# Budget and Fiscal Policies

CITY OF AVALON

Adopted: July 6, 2021

The following policies outline the City of Avalon's (City) guidelines for budgetary decision-making and sets standards for sound budgetary practices and fiscal performance.

An adopted set of budget policies that are consistently followed will assist the City in achieving its current and future goals in a fiscally responsible and sustainable manner. These policies establish guidelines for developing and monitoring the City's annual operating and capital budgets as recommended by the Government Finance Officers Association (GFOA) and the National Advisory Council on State and Local Budgeting (NACSLB). This document shall be reviewed on an annual basis to reflect the highest standards of fiscal management and the City's budgetary goals.

The City's budget and fiscal policies have been organized under the following components:

A. Accounting and Annual Reporting
B. Budget Process
C. Structurally Balanced Budget
D. Revenues
E. Expenditures
F. General Fund Reserves
G. Enterprise Fund Working Capital Targets
H. Investment Policy

## A. ACCOUNTING AND ANNUAL REPORTING POLICIES

**Purpose:** The purpose of this policy is to ensure the proper recording of financial transactions and identify the parties responsible for financial reporting.

**Background:**
The City's Comprehensive Annual Financial Report (CAFR) presents the government and its component units (entities for which the government is considered to be financially accountable) financial and operating activities. The City's blended component units, although legally separate entities, are, in substance, part of the City's operations and financial data from these units are combined with data of the City. The City's financial statements and accounting records are maintained in accordance with the recommendations of the Governmental Accounting Standards Board (GASB).

The government-wide financial statements report information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of inter-fund activity has been removed from these statements. Governmental activities, normally supported by taxes and inter-governmental revenues, are reported separately from business-type activities that rely, to a significant extent, on fees and charges for support.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements. The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the providers have been met. As a general rule, the effect of inter-fund activity has been eliminated from the government-wide financial statements. Direct expenses have not been eliminated from the functional categories; however, indirect expenses and internal payments have been eliminated.

Amounts reported as program revenues include: 1) charges to customers or applicants for goods, services, or privileges provided; 2) operating grants and contributions; and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than program revenues. Likewise, general revenues include all taxes.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences are recorded only when payment is due.

Taxes, licenses and interest associated with the current fiscal period are all considered to be susceptible to accrual and are therefore recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered measurable and available only when the City receives cash.

The City reports the following governmental fund types:

- General Fund has been classified as a major fund and is used to account for resources traditionally associated with governments which are not required legally or by sound financial management to be accounted for in another fund.
- Special Revenue Funds account for proceeds of specific revenue sources that are legally restricted or otherwise designated for specific purposes.
- Nonmajor Funds is the aggregate of all the other government funds.

The City reports the following proprietary funds:

- Harbor Fund has been classified as an enterprise fund and is used to account for all harbor operations
- Sewer Fund has been classified as an enterprise fund and is used to account for the fees and services for the operation and maintenance of sewer system.
- Saltwater Fund has been classified as an enterprise fund and is used to account for the operation of the City's saltwater pumping plants and systems.
- Solid Waste Fund has been classified as an enterprise fund and is used to account for the solid waste collection and disposal costs.
- General Administration, Insurance, and Vehicle Maintenance have been classified as internal service funds and are used to account for operations that provide services to other departments of the City on a cost reimbursement basis.

Additionally, the City reports its Success Agency activity in a Private-Purpose Trust Fund.

**Policy:**
Each year an audit will be conducted by an independent Certified Public Accountant Firm (CPA Firm). The selection of the independent CPA Firm shall be in conformance with the City's professional services bidding procedures. Generally, the City shall request bids for audit services no less frequently than every five years. The CPA Firm shall provide the City Council with an Audit Communication Letter addressing significant findings of the auditors in conjunction with their opinion on the City's Comprehensive Annual Financial Report. These reports shall be submitted to the City Council within 60 days of receipt of the report.

During the annual budget process, the City will make available a preliminary year end, unaudited, General Fund fund balance. It should be recognized, however, that the balance provided is subject to both unforeseen financial transactions of a material nature and subject to findings of the independent audit. An audit verified year-end balance should be available by the end of December. The City will use generally accepted accounting principles in preparing its annual financial statements, and will strive to meet the requirements of the GFOA's Award for Excellence in Financial Reporting program.

## B. BUDGET PROCESS

**Purpose:**
The purpose of this policy is to establish guidelines for the preparation, adoption, and presentation of the City's annual budget.

