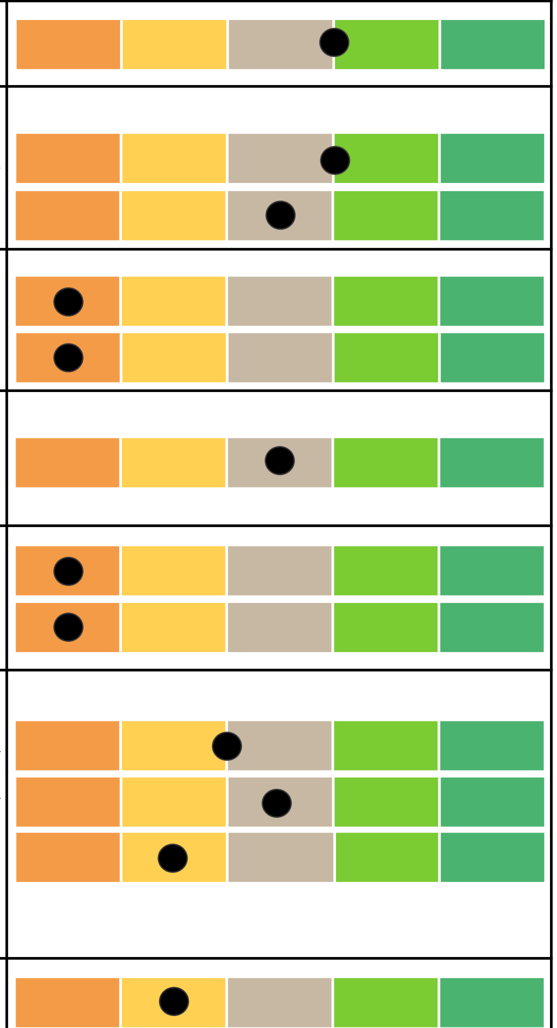
Portfolio Total Return Performance[1,2,3]

For Periods Ending June 30, 2021[1,2]					
	Effective Duration	**Past 1 Year**	**Past 3 Years**	**Past 5 Years**	**Since Inception[3]**
City of Los Altos	1.86	0.44%	2.99%	1.92%	1.35%
ICE BofAML 1-3 Year U.S. Treasury Index[4]	1.84	0.07%	2.68%	1.60%	1.21%
		+0.37%	***+0.31%***	***+0.32%***	***+0.14%***

1. Performance on trade-date basis, gross (i.e., before fees), in accordance with the CFA Institute's Global Investment Performance Standards (GIPS).
2. Returns for periods greater than one year are annualized.
3. Inception date is June 30, 2010.
4. ICE BofAML Indices provided by Bloomberg Financial Markets.

Fixed Income Sector Outlook – Third Quarter 2021

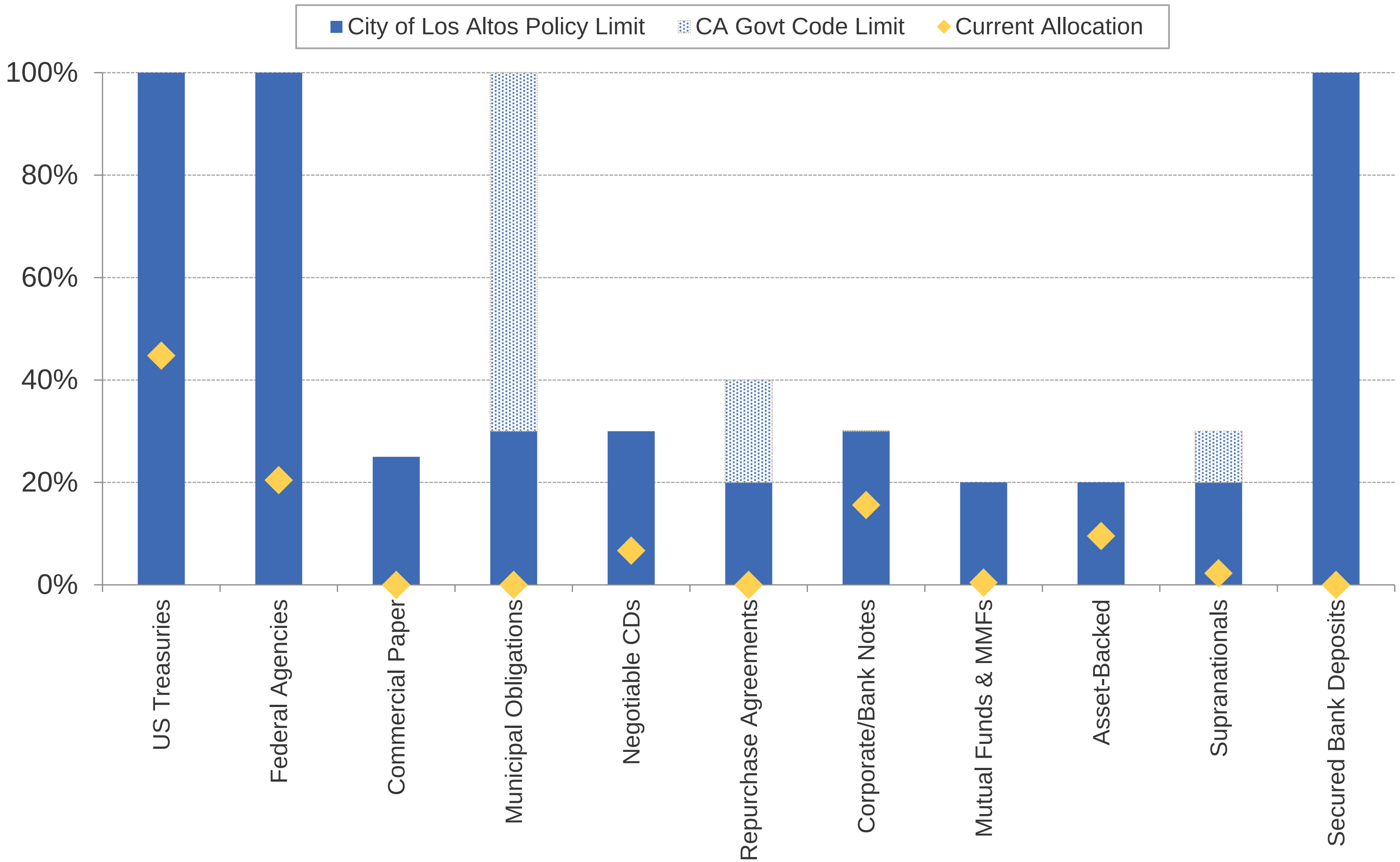
Sector	Our Investment Preferences
COMMERCIAL PAPER / CD	
TREASURIES	
T-Bill	
T-Note	
FEDERAL AGENCIES	
Bullets	
Callables	
SUPRANATIONALS	
CORPORATES	
Financials	
Industrials	
SECURITIZED	
Asset-Backed	
Agency Mortgage-Backed	
Agency CMBS	
MUNICIPALS	



