

**CITY OF DANA POINT**  
**AGENDA REPORT**

Reviewed By:	
DH	<u>  x  </u>
CM	<u>  x  </u>
CA	<u>      </u>

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**DATE:** NOVEMBER 9, 2005

**TO:** CITY COUNCIL/CITY MANAGER

**FROM :** SHARIE APODACA, DIRECTOR OF ADMINISTRATIVE SERVICES

**SUBJECT:** APPROVAL OF REVISED INVESTMENT POLICY

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**RECOMMENDED ACTION:**

Approve the recommended revisions to the Statement of Safekeeping and Investment of Public Funds (Investment Policy).

**ISSUES:**

Shall the Investment Policy be updated to reflect changes in State law and governmental investment practices?

**BACKGROUND:**

The Investment Review Committee (IRC) is comprised of two Council Members, the City Manager /City Treasurer, the Director of Financial Services, a public representative appointed by the Council and a public representative appointed by the City Manager.

The IRC consists of six members as follows: Mayor Wayne Rayfield, Councilmember Harkey, Public Member James Kettler, Public Member Larry Rolapp, City Manager/City Treasurer Doug Chotkevys, and Administrative Services Director Sharie Apodaca. Andy Glass, our Accounting Manager/Assistant Treasurer and Shanna Wolf, Management Analyst serve as staff liaisons to the committee.

**DISCUSSION:**

State law contained in Government Code Section 53646 requires the Council to annually consider the official statement of Investment Policy. The Investment Policy itself requires the Investment Review Committee to also meet annually to review the policy. The policy was last reviewed and approved by the Council in October 2004. It is the intent of this staff to ensure that the policy is reviewed by the Committee and the Council each year.

In October the City engaged its auditors, Teaman, Ramirez & Smith to perform a review of the Investment Policy. The purpose of the review was to identify any required modifications due to changes in State laws governing the investment of public funds, and also to identify any other recommended enhancements to the Investment Policy.

The Investment Review Committee held a meeting on October 25, 2005 at which time it reviewed the policy and developed recommended revisions for the City Council's consideration. These revisions are incorporated into the attached Investment Policy as indicated by *italicized and underlined* text formatting. The proposed revisions to the policy are as follows:

- o Add the following paragraph to Section V- Reporting:

"The Chief Financial Officer pursuant to Government Code Section 53646(g) shall submit copies of its second and fourth quarter Treasurer's reports to the California Debt and Investment Advisory Commission within 60 days after the close of the second and fourth quarters of each calendar year."

The City is in compliance with this requirement; however felt it prudent to memorialize it in the policy.

- o Add this language to Section VII.G - Local Agency Investment Fund:

"At the discretion of the City Treasurer, the 50% maximum investment ceiling in LAIF may be exceeded under extraordinary circumstances, but not for more than one-hundred twenty (120) days."

The IRC recommends a revision to Section VII.G that would allow the City to invest more than 50% of the total portfolio in the Local Agency Investment Fund (LAIF), under extraordinary circumstances. This recommendation stemmed from the recent receipt of \$3.6 million in proceeds as a result of the relinquishment of Pacific Coast Highway. Because the investment policy does not currently allow the City to exceed its authority to invest more than 50% of the total portfolio in LAIF, a portion of the proceeds had to be invested in a Treasury Note which temporarily restricts access to the funds based on maturity dates.

It should be noted that the City is currently in full compliance with its Investment Policy as well as all State laws governing the investment of public funds. None of these proposed changes impact the City's investment portfolio as it is currently constituted.

**NOTIFICATION/FOLLOW UP:**

Investment Review Committee – provide each member with a copy of the final Investment Policy.

**STRATEGIC PLAN IMPLEMENTATION:**

To achieve total excellence in municipal services and City administration/planning with excellent customer service and cost-effectiveness.

**FISCAL IMPACT:**

None.

**ALTERNATIVE ACTIONS:**

1. Do not approve the proposed changes and take no action.
2. Other actions as may be determined by the City Council.

<b><u>ACTION DOCUMENTS:</u></b>	<b><u>PAGE</u></b>
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**Action Document A**  
**CITY OF DANA POINT**

**STATEMENT OF SAFEKEEPING  
AND INVESTMENT OF PUBLIC FUNDS**

**OCTOBER 2004**  
(Adopted October 13, 2004)

Doug Chotkevys, City Manager/City Treasurer

Prepared by  
Department of Finance and Administration  
Sharie L. Apodaca, Director  
Andrew Glass, Accounting Manager

