



**CITY of NOVI CITY COUNCIL**

**Agenda Item <sup>D</sup>  
June 21, 2010**

**SUBJECT:** Approval of the revised *City of Novi Investment Policy* (add permissible investment instruments under Public Act 20 of 1943 and to update List of Approved Financial Institutions).

**SUBMITTING DEPARTMENT:** Finance/Treasury

**CITY MANAGER APPROVAL:** 

**BACKGROUND INFORMATION:**

Attached is the revised *City of Novi Investment Policy*. Please see page 5, *In accordance with Michigan Public Act 20 of 1943 as amended, the surplus funds of the City of Novi will be invested as follows:* added "(F) Obligations of this state or any of its political subdivisions that at the time of purchase are rated as investment grade by not less than 1 standard rating service" (reflects change from non-permissible to permissible as provided by the State). Also, please see page 15 for changes under List of Approved Financial Institutions.

**RECOMMENDED ACTION:** Approval of the revised *City of Novi Investment Policy* (add permissible investment instruments under Public Act 20 of 1943 and to update List of Approved Financial Institutions).

|                         | 1 | 2 | Y | N |
|-------------------------|---|---|---|---|
| Mayor Landry            |   |   |   |   |
| Mayor Pro Tem Gatt      |   |   |   |   |
| Council Member Crawford |   |   |   |   |
| Council Member Fischer  |   |   |   |   |

|                         | 1 | 2 | Y | N |
|-------------------------|---|---|---|---|
| Council Member Margolis |   |   |   |   |
| Council Member Mutch    |   |   |   |   |
| Council Member Staudt   |   |   |   |   |

**City of Novi**  
Oakland County  
MICHIGAN

INVESTMENT POLICY

1.0 POLICY:

The City of Novi investment officer will invest public funds in a manner consistent with this policy. Investments shall be timed to meet the daily cash flow demands of the city, while at all times conforming to state statutes and local ordinances governing the investment of public funds.

2.0 SCOPE:

This investment policy applies to the investment activities of the City of Novi. Funds that are accounted for in the city financial report include:

- A) General Fund
- B) Special Revenue Funds
- C) Debt Funds
- D) Capital Funds
- E) Enterprise Funds
- F) Trust and Agency Funds
- G) Component Units
- H) Any new fund created by the city council, unless specifically exempted

This policy does not cover investment activities of pension fund or deferred compensation monies in the event the city ever privatizes these retirement programs.

3.0 PRUDENCE:

The standard of prudence to be applied by the investment officer shall be the "prudent person" rule which states; "Investments shall be made with judgment and care - under circumstances then prevailing - which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived." The prudent person rule shall be applied in the context of managing the overall portfolio. Investment officers acting in accordance with written procedures and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price change, provided deviations from expectations are reported to the chief financial officer in a timely fashion and appropriate action is taken to control adverse

developments.

#### 4.0 ETHICS AND CONFLICT OF INTEREST:

Officers and employees involved in the investment process shall refrain from personal business activity that would 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 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 which business is conducted on behalf of the City of Novi.

#### 5.0 OBJECTIVES:

Funds of the City of Novi will be invested in accordance with Michigan Public Act 20 of 1943 as amended and in accordance with the following objectives, procedures and policy.

A) Safety of Capital - Safety of principal will be the foremost objective of the City of Novi. Each investment transaction shall seek to first ensure that capital losses are avoided whether they are from defaults or erosion of market value.

B) Liquidity - The City's investment portfolio will remain sufficiently liquid to enable the city to meet all operating requirements that might be reasonably anticipated.

C) Return on Investment - The investment portfolio of the City of Novi shall be designed in a manner to attain a market rate of return throughout budgetary and economic cycles while preserving and protecting capital.

D) Protection of Purchasing Power - Funds held for capital projects shall be invested so that they can reasonably be expected to produce enough income to offset inflationary construction cost increases. However, such funds shall never be exposed to risks that would jeopardize the assets capital value or be in conflict with state law.

E) Maintain the Public's Trust - All participants in the investment process shall seek to act responsibly as custodians of the public trust. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. In addition, the overall investment program shall be designed and managed with a degree of professionalism worthy of the public trust. Investment officials shall also avoid any transaction that might knowingly impair public confidence in the City of Novi's ability to govern effectively. Investment officers should have sufficient knowledge of financial markets and investment management, and should not be delegated to persons without proper credentials.

Minimum credentials should include a four-year degree in finance or related area by an accredited college or university.

#### 6.0 DELEGATION OF AUTHORITY:

The City Treasurer and Assistant Treasurer shall be designated as the "Investment Officers" for the City of Novi and are responsible for investment decisions and activities. No person, including the Investment Officers, shall engage in investment transactions on behalf of the city except as provided under the terms of this policy and the administrative procedures as established by the City Treasurer.

#### 7.0 QUALIFIED INSTITUTIONS:

The city shall maintain a listing of financial institutions that are approved for investment purposes. Banks shall provide, at minimum, their annual financial statements. The city shall conduct an annual evaluation of each bank's credit worthiness to determine whether it should be on the "Qualified Institution" listing.

When making a decision on the credit worthiness of a particular financial institution, rating agencies, the annual financial statement, reports, and other independently secured information on the financial health of the institution shall be taken into account. Any financial institution not posting a rating of one of the 2 highest classifications by one of the national rating organizations shall not be used for debt investments secured by their own credit worthiness.