● *Current outlook* | Negative | Slightly Negative | Neutral | Slightly Positive | Positive

City’s Investment Policy

City's Investment Policy Comparison (as of 6/30/21)



Other Changes to Investment Policy

We have reviewed the City of Los Altos' Investment Policy (the "Policy"). The Policy is comprehensive, well-written, and in compliance with all applicable California Government Code (the "Code") statutes regulating the investment of public funds. This year, our proposed changes to the Policy reflect recent Code changes resulting from the passage of Senate Bill 998, as well as changes to bring some of the Policy language more in line with Code language.

- Senate Bill 998 ("SB 998"), which took effect on January 1, 2021, and shall be in effect until January 1, 2026, made a number of amendments to certain sections of the Code which govern the investment of public funds. The bill was written in response to the potential impact COVID-19 may have on the California economy and the investment opportunities of California local agencies. Changes resulting from SB 998 include the following:
  - allowing investment in securities issued or backed by the U.S. government that could result in zero- or negative-interest accrual if held to maturity, in the event of, and for the duration of, a period of negative market interest rates;
  - allowing local agencies that have more than $100 million of investment assets under management to invest up to 40% in commercial paper (existing limit is 25% for all agencies, other than a county or a city and county);
  - deleting the commercial paper language regarding the issuing corporation's outstanding paper;
  - establishing a 10% issuer limit on commercial paper and corporate notes for all agencies, other than a county or a city and county; and
  - adding permission for federally recognized Indian tribes to invest and participate in investment JPAs.

Our Analysis and Recommendations

- We recommend that the City amend the Policy's prohibited investments language to reflect the fact that public agencies are now permitted to invest in zero- or negative-interest accrual securities, under certain circumstances, and provided that the securities are issued by, or backed by, the United States government.
  - When short-term interest rates are yielding near 0%, as they currently are, banks sometimes refuse deposits or charge customers to hold cash. Having the option to invest at zero or negative yields could be beneficial to the City during periods of extremely low or negative yields. While we do not view that investment in such security types is likely, we do recommend that the City allow these types of investments in order to provide maximum prudent investment flexibility (*Prohibited Investments Section).*
- The change described in bullet 2 does not impact the City's Policy.
- The change described in bullet 3 does not impact the City's Policy.
- With regards to bullet 4, we are not recommending any changes to the City's Policy. We note that the Policy already establishes a more stringent 3% to 5% issuer limit across all credit-sensitive security types (*Diversification Section).*
- The change described in bullet 5 does not impact the City's Policy.

Thank You!

Sector Allocation and Compliance

Security Type	Market Value	% of Portfolio	% Change vs. 3/31/21	Permitted by Policy	In Compliance
U.S. Treasury	$24,600,838	44.9%	4.0%	100%	✓
Federal Agency	$9,951,612	18.2%	-2.3%	100%	✓
Federal Agency CMOs	$1,283,936	2.3%	-	100%	✓
Supranationals	$1,249,749	2.3%	0.7%	10%	✓
Negotiable CDs	$3,670,891	6.7%	-0.7%	30%	✓
Corporate Notes	$8,567,698	15.6%	-0.4%	30%	✓
Asset-Backed Securities	$5,240,802	9.6%	-1.4%	20%	✓
Securities Sub-Total	**$54,565,527**	**99.5%**			
Accrued Interest	$147,589				
Securities Total	**$54,713,116**	**99.5%**			
Money Market Fund	$249,088	0.5%	0.2%	20%	✓
Total Investments	**$54,962,204**	**100.0%**			

Market values, excluding accrued interest. Detail may not add to total due to rounding.
The portfolio is in compliance with the City's Investment Policy and California Government Code.