**Background:**
The City of Avalon operates on a fiscal year basis, starting July 1 and ending June 30. The budget is prepared by the Finance Department with the support of each operating department under the direct supervision of the City Manager. The Finance Department is responsible for coordinating all revenues estimates contained in the budget. Estimates are reached by analyzing historical revenue history, national and local economic trends and indices, and development patterns in the local economy. The Finance Department also coordinates the development of the expenditure budgets with the support of each operating department and the City Manager.

The budget is structured to separate operating and capital activity at the fund and department level. The operating budget is a guide for the receipt and disbursement of funds used to provide daily, routine public services to the community. The operating budget is structured to include historical budget and actual revenues and expenditures, along with the current revenue estimates and proposed expenditures required in order to implement and maintain services to the community. The Capital Improvement Program (CIP) budget details the acquisition, construction, or rehabilitation of major capital facilities and infrastructure over a ten year period.

**Policy:**
The proposed budget is to be presented to the City Council and community in public workshop meetings in May or June for review, public input, and deliberation. After providing opportunities for public review and discussion at City Council workshops and City Council meetings, the budget is adopted by the City Council prior to June 30 at either a regular or special City Council Meeting. The City Council may amend or supplement the budget at any time after its adoption by majority vote of the Council Members.

The budget document should incorporate the following guidelines to facilitate broader consumption and greater comprehension. The document should be organized in a manner that reduces redundancy and allows for a logical flow of information. The budget document should include an introduction and overview, financial summaries, operating and capital detail, departmental information, and a glossary. The document should avoid excessive detail, which can distract from the primary points presented, and should present the information in a consistent manner across departments and budget years.

## C. STRUCTURALLY BALANCED BUDGET

**Purpose:**
The purpose of this policy is to establish guidelines for the City's operating funds aimed at achieving and maintaining a structurally balanced budget. State law requires that the City adopts a balanced budget. However, a budget that is balanced by the state's definition may not necessarily be structurally balanced or sustainable if recurring expenditures are covered by reserves or non-recurring or highly volatile revenues. This policy supports the on-going financial stability of the City by advancing a more sustainable definition of a balanced budget – a structurally balanced budget.

**Background:**
This section defines key terms related to a structurally balanced budget:

***Recurring Revenues*** are the portion of the City's revenues that can reasonably be predicted to continue year-to-year, with some degree of predictability. Property taxes are an example of a recurring revenue. ***Non-recurring Revenue*** are revenues that are one-time in nature and cannot be reasonably expected to continue year-to-year.

Some revenue sources may have both recurring and non-recurring components. These sources require the City to exercise judgment in determining how much of the source is truly recurring. For example, the City regularly receives transfer fees for the sale of moorings in the harbor; however, the amount received varies year-to-year based on the value of moorings and number of sales. In this case, it may be prudent to regard unusually high transfer revenues as non-recurring revenue under the assumption that such revenues are unlikely to continue, making it imprudent to use them for recurring expenditures.

***Recurring expenditures*** appear in the budget each year. Salaries, benefits, rent, utilities, maintenance costs and certain contracted services are common examples of recurring expenditures. In general, recurring expenditures should be those that the City expects to fund every year in order to maintain current service levels. ***Non-recurring expenditures*** comprise special projects such as capital improvements, asset acquisitions, and other costs incurred infrequently by the City. In general, the City has a greater degree of flexibility to defer non-recurring expenditures than recurring ones.

***Reserves*** are the portion of fund balance set aside as a hedge against risk. The City has defined a minimum amount of funds it will hold in reserve. This serves as a "bottom line measure" to help determine the extent to which the City's structural balance policy is being met – if reserves are maintained at their desired levels, it is an indication that the City is maintaining a structurally balanced budget. If reserves are declining, it may indicate an imbalance in the budget (e.g. if reserves are being used to fund on-going expenditures). Desired reserve levels are further discussed in Sections F and G of this document.

**Policy:**
The City shall endeavor to adopt a structurally balanced budget. Generally, this means that recurring expenditures should be covered by recurring revenues and that non-recurring revenues should be used

to fund non-recurring expenditures. The Finance Department shall incorporate information into its budget presentation demonstrating the City's progress in achieving a structurally balanced budget.