Security dealers not affiliated with a bank shall be required to be classified as reporting dealers affiliated with the New York Federal Reserve Bank as primary dealers or be non primary reporting dealers that have net capital equal to or greater than twice the amount required by the Securities and Exchange Commission's net capital rule. All security dealers must complete a Broker/Dealer Questionnaire that includes no less than the following:

- A) Name, address, and federal ID number of the parent firm;
- B) Address of the local office doing business with the City of Novi;
- C) The name and license number of the primary representative that will be conducting business with the city;
- D) A listing of all other personnel who will be offering, bidding, and quoting securities to the City of Novi authorized investment officer;
- E) Whether the firm is a primary dealer in U.S. Government Securities;
- F) The previous three years audited financial statement;

- G) A list of other public-sector clients;
- H) An explanation of the firm's precautions taken, if any, to protect the interests of the public when dealing with governmental agencies;
- I) And the following authorizations:
  - a) Whether or not any public-sector clients ever sustained a loss on a security transaction where the public sector client made a claim that the loss was due in whole or in part from a misunderstanding or misrepresentation of the risk characteristics of the instrument?
  - b) Whether any of their public-sector clients ever had to report a realized loss equaling more than 10% of the original purchase price on an investment purchased from your firm within a single year.
  - c) Whether their firm, or any of their employees doing business with the City of Novi, ever been subject to a regulatory, state or federal agency investigation for the alleged improper, fraudulent, disreputable or unfair activities related to the sale or purchase of a security, government obligation, agency, or pooled/fund type investment.
  - d) Whether a public-sector client of theirs ever claimed in writing that their firm was responsible for an investment loss?
  - e) How many investments offered to public sector clients failed last month? Last year?
  - f) Whether their firm consistently complied with, and is currently in conformance with, the Federal Reserve Bank's Securities Exchange Commission's capital adequacy guidelines. Have they ever exceeded the capital adequacy guidelines? Does the firm have a policy on the amount of capital to be used for this purpose? If your firm has fallen short within the past three years, by how much and for how long was each period?
  - g) Whether they participate in the SIPC insurance program?

All qualified institutions must acknowledge receipt of a copy of this policy in writing on their official letterhead before any transactions can be completed.

## 8.0 INSTRUMENTS:

In accordance with Michigan Public Act 20 of 1943 as amended, the surplus funds of the City of Novi will be invested as follows:

- (A) In bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.
- (B) In certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank or a savings and loan association which is a member of the Federal Deposit Insurance Corporation or a credit union which is insured by the National Credit Union Administration. The bank, savings and loan association or credit union must be eligible to be a depository of surplus funds belonging to the State.
- (C) In commercial paper rated at the time of purchase within the highest classification established by not less than two standard rating services and which matures not more than 270 days after the date of purchase.
- (D) In United States government or federal agency obligation repurchase agreements. Repurchase agreements shall be negotiated only with dealers or financial institutions with which the city has negotiated a Master Repurchase Agreement. Repurchase Agreements must be signed with the bank or dealer and must contain provisions similar to those outlined in the Public Security Association's model Master Repurchase Agreement.
- (E) In bankers' acceptances of United States banks.
- (F) Obligations of this state or any of its political subdivisions that at the time of purchase are rated as investment grade by not less than 1 standard rating service.
- (G) Mutual funds registered under the investment company act of 1940, title I of Michigan chapter 686, 54 Stat. 789, 15 U.S.C. 80a-1 to 80a-3 and 80a-4 to 80a-64, with authority to purchase only investment vehicles that are legal for direct investment by a public corporation. Included in this authorization are mutual funds that have net asset values (NAV) that fluctuate or can fluctuate on a periodic basis. A mutual fund is not disqualified as a permissible investment solely by reason of either of the following:
  - (a) The purchase of securities on a when-issued or delayed delivery basis.
  - (b) The ability to lend portfolio securities as long as the mutual fund receives collateral at all times equal to at least 100% of the value of the securities loaned.

- (c) The limited ability to borrow and pledge a like portion of the portfolio's assets for temporary or emergency purposes.
- (d) Investment pools organized under the surplus funds investment pool act, 1982 PA 367, 129.111 to 129.118.
- (e) Obligations described in (a) through (g) if purchased through an interlocal agreement under the urban cooperation act of 1967, 1967(Ex Sess) P.A. 7, MCL 124.501 to 124.512.

~~(HG)~~ The investment of Retiree Health Care funds pursuant to Act 149 PA 1999, as allowed under Section 13 of Public Act 314, in assets that are generally permissible for the investment of pension funds. This would include investments in equities and other financial instruments that provide historically higher returns in exchange for an increase in investment risk. Investment risk is defined here as risk in capital market fluctuating (loss of value), risk in investment return (fluctuations in income producing products), and the possible loss of capital (underlying assets becoming worthless).

For purposes of this section, the objectives listed in section 5 shall be altered in that the return on investment shall be of primary concern, followed by safety of capital and liquidity.

While permissible under state law, the City of Novi will not invest in the following:

~~(A) — Obligations of this state or any of its political subdivisions that at the time of purchase are rated as investment grade by not less than 1 standard rating service.~~

~~(A)(B)~~ The investment pools organized under the local government investment pool act, 1985 PA 121, MCL 129.141 to 129.150.

Although permitted under state law, *collateralization will not be required on all investments with the exception of repurchase or reverse repurchase agreements.* Repurchase and reverse repurchase agreements must be collateralized at 102% of the market value of principal and accrued interest. All other investments will be looked at on a case-by-case basis taking into account liquidity, safety and yield.