ATTACHMENT 2

pfm

August 12, 2021

Memorandum

To: Financial Commission
City of Los Altos

From: Monique Spyke, Managing Director
PFM Asset Management LLC

Re: Questions on the Quarterly Investment Report Ending March 31, 2021

Question 1: *We would like to understand the reason for purchasing Agency bonds such as Fannie Mae, Freddie Mac. They appear to be at a lower rate than Treasuries. The amount in Agencies bonds seems to be growing from 12.3% to 20.5% (page 10+ 14).*

Federal agency allocations grew from June to December of 2020 because agencies offered incremental yield over Treasuries during that period. The last agency purchase was December 4, 2020, and no further agency purchases have been made in the portfolio since that time as agencies now offer little incremental yield, and as you note, in some instances offer yields lower than Treasuries. As such, we would currently prefer selling expensive agency issues rather than purchasing further agency securities.

Question 2: *Does the Federal government still take surplus from Fannie Mae and Freddie Mac as a dividend? If so, does this make Fannie and Freddie less secure due to low capitalization rates?*

No. Amendments to the Senior Preferred Stock Agreements with both agencies in September 2019 allowed the agencies to retain earnings up to $25 billion each, thereby deferring any dividend. In January 2021, the Agreements were amended again to defer future dividends until Fannie Mae and Freddie Mac accumulate or raise capital to meet the capital requirements and buffers under the 2020 Enterprise Regulatory Capital Framework (currently estimated at $171 billion for Fannie Mae and $112 billion for Freddie Mac). As of June 30, 2021, Fannie Mae had a net worth of $37.3 billion and Freddie Mac had $22.4 billion – much higher than in previous years, but well below the capital targets. The ability to accumulate additional capital over time will reduce their risk. Note, however, that both agencies still benefit from explicit contractual capital support from the U.S. Treasury which provides a significant ongoing backstop for bondholders.

Question 3: *What is your understanding of the stability of these two agencies given their potentially low capital rates?*

Both agencies are currently profitable and as noted above are building capital. Also as noted, both agencies still benefit from explicit contractual capital support from the U.S. Treasury which provides a significant ongoing backstop for bondholders. Our view is that Fannie Mae and Freddie Mac represent minimal risk given those factors.

Question 4: *Did the FHFA hire an Investment Banker to end the conservatorship? How does this affect the risk given the low capital rates? What would happen to the price of the bonds if they were spin-off as private corporations?*

The Federal Housing Finance Agency (FHFA) hired an investment bank advisor in February 2020 to “assist in the development and implementation of a roadmap to responsibly end the conservatorships of Fannie Mae and Freddie Mac.” That roadmap would include business and capital structures, market impacts and timing, and available capital-raising alternatives. At present, both agencies are still under conservatorship, and while ending conservatorship was always going to be a long-term project, that is even less likely to change under the Biden Administration. Ending conservatorship can only occur if the agencies build capital to meet the new framework, which will take a number of years. If the entities were to be privatized, our expectation is that existing GSE debt would be grandfathered and continue to benefit from U.S. government support. Uncertainty during a transition could widen agency spreads (hurting agency prices), and new debt issued by privatized firms would likely be at wider spreads versus Treasuries.

Question 5: *Would Fannie and Freddie Bonds have any capital risk with interest rates potentially rising and housing prices falling because of higher interest rates?*

As noted above, Fannie Mae and Freddie Mac have substantially increased capital over the past couple of years. The impact of rate changes—up or down—is generally neutral, as the agencies seek to regularly hedge out interest rate risk. Falling home prices could increase delinquencies and foreclosures, but levels today are low. In addition, underwriting standards are substantially stronger today compared to the 2005-2008 period, average borrower credit scores are much higher, and average loan-to-value ratios are lower—all of which reduces their risk profile. Lastly, the GSEs continue to issue specialized debt (not the kind that we purchase) that includes credit risk transfer elements to reduce the overall risk.

Question 6: *Does it make sense to divide the money for the above agencies and put it in Treasures and AAA grade corporate bonds?*

We are actively managing the portfolio, utilizing the full range of permitted investment types. As part of this investment framework, we are continually looking for opportunities to add relative value to the portfolio (selling expensive issues and swapping into better alternatives). There very well may be a situation where we sell some of the agency allocation and reinvest the proceeds into other permitted sectors. As it currently stands, corporate notes are expensive as well, although they do provide higher incremental yields than agencies. In particular, there are only a small number of AAA-rated corporates left, and they trade at very tight yield spreads, sometimes on top of Treasuries. Should such a swap opportunity arise into corporates rated A or better, or into other sectors, we would seek to take advantage of it.

Question 7: *What is a Supra-National Agency Bond on Page 11?*

Supra-National Agency Bonds ("Supranationals") are international development institutions that provide financing, advisory, and/or other financial services to their member countries to achieve the overall of improving living standards through sustainable economic growth.

As of March 31, 2021, the City was holding two Supra-National Agency Bonds. The first was an Inter-American Development Bank ("IDB") note and the other holding was an International Bank for Reconstruction and Development ("IBRD") note. The IDB focuses on improving lives in Latin America and the Caribbean through the development of healthcare, education, and infrastructure. The IBRD is a global development cooperative that works with the IDA to support developing countries.

