



Good Neighbors

San Diego
Housing Commission

REPORT

DATE ISSUED: August 19, 2005

ITEM 101

REPORT NO. HCR05-77
For the Agenda of August 26, 2005

SUBJECT: Proposed Investment Policy

SUMMARY

Issue: Should the Housing Commission approve the attached Investment Policy and the proposed Investment Quarterly Report format?

Recommendation: Adopt the proposed Investment Policy (Attachment 1) and the Investment Quarterly Report format (Attachment 2).

Future Related Actions: As detailed in Section 11 of the Investment Policy, this policy will be presented each year during the budget process to the Housing Commission for review, and any modifications will require Housing Commission approval.

Environmental Review: This activity and the proposed action is not a project within the meaning of CEQA. Further, this activity is categorically excluded and exempt under the applicable provisions of NEPA.

BACKGROUND

For many years, staff has followed all applicable Department of Housing and Urban Development (HUD) requirements concerning cash management and the investment of funds not required for current operations. During the course of the FY04 audit, the auditors referred to various sections of the California Government Code regarding the formal establishment of an investment policy and investment report for all local agencies. The auditors recommended that staff review the investment process, create a written investment policy, and that the Housing Commission adopt the policy. In addition, an investment report is to be submitted on a quarterly basis to the Board. The Investment Policy and report will ensure the Housing Commission complies fully with the Code.



A state agency authorized by the City of San Diego

DISCUSSION

Staff reviewed HUD requirements and the California Government Code on these matters; and extensive research on this subject was conducted. Numerous investment policies and reporting formats from other agencies were reviewed. Sample investment policies recommended by the Government Finance Officer's Association (G.F.O.A.) and the Municipal Treasurer's Association (M.T.A) were used to develop the proposed Investment Policy which addresses eleven major areas as follows:

1. **Policy** – General Statement of Investment Policy.
2. **Scope** – includes all funds of the Housing Commission except retirement and deferred compensation.
3. **Standards of Care** - includes the standards for prudence, ethics, conflicts of interest and delegation of authority.
4. **General Objectives** – provides for the objectives of safety, liquidity, yield and local considerations.
5. **Authorized Financial Institutions, Depositories and Broker/Dealers** – provides criteria for the selection of financial institutions, broker dealers, and minority and community financial institutions.
6. **Safekeeping and Custody** – provides for delivery vs payment, safekeeping and internal controls.
7. **Authorized and Suitable Investments** – provides investment options for HUD and non-HUD funds.
8. **Collateralization** – provides for collateralization of certificates of deposits and repurchase agreements.
9. **Diversification** – limits investments to avoid over concentration in securities of a specific issuer, business sector, high credit risk or maturities.
10. **Reporting** – defines the description of the report, the frequency and the certifications by the Investment Officer. Also, provides the composition of the Investment Review Committee, the appointing authority and the frequency of the Investment Review Committee meetings.
11. **Approval of Investment Policy** – provides for an annual review and approval of modifications.

The California Government Code (CGC 53646 (b)) provides that each local agency “may render a quarterly report to the chief executive officer, the internal auditor, and the legislative body of the local agency.” Accordingly, staff is proposing an investment report format that includes the following eight issues:

1. Types of Investments
2. Issuers
3. Maturity Dates
4. Book Value
5. Current Market Value
6. Source of the Valuation of the Securities

7. Certification that investment actions are in compliance
8. Certification that the SDHC can meet six months expenditure obligations

The Investment Policy and any proposed modifications will be presented on an annual basis as an adjunct to approval of the annual fiscal year budget. The Investment Report will be prepared quarterly and included with the Budget Status Report as an Informational Report to the Housing Commission. In addition, an Investment Review Committee consisting of two Housing Commission Board members and one staff member to be appointed by the Chair of the Housing Commission will meet on a quarterly basis to review the investments of the agency.