## 9.0 INVESTMENT POOLS

Any investment into a pooled type account can only be made after the Investment Officer has completed a thorough investigation. After the initial investment has been approved,

the investment officer must continue to monitor the account, reviewing the account's suitability as an investment vehicle. Due diligence by the Investment Officer is required. When reviewing the pooled account, the investment officer shall take into account the following:

- A) A detailed description of eligible investments made by the pool or fund;
- B) A written statement of the investment policy and the pool or fund objectives;
- C) A description of interest calculations and how interest is distributed;
- D) An explanation on how the fund will handle gains and losses within the fund;
- E) A description on how the funds will be safeguarded, and how often the underlying securities will be marked-to-market;
- F) Who will audit the fund or pool and how often;
- G) An explanation of who will be able to invest in the fund, how often investments can be made, and what size limitations, if any, will be in effect for the fund;
- H) A schedule for receiving statements and portfolio listings;
- I) A fee schedule, explaining how and when the fees will be assessed;
- J) Whether the fund will be able to receive bond proceeds, and whether they will accept bond proceeds;
- K) Does the pool or fund utilize any type of reserves or a retained earnings account? If so, how does this effect the interest earnings of the participants?

#### 10.0 SAFEKEEPING AND DELIVERY-VS-PAYMENT:

All securities purchased by the City of Novi shall be properly designated as an asset of the city and held in safekeeping. No withdrawal of such securities, in whole or in part, shall be made from safekeeping except by the Treasurer or Assistant Treasurer as authorized herein.

The State of Michigan does not require collateralization of public funds. However, all security transactions having a value greater than SPIC or other applicable insurance shall be settled on a Delivery-vs-Payment (DVP) basis. A Trust or Safekeeping Receipt and proof of the applicable insurance will be required. Non-negotiable, non-collateralized Certificates of Deposit, as allowed under the law in the State of Michigan, shall be evidenced by a Safekeeping Receipt from the issuing bank.



### 11.0 DIVERSIFICATION:

It is the objective of the City of Novi to diversify its investment portfolios. Assets held in the common cash fund and other investment funds shall be diversified to eliminate the risk of loss resulting from over concentration of assets of a specific maturity, individual financial institution, or type of security. Diversification strategies shall be determined and revised by the city Treasurer from time to time to meet diversification objectives (reducing overall portfolio risk while attaining market or above market average rates of return). It is also understood that temporary deviations from this objective may be necessary from time to time in order to accommodate certain financial goals and obligations.

Investment maturities for operating funds shall be scheduled to coincide with projected cash flow needs, taking into account large routine expenditures (payroll, debt service) as well as considering sizable blocks of anticipated revenue (taxes, state revenue sharing payments).

It is also desirable to maintain a portfolio that has as it's investments no more than a 50% concentration in commercial paper. It is also desirable to maintain an individual fund at a 50% concentration in commercial paper or less. However, short-term fluctuations over the 50% target are acceptable within the individual fund as long as the entire portfolio maintains no more than a 50% concentration.

Permitted pool accounts will not be limited in use except by the general limitations issued under this policy under diversification and by the liquidity/safety/yield principle.

Direct term purchases by the investment officer of repurchase agreements or Bankers Acceptances generally should not exceed 25% of the fund portfolio.

CD's shall not be limited in use within the portfolio.

### 12.0 SHORT-TERM VERSUS LONG-TERM PORTFOLIO:

Limitations on instruments, diversification, and maturity scheduling shall depend upon whether the funds being invested are considered short-term or long-term funds. With the exception of capital funds, special assessment funds, the post retirement health care fund, the perpetual drain fund and water and sewer funds, all funds shall be considered short-term and shall be invested in instruments whose maturities do not exceed two years at the time of purchase. In addition, a portion of each fund eligible for long term investment shall held in short term or highly liquid investment funds to meet anticipated and unanticipated needs.

### 13.0 INTERNAL CONTROLS:

The Treasurer shall establish a system of internal controls. The controls shall be designed to prevent loss of public funds due to fraud, error, misrepresentation, unanticipated market changes or imprudent actions. The investment procedure, compliance, and the internal controls will be reviewed annually by the city audit firm, an independent public accounting firm.

#### 14.0 PERFORMANCE STANDARDS:

The investment portfolio will be designed to obtain a market average rate of return during budgetary and economic cycles, taking into account the city's investment risk constraints and cash flow needs. Because the investment portfolio is designed to operate on a 'hold-to-maturity' premise (or passive investment style), and because of the safety, liquidity, and yield priorities, the basis that will be used by the Treasurer to determine whether market yields are being achieved shall be the U.S. Treasury Bill maturing closest to the weighted average maturity of the City's overall portfolio.

#### 15.0 INVESTMENT PROCEDURES

Whenever possible, all investment decisions should be made on a competitive-bid basis, selecting the investment with the highest return.

When funds become available for investment (often timed to match council approved warrants), the first step would be to review the city's cash flow requirements. Once cash flow needs have been assessed, 'model' investments of dollar amount and maturity date are made to determine an appropriate distribution. Once the dollar amounts and maturity dates are decided, a list of possible investments that most closely match amount and maturity date distributions of investible funds is gathered from the list of approved financial institutions. A review of the bids (investment vehicles) received is then made taking into account percentage limitations of investment vehicles as described in section 8 and 11. At the same time, any investment that must be separated from the other investible funds for legal reasons are identified and separated as a separate investment. Once this has been done, diversification goals are re-reviewed as described in section 11. Final decisions are then made taking into account risk factors of the buyer, current economic conditions, future expectations and portfolio concentrations at individual financial institutions.