**CITY OF DANA POINT****STATEMENT OF SAFEKEEPING  
AND INVESTMENT OF PUBLIC FUNDS****TABLE OF CONTENTS**

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**CITY OF DANA POINT****STATEMENT OF SAFEKEEPING AND INVESTMENT OF PUBLIC FUNDS****INTRODUCTION:**

The safekeeping of public funds and investment policies and practices of the City of Dana Point are based upon State Law and prudent money management. The primary objectives, in priority order, of the City's investment activities shall be:

1. To provide safekeeping and to protect the principal monies entrusted to this office.
2. To provide sufficient liquidity to meet normal operating and unexpected expenditures.
3. To assure compliance with all Federal, State and Local laws governing the investment of monies under the control of the City Treasurer.
4. To generate a maximum amount of investment income within the parameters of prudent risk management and consistent with the above policies, particularly in regard to the safekeeping of public funds.

The monies entrusted to the City Treasury (referred to as the "Fund" throughout the remainder of this document) will be kept safe, invested, administered and reported in a timely and prudent manner. The Director of Administrative Services (Chief Financial Officer), by delegation from the City Treasurer and staff will observe, review and react to changing conditions that affect the fund. Approval of investment transactions that will affect the fund are limited to:

- City Manager (City Treasurer)
- Director of Administrative Services (Chief Financial Officer)

An Investment Review Committee consisting of up to two City Council Members and the above officers in conjunction with the Independent Auditor serving as an ex officio member, a public representative appointed by the City Council and a public representative appointed by the City Manager shall meet at least annually to review the City's portfolio. If changes are being proposed to the Investment Policy, additional meetings may be held. The City Manager and Director of Administrative Services will meet additional times as necessary to review the Investment Program. The meeting(s) of the Investment review Committee shall be a public meeting and posted appropriately.

In addition, the City may, at the City Treasurer's discretion, periodically retain an independent, outside advisor with specific expertise in the investment of municipal funds. The advisor will also be available to provide additional assistance as the need arises.

This policy statement will also address the safekeeping of public funds and risk management as it is an integral part of the investment policy. To concentrate only on maximizing return would be dangerous; therefore policy issues will be directed toward:

1. limiting the Fund's exposure to issue and issuer, credit and market risks and
2. determining a minimum credit requirement that firms must have in order to safekeep City money.

## I. SCOPE

In accordance with Dana Point Ordinance No. 89-2 and as prescribed by Section 41000 through 41007 of the Government Code of the State, the City Treasurer is responsible for the safekeeping and investing the unexpended cash in the City Treasury.

This Policy shall direct the investment of all City monies, unless specifically exempted by the legislative body. This policy will not direct the investment of funds held for employees in deferred compensation plans, or the investment of bond proceeds which are specifically governed by the individual bond documents and trust indentures.

## II. INVESTMENT OBJECTIVES

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

### A. Safety of Principal

Safety of principal is the foremost objective of the City's investment program. Each investment transaction shall seek to ensure that safety of principal is the foremost objective and that capital losses are to be avoided, whether from securities default, broker-dealer default or erosion of market value. The City shall seek to preserve safety of principal by mitigating two types of risk: credit and interest rate risk.

1. **Credit Risk.** Credit risk is defined as a) the risk of loss due to failure of the issuer of a security to perform as expected and b) risk of loss of value of security resulting from drop in credit quality of issuer. Credit risk shall be mitigated by investing only with issuers whose financial strength and reputation can be verified to be highly rated by nationally known rating agencies and by diversifying the investment portfolio so that the failure of any one issuer would not unduly harm the City's cash flow.

2. **Interest Rate Risk.** Interest Rate risk, the risk that changes in interest rates will adversely affect the fair value of an investment, shall be mitigated by: (a) structuring the portfolio so that securities mature earlier than or concurrent with the timing of major cash outflows, thus eliminating the need to sell securities prior to their maturity; (b) prohibiting the use of (leverage and margin accounts); and (c) prohibiting the taking of short positions, that is, selling securities which the City does not own. 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 investment return.

B. Diversification

Safety of principal shall be maximized by diversifying the City's investment portfolio consistent with the specific requirements of Section VII of this policy which lists authorized investments and enumerates the diversification requirements for each.

C. Liquidity

The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated.

To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than five (5) years from the date of purchase.

D. Return on Investment

The City's investment portfolio shall be designed to attain a market-average rate of return through economic cycles. The market-average rate of return is defined as the average return of three-month U.S. Treasury bills. Whenever possible, consistent with risk limitations as defined herein, consistent with prudent investment principles and consistent with consideration of safety of principal as noted above, the Treasurer shall seek to augment returns above the market average rate of return.