Respectfully submitted,

Ed Mauk
Director of Financial Services

**Signature on File
With Original Document**

Approved by,

Elizabeth C. Morris
President & Chief Executive Officer

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Attachment 1: Proposed Investment Policy
Attachment 2: Proposed Quarterly Investment Report Format

SAN DIEGO HOUSING COMMISSION INVESTMENT POLICY

1.0 POLICY

WHEREAS; the U. S. Department of Housing & Urban Development has established requirements governing cash management and approved investment instruments for certain funds under the control of Public Housing Authorities (PIH Notice 96-33); and

WHEREAS; the Legislature of the State of California has declared that the deposit and investment of public funds by local officials and local agencies is an issue of statewide concern (CGC 53600.6); and

WHEREAS; the legislative body of a local agency may invest surplus monies not required for the immediate necessities of the local agency in accordance with the provisions of U.S. Department of Housing & Urban Development Notice PIH 96-33 and California Government Code Sections 5922 and 53601; and

WHEREAS; the Budget Officer of the San Diego Housing Commission, hereinafter referred to as the investment officer, shall annually prepare and submit a statement of investment policy; and such policy, and any changes thereto, shall be considered by the legislative body at a public meeting [CGC 53646(a)];

NOW THEREFORE; it shall be the policy of the San Diego Housing Commission to invest funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the San Diego Housing Commission and conforming to all state and local statutes governing the investment of public funds.

2.0 SCOPE

This investment policy applies to the investment of short-term operating funds and includes all financial assets of the San Diego Housing Commission. These funds are accounted for in the Comprehensive Annual Financial Report and include General Funds, HUD Funds, State Funds, CDBG Funds, Management Funds, Trust Funds and any new fund created by the legislative body unless specifically exempted.

Except for cash in certain restricted and special funds, the San Diego Housing Commission will consolidate cash balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration. Investment income will be allocated to the various funds based

on their respective participation and in accordance with generally accepted accounting principles.

Funds not included in the policy include retirement and deferred compensation funds, which are covered under a separate policy.

3.0 STANDARDS OF CARE

A. Prudence: 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 standard of prudence to be used by investment officials shall be the "prudent person" standard (CGC 53600.3) and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and the investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments. Also, the liquidity and the sale of securities must be carried out in accordance with the terms of this policy.

B. Ethics and Conflicts of Interest: Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose to the President and Chief Executive Officer any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the San Diego Housing Commission.

C. Delegation of Authority: Authority to manage the investment program is derived from Section 401(E) of the HUD/PHA Annual Contributions Contract and California Government Code Sections 53601, et seq. Management responsibility for the investment program is hereby delegated to the investment officer, who shall establish and act in accordance with written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures should include references to safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking services contracts, as appropriate. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may

engage in an investment transaction except as provided under the terms of this policy and the procedures established by the investment officer. The investment officer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials. The investment officer is a trustee and a fiduciary subject to the prudent investor standard. (CGC 53600.3).

4.0 GENERAL OBJECTIVES:

When investing, reinvesting, purchasing, acquiring, exchanging, selling and managing public funds, the primary objectives (CGC 53600.5), in priority order, of the investment activities shall be:

- A. Safety:** Safety of principal is the foremost objective of the investment program. Investments of the San Diego Housing Commission shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and interest rate risk.
- 1. Credit Risk:** The San Diego Housing Commission will minimize credit risk, the risk of loss due to the failure of the security issue or backer, by:
 - a. Limiting investments to the safest types of securities listed in Section 7.0 of this Investment Policy.
 - b. Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisors with which the San Diego Housing Commission will do business in accordance with Section 5.0 of this Investment Policy.
 - c. Diversifying the investment portfolio so that the impact of potential losses from any one type of security or from any one individual issuer will be minimized.
 - 2. Interest Rate Risk:** The San Diego Housing Commission will minimize the risk that the market value of securities in the portfolio will fall due to changes in general interest rates, by:
 - a. Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity.
 - b. Investing operating funds primarily in shorter-term securities, money market mutual funds or similar investments and limiting the average maturity of the portfolio in accordance with Section 9.0 of this policy.
- B. Liquidity:** The investment portfolio will remain sufficiently liquid to enable the San Diego Housing Commission to meet all operating requirements that

might be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands. Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets. A portion of the portfolio also may be placed in money market mutual funds or local government pools which offer same-day liquidity for short term funds.

C. Yield: The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and the cash flow characteristics of the portfolio. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

1. A security with declining credit may be sold early to minimize loss of principal.
2. A security swap would improve the quality, yield or target duration in the portfolio.
3. Liquidity needs of the portfolio require that the security be sold.