In order to achieve a structurally balanced budget, the City should consider the following:

- **Employee compensation and non-recurring revenues** – With limited exceptions, non-recurring revenues and reserves should not be used to fund employee compensation. One such exception might be a severe economic downturn where non-recurring revenues are temporarily used to ease the transition to an expenditure structure that is in line with new economic realities. Even this should only be done in the context of a plan to return to structural balance and replenish any reserves that had been used.
- **Operating and maintenance costs of capital assets purchased with non-recurring revenues –** While capital assets are often funded with non-recurring revenues, the City shall be observant of the long-term operating and maintenance costs of such purposes, to prevent the creation of new on-going expenditures that cannot be maintained by recurring revenues.
- **Replacement of short-lived assets and non-recurring revenues** – The City shall prioritize the use of non-recurring revenues to replace current assets that have outlived their useful lives over the purchase of entirely new assets, where the replacement of the expired or obsolete assets is critical to the maintenance of the City's core programs. A replacement schedule for such assets is a good indicator of when to budget for these items.

## D. REVENUES

**Purpose:**
The purpose of this policy is to establish guidelines for (a) the development of revenue estimates, (b) fee structures, and (c) use of new recurring and non-recurring revenues in order to achieve a structurally balanced budget.

**Background:**
Revenue projections and assumptions are critical to budget decisions, particularly in order to achieve a structurally balanced budget. The Finance Department is responsible for coordinating all revenues estimates contained in the budget. Estimates are reached by analyzing historical revenue history, national and local economic trends and indices, and development patterns in the local economy. Many of the City's key revenues are subject to significant fluctuation dependent on a number of economic factors. While it is difficult to always achieve accurate projections in a dynamic economic environment, it is important to have a consistent approach to projecting revenues in order for decision-makers to understand the basis used to project the resources available for the budget. Revenue should be projected in a way that is not likely to lead to a revenue shortfall, but also not to be so conservative that the projections consistently and substantially underestimate revenues.

The City utilizes user charges and fees to help fund services. When certain services provided especially benefit a particular group, the City should consider charges and fees on the direct recipients of those that receive benefits for such services. The City may elect to subsidize a service for various reasons, including the ability of residents or businesses to pay; however, the City should have a documented rationale regarding why the full cost is not recovered.

By definition, non-recurring revenues cannot be relied upon in future budget periods. Non-recurring revenues include the sales of government assets, infrequent revenues from development and grants.

**Policy:**
The following guidelines are to be considered with regards to City revenues:

a. *Development of Revenue Estimates* - The City will estimate revenues using an objective and analytical process, with a conservative approach adopted to address any uncertainties. The approach should result in overall budgeted revenues for a fund being set at a level such that it is unlikely that actual revenues are lower than budgeted. The City should be transparent concerning its forecasting approach and underlying assumptions.

b. *Fee Structure* - The City will comply with all applicable laws regarding the designation and assessment of fees for services and other fees. The City will calculate the full cost of providing a service in order to provide a basis for setting the charge or fee. The City will then identify whether it intends to set the fee at an amount to recover the full cost of providing the good or service or subsidize a portion of the cost. If the full cost of the good or service is not recovered, then an explanation of the rationale for not recovering the full amount should be provided to the public. The City should consider reviewing and updating charges and fees periodically based on factors such as the impact of inflation, other cost increases, adequacy of cost recovery, use of services, and competitiveness of current rates.

c. *Use of New Recurring and Non-Recurring Revenues* – Non-recurring revenues should be used to fund non-recurring expenditures only. The City should dedicate new recurring revenue sources in the following manner and priority:

1. Fixed cost increases, including built-in contract escalators, and benefit increases outside of City control (e.g. annual unfunded pension liability contributions);
2. Replenishing reserves to established targets;
3. Funding significant long-term liabilities;
4. Replenishing internal service funds for vehicle replacement and deferred maintenance; and
5. Other discretionary expenditures and negotiable items.

## E. EXPENDITURE CONTROLS

**Purpose:**
The purpose of this policy is to provide outline appropriation and expenditure controls designed to safeguard limited government assets and ensure that resources are maintained where they were originally approved during the budget process.

**Background:**
The budget document serves as a plan of financial operation, identifying adopted appropriations as well as the specific types and levels of services to be provided. Appropriations are made by City Council at the fund level, with expenditures grouped into the following major categories:

- Personnel – Expenditures related to labor including salaries, overtime, worker's compensation, health, insurance, and retirement benefits
- Maintenance and Operations – Expenditures for items which primarily benefit the current period and are not defined as personnel, contract services, or capital outlays.
- Contract Services – Expenditures rendered to a government by private firms, individuals, or other government agencies.
- Capital Outlays – Expenditures that result in the acquisition of, or addition to, fixed assets that are tangible, durable, non-consumable, costs $5,000 or more, and have a useful life of more than one year.