Question 8: *Help us understand why the numbers are different between slide page 11 and Pie Chart Attachment 1 and Attachment 2. Example Federal Agency is $11,206,171 on Page 11 and 12,542,800 on Attachment 1 +2? All the charts appear to have the same date.*

The values on page 11 of the quarterly report are based on the market value of the securities, while the $12,542,800 seen on Attachment 1 and 2 is the par value of the Federal Agency securities. Par and market value rarely equal one another as the market value of a security fluctuates with changes in market conditions.

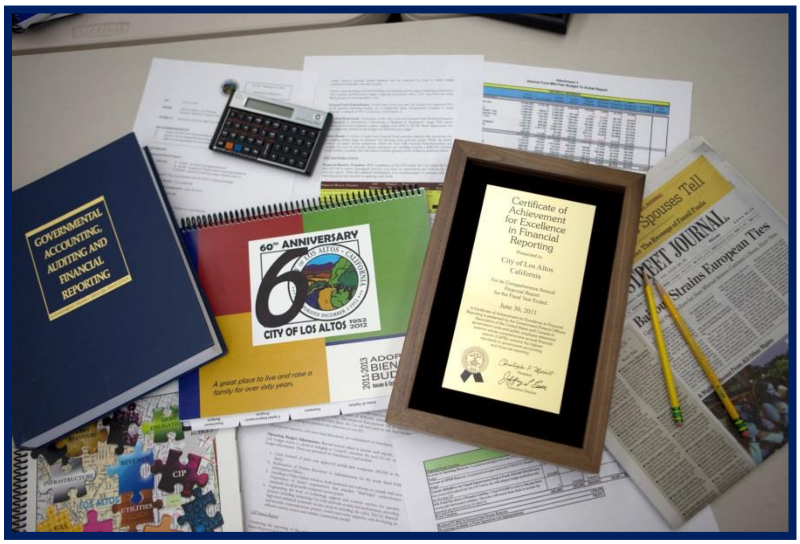
Question 9: *How does PFM get paid? Do they charge a flat fee? If so, what is it? Do they charge commission? Who executes the bond trades and how much does that cost?*

PFM's fees are based on assets under management. PFM's current fee structure for the City's portfolio is 0.10% on the first $25 million of assets under management and 0.08% thereafter.

There is no per trade fee or commission that could lead to account churning. PFM has no soft dollar arrangements with broker/dealers, and we do not accept finder's fees nor earn commissions nor have any fee arrangements with mutual funds. PFM does not receive any brokerage fees, referral fees, origination fees, inventory mark-up, trading spreads, commission, or any other source of income.

The City's bond trades are executed by the City's assigned portfolio manager, Brian Raubenstine. All investment transactions are executed through a competitive bidding process to help ensure the best price for our clients. We have no business affiliations which would affect the investment performance of the School District's account. As a practice PFM charges fees based on AUM, regardless of the number of transactions we undertake for clients.

ATTACHMENT 3



CITY OF LOS ALTOS INVESTMENT POLICY

JUNE 2019

A. INTRODUCTION

This document sets forth policies designed to ensure that the City's public funds are invested prudently, efficiently, and in compliance with legal requirements. It was developed in accordance with California Government Code Sections 53600 *et seq.* and is reviewed by the Financial Commission and adopted by City Council each fiscal year.

This document discusses the most important elements of investment management in one comprehensive centralized format and is organized into the following areas of discussion:

A. Introduction
B. Scope
C. Prudent Investor Standard
D. Objectives
E. Guiding Principles
F. Delegation of Authority
G. Financial Commission Oversight
H. Ethics and Conflict of Interest
I. Safekeeping and Custody
J. Reporting Requirements
K. Maximum Maturity
L. Permitted Investment Instruments
M. Prohibited Investment Instruments
N. Glossary of Investment Terms

B. SCOPE

This policy covers all public funds under the direction of the Finance/Administrative Services Director or their successor within the following fund types:

- Governmental Funds
- Proprietary Funds
- Fiduciary Funds

The investment of bond proceeds is governed separately by the provisions of the relevant bond documents.

C. PRUDENT INVESTOR STANDARD

All persons involved in investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing the City's investment portfolio shall act with the 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 City, 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 City.

D. OBJECTIVES

The primary objectives, in order or their priority, of the City's investment program shall be:

Safety - The preservation of the principal of the City's overall investment portfolio is the foremost objective of the investment program.

Liquidity - The City's investment portfolio will remain sufficiently liquid to meet its cash flow requirements.

Return on Investment - The City's investment portfolio shall be designed with the objective of attaining a reasonable and prudent rate of return consistent with the risk constraints and liquidity demands imposed by its safety objective and cash flow requirements.

E. GUIDING PRINCIPLES

The following guiding principles are important in the pursuit of such objectives:

Minimizing Liquidity, Credit and Market Risks: Investment decisions should minimize liquidity, credit or market risks in the following ways:

Liquidity Risk - The risk that the investment portfolio will not provide adequate cash liquidity for operations shall be mitigated by structuring the portfolio so that securities mature at the same time that major cash outflows occur, thus minimizing the need to sell securities prior to their scheduled maturity date unless market conditions present favorable repositioning opportunities.