D. Local Considerations: Where possible, funds may be invested for the betterment of the local economy or that of local entities within the State. The San Diego Housing Commission may accept a proposal from an eligible institution that provides for a reduced rate of interest provided that such institution documents the use of deposited funds for community development projects.

5.0 AUTHORIZED FINANCIAL INSTITUTIONS, DEPOSITORIES and BROKER/DEALERS

A. Authorized Financial Institutions, Depositories and Broker/Dealer: The investment officer will maintain a list of financial institutions, selected on the basis of credit worthiness, financial strength, experience and minimal capitalization that are authorized to provide investment services. In addition, if needed, a list of approved security broker/dealers who are authorized to provide investment and financial advisory services in the State of California will be maintained. No public deposit shall be made except in a qualified public depository as established by state laws.

All financial institutions and broker/dealers who desire to become qualified bidders for the San Diego Housing Commission's investment transactions must supply the following as appropriate:

1. Audited Financial Statements demonstrating compliance with state and federal capital adequacy guidelines.
2. Proof of National Association of Security Dealers (NASD) certification
3. Proof of State of California registration
4. Certification of having read and understood and agreeing to comply with the San Diego Housing Commission's investment policy
5. Evidence of adequate insurance coverage
6. A listing of litigation pending against the broker/dealer within the last five (5) year period that for each matter that has been evidenced by a judgment, either for or against the broker/dealer, concerning professional services rendered together with a listing of all pending actions involving professional service. This information shall be utilized in evaluating the prospective broker/dealer's fitness to represent the Commission.

An annual review of the financial condition and registrations of qualified bidders will be conducted by the investment officer.

B. Minority and Community Financial Institutions: From time to time, the investment officer may choose to invest in instruments offered by minority and community financial institutions. In such situations, a waiver to certain parts of the criteria under Paragraph A shown immediately above may be granted. All terms and relationships will be fully disclosed prior to purchase and will be reported to the appropriate entity on a consistent basis and will be consistent with state and local law. These types of investment purchases should be approved by the appropriate legislative or governing body in advance.

6.0 SAFEKEEPING AND CUSTODY

- A. Delivery vs. Payment:** All trades of marketable securities will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in an eligible financial institution prior to the release of funds.
- B. Safekeeping:** Securities will be held by a centralized independent third-party custodian selected by the entity as evidenced by safekeeping receipts in the San Diego Housing Commission's name. The safekeeping institution shall annually provide a copy of its most recent report on internal controls (Statement of Auditing Standards No. 70, or SAS 70).
- C. Internal Controls:** The investment officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the San Diego Housing Commission are protected from loss, theft or misuse. Details of the

internal controls system shall be documented in an investment procedures manual and shall be reviewed and updated annually.

1. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived.
2. The valuation of costs and benefits requires estimates and judgments by management. The internal controls structure shall address the following points:
 - a. Control of collusion
 - b. Separation of transaction authority from accounting and recordkeeping
 - c. Custodial safekeeping
 - d. Avoidance of physical delivery securities
 - e. Clear delegation of authority to subordinate staff members
 - f. Written confirmation of transactions for investments and wire transfers
 - g. Dual authorizations of wire transfers
 - h. Development of a wire transfer agreement with the lead bank and third-party custodian
 - i. Quarterly investment reports to the legislative body in accordance with Section 10 of this policy.

Accordingly, the investment officer shall establish a process for an annual independent review by an external auditor to assure compliance with policies and procedures or, alternatively, compliance should be assured through the San Diego Housing Commission's annual independent audit.

7.0 AUTHORIZED AND SUITABLE INVESTMENTS:

- A. The San Diego Housing Commission is empowered by HUD Notice PIH 96-33 to invest HUD funds in the following:
 1. United States Treasury Bills, Notes & Bonds.
 2. Obligations issued by Agencies or Instrumentalities of the US Government.
 3. State or Municipal Depository Funds, such as The Local Agency Investment Fund (LAIF) or pooled cash investment funds managed by County treasurers.
 4. Insured Demand and Savings Deposits, provided that deposits in excess of the insured amounts must be 100% collateralized by securities listed in A & B above.