With the investment decision making process being fluid, there is a great deal of back and fourth adjustments until the best alternatives are identified. Once the desired investments are selected, investment purchases are made and recorded.

#### 16.0 REPORTING REQUIREMENTS:

The investment officer shall provide in writing a quarterly investment report that provides a clear picture of the status of the current investment portfolio. The management report will include comments on the fixed income markets and current economic conditions. A brief

discussion on key investment policies as they relate to the investment portfolio, diversification, and possible changes to the portfolio structure going forward shall also be included in the report.

Schedules will include a listing of securities currently held at the end of the reporting period, final maturity of each investment, earnings rate by security, book value, amortized value and market value if applicable, and percentage of portfolio by security type. Also included will be the average weighted days to maturity of the entire portfolio that will be used as the comparison against the established benchmark.

Annually, a detailed report indicating the investment agenda for the upcoming year along with a report on the investment earnings from the previous year shall supplement the quarterly reports. The year-end report shall also include thoughts on investment strategies for the upcoming year.

#### 17.0 GLOSSARY OF TERMS

Please see Appendix A

#### 18.0 EFFECTIVE DATE:

The City of Novi investment policy shall be adopted by resolution of the City Council. The Finance Director and Treasurer shall review the policy at least annually. Any changes to this policy must be submitted to the city council for approval.

## Appendix A

The following is a list of terms used in this policy and the meaning to be assigned:

|                              |   |
|------------------------------|---|
| Banker's Acceptances         | A time draft (bill of exchange) drawn on and accepted by a bank used to effect payment for merchandise sold in import - export transactions. Backed by the credit strength of the accepting bank. |
| Benchmark                    | An independent index that is used for comparison against the return of another portfolio. In our case, the benchmark used is the 6-month T-Bill rate.   |
| Bond                         | In our case, federally issued and federally backed bonds having a stated coupon interest rate and maturity.   |
| Capital Losses               | Losses that occur from the sale of investments.   |
| Capital                      | For our purposes, money available for investment.   |
| Capital Gains                | Gains that are experienced from the sale of investments.  |
| Cash Flow                    | An analysis of all the changes that affect the cash account during the time period under consideration.   |
| Certificates of Deposit (CD) | Debt instruments issued by banks whose interest rates are set by competitive market forces.   |
| Commercial Paper             | Debt instruments issued by highly rated large corporations. Usually multi-nationals.  |
| Debt Funds                   | Funds set up to provide for the retirement of debt instruments issued by the city.  |
| Deposit Accounts             | Checking Accounts or other non-interest bearing accounts.   |
| Diversification              | Spreading of risk by putting assets into several categories of investments.   |
| Economic Cycle               | For our purposes, the general, recurring and predictable cycles experienced by the city of  |

|                      |  |
|----------------------|--|
|                      | Novi.  |
| Equities             | Stock in a publicly held corporation.  |
| Equity Capital       | Price paid for the stock purchase.   |
| Financial Instrument | A marketable financial asset.  |
| FDIC                 | Federal Deposit Insurance Corporation:<br>Insurance corporation established in 1933 to guarantee depositors against loss of their deposits in member banks for up to \$100,000.  |
| Financial Markets    | Securities markets in the aggregate, such as the New York Stock Exchange.  |
| Funds                | Accounting term for categorizing financial resources into use groups. Specifically for purposes of this policy, a fund will mean the money assets of this city, the investment of which is not otherwise subject to a public act of this state or bond authorizing ordinance or resolution of the city that permits investments in fewer than all of the investment options listed in section 8 "Instruments" or imposes 1 or more conditions upon an investment in an option listed in section 8. |
| Governing Body       | Four purposes of this policy, the governing body is the City of Novi City Council.   |
| Investment Return    | The rate of return, or interest rate paid, on an investment based on a 360 day year.   |
| Investment Officials | Finance Director/Treasurer; Assistant Treasurer  |
| Investment Pools     | Those investment pools organized under the authority of the urban cooperation act of 1967, 1967 (Ex Sess) PA7 (managed contractually), the surplus funds investment pool act, 1982 PA 367 (managed by banks), and the local government investment pool act, 1985 PA 121 (managed by county treasurer). All pools are limited to investments described in section 8.  |
| Liquidity            | How fast an investment can be turned into cash.  |
| Market Value         |  |

|                       |   |
|-----------------------|---|
|                       | Current market price of an investment as indicated by the latest trade record.  |
| Market rate of return | A benchmark selected as a indicator of the market's performance as measured by the rate of return expressed as a percentage.  |
| Mutual Funds          | For the purpose of this document, a fund operated by an investment company that raises money from shareholders and invests it in legally permissible investments as provided for under the law for municipalities.                    |
| Negative Cash Flow    | Times when more money is going out than is coming in.   |
| Net Capital Rule      | Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1.   |
| Portfolio             | The aggregate of the investments taken as a whole.  |
| Positive Cash Flow    | Times when more money is coming in than is being paid out.  |
| Primary Dealers       | A bank or financial institution authorized to deal directly with the Federal Reserve Bank of New York for purposes of buying and selling government securities in the Federal Reserve's Bank execution of Fed Open Market Operations. |
| PRINS or STRIP's      | "Separate Trading of Registered Interest and Principle of Securities" A prestripped zero-coupon bond that is a direct obligation of the US Treasury.  |
| Rating Service        | Services that provide unbiased, third party ratings to issuers of debt. No guarantee of accuracy is provided.   |
| Repurchase Agreements | An agreement between a seller and buyer (in U.S. government securities), whereby the seller agrees to repurchase the securities at an agreed upon price and, usually, at a stated   |