Credit Risk - The risk of loss of principal associated with the failure of any one security issuer shall be mitigated by investing in only very safe highly-rated securities and prudently diversifying the investment portfolio to avoid concentrating investments in specific security types, maturity durations, or in individual financial institutions.

Market Risk - The risk of market value fluctuations arising from overall changes in the general level of interest rates shall be mitigated through maintaining prudent duration levels, staggering investment maturity dates evenly over a desired overall duration target and prohibiting the taking of short positions (selling securities that the City does not own) and interest rate sensitive derivative instruments. It is explicitly recognized herein, however, that in a diversified portfolio occasional measured losses are inevitable and must be considered within the context of the overall portfolio's structure and expected investment return, with the proviso that adequate diversification and credit analysis have been implemented.

Market Average Rate of Return: The investment portfolio shall be managed to attain a market average rate of return based upon a benchmark that is appropriate for a fund of like character and aims and commensurate with the portfolio's current investment strategy.

Non-Speculative Approach: This policy specifically prohibits all speculative investment practices, including, but not limited to, those that seek to gain or profit through transactions of high and unusual risk, or that utilize securities whose price is dependent upon or derived from one or more underlying assets (Derivatives).

Professionalism and Public Trust: The City's investment portfolio is subject to public review and evaluation and shall be designed and managed with the high degree of professionalism that is worthy of the public trust.

F. DELEGATION OF AUTHORITY

The management responsibility for the City's investment program has been delegated to the Finance/Administrative Services Director or their successor. The Finance/Administrative Services Director or their successor shall monitor and review all investments for consistency with this policy, and may delegate investment decision-making and execution authority to investment advisors in accordance with an agreement as authorized by the City Council. The investment advisor shall follow and comply with this policy and all other written instructions provided by the City. The Finance/Administrative Services Director or their successor may, in writing, further delegate such investment authority to designated management staff in the Executive and/or Finance Department in the event of the Finance/Administrative Services Director or their successor's absence or other unavailability. The Finance/Administrative Services Director or their successor shall prepare and file documents with all financial institutions with which the City conducts investment activities certifying the names of those persons authorized to effect transactions on behalf of the City.

G. FINANCIAL COMMISSION OVERSIGHT

The Financial Commission consists of citizen members appointed by the City Council. The Financial Commission shall meet periodically, at least quarterly, to review general investment strategies and monitor the results of the City's investment portfolio in coordination with the Finance/Administrative Services Director or their successor or finance staff designee. The Financial Commission shall also review any proposed changes to this policy before they are submitted to the City Council for final adoption.

H. ETHICS AND CONFLICT OF INTEREST

All persons involved in the investment process shall refrain from personal business activities that could conflict with proper execution of the City's investment program or which could impair their ability to make impartial decisions.

I. SAFEKEEPING AND CUSTODY

All investments of the City's investment portfolio shall have the City of Los Altos as the registered owner, and all interest and principal payments and withdrawals shall indicate the City of Los Altos as the payee.

All securities shall be safely kept with a qualified financial institution, contracted independently by the City as a third party. All securities shall be acquired by the safekeeping institution on a "delivery-vs.-payment" (DVP) basis. In other words, the security must be delivered before funds are released. The DVP basis for delivery applies also to the delivery and safekeeping of repurchase agreement collateral.

J. REPORTING REQUIREMENTS

The Finance/Andre Director will present to the City Council quarterly investment reports, which will present an overall summary of investment performance and include the following type of information:

- Description of investment instruments held
- Interest rate and yield to maturity
- Maturity dates
- Purchase price
- Par value
- Current market value as of the date of the report, including the source of such valuation
- Overall portfolio yield based on cost
- Total return (Quarterly)
- Benchmark comparisons
- Detailed transaction reports shall be made available upon request by any governing member or member of the public

K. MAXIMUM MATURITY

The City may not invest in a security with a maturity date that exceeds five years from the date of purchase.

L. PERMITTED INVESTMENT INSTRUMENTS

The California Government Code in section 53600 *et seq*. sets certain limits on the investment instruments, credit criteria, maximum maturity dates, concentration percentages and other conditions of eligibility in which a government agency's funds may be invested. However, this policy sets limits on the investment of the City's investment portfolio that are more restrictive than such California law. The California Code limits and the more restrictive limits applicable to this policy are listed and summarized in the attached **Exhibit A** (City of Los Altos Allowable Investments). The City's investment portfolio may be invested only in those instruments permitted in **Exhibit A.**

It is important to note that from time to time the City may be invested in a security whose rating is downgraded subsequent to the original date of purchase. The Finance/Administrative Services Director or their successor, directly or indirectly through the delegation of authority to the investment advisor, shall monitor the status of security ratings. When the City uses the services of outside investment advisors and a rating of a prior-purchased security drops below the minimum allowed rating category for that given investment type, the investment advisor shall immediately notify the Finance/Administrative Services Director or their successor and recommend a plan of action.