5. Insured Money Market Deposit Accounts, provided that deposits in excess of the insured amount must be 100% collateralized by securities listed in A & B above.
 6. Insured Super NOW Accounts, provided that deposits in excess of the insured amount must be 100% collateralized by securities listed in A & B above.
 7. Negotiable Certificates of Deposit issued by federally or state chartered banks or associations provided that deposits in excess of the insured amount must be 100% collateralized by securities listed in A & B above.
 8. Repurchase/Reverse Repurchase Agreements of any securities authorized by this Section. Securities purchased under these agreements shall be no less than 102% of market value. (See special limits in HUD Notice 96-33 and CGC 53601.0)
 9. Sweep Accounts that are 100% collateralized by securities listed in A & B above.
 10. Shares of beneficial interest issued by diversified management companies (Money Market Mutual Funds) investing in the securities and obligations authorized by this Section.
 11. Funds held under the terms of a Trust Indenture or other contract or agreement, including the HUD/PHA Annual Contributions Contract, may be invested according to the provisions of those indentures or contracts.
 12. Principal only STRIPS.
 13. Any other investment security authorized under the provisions of HUD Notice PIH 96-33.
- B.** The San Diego Housing Commission is empowered by California Government Code (CGC) Sections 5922 and 53601 et seq. to invest non-HUD funds in the following:
1. Bonds issued by the San Diego Housing Commission.
 2. United States Treasury Bills, Notes & Bonds.
 3. Registered state warrants or treasury notes or bonds issued by the State of California.
 4. Bonds, notes, warrants or other evidence of debt issued by a local agency within the State of California, including pooled investment accounts

sponsored by the State of California, County Treasurers, other local agencies or Joint Powers Agencies.

5. Obligations issued by Agencies or Instrumentality of the US Government.
6. Bankers Acceptances with a term not to exceed 180 days.
7. Prime Commercial Paper with a term not to exceed 180 days.
8. Negotiable Certificates of Deposit issued by federally or state chartered banks or associations.
9. Repurchase/Reverse Repurchase Agreements of any securities authorized by this Section. Securities purchased under these agreements shall be no less than 102% of market value. (See special limits in CGC 53601.
10. Medium term notes (not to exceed 5 Years) of US corporations rated "A" or better by Moody's' or S&P.
11. Shares of beneficial interest issued by diversified management companies (Money Market Mutual Funds) investing in the securities and obligations authorized by this Section.
12. Funds held under the terms of a Trust Indenture or other contract or agreement may be invested according to the provisions of those indentures or agreements.
13. Collateralized bank deposits with a perfected security interest in accordance with the Uniform Commercial Code (UCC) or applicable federal security regulations.
14. Any mortgage pass-through security, collateralized mortgage obligation, mortgaged backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate or consumer receivable backed bond of a maximum maturity of five years.
15. Any other investment security authorized under the provisions of CGC 5922 and 53601.

Also, see CGC 53601 and Attachment A to HUD Notice 96-33, HUD Approved Investment Instruments, for a detailed summary of the limitations and special conditions that apply to each of the above listed investment securities. CGC 53601 and Attachment A to HUD Notice 96-33, HUD Approved Investment Instruments are included by reference in this investment policy.

Prohibited Investments: Under the provisions of CGC 53601.6, the San Diego Housing Commission shall not invest any funds covered by this Investment Policy in inverse floaters, range notes, interest-only strips derived from mortgage pools or any investment that may result in a zero interest accrual if held to maturity.

8.0 COLLATERALIZATION:

All certificates of deposits must be collateralized by U.S. Treasury Obligations. Collateral must be held by a third party and valued on a monthly basis. The percentage of collateralization on repurchase agreements will conform to the amount required under CGC 53601(i)(2).

9.0 DIVERSIFICATION:

It is the policy of the San Diego Housing Commission to diversify its investment portfolio. Diversification strategies shall be determined and revised periodically. In establishing specific diversification strategies, the following guidelines shall apply:

- A.** Limit investments to avoid over-concentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities). There will be an exception made for a specific issuer who provides fully collateralized certificates of deposits due to the security provided by the collateral.
- B.** Limit investments in securities that have higher credit risk.
- C.** Portfolio maturities shall be matched against projected liabilities to avoid an overconcentration in a specific series of maturities.
- D.** Continuously investing a portion of the portfolio in readily available funds to ensure that appropriate liquidity is maintained in order to meet ongoing operations.