Department heads and their designated representatives may authorize expenditures that are based on appropriations previously authorized by City Council action, generally through the adopted budget, and only from accounts under their organizational responsibility. Individual transactions are classified by departments at the account level, with the most appropriate account used to classify the expenditure. During the course of the year, departments may encounter necessary and unanticipated expenditures that are able to be covered through budget savings in other accounts under their control. These budget transfers allow the City to operate more efficiently with the implementation of controls to ensure the budget goals are still met with the approved appropriations.

**Policy:**
City Council approval is required for any budget revisions or amendments that increase the total amount appropriated by fund. Budget transfers require the following approvals and processes:

<u>Transfers of Operating Expenditure Budgets</u>
City Council approval is required for the following transfers:

- Between personnel and non-personnel accounts within the same fund in excess of $10,000;
- Between departments or accounts within the same fund in excess of $50,000.

City Manager approval is required for the following transfers:

- Between personnel and non-personnel accounts of less than $10,000;
- Between departments within the same fund under $50,000;
- Between accounts within the same fund and department between $25,000 and $50,000.

- In case of an emergency or other circumstances where the delay would have a material negative impact on the City, the City Manager can approve transfers in excess of $50,000 provided that transfers are reported to Council at the next scheduled meeting.

Finance Director approval is required for the following transfers:

- Between accounts within the same fund and department under $25,000

Transfers of Capital Improvement Budgets

Projects are approved over a ten-year period by Council as part of the City's ten-year Capital Improvement Program. Any revisions increasing the total amount appropriated by fund require City Council approval. City Council approval is also required for transfers of capital improvements over $100,000. For transfers under $100,000, City Manager approval is required for transfers between capital projects in the same year and same fund, and transfers for the same project scheduled in different years.

Prepaid Expenses

The City Manager is authorized to approve prepaid expenditures when the payment relates to an ongoing service provided to the City and when failing to make payment would either cause an interruption to ongoing City operations or cause the City to operate illegally (e.g. failing to renew an insurance policy or software license). However, the payment classified as a prepaid expense shall not include more than a 10% increase over the prior year's payment for the same product and a list is to be provided to Council for all prepaid expenditures that occurred under this authority.

Purchasing Process

The Finance Director will establish appropriate purchasing processes with adequate controls to ensure expenditures are properly approved and do not exceed City Council appropriations.

## F. GENERAL FUND RESERVES

**Purpose:**
The purpose of this policy is to establish guidelines for the General Fund's unrestricted fund balance to improve and maintain the City's financial stability in order to protect the City from unforeseen or unbudgeted situations (e.g. natural disasters, major infrastructure failures, unexpected litigation).

**Background:**
Fund balance serves as a measure of the financial resources available in a governmental fund. It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g. revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates.

In February 2009, the Governmental Accounting Standards Board issued GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which separates fund balance into five separate categories based on the type and source of constraints placed on how resources can be spent. Presented in descending order from most constraining to least constraining, they include: nonspendable fund balance, restricted fund balance, committed fund balance, assigned fund balance, and unassigned fund balance. The total amounts in the last three categories (where the only constraint on spending, if any, is imposed by the government itself) is termed unrestricted fund balance. GASB Statement No. 54 recommends "…at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures. The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances."

The adequacy of unrestricted fund balance in the General Fund should take into account the City's unique circumstances and the City should consider the following factors to assess the adequacy of unrestricted fund balance:

- Predictability of its revenues and volatility of its expenditures;
- Perceived exposure to significant one-time outlays;
- Potential drain upon General Fund resources from other funds, as well as the availability of resources in other funds;
- Potential impact on the entity's bond ratings and the corresponding increased cost of borrowed funds;
- Commitments and assignments included in the unrestricted fund balance

**Policy:**
The City of Avalon will strive to maintain an *unrestricted fund balance* equal to no less than **six (6)** months of regular General Fund operating expenditure budget. The regular operating expenditure budget includes all current operating expenditure appropriations, excluding capital outlays and other one-time discretionary payments.