M. Prohibited Investment Instruments

Investment of the City's investment portfolio in any of the following identified instruments is specifically prohibited:

- **Reverse Repurchase Agreements -** Differs from a Repurchase Agreement in the sense that a reverse repurchase agreement is one that sells security positions in return for cash with an agreement to repurchase the securities for an agreed upon price.
- **Derivatives -** Financial instruments whose values are based on or determined by another security, financial instrument or index, including instruments used for hedging.
- **California State and Local Agency Obligations -** Obligations of the State of California or any local agency within the state, including bonds payable solely out of revenues from a revenue producing property owned, controlled or operated by the state or any local agency or by a department, board, agency or authority of the state or any local agency. Nothing in this section shall be construed to exclude the City's participation in the Local Agency Investment Fund (LAIF) operated by the State of California Treasurer's Office.
- **Other State Obligations -** Registered debt obligations of any of the other 49 United States beyond California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority.
- **Prohibited Investments Cited in California Government Code Section 53601.6 including, but not limited to:**
  - Inverse Floaters
  - Range Notes
  - Mortgage Derivatives or other similar asset backed securities
  - Interest Only Strips
  - Zero Interest Coupon Securities

N. Glossary of Investment Terms

Exhibit B contains a glossary of key investment terms that may be used in this policy.

Exhibit A
City of Los Altos Allowable Investments

Exhibit A

City of Los Altos Allowable Investments

Investment Instruments	Calif. Code Limitation	City Policy Limitation
Collateralized Bank Deposits	No term 100% of portfolio	No term 100% of portfolio
State of California - Local Agency Investment Fund (LAIF)	No term 100% of portfolio Max $65 million	No term 100% of portfolio Max $65 million
Money Market Mutual Funds (SEC Rule 2a7)	No term 20% of portfolio 10% per issuer	Overnight 20% of portfolio US owned Calif. institution 10% of portfolio per issuer
U.S. Treasuries	5 years 100% of portfolio	5 years 100% of portfolio
Federal Agencies (including, mortgage-backed securities, callable securities)	5 years 100% of portfolio	5 years 100% of portfolio 20% of portfolio per issuer 35% of portfolio in callables
Municipal Obligations (including notes issued by the State of California, California local agencies, and the other 49 states)	5 years 100% of portfolio	5 years 30% of portfolio Credit rating category of "A" or its equivalent or higher by a nationally recognized statistical-rating organization (NRSRO) Other[1]
Bank /Time Certificates of Deposit	5 years 100% of portfolio	3 years 50% of portfolio 10% of portfolio per issuer US owned Calif. institution FDIC/NCUA Insured and/or collateralized in Treasuries and Agencies
Negotiable Certificates of Deposit	5 years 30% of portfolio	5 years 30% of portfolio 3% of portfolio per issuer Credit rating category of "A" or its equivalent or higher by a NRSRO
Corporate Medium Term Notes	5 years 30% of portfolio Credit rating of no less than A by any NRSRO	5 years 30% of portfolio 3% of portfolio per issuer Credit rating category of "A" or its equivalent or higher by a NRSRO

[1]Municipal bonds must also be either (1) a general obligation bond whose principal and interest payments are secured by the full faith and credit of the issuer and supported by either the issuer's unlimited or limited taxing power, or (2) an essential service bond secured with revenue from a water, sewer, power or electric system.

Investment Instruments	Calif. Code Limitation	City Policy Limitation
Repurchase Agreements	1 year 100% of portfolio 102% Collateral	180 days 20% of portfolio 10% of portfolio per issuer 102% Collateral Treasuries/Agencies US owned Calif. financial institution
Bankers' Acceptances	180 days 40% of portfolio 30% per issuer	180 days 20% of portfolio 10% of portfolio per issuer US owned Calif. institution
Commercial Paper	270 days 25% of portfolio 10% per issuer	270 days 25% of portfolio 5% of portfolio per issuer Credit rating of no less than "A-1" or its equivalent or higher by an NRSRO.
Obligations issued by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank	5 years 30% of portfolio Credit rating of no less than AA by an NRSRO	5 years 10% of portfolio Credit rating of no less than AAA by an NRSRO
Asset-Backed Securities[2]	5 years 20% of portfolio Credit rating of no less than AA by an NRSRO	5 years (WAM) 20% of portfolio 3% of portfolio per issuer Security shall be rated AAA by an NRSRO
Supranationals	5 years 30% of portfolio Credit rating of no less than AA by an NRSRO	5 years 20% of portfolio Credit rating of no less than AA by an NRSRO
Local Government Investment Pools	100% of portfolio Advisor requirements	Not permitted

[2] Asset-Backed Securities shall not include mortgage related products issued by commercial entities. Investments in asset-backed securities shall generally be limited to those in "senior" tranches.

Exhibit B

Glossary of Investment Terms

Exhibit B

Glossary of Investment Terms

Agency - See "Federal Agency."

Asset-Backed Securities (ABS) - Securities whose income payments and hence value is derived from and collateralized (or "backed") by a specified pool of underlying assets which are receivables. Pooling the assets into financial instruments allows them to be sold to general investors, a process called securitization, and allows the risk of investing in the underlying assets to be diversified because each security will represent a fraction of the total value of the diverse pool of underlying assets. The pools of underlying assets can comprise common payments credit cards, auto loans, mortgage loans, and other types of assets. Interest and principal is paid to investors from borrowers who are paying down their debt.