### III. ETHICS AND CONFLICTS OF INTEREST

Officers and 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 their ability to make impartial investment decisions. Employees and investment officials shall disclose to the City Manager any material financial interests in financial institutions that conduct business within their jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City, consistent with the regulations and filing obligations of the Fair Political Practices Commission and the City's Conflict of Interest Code.

#### **IV. SAFEKEEPING OF SECURITIES**

To protect against potential losses by collapse of individual securities dealers, all securities owned by the City, including collateral on repurchase agreements, shall be held in safekeeping by a third party bank trust department, acting as agent for the City under the terms of a custody agreement executed by the bank and by the City. All security transactions entered into by the City shall be conducted on a delivery-versus-payment basis, i.e., the City's safekeeping agent will only release payment for a security after the security has been properly delivered.

#### **V. REPORTING**

The Chief Financial Officer shall render a monthly Treasurer's report to the City Manager and City Council summarizing the type of investment, issuer, maturity, purchase price, current market value, dollar amount invested, issuing institution, selling institution, date of maturity, amount of deposit, yield to maturity, a statement indicating the City's ability to meet its upcoming six month cash flow requirements and such data as may be required by the City Council. The report shall identify the source of the current market values listed in the report. The report shall also state its compliance with this statement of investment policy, as directed under the code. A recommended updated Investment Policy will be reviewed and approved annually by Council.

**The Chief Financial Officer pursuant to Government Code Section 53646(g), shall submit copies of its second and fourth quarter Treasurer's reports to the California Debt and Investment Advisory Commission within 60 days after the close of the second and fourth quarters of each calendar year.**

#### **VI. QUALIFIED FINANCIAL DEALERS AND INSTITUTIONS**

The City shall transact business only with qualified banks, savings and loans and investment security dealers as set forth in Government Code Section 53601.5. Investment staff shall investigate the qualifications of financial institutions and dealers that wish to do business with the City in order to determine if they are adequately capitalized, make markets in securities appropriate to the City's needs and are recommended by managers of portfolios like the City's. Security transactions involving the payment of brokers through the reduction in rate of return, (soft dollars) and directed brokerage arrangements shall be conducted at the lowest responsible transaction cost available and shall contain the specified contract requirements set forth in the California Government Code.

The City shall at least annually send a copy of the current investment policy to all dealers approved to do business with the City. Confirmation of receipt of this policy shall be considered as evidence that the dealer understands the City's investment policies and intends to show the City only appropriate investments.

Annually, in conjunction with the adoption of the investment policy, the City Council shall be provided with a list of dealers currently providing services to the City, and the list shall specify any additions or deletions to that list since the prior investment policy was adopted.

With the exception of the Local Agency Investment Fund, investments are to be placed with financial institutions maintaining local offices within the limits of Orange County.

## **VII. AUTHORIZED INVESTMENTS**

Generally, investments shall be made in the context of the "prudent investor" rule, which states:

"Investments shall be made with judgement 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 is further governed by the California Government Code, Sections 53600 et seq. Within the context of these limitations, the following investments are authorized as further limited herein:

- A. United States Treasury Bills, Bonds and Notes or those for which the full faith and credit of the United States are pledged for payment of principal and interest. There is no limitation as to the percentage of the portfolio which can be invested in this category. Maturity is not to exceed the projected dates of the City's cash needs or five years, whichever is less.
- B. Obligations issued by the Government National Mortgage Association (GNMA), the Federal Farm Credit Bank System (FFCB), the Federal Home Loan Bank Board (FHLB) and the Federal National Mortgage Association (FNMA). Although there is no percentage limitation on the dollar amount that can be invested in the issues, the "prudent investor" rule shall apply for a single agency name. Maturity is not to exceed the projected dates of the City's cash needs or five years, whichever is less.
- C. Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as banker's acceptances. Banker's acceptances purchased may not exceed 180 days to maturity or 40% of the market value of the portfolio. No more than 10% of the market value of the portfolio may be invested in banker's acceptances issued by any one bank.
- D. Commercial paper of "prime" quality of the highest ranking or of the highest letter and number rating as provided for by a nationally recognized statistical-rating organization (NRSRO). The entity that issues the commercial paper shall meet all of the following conditions in either paragraph 1 or paragraph 2:
1. The entity meets the following criteria:
    - a. Is organized and operating in the United States as a general corporation.
    - b. Has total assets in excess of five hundred million dollars (\$500,000,000).
    - c. Has debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.
  2. The entity meets the following criteria:
    - a. Is organized within the United States as a special purpose corporation, trust, or limited liability company.
    - b. Has programwide credit enhancements including, but not limited to, overcollateralization, letters of credit, or surety bond.

