



City Council Investment Policy Update

April 9, 2013

PFM Asset Management LLC
50 California Street, Suite 2300
San Francisco, CA 94111
(415) 982-5544

City's Investment Objectives

- **Safety of Principal:** Ensure preservation of capital
- **Liquidity:** Provide liquidity to meet operating requirements
- **Yield:** Attain market rate of return; subordinate to safety and liquidity

City's Investment Policy Parameters

Security Type	% Allowed by		Credit Requirements	
	CA Government Code	City's Investment Policy	CA Government Code	City's Investment Policy
U.S Treasury Notes	100%	100%	-	-
Federal Agencies	100%	100%	-	-
CA Municipal Investments	100%	100%	-	Rated in two highest categories by a NRSRO
Corporate Notes	30%	30%	"A" or better	Same as CA code
Mortgage-Backed Securities	20%	20%	"A" rated issuer debt and rated "AA" by a NRSRO	Same as CA code
Commercial Paper	25%	25%	"A1/P1/F1"	Same as CA code
Time Certificates of Deposit	100%	100%	-	-
Negotiable Certificates of Deposit	30%	30%	-	"A" or better
Bankers' Acceptances	40%	40%	-	-
Repurchase Agreements	20%	20%	-	-
Money Market Funds	20%	20%	"AAA" by two NRSRO OR \$500 million	Same as CA code
Local Government Pools	100%	15%	Investment Advisor Requirements	Same as CA code
Local Agency Investment Fund (LAIF)	\$50 million	\$50 million	-	-

Sources: CA Government Code §53601 and 16429 and City of Santa Rosa Investment Policy



Investment Policy Review

Policy Review Results:

- City's Investment Policy is well-written and comprehensive
- Supports the City's investment program objectives: Safety, Liquidity, and Yield

Suggested Policy Changes:

- Administrative:
 - Incorporate City's Community Banking Program and Guidelines
 - Correct formatting that does not affect the substance of the Policy
- Strategic:
 - Add investment sector: municipal obligations of 49 non-California states

Administrative Revision: Community Banking Program and Guidelines

Recommended Action:

Insert overview of the Community Banking Program into Section VIII. Investment Parameters. Add specific program guidelines to Policy's appendix.

Rationale:

- The Community Banking Program and Guidelines were previously approved by the Council; this action formally incorporates the Program and Guidelines into the Policy.
- Addition of program overview is consistent with City's specific investment objectives such as socially responsible investing.
- Appendix section for program guidelines allows for edits and changes without affecting the structure and formatting of the entire Policy.

About PFM Asset Management LLC

- Independent investment advisor
- City's investment advisor since 2008
- Registered with SEC
- Over 30 years serving the public sector
- \$47 billion* of public assets under management
- 187 investment professionals
- Significant financial strength
- Extensive management experience for northern California cities

Representative List of PFM's City Clients

Alameda	Napa
Antioch	Petaluma
Benicia	Pittsburg
Dixon	Roseville
Fairfield	San Francisco
Manteca	Ukiah
Modesto	Yuba City

*As of December 31, 2012

City's Dedicated Investment Management Team



National Economic Overview

Low Interest Rate Environment

- Fed's overnight rate at 0.00-0.25% since 2008
- Accommodative monetary policy
- Interest rates reached all-time lows in the past year
- Extraordinary demand for high-quality fixed-income securities