Bankers' Acceptance (BA's) - A draft or bill of exchange drawn upon and accepted by a bank frequently used to finance the shipping of international goods. Used as a short-term credit instrument, bankers' acceptances are traded at a discount from face value as a money market instrument in the secondary market on the basis of the credit quality of the guaranteeing bank.

Benchmark - A market index used as a comparative basis for measuring the performance of an investment portfolio. A performance benchmark should represent a close correlation to investment guidelines, risk tolerance, and duration of the actual portfolio's investments.

Certificate of Deposit (CD) - Bank obligation issued by a financial institution generally offering a fixed rate of return (coupon) for a specified period of time (maturity). Can be as long as ten years to maturity, but most CDs purchased by public agencies are one year and under.

Collateral - Investment securities or other property that a borrower pledges to secure repayment of a loan, secure deposits of public monies, or provide security for a repurchase agreement.

Commercial Paper - Short-term unsecured promissory note issued by a company or financial institution that is issued at a discount and matures for par or face value. This instrument usually matures at a maximum maturity of 270 days and bears a short-term debt rating by one or more Nationally Recognized Statistical Rating Organization (NRSRO).

Corporate Medium Term Notes - A debt instrument issued by a corporation with a maturity of greater than one year and less than ten years. Used frequently to refer to corporate notes of medium maturity (five years and under).

Custody - Safekeeping services offered by a bank, financial institution or trust company, referred to as the "custodian." Service normally includes the holding and reporting of the customer's securities, the collection and disbursement of income, securities settlement and market values.

Delivery Versus Payment (DVP) - The settlement procedure in which securities are delivered versus payment of cash, but only after cash has been received. Most security transactions, including those through the Federal Reserve Securities Wire system and DTC, are done DVP as a protection for both the buyer and seller of securities.

Depository Trust Company (DTC) - A firm through which members can use a computer to arrange for securities to be delivered to other members without physical delivery of certificates. A member of the Federal Reserve System and owned mostly by the New York Stock Exchange, the Depository Trust Company uses computerized debit and credit entries. Most corporate securities, commercial paper, CDs, and BAs clear through DTC.

Derivative - A financial instrument whose value is based on or determined by another security, financial instrument, or index.

Diversification - Dividing investment funds among a variety of security types, maturities, industries, and issuers offering potentially independent returns.

Federal Agency - These are Federal government sponsored and/or owned entities created by the U.S. Congress, generally for the purpose of acting as a financial intermediary by borrowing in the marketplace and directing proceeds to specific areas of the economy considered to otherwise have restricted access to credit markets. The largest federal agencies are Fannie Mae, Freddie Mac, FHLB, FFCB, and TVA.

Federal Reserve System (the Fed) - The independent central bank system of the United States that establishes and conducts the nation's monetary policy. This is accomplished in three major ways: (1) raising or lowering bank reserve requirements, (2) raising or lowering the target Federal Reserve Funds Rate and Discount Rate, and (3) in open market operations by buying and selling government securities. The Federal Reserve System is made up of twelve Federal Reserve District Banks, their branches, and many national and state banks throughout the nation. It is headed by the seven-member Board of Governors known as the "Federal Reserve Board" and led by its Chairman.

Federal Treasuries - A collective term used to describe debt instruments backed by the U.S. Government and issued through the U.S. Department of the Treasury that includes Treasury bills, Treasury notes, and Treasury bonds. Also a benchmark term used as a basis by which the yields of non-Treasury securities are compared (e.g., "trading at 50 basis points over Treasuries").

Fiduciary Funds - Term used when a governmental unit acts in a fiduciary capacity such as a trustee or agent. The government unit is responsible for handling the assets placed under its control.

Government Sponsored Enterprise (GSE) - A privately owned entity subject to federal regulation and supervision, created by the U.S. Congress to reduce the cost of capital for certain borrowing sectors of the economy such as students, farmers, and homeowners. GSEs carry the implicit backing of the U.S. Government, but they are not direct obligations of the U.S. Government. For this reason, these securities will offer a yield premium over Treasuries. Examples of GSEs include: FHLB, FHLMC, FNMA, and SLMA.

Governmental Funds - Term used in Government Accounting to apply to all funds except for the profit and loss funds (e.g., enterprise fund, internal service fund) and trust and agency funds. Examples of government funds are the general fund, special assessment fund, and capital projects fund. Governmental funds use the modified accrual accounting method.

Government Instrumentalities (Supranationals) – Entities formed by two or more central governments with the purpose of promoting economic development for the member countries. Supranational institutions finance their activities by issuing debt, such as supranational bonds. Examples of supranational institutions include the European Investment Bank and the World Bank. Similarly to the government bonds, the bonds issued by these institutions are considered direct obligations of the issuing nations and have a high credit rating.

Index - A compilation of statistical data that tracks changes in the economy or in financial markets.

Interest-Only (IO) Strips - A security based solely on the interest payments from the bond. After the principal has been repaid, interest payments stop and the value of the security falls to nothing. Therefore, IOs are considered risky investments and are usually associated with mortgage-backed securities.

Inverse Floater - A floating rate security structured in such a way that it reacts inversely to the direction of interest rates. Considered risky as their value moves in the opposite direction of normal fixed income investments and whose interest rate can fall to zero.

Investment Advisor - A company that provides professional advice managing investment portfolios offers investment recommendations and/or research in exchange for a management fee.