- c. Has commercial paper that is rated "A-1" or higher, or the equivalent, by a NRSRO.

Purchases of eligible commercial paper may not exceed 15% of the market value of the portfolio. No more than 10% of the market value of the portfolio may be invested in commercial paper issued by any one corporation. The City may purchase no more than 10% of the outstanding commercial paper of any single issuer. Maturity is not to exceed 270 days.

- E. Negotiable certificates of deposit issued by a nationally or state-chartered Bank or state or federal savings and loan association. Negotiable certificates of deposit (NCDs) differ from other certificates of deposit by their deposit liquidity. They are issued against funds deposited for specified periods of time and earn specified or variable rates of interest. NCDs are traded actively in secondary markets. When feasible, an independent trading service will be used as part of the evaluation process. The financial institution should maintain a rating equivalent to Keefe Bank Watch Service of "A/B" or better. To be eligible for purchase by the City, the NCD must be issued by:

1. a California bank rated "A/B" or better by the rating service of Keefe, Bruyette and Woods, (Keefe) (or equivalent);
2. a major national or regional bank outside of California rated "B" or better by Keefe, (or equivalent);
3. a domestic branch of a foreign bank ("Yankee") rated I for country rating, II or better for peer-group rating and II or better for dollar access by Keefe; or
4. a savings and loan association operating in California rated "A/B" or better by Keefe.

Notwithstanding the provisions of section II.A.2. of this policy, the maturity of the bank NCDs shall not exceed two years; the maturity of savings and loan association NCDs shall not exceed two years. Purchases of negotiable certificates of deposit may not exceed 30 percent of the City's money which may be invested pursuant to this policy.

F. Repurchase Agreements. The City may invest in repurchase agreements with banks and dealers with which the City has entered into a master repurchase agreement which specifies terms and conditions of repurchase agreements.

1. To the extent required by statute, the City will restrict transactions to primary dealers only. To the extent permitted by law, transactions will be limited to security dealers or financial institutions with a credit rating of "A" or better by a major rating agency.

The market value of securities that underlay a repurchase agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be adjusted no less than quarterly. In order to conform with provisions of Federal Bankruptcy Code which provide for the liquidation of securities held as collateral for repurchase agreements, the only securities acceptable as collateral shall be securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States.

2. No more than 50% of the portfolio may be invested in repurchase agreements.
3. The term of repurchase may not exceed one year.

G. Local Agency Investment Fund. The City may invest in the Local Agency Investment Fund (LAIF) established by the State Treasurer for the benefit of local agencies up to the maximum permitted by State law. However, the City shall not invest more than 50% of its investment portfolio in this pool or in any other single investment pool which may be authorized by this policy.

**At the discretion of the City Treasurer, the 50% maximum investment ceiling in LAIF may be exceeded under extraordinary circumstances, but not for more than one-hundred twenty (120) days.**

H. Time Deposits. The City may invest in nonnegotiable time deposits collateralized in accordance with the California Government Code in those banks and savings and loan associations which meet the requirements for investment in negotiable certificates of deposit. Since time deposits are not liquid, no more than 15% of the portfolio may be invested in this category. The issuer firm should have been in existence for at least five years. The City may waive the first \$100,000 of collateral security for such deposits if the institution is insured pursuant to federal law. In order to secure the uninsured portions of

such deposits, an institution shall maintain collateral and interest of at least 10% in excess of the total amount deposited. Real estate mortgages may not be accepted as collateral. The maximum term for deposits shall be one year. In general, the issuer must have a minimum 6% net worth to assets ratio or the minimum ratio established by the Controller of the Currency. The issuer's operation must have been profitable during their last reporting period. In order to secure the interest earnings of time deposits, the interest earnings must be collateralized.

- I. Money Market Funds. The City may invest only in money market funds investing solely in U.S. treasuries, obligations of the U.S. Treasury and repurchase agreements relating to such treasury obligations. To be eligible, these companies must have an investment advisor with not less than five years experience and registered with the SEC. The fund must have the highest ranking available as evaluated by not less than two of the three largest nationally recognized statistical rating organizations and have assets in excess of \$500 million. The purchase price of shares of money market funds shall not exceed 20% of the City's money that may be invested pursuant to this investment policy. No more than 15% of the City's investment portfolio may be invested in any single money market fund of this type. At least annually, the City shall review the fund for continuing compliance with the requirements set forth in this section.
  