Tentative Economic Recovery

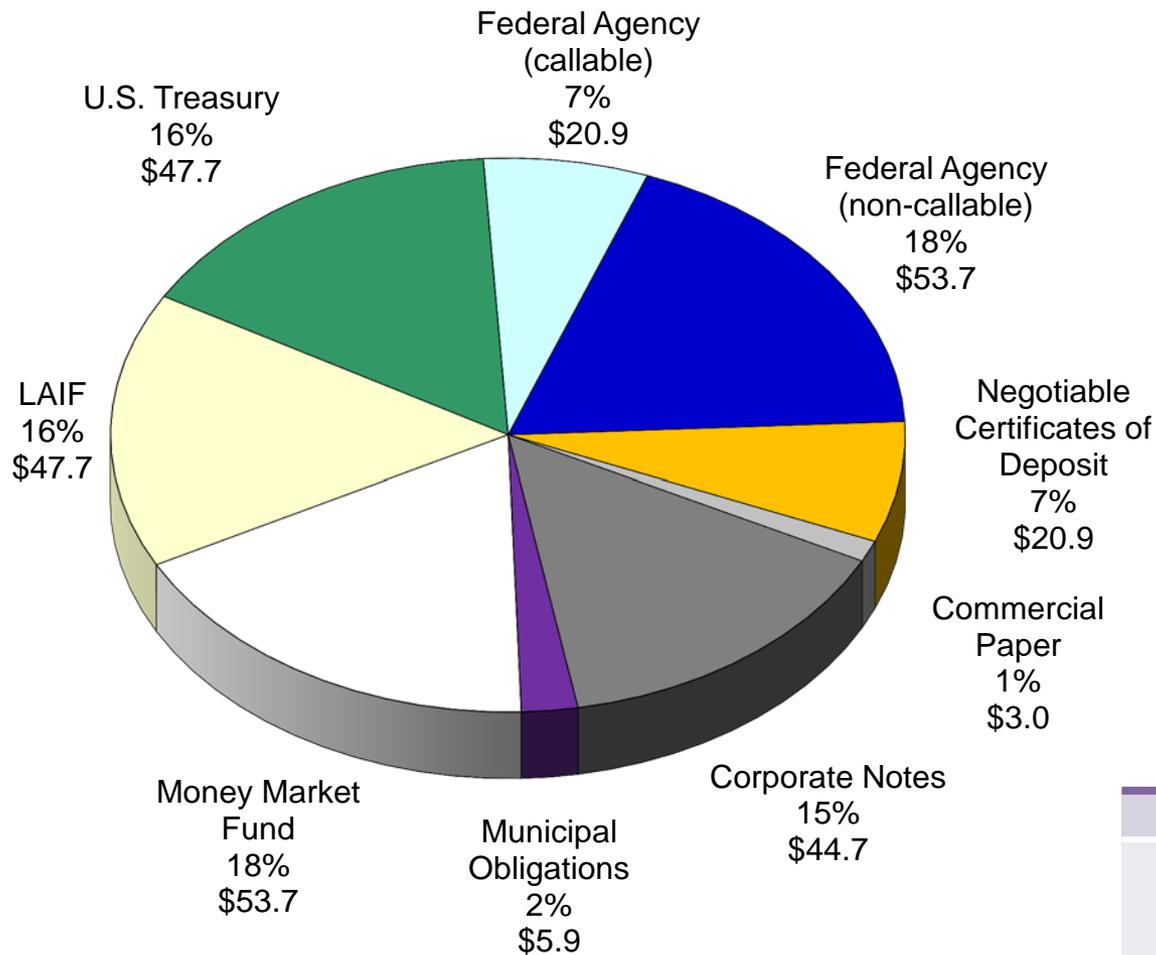
- 7.7% Unemployment rate; 4-year low
- Positive GDP growth
- Equities at historic highs
- Uneven global recovery
- Political concerns (Sequester and debt ceiling)

U.S. Treasury	10 Year Average	2012 Average
1-Year	1.91%	0.20%
2-Year	2.13%	0.27%
5-Year	2.87%	0.76%
10-Year	3.66%	1.77%
30-Year	4.37%	2.92%

Sources: Bloomberg and BofA/Merrill Lynch Bond Indices

City's Portfolio is Well Diversified and of High Credit Quality

Portfolio Total: \$298.2 million



Corporate Issuers (15%)	
Bank of New York	(2%)
Caterpillar Inc	(1%)
Deere & Co	(1%)
General Electric	(2%)
IBM	(1%)
JP Morgan Chase	(2%)
Pepsi Co	(1%)
Toyota Motor Credit Corp	(1%)
US Bancorp	(1%)
Walt Disney Corp	(2%)
Wells Fargo	(1%)