|                      |  |
|----------------------|--|
|                      | time.  |
| Return on Investment | See Investment Return  |
| Risk                 | For purposes of this policy, risk is defined as the possible reduction of equity capital, the fluctuating in investment earnings including the possible loss of investment earnings, or the complete loss of the investment. |
| Securities           | Any investment vehicle that can be bought and sold in the market.  |
| TINTS                | Treasury interest securities.  |
| Trust Accounts       | Money accounts that are not the property of the bank or trustee. Account assets are usually short-term in nature and deposits are interest bearing.  |
| US Treasury Strips   | Separate trading of registered interest and principal securities (coupons grouped in one pool and principal in another).   |
| US Treasury Bonds    | Similar to notes except original maturities are ten years and longer.  |
| US Treasury Bills    | Obligations of the United States Government sold at a discount from par with a specific maturity date up to a maximum maturity of one year. Interest is calculated using actual number of days over a 360-day year.          |
| US Treasury Notes    | Obligations of the United States government bearing interest payable at six-month intervals until maturity. Maturities are from one to ten years.  |

City of Novi Investment Policy Addendum

**List of Approved Financial Institutions**

**Banks:**

Chase

~~National City Bank~~ PNC (Formally National City Bank)

Bank of America

Comerica Bank

TCF

Charter One Bank

Fifth Third Bank

Flagstar Bank

Huntington Bank

Citizens Republic Bank

Franklin Bank

Macomb Community Bank

Mercantile Bank of Michigan

The Private Bank

~~Citizens First~~

~~Michigan Heritage~~

Lotus Bank

**Other Financial Service Institutions**

Ambassador Capital Management

J P Morgan Chase

Municipal Investors Service Corporation Cooperative Liquid Assets Securities Corporation (MBIA CLASS)

PFM Group

~~Morgan Stanley/Smith Barney Inc. Investment Services~~

Federated Securities Corp.

~~PNC (Formally NatCity Investments)~~

Novi Credit Union

UBS Financial Services Inc.

Municipal Employees' Retirement System

Merrill Lynch



**City of Novi**  
Oakland County  
MICHIGAN

INVESTMENT POLICY

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C) Return on Investment - The investment portfolio of the City of Novi shall be designed in a manner to attain a market rate of return throughout budgetary and economic cycles while preserving and protecting capital.

D) Protection of Purchasing Power - Funds held for capital projects shall be invested so that they can reasonably be expected to produce enough income to offset inflationary construction cost increases. However, such funds shall never be exposed to risks that would jeopardize the assets capital value or be in conflict with state law.

E) Maintain the Public's Trust - All participants in the investment process shall seek to act responsibly as custodians of the public trust. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. In addition, the overall investment program shall be designed and managed with a degree of professionalism worthy of the public trust. Investment officials shall also avoid any transaction that might knowingly impair public confidence in the City of Novi's ability to govern effectively. Investment officers should have sufficient knowledge of financial markets and investment management, and should not be delegated to persons without proper credentials. Minimum credentials should include a four-year degree in finance or related area by an accredited college or university.

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When making a decision on the credit worthiness of a particular financial institution, rating agencies, the annual financial statement, reports, and other independently secured information on the financial health of the institution shall be taken into account. Any financial institution not posting a rating of one of the 2 highest classifications by one of the national rating organizations shall not be used for debt investments secured by their own credit worthiness.

Security dealers not affiliated with a bank shall be required to be classified as reporting dealers affiliated with the New York Federal Reserve Bank as primary dealers or be non primary reporting dealers that have net capital equal to or greater than twice the amount required by the Securities and Exchange Commission's net capital rule. All security dealers must complete a Broker/Dealer Questionnaire that includes no less than the following:

- A) Name, address, and federal ID number of the parent firm;
- B) Address of the local office doing business with the City of Novi;
- C) The name and license number of the primary representative that will be conducting business with the city;
- D) A listing of all other personnel who will be offering, bidding, and quoting securities to the City of Novi authorized investment officer;
- E) Whether the firm is a primary dealer in U.S. Government Securities;
- F) The previous three years audited financial statement;
- G) A list of other public-sector clients;
- H) An explanation of the firm's precautions taken, if any, to protect the interests

- of the public when dealing with governmental agencies;
- l) And the following authorizations:
- a) Whether or not any public-sector clients ever sustained a loss on a security transaction where the public sector client made a claim that the loss was due in whole or in part from a misunderstanding or misrepresentation of the risk characteristics of the instrument?
  - b) Whether any of their public-sector clients ever had to report a realized loss equaling more than 10% of the original purchase price on an investment purchased from your firm within a single year.
  - c) Whether their firm, or any of their employees doing business with the City of Novi, ever been subject to a regulatory, state or federal agency investigation for the alleged improper, fraudulent, disreputable or unfair activities related to the sale or purchase of a security, government obligation, agency, or pooled/fund type investment.
  - d) Whether a public-sector client of theirs ever claimed in writing that their firm was responsible for an investment loss?
  - e) How many investments offered to public sector clients failed last month? Last year?
  - f) Whether their firm consistently complied with, and is currently in conformance with, the Federal Reserve Bank's Securities Exchange Commission's capital adequacy guidelines. Have they ever exceeded the capital adequacy guidelines? Does the firm have a policy on the amount of capital to be used for this purpose? If your firm has fallen short within the past three years, by how much and for how long was each period?
  - g) Whether they participate in the SIPC insurance program?