- J. Monies Held by Trustee or Fiscal Agent. Notwithstanding anything to the contrary contained in this section, Section 53635 or any other provision of law, monies held by a trustee or fiscal agent and pledged to the payment or security of bonds or other indebtedness or obligations under a lease, installment sale or other agreement of a local agency or certificates of participation in those bonds, indebtedness or lease installment sale or other agreements may be invested in accordance with the statutory provisions governing the issuance of those bonds, indebtedness or lease installment sale or other agreement or to the extent not consistent therewith of if there are no specific statutory provisions in accordance with the ordinance, resolution, indenture or agreement of the local agency providing for the issuance.

The following instruments are not be used for investments: reverse repurchase agreements, mutual funds (excluding Money Market Funds as listed in Section VII.I.), zero coupon bonds, mortgage backed securities, common stocks and corporate notes and bonds, inverse floaters, range notes, interest only strips derived from CMOs and any security that could result in zero or negative interest accrual if held to maturity except as these instruments may be utilized by agencies such as the State of California Local Agency Investment Fund which this policy specifically names as an "authorized investment".

Where this section specifies a percentage limitation for a particular category of investment, that percentage is applicable only at the date of purchase. Where this section does not specify a limitation on the term or remaining maturity at the time of the investment, no investment shall be made in any security that at the time of the investment has a term remaining to maturity in excess of five years, unless the City Council has granted express authority to make that investment either specifically or as a part of an investment program approved by the City Council no less than three months prior to the investment.

#### **VIII. PURCHASE OF SECURITIES**

To assure all securities are purchased at a competitive market price, the City will obtain at least three bids, one of which will be obtained from a primary dealer.

#### **IX. SWAPPING OF SECURITIES**

A swap is the movement from one security to another and may be done for a variety of reasons, such as to increase yield, lengthen or shorten maturities, to take a profit or to increase investment quality. The purchase transaction and the sale transaction must each be recorded separately and any losses or gains on the sale must be recorded.

#### **X. PORTFOLIO ADJUSTMENTS**

Should an investment percentage-of-portfolio limitation be exceeded due to an incident such as fluctuation in portfolio size, the affected securities may be held to maturity to avoid losses. When no loss is indicated, the Treasurer shall consider reconstructing the portfolio basing his decision in part on the expected length of time the portfolio will be unbalanced.

#### **XI. INTERNAL CONTROL AND REVIEW**

Internal controls shall be established and maintained 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. Controls deemed most important include: separation of duties, separation of transaction authority from accounting and record keeping, custodial safekeeping, clear delegation of authority, specific limitations regarding securities losses and remedial action, control over wire transfers, minimizing the number of authorized investment officials and documentation of transactions and strategies.

This 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 and financial and economic trends. The Investment Review Committee shall meet at least annually to review the City's portfolio. The City Council shall be responsible for maintaining guidance over this investment policy to insure that the City can adapt readily to changing market conditions and shall approve any modification to the investment policy prior to implementation.

**STATE LAW**

The legislated authority of the fund is covered in sections 53601 et.seq., of the Government Code. It is the policy of the City Treasurer to comply with the State laws governing the Fund.

## GLOSSARY OF TERMS

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

**BID:** The price asked by a seller of securities.

**BOND:** A financial obligation for which an issuer promises to pay the bondholder a specified stream of future cash flows, including periodic interest payments and a principal repayment.

**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 secure deposits of public monies.

**COMMERCIAL PAPER:** An unsecured, short-term promissory note issued by a corporation for financing accounts receivable and inventories. It is usually issued at a discount reflecting prevailing market interest rates. Maturities range up to 270 days.

**COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR):** The official annual report for the City of Dana Point. It includes entity-wide and fund financial statements 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.

**DEALER:** A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his 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. 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.

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

## GLOSSARY OF TERMS

**FEDERAL FARM CREDIT BANK SYSTEM:** Agency of the Federal government set up to supply credit to farmers.

**FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC):** A federal agency that insures bank deposits, currently up to \$100,000 per deposit.

**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 FHLB's 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.

**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 AGENCY INVESTMENT FUND (LAIF):** 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.

## GLOSSARY OF TERMS

**MASTER REPURCHASE AGREEMENT:** A written contract covering all future transactions between the parties to repurchase-reverse repurchase agreements that establishes 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.

**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.

**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.

**REPURCHASE AGREEMENT (RP):** 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 the 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.

**RISK:** Degree of uncertainty of return on an asset.

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

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

## GLOSSARY OF TERMS

**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.

**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.