Negotiable CD Issuers (7%)	
Australian & New Zealand Bank-NY	(2%)
Bank of Nova Scotia-TX	(2%)
Standard Chartered Bank NY	(1%)
Westpac Banking Corp-NY	(2%)

Municipal Issuers (2%)	
Metropolitan Water District of Southern CA	(1%)
State of California	(0.5%)
University of California	(0.5%)

*"Portfolio Total" represents market value in millions including accrued interest as of February 28, 2013
 LAIF is the "Local Agency Investment Fund," a short-term pool managed by the California State Treasurer
 All corporate investments are issued by domestic branches of issuers domiciled in the United States*

Socially Responsible Investment

- City's Investment Policy advocates socially responsible investment:

"When possible, it is the City's policy to invest in companies that promote the use and production of renewable energy resources and any other socially responsible investments, subject to the prudent investment standard."

- PFM does NOT buy corporate investments for the City's portfolio in the following sectors:

- | | |
|------------|---------------|
| ✓ Tobacco | ✓ Pornography |
| ✓ Firearms | ✓ Gambling |
| ✓ Alcohol | ✓ Petroleum |

- Calvert Social Index®: Benchmark measuring the performance of US-based sustainable and responsible companies.

- Index includes 675 companies; index analyzes 1,000 largest US companies based on:

- | | |
|-----------------------------|------------------------------|
| ✓ Governance and Ethics | ✓ Community Relations |
| ✓ Environment | ✓ International operations |
| ✓ Product safety and impact | ✓ Human rights |
| ✓ Workplace | ✓ Indigenous Peoples' rights |

*The "Calvert Social Index®" is a registered trademark of Calvert Investments, Inc. <http://www.calvert.com>

Strategic Revision: State Municipal Obligations

Recommended Action:

Add state municipal obligations of the 49 non-California states to the City's list of permitted investments in Section VI. Authorized and Suitable Investments.

Rationale:

- City currently allows California municipal obligations.
- Increased diversification and greater access to municipal sector.
- Potential for enhanced return.
- Alternative investment as Agency sector shrinks.

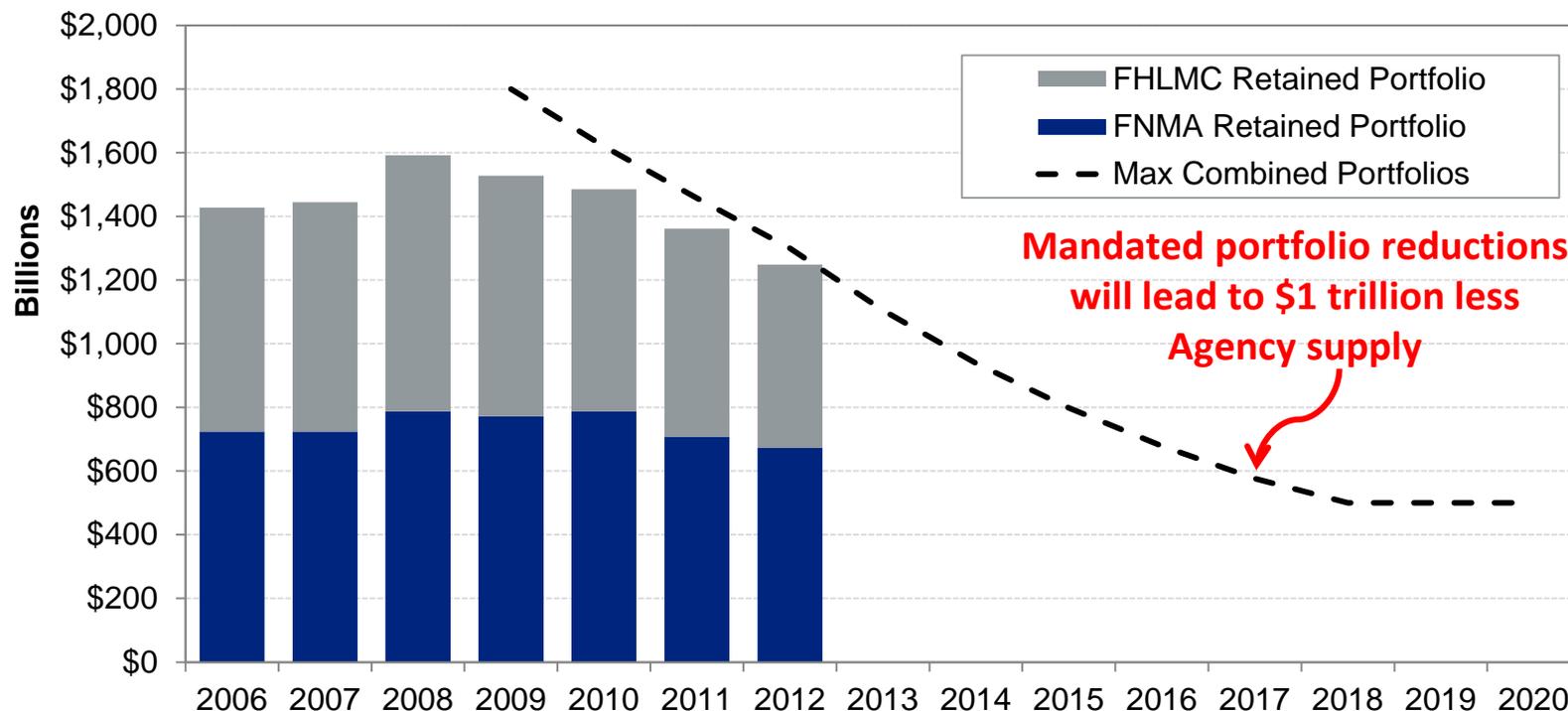
Safeguards and Limits:

- Investment limited to State obligations.
- Rated in the two highest categories by a nationally recognized statistical ratings organization and a limit of 10% per issuer.
- Consistent with CA Government Code and Policy's current treatment of municipal investments.

Federal Agency Sector Will Continue to Shrink

- The government is gradually reducing the size and outstanding debt of the Federal Agencies
 - Accelerating annual reduction of retained portfolios from 10% to 15%

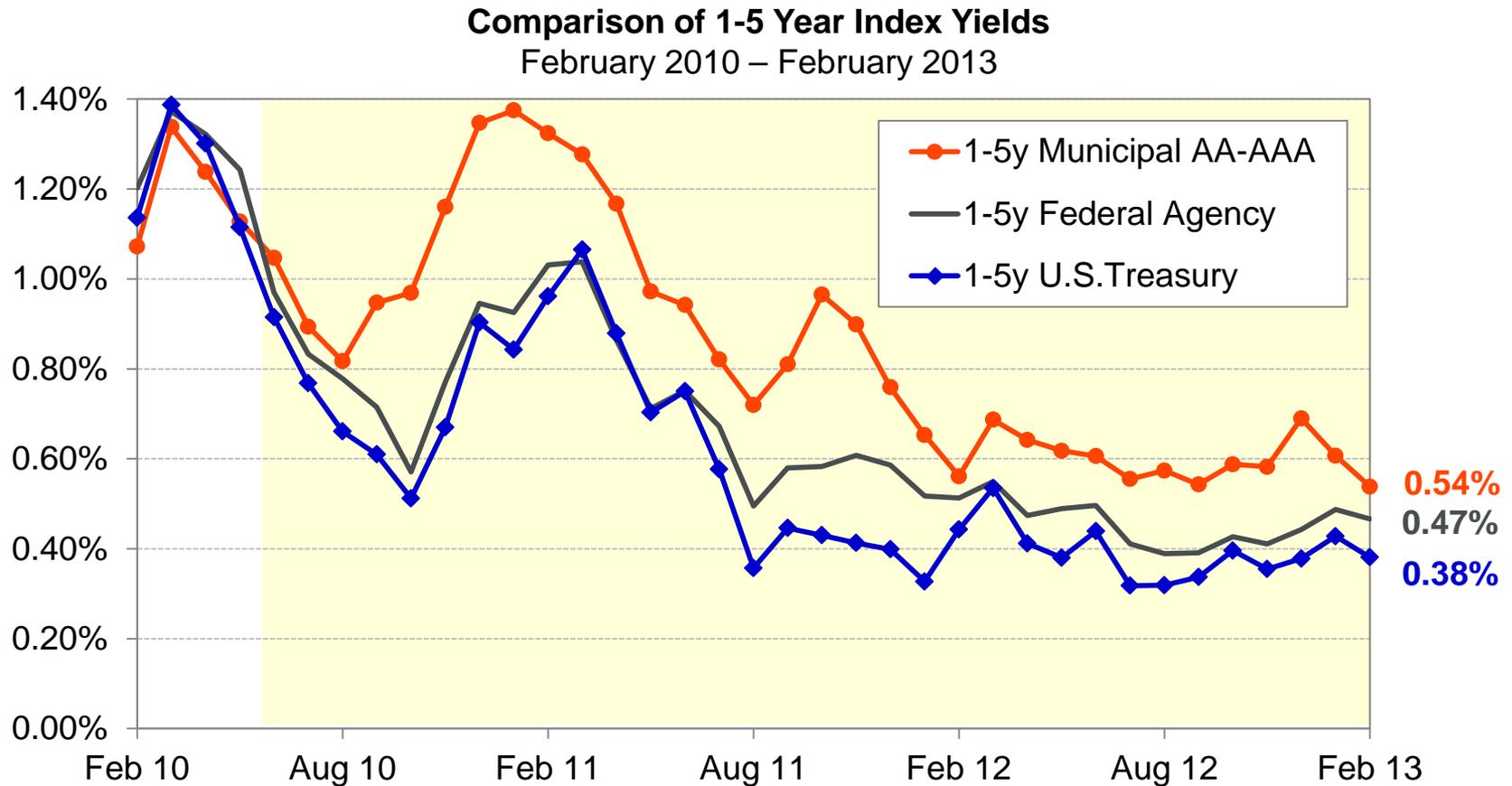
Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) Investment Portfolios



Source: Treasury Department announcement August 17, 2012; Fannie Mae, and Freddie Mac

Municipal Sector is Attractive

- Recently, the municipal sector has offered value over the Treasury and Agency sectors.





PFM's Comprehensive Municipal Credit Evaluation

- Established “Municipal Credit Committee” (sub-committee of Credit Committee)
 - Dedicated to review and on-going monitoring of municipal credits
- Types of Deals Evaluated
 - General Obligation and essential services sector bonds
 - Ratings: AA long-term, highest short-term category (eg. MIG-1 & SP1)
- Aspects of Review
 - Analyze all relevant documentation
 - Research overall credit history of issuer
 - Macro-review of issuer
 - Evaluate emerging trends in municipal sector and market event risk

Fixed-Income Investment Glossary

Glossary of Terms

- **Bankers Acceptance** - A draft or bill of exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.
- **Basis Point** - A unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.
- **Benchmark** - A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.
- **Certificate of Deposit Registry Account Service (CDARS)** - A private, patented, for-profit service that breaks up large deposits and places them across a network of more than 3000 banks and savings associations in the United States. This allows depositors to deal with a single bank that participates in CDARS, but avoid having funds above the FDIC deposit insurance limits in any one bank.
- **Commercial Paper** - An unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. Maturities on commercial paper rarely range any longer than 270 days. The debt is usually issued at a discount, reflecting prevailing market interest rates.