All qualified institutions must acknowledge receipt of a copy of this policy in writing on their official letterhead before any transactions can be completed.

#### 8.0 INSTRUMENTS:

In accordance with Michigan Public Act 20 of 1943 as amended, the surplus funds of the City of Novi will be invested as follows:

- (A) In bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.
- (B) In certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank or a savings and loan association which is a member of the Federal Deposit Insurance Corporation or a credit union which is insured by the National Credit Union Administration. The bank, savings and loan association or credit union must be eligible to be a depository of surplus funds belonging to the State.
- (C) In commercial paper rated at the time of purchase within the highest classification established by not less than two standard rating services and which matures not more than 270 days after the date of purchase.
- (D) In United States government or federal agency obligation repurchase agreements. Repurchase agreements shall be negotiated only with dealers or financial institutions with which the city has negotiated a Master Repurchase Agreement. Repurchase Agreements must be signed with the bank or dealer and must contain provisions similar to those outlined in the Public Security Association's model Master Repurchase Agreement.
- (E) In bankers' acceptances of United States banks.
- (F) Obligations of this state or any of its political subdivisions that at the time of purchase are rated as investment grade by not less than 1 standard rating service.
- (G) Mutual funds registered under the investment company act of 1940, title I of Michigan chapter 686, 54 Stat. 789, 15 U.S.C. 80a-1 to 80a-3 and 80a-4 to 80a-64, with authority to purchase only investment vehicles that are legal for direct investment by a public corporation. Included in this authorization are mutual funds that have net asset values (NAV) that fluctuate or can fluctuate on a periodic basis. A mutual fund is not disqualified as a permissible investment solely by reason of either of the following:
  - (a) The purchase of securities on a when-issued or delayed delivery basis.
  - (b) The ability to lend portfolio securities as long as the mutual fund receives collateral at all times equal to at least 100% of the value of the securities loaned.
  - (c) The limited ability to borrow and pledge a like portion of the portfolio's assets for temporary or emergency purposes.
  - (d) Investment pools organized under the surplus funds investment pool

act, 1982 PA 367, 129.111 to 129.118.

(e) Obligations described in (a) through (g) if purchased through an interlocal agreement under the urban cooperation act of 1967, 1967(Ex Sess) P.A. 7, MCL 124.501 to 124.512.

(H) The investment of Retiree Health Care funds pursuant to Act 149 PA 1999, as allowed under Section 13 of Public Act 314, in assets that are generally permissible for the investment of pension funds. This would include investments in equities and other financial instruments that provide historically higher returns in exchange for an increase in investment risk. Investment risk is defined here as risk in capital market fluctuating (loss of value), risk in investment return (fluctuations in income producing products), and the possible loss of capital (underlying assets becoming worthless).

For purposes of this section, the objectives listed in section 5 shall be altered in that the return on investment shall be of primary concern, followed by safety of capital and liquidity.

While permissible under state law, the City of Novi will not invest in the following:

The investment pools organized under the local government investment pool act, 1985 PA 121, MCL 129.141 to 129.150.

Although permitted under state law, *collateralization will not be required on all investments with the exception of repurchase or reverse repurchase agreements.* Repurchase and reverse repurchase agreements must be collateralized at 102% of the market value of principal and accrued interest. All other investments will be looked at on a case-by-case basis taking into account liquidity, safety and yield.

## 9.0 INVESTMENT POOLS

Any investment into a pooled type account can only be made after the Investment Officer has completed a thorough investigation. After the initial investment has been approved, the investment officer must continue to monitor the account, reviewing the account's suitability as an investment vehicle. Due diligence by the Investment Officer is required. When reviewing the pooled account, the investment officer shall take into account the following:

- A) A detailed description of eligible investments made by the pool or fund;
- B) A written statement of the investment policy and the pool or fund objectives;
- C) A description of interest calculations and how interest is distributed;

- D) An explanation on how the fund will handle gains and losses within the fund;
- E) A description on how the funds will be safeguarded, and how often the underlying securities will be marked-to-market;
- F) Who will audit the fund or pool and how often;
- G) An explanation of who will be able to invest in the fund, how often investments can be made, and what size limitations, if any, will be in effect for the fund;
- H) A schedule for receiving statements and portfolio listings;
- I) A fee schedule, explaining how and when the fees will be assessed;
- J) Whether the fund will be able to receive bond proceeds, and whether they will accept bond proceeds;
- K) Does the pool or fund utilize any type of reserves or a retained earnings account? If so, how does this effect the interest earnings of the participants?

10.0 SAFEKEEPING AND DELIVERY-VS-PAYMENT:

All securities purchased by the City of Novi shall be properly designated as an asset of the city and held in safekeeping. No withdrawal of such securities, in whole or in part, shall be made from safekeeping except by the Treasurer or Assistant Treasurer as authorized herein.

The State of Michigan does not require collateralization of public funds. However, all security transactions having a value greater than SPIC or other applicable insurance shall be settled on a Delivery-vs-Payment (DVP) basis. A Trust or Safekeeping Receipt and proof of the applicable insurance will be required. Non-negotiable, non-collateralized Certificates of Deposit, as allowed under the law in the State of Michigan, shall be evidenced by a Safekeeping Receipt from the issuing bank.