10.0 REPORTING

- A.** The Investment Officer shall submit to each member of the Board of Commissioners a quarterly investment report. The report shall include a complete description of the portfolio, the type of investments, the issuers, maturity dates, book values and the current market values of each component of the portfolio, including funds managed by third party contractors. The report will also include the source of the portfolio valuation. In the case of funds invested in The Local Agency Investment Fund (LAIF), FDIC Insured accounts or county investment pools, current statements from those institutions will satisfy the above reporting requirement. The report will also include a certification that (1) all investment actions executed since the last report have been made in full compliance with the Investment Policy and, (2) the San Diego Housing Commission will meet its expenditure obligations for the next

six months. [CGC 53646(b)]. The Investment Officer shall maintain a complete and timely record of all investment transactions.

- B.** In addition, an Investment Review Committee consisting of two Housing Commission Board members and one staff member to be appointed by the Chair of the Housing Commission will meet on a quarterly basis to review the investments of the agency.

11.0 APPROVAL OF INVESTMENT POLICY

The Investment Policy shall be adopted by resolution of the San Diego Housing Commission. Moreover, the Investment Policy shall be reviewed on an annual basis, and modifications must be approved by the governing body.

San Diego Housing Commission
Investment Report
as of 6/30/05

A. Description of Investment Portfolio

The San Diego Housing Commission regularly invests monies in excess of prudently estimated needs in HUD approved investments for both HUD and Non-HUD programs. The investment options currently utilized include the Local Agency Investment Fund of the State of California and certificates of deposits. The blended return on the portfolio as of 6/30/05 is 3.15%.

B. Summary of Investment Portfolio End of Quarter

Account	Issuer	Original Term	Book Value (millions)	Percent of Portfolio	Not to Exceed Limit	Days to Maturity	Yield (%)	Actual (%)
Local Agency Investment Fund	State of California		\$3.50	6.80%	\$30 million	1	2.97	2.97
Certificates of Deposit (Collateralized)					N/A			
1.Matures 7/21/2005	U.S. Bank	365	\$3.00	5.83%		21	2.18	2.21
2.Matures 8/17/2005	U.S. Bank	300	\$3.00	5.83%		48	2.25	2.28
3.Matures 9/16/2005	U.S. Bank	330	\$3.00	5.83%		78	2.28	2.31
4.Matures 10/12/2005	U.S. Bank	300	\$3.00	5.83%		104	2.78	2.82
5.Matures 11/14/2005	U.S. Bank	333	\$3.00	5.83%		137	2.82	2.86
6.Matures 12/16/2005	U.S. Bank	365	\$3.00	5.83%		169	2.86	2.90
7.Matures 1/13/2006	U.S. Bank	365	\$3.00	5.83%		197	3.11	3.15
8.Matures 2/17/2006	U.S. Bank	393	\$3.00	5.83%		232	3.17	3.21
9.Matures 3/15/2006	U.S. Bank	393	\$3.00	5.83%		258	3.28	3.33
10.Matures 4/17/2006	U.S. Bank	426	\$3.00	5.83%		291	3.32	3.37
11.Matures 5/17/2006	U.S. Bank	426	\$3.00	5.83%		321	3.52	3.57
12.Matures 6/13/2006	U.S. Bank	391	\$3.00	5.83%		348	3.58	3.63
13.Matures 7/18/2006	U.S. Bank	456	\$3.00	5.83%		383	3.59	3.64
14.Matures 8/08/2006	U.S. Bank	456	\$3.00	5.83%		404	3.75	3.80
15.Matures 9/13/2006	U.S. Bank	483	\$3.00	5.83%		440	3.70	3.75
16.Matures 10/16/2006	U.S. Bank	483	\$3.00	5.83%		473	3.78	3.83
Sub-total Certificate of Deposits		392	\$48.00	93.20%		244		3.17
Total Cash & Investments			\$51.50	100.00%		227		3.15

Statement of Compliance

I certify to the best of my knowledge and belief that all investment transactions executed have been in full compliance with the investment policy of the San Diego Housing Commission. I further assert that sufficient investment liquidity and anticipated revenues and subsidies are available to meet the expected obligations of the San Diego Housing Commission expenditures for six months.

Tim Sturtevant Date
Investment Officer