Glossary of Terms

- **Constant Maturity Treasury** - This index is an average yield on United States Treasury securities adjusted to a constant maturity of 1 year, as made available by the Federal Reserve Board. Yields are interpolated by the United States Treasury from the daily yield curve. This curve, which relates the yield on a security to its time to maturity, is based on the closing market bid yields on actively traded Treasury securities in the over-the-counter market.
- **Corporate Notes** - A debt security issued by a corporation and sold to investors. The backing for the bond is usually the payment ability of the company, which is typically money to be earned from future operations. In some cases, the company's physical assets may be used as collateral for bonds.
- **Federal Agency Securities** - Debt instruments issued by federal credit agencies. These securities are fully backed by the U.S. government guarantee but not by its full faith and credit. These securities have a very high credit rating - second only to Treasury bonds. The agencies that can issue these securities include Federal Home Loan Bank, Federal Home Loan Mortgage Association, Federal National Mortgage Association, and Federal Farm Credit Bureau.

Glossary of Terms

- **Fixed Income Security** - An investment that provides a return in the form of fixed periodic payments and the eventual return of principal at maturity. Unlike a variable-income security, where payments change based on some underlying measure such as short-term interest rates, the payments of a fixed-income security are known in advance.
- **Government Investment Pool** – A state or local government pool offered to public entities for the investment of public funds.
- **Local Agency Investment Fund (LAIF)** - An investment pool for California local governments and special districts that is managed by the State Treasurer's office and Local Investment Advisory Board.
- **Money Market Fund** - An investment fund that holds the objective to earn interest for shareholders while maintaining a net asset value (NAV) of \$1 per share. Mutual funds, brokerage firms and banks offer these funds. Portfolios are comprised of short-term (less than one year) securities representing high-quality, liquid debt and monetary instruments.

Glossary of Terms

- **Mutual Fund** - An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. Mutual funds are regulated by the Investment Company Act of 1940 and must abide by certain Securities and Exchange Commission (SEC) disclosure guidelines.
- **Nationally Recognized Statistical Rating Organization (NRSRO)** - A credit rating agency is a firm that provides its opinion on the creditworthiness of an entity and the financial obligations (such as, bonds, preferred stock, and commercial paper) issued by an entity. Generally, credit ratings distinguish between investment grade and non-investment grade. Credit rating agencies registered as such with the SEC are known as “Nationally Recognized Statistical Rating Organizations.”
- **Negotiable Certificates of Deposit** - A certificate of deposit with a minimum face value of \$250,000. These are guaranteed by the bank and can usually be sold in a highly liquid secondary market, but they cannot be cashed-in before maturity.
- **Repurchase Agreements** - A financial transaction in which a dealer in effect borrows money by selling securities and simultaneously agreeing to buy them back at a higher price at a later time. The dealer invests the money paid for the securities, hoping to get a higher return than he owes on his obligation to repurchase the securities.

Glossary of Terms

- **Time Certificates of Deposit** - An interest bearing deposit held for a specified term and redeemable only at maturity. These do not usually trade in the secondary market.
- **Total Return** - When measuring performance, the actual rate of return of an investment or a pool of investments over a given evaluation period. Total return includes interest, capital gains, dividends and distributions.
- **U.S Treasury Securities** - Debt instruments issued by the United States Department of the Treasury through the Bureau of the Public Debt. They are direct obligations of the Federal Government, so they are considered free of credit risk.
- **Weighted Average Maturity (WAM)** - The average maturity of all the securities that comprise a portfolio. According to SEC rule 2a-7, the WAM for SEC registered money market mutual funds may not exceed 90 days and no one security may have a maturity that exceeds 397 days.
- **Yield Curve** – A line that plots interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates. The curve is used as a benchmark for other debt in the market, such as mortgage rates or lending rates. The curve is also used to predict changes in economic output and growth.

Disclaimer

This material is based on information obtained from sources generally believed to be reliable and available to the public, however PFM Asset Management LLC cannot guarantee its accuracy, completeness or suitability. This material is for general information purposes only and is not intended to provide specific advice or a specific recommendation. All statements as to what will or may happen under certain circumstances are based on assumptions, some but not all of which are noted in the presentation. Assumptions may or may not be proven correct as actual events occur, and results may depend on events outside of your or our control. Changes in assumptions may have a material effect on results. Past performance does not necessarily reflect and is not a guaranty of future results. The information contained in this presentation is not an offer to purchase or sell any securities.