11.0 DIVERSIFICATION:

It is the objective of the City of Novi to diversify its investment portfolios. Assets held in the common cash fund and other investment funds shall be diversified to eliminate the risk of loss resulting from over concentration of assets of a specific maturity, individual financial institution, or type of security. Diversification strategies shall be determined and revised by the city Treasurer from time to time to meet diversification objectives (reducing overall portfolio risk while attaining market or above market average rates of return). It is also understood that temporary deviations from this objective may be necessary from time to

time in order to accommodate certain financial goals and obligations.

Investment maturities for operating funds shall be scheduled to coincide with projected cash flow needs, taking into account large routine expenditures (payroll, debt service), as well as considering sizable blocks of anticipated revenue (taxes, state revenue sharing payments).

It is also desirable to maintain a portfolio that has as its investments no more than a 50% concentration in commercial paper. It is also desirable to maintain an individual fund at a 50% concentration in commercial paper or less. However, short-term fluctuations over the 50% target are acceptable within the individual fund as long as the entire portfolio maintains no more than a 50% concentration.

Permitted pool accounts will not be limited in use except by the general limitations issued under this policy under diversification and by the liquidity/safety/yield principle.

Direct term purchases by the investment officer of repurchase agreements or Bankers Acceptances generally should not exceed 25% of the fund portfolio.

CD's shall not be limited in use within the portfolio.

#### 12.0 SHORT-TERM VERSUS LONG-TERM PORTFOLIO:

Limitations on instruments, diversification, and maturity scheduling shall depend upon whether the funds being invested are considered short-term or long-term funds. With the exception of capital funds, special assessment funds, the post retirement health care fund, the perpetual drain fund and water and sewer funds, all funds shall be considered short-term and shall be invested in instruments whose maturities do not exceed two years at the time of purchase. In addition, a portion of each fund eligible for long term investment shall held in short term or highly liquid investment funds to meet anticipated and unanticipated needs.

#### 13.0 INTERNAL CONTROLS:

The Treasurer shall establish a system of internal controls. The controls shall be designed to prevent loss of public funds due to fraud, error, misrepresentation, unanticipated market changes or imprudent actions. The investment procedure, compliance, and the internal controls will be reviewed annually by the city audit firm, an independent public accounting firm.

#### 14.0 PERFORMANCE STANDARDS:

The investment portfolio will be designed to obtain a market average rate of return during budgetary and economic cycles, taking into account the city's investment risk constraints



and cash flow needs. Because the investment portfolio is designed to operate on a 'hold-to-maturity' premise (or passive investment style), and because of the safety, liquidity, and yield priorities, the basis that will be used by the Treasurer to determine whether market yields are being achieved shall be the U.S. Treasury Bill maturing closest to the weighted average maturity of the City's overall portfolio.

#### 15.0 INVESTMENT PROCEDURES

Whenever possible, all investment decisions should be made on a competitive-bid basis, selecting the investment with the highest return.

When funds become available for investment (often timed to match council approved warrants), the first step would be to review the city's cash flow requirements. Once cash flow needs have been assessed, 'model' investments of dollar amount and maturity date are made to determine an appropriate distribution. Once the dollar amounts and maturity dates are decided, a list of possible investments that most closely match amount and maturity date distributions of investible funds is gathered from the list of approved financial institutions. A review of the bids (investment vehicles) received is then made taking into account percentage limitations of investment vehicles as described in section 8 and 11. At the same time, any investment that must be separated from the other investible funds for legal reasons are identified and separated as a separate investment. Once this has been done, diversification goals are re-reviewed as described in section 11. Final decisions are then made taking into account risk factors of the buyer, current economic conditions, future expectations and portfolio concentrations at individual financial institutions.

With the investment decision making process being fluid, there is a great deal of back and fourth adjustments until the best alternatives are identified. Once the desired investments are selected, investment purchases are made and recorded.

#### 16.0 REPORTING REQUIREMENTS:

The investment officer shall provide in writing a quarterly investment report that provides a clear picture of the status of the current investment portfolio. The management report will include comments on the fixed income markets and current economic conditions. A brief discussion on key investment policies as they relate to the investment portfolio, diversification, and possible changes to the portfolio structure going forward shall also be included in the report.

Schedules will include a listing of securities currently held at the end of the reporting period, final maturity of each investment, earnings rate by security, book value, amortized value and market value if applicable, and percentage of portfolio by security type. Also included will be the average weighted days to maturity of the entire portfolio that will be used as the comparison against the established benchmark.

Annually, a detailed report indicating the investment agenda for the upcoming year along

with a report on the investment earnings from the previous year shall supplement the quarterly reports. The year-end report shall also include thoughts on investment strategies for the upcoming year.

17.0 GLOSSARY OF TERMS

Please see Appendix A

18.0 EFFECTIVE DATE:

The City of Novi investment policy shall be adopted by resolution of the City Council. The Finance Director and Treasurer shall review the policy at least annually. Any changes to this policy must be submitted to the City Council for approval.