Liquidity – This is a measure of the relative ease of converting an asset into cash without significant loss of value and the level of cash and near-cash items in a portfolio of assets. This term also describes the marketability of money market security correlating to the narrowness of the spread between bid and ask prices.

Local Agency Investment Fund (LAIF) - Special fund in the California State Treasurer's Office which local agencies may access to deposit funds for short-term investment and reinvestment.

Market Value - The fair market value of a security or commodity or the price at which a willing buyer and seller would pay for a security.

Maturity Date - Date on which principal payment of a financial obligation is due.

Money Market Mutual Fund (2a-7) - A type of mutual fund that invests solely in money market instruments, such as Treasury bills, commercial paper, bankers' acceptances, and repurchase agreements. Money market mutual funds are registered with the SEC under the Investment Company Act of 1940 and are subject "rule 2a-7" which significantly limits average maturity and credit quality of holdings.

Mortgage-Backed Securities (MBS) - Mortgage-backed securities represent an ownership interest in a pool of mortgage loans made by financial institutions, such as savings and loans, commercial banks, or mortgage companies, to finance the borrower's purchase of a home or other real estate. The majority of MBS are issued and/or guaranteed by GNMA, FNMA and FHLMC. There are a variety of MBS structures, some of which can be very risky and complicated. All MBS have reinvestment risk as actual principal and interest payments are dependent on the payment of the underlying mortgages which can be prepaid by mortgage holders to refinance at lower rates or simply because the underlying property was sold.

Mortgage Pass-Through Securities - A pool of residential mortgage loans with the monthly interest and principal distributed to investors on a pro-rata basis. Largest issuer is GNMA.

Municipal Note/Bond - Debt issued by a state or local government unit or public agency. The vast majority of municipals are exempt from state and federal income tax, although some non-qualified issues are taxable.

Mutual Fund - Portfolio of securities professionally managed by a registered investment company that issues shares to investors. Many different types of mutual funds exist (bond, equity, money market fund); all except money market funds operate on a variable net asset value (NAV).

NRSRO - "Nationally Recognized Statistical Rating Organization." An entity designated as a rating organization that the SEC has recognized as having a strong national presence in the U.S. NRSROs provide credit ratings on corporate and bank debt issues. Only ratings of an NRSRO may be used for the regulatory purposes of rating. They include Moody's, Standard & Poor's, and Fitch among others.

Par Value - Face value, stated value or maturity value of a security.

Principal - Face value of a financial instrument on which interest accrues which may be less than par value if some principal has been repaid or retired. For a transaction, principal is par value as a factor of price and includes any premium or discount.

Proprietary Funds - In governmental accounting, one having profit and loss aspects; therefore it uses the *accrual* rather than modified accrual accounting method. The two types of proprietary funds are the Enterprise Fund and the Internal Service Fund.

Prudent Investor Standard - Standard that requires that 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 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 agency. This standard is more stringent than the "prudent person" standard as it implies a level of knowledge commensurate with the responsibility at hand.

Range Note - A type of structured note that accrues interest daily at a set coupon rate that is tied to an index. Most range notes have two coupon levels; a higher accrual rate for the period the index is within a designated range, the lower accrual rate for the period that the index falls outside the designated range. This lower rate may be zero and may result in zero earnings.

Rate of Return - Amount of income received from an investment, expressed as a percentage of the amount invested.

Repurchase Agreement (Repo) - A short-term investment vehicle in which an investor agrees to buy securities from a counterparty and simultaneously agrees to resell the securities back to the counterparty at an agreed upon time and for an agreed upon price. The difference between the purchase price and the sale price represents interest earned on the agreement. In effect, it represents a collateralized loan to the investor, where the securities are the collateral. Can be DVP, where securities are delivered to the investor's custodial bank, or "tri-party" where the securities are delivered to a third-party intermediary. Any type of security can be used as "collateral," but only some types provide the investor with special bankruptcy protection under the law. Repos should be undertaken only when an appropriate approved banking master repurchase agreement is in place.

Reverse Repurchase Agreement (Reverse Repo) - This is a repo from the point of view of the original seller of securities. Used by dealers to finance their inventory of securities by essentially borrowing at short-term rates. Can also be used to leverage a portfolio and in this sense, can be considered risky if used improperly.

Safekeeping - Service offered for a fee, usually by financial institutions, for the holding of securities and other valuables. Safekeeping is a component of custody services.

Supranational Bonds - Are defined as those issued by entities formed by two or more central governments to promote economic development for the member countries. For example, United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank.

Total Return - Investment performance measured over a period of time that includes coupon interest, interest on interest, and both realized and unrealized gains or losses. Total return includes, therefore, any market value appreciation/depreciation on investments held at period end.

Weighted average maturity (WAM) - is the weighted average amount of time of the maturities on the underlying mortgages in a mortgage-backed security (MBS) and assets in asset backed securities (ABS). This term is used more broadly to describe maturities for these instruments as these securities invest in multiple specified pools of underlying assets and these underlying pools may have varying maturities.

Yield to Maturity (YTM) - Calculated return on an investment, assuming all cash flows from the security are reinvested at the same original yield. Can be higher or lower than the coupon rate depending on market rates and whether the security was purchased at a premium or discount. There are different conventions for calculating YTM for various types of securities.