## Appendix A

The following is a list of terms used in this policy and the meaning to be assigned:

|                              |   |
|------------------------------|---|
| Banker's Acceptances         | A time draft (bill of exchange) drawn on and accepted by a bank used to effect payment for merchandise sold in import - export transactions. Backed by the credit strength of the accepting bank. |
| Benchmark                    | An independent index that is used for comparison against the return of another portfolio. In our case, the benchmark used is the 6-month T-Bill rate.   |
| Bond                         | In our case, federally issued and federally backed bonds having a stated coupon interest rate and maturity.   |
| Capital Losses               | Losses that occur from the sale of investments.   |
| Capital                      | For our purposes, money available for investment.   |
| Capital Gains                | Gains that are experienced from the sale of investments.  |
| Cash Flow                    | An analysis of all the changes that affect the cash account during the time period under consideration.   |
| Certificates of Deposit (CD) | Debt instruments issued by banks whose interest rates are set by competitive market forces.   |
| Commercial Paper             | Debt instruments issued by highly rated large corporations. Usually multi-nationals.  |
| Debt Funds                   | Funds set up to provide for the retirement of debt instruments issued by the city.  |
| Deposit Accounts             | Checking Accounts or other non-interest bearing accounts.   |
| Diversification              | Spreading of risk by putting assets into several categories of investments.   |
| Economic Cycle               | For our purposes, the general, recurring and predictable cycles experienced by the city of  |

|                      |  |
|----------------------|--|
|                      | Novi.  |
| Equities             | Stock in a publicly held corporation.  |
| Equity Capital       | Price paid for the stock purchase.   |
| Financial Instrument | A marketable financial asset.  |
| FDIC                 | Federal Deposit Insurance Corporation:<br>Insurance corporation established in 1933 to guarantee depositors against loss of their deposits in member banks for up to \$100,000.  |
| Financial Markets    | Securities markets in the aggregate, such as the New York Stock Exchange.  |
| Funds                | Accounting term for categorizing financial resources into use groups. Specifically for purposes of this policy, a fund will mean the money assets of this city, the investment of which is not otherwise subject to a public act of this state or bond authorizing ordinance or resolution of the city that permits investments in fewer than all of the investment options listed in section 8 "Instruments" or imposes 1 or more conditions upon an investment in an option listed in section 8. |
| Governing Body       | Four purposes of this policy, the governing body is the City of Novi City Council.   |
| Investment Return    | The rate of return, or interest rate paid, on an investment based on a 360 day year.   |
| Investment Officials | Finance Director/Treasurer; Assistant Treasurer  |
| Investment Pools     | Those investment pools organized under the authority of the urban cooperation act of 1967, 1967 (Ex Sess) PA7 (managed contractually), the surplus funds investment pool act, 1982 PA 367 (managed by banks), and the local government investment pool act, 1985 PA 121 (managed by county treasurer). All pools are limited to investments described in section 8.  |
| Liquidity            | How fast an investment can be turned into cash.  |
| Market Value         |  |

|                       |   |
|-----------------------|---|
|                       | Current market price of an investment as indicated by the latest trade record.  |
| Market rate of return | A benchmark selected as a indicator of the market's performance as measured by the rate of return expressed as a percentage.  |
| Mutual Funds          | For the purpose of this document, a fund operated by an investment company that raises money from shareholders and invests it in legally permissible investments as provided for under the law for municipalities.                    |
| Negative Cash Flow    | Times when more money is going out than is coming in.   |
| Net Capital Rule      | Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1.   |
| Portfolio             | The aggregate of the investments taken as a whole.  |
| Positive Cash Flow    | Times when more money is coming in than is being paid out.  |
| Primary Dealers       | A bank or financial institution authorized to deal directly with the Federal Reserve Bank of New York for purposes of buying and selling government securities in the Federal Reserve's Bank execution of Fed Open Market Operations. |
| PRINS or STRIP's      | "Separate Trading of Registered Interest and Principle of Securities" A prestripped zero-coupon bond that is a direct obligation of the US Treasury.  |
| Rating Service        | Services that provide unbiased, third party ratings to issuers of debt. No guarantee of accuracy is provided.   |
| Repurchase Agreements | An agreement between a seller and buyer (in U.S. government securities), whereby the seller agrees to repurchase the securities at an agreed upon price and, usually, at a stated   |

|                           |   |
|---------------------------|---|
|                           | time.   |
| Return on Investment Risk | See Investment Return<br>For purposes of this policy, risk is defined as the possible reduction of equity capital, the fluctuating in investment earnings including the possible loss of investment earnings, or the complete loss of the investment. |
| Securities                | Any investment vehicle that can be bought and sold in the market.   |
| TINTS                     | Treasury interest securities.   |
| Trust Accounts            | Money accounts that are not the property of the bank or trustee. Account assets are usually short-term in nature and deposits are interest bearing.   |
| US Treasury Strips        | Separate trading of registered interest and principal securities (coupons grouped in one pool and principal in another).  |
| US Treasury Bonds         | Similar to notes except original maturities are ten years and longer.   |
| US Treasury Bills         | Obligations of the United States Government sold at a discount from par with a specific maturity date up to a maximum maturity of one year. Interest is calculated using actual number of days over a 360-day year.                                   |
| US Treasury Notes         | Obligations of the United States government bearing interest payable at six-month intervals until maturity. Maturities are from one to ten years.   |

City of Novi Investment Policy Addendum

**List of Approved Financial Institutions**

**Banks:**

Chase  
PNC (Formally National City Bank)  
Bank of America  
Comerica Bank  
TCF  
Charter One Bank  
Fifth Third Bank  
Flagstar Bank  
Huntington Bank  
Citizens Republic Bank  
Franklin Bank  
Macomb Community Bank  
Mercantile Bank of Michigan  
The Private Bank

Lotus Bank

**Other Financial Service Institutions**

Ambassador Capital Management  
J P Morgan Chase  
Municipal Investors Service Corporation Cooperative Liquid Assets Securities Corporation (MBIA CLASS)  
PFM Group  
Morgan Stanley/Smith Barney  
Federated Securities Corp.  
PNC (Formally NatCity Investments)  
Novi Credit Union  
UBS Financial Services Inc.  
Municipal Employees' Retirement System  
Merrill Lynch