Visitor-driven tax revenues (e.g. transient occupancy tax, sales tax, admission tax) account for the majority of the City's General Fund revenues, with the predictability of these revenues dependent on overall tourism demand. Due to its unique location, City revenues are particularly vulnerable to disruptions to leisure travel and tourism caused by pandemics or other natural disasters. In addition, the City is responsible for managing multiple enterprise funds, with operating expenditures comparable in size to its General Fund, and the City needs to maintain reserves in order to cover immediate capital needs, if working capital is not sufficient in those funds.

Funds appropriated from unrestricted fund balance should be appropriated for non-recurring expenditures, as they represent prior year surpluses that may or may not materialize in subsequent years. However, draws from unrestricted fund balance below the six month target amount or to cover recurring operating costs are generally reserved for emergency or unforeseen situations but may be accessed by Council by simple budget appropriation. Examples of situations may include but not limited to the following:

A. Sudden and unexpected significant facility failure that presents an immediate public safety concern to the community;
B. Declaration of a State of Emergency by the Governor;
C. Unanticipated expenditures as a result of legislative changes from State/Federal governments in the current fiscal year;
D. Acts of Terrorism declared by the Governor or the President of the United States;
E. Acts of nature, which are infrequent in occurrence; or
F. Other emergency as defined by City Council

If unrestricted fund balance is to be used to fund recurring operating expenditures or if unrestricted fund balance falls below the minimum threshold, the Finance Director shall recommend and submit to City Council a plan to replenish reserves to minimum levels. This plan will specify the source of funding and timeframe for replenishment. Reserves should be replenished within three years, if possible.

## G. ENTERPRISE FUNDS WORKING CAPITAL TARGETS

**Purpose:**
The purpose of this policy is to establish guidelines for the enterprise funds' working capital target to improve and maintain the City's financial stability in order to protect the City from unforeseen or unbudgeted situations (e.g. natural disasters, major infrastructure failures, unexpected litigation).

**Background:**

Generally Accepted Accounting Principles (GAAP) does not permit the reporting of fund balance for enterprise funds. However, enterprise funds distinguish between current and non-current assets and liabilities, allowing for the calculation of working capital (i.e. current assets less current liabilities). Working capital indicates the relatively liquid portion of total enterprise fund capital, which constitutes a margin or buffer for meeting obligations. For all further references to reserves for enterprise funds, net working capital is the intended meaning.

It is essential that a government maintain adequate levels of reserves or working capital in enterprise funds to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenses) and to ensure stable services and fees. Strength of collection practices, historical consumption of inventories, support from the general government, transfers out, cash cycles, customer concentration, demand for services, control over rates and revenues, asset age and condition, volatility of expenses, control over expenses, management plans for working capital and debt position should all be considered in determining adequate working capital or reserve targets for each fund.

**Policy:**

The City's Enterprise Funds include the Harbor Fund, Sewer Fund, Saltwater Fund, Solid Waste Fund, and Avalon Transit Fund. Reserve levels for each fund are as follows:

- Harbor Fund - The City of Avalon will strive to maintain a working capital balance equal to no less than **four (4)** months of regular Harbor Fund operating expenditure budget to cover harbor operations (Fund 103) and a minimum reserve of **five hundred thousand dollars ($500,000)** to provide funding to cover emergency capital costs in the harbor (Fund 104). The reserve amount exceeds the GFOA's 45-day minimum working capital recommendation due to the Harbor's limited ability to reduce variable costs in response to lower revenues (i.e. public safety costs relatively fixed), customer concentration (i.e. majority of revenues paid by cross channel and cruise ship carriers), and condition of infrastructure.

- Sewer Fund – The City of Avalon will strive to maintain a target reserve balance equal to no less than **three (3)** months of operating and maintenance expenses, as outlined in the cost of service study. The reserve amount exceeds the GFOA's 45-day minimum working capital recommendation due to the cash cycle, with remittances concentrated in the second half of the fiscal year, and condition of infrastructure.

- Saltwater Fund – The City of Avalon will strive to maintain a target reserve balance equal to no less than **three (3)** months of operating and maintenance expenses, as outlined in the cost of service study. The reserve amount exceeds the GFOA's 45-day minimum working capital recommendation due to the cash cycle, with remittances concentrated in the second half of the fiscal year, and condition of infrastructure.

- Solid Waste Fund – The City of Avalon will strive to maintain a target reserve balance equal to no less than **three (3)** months of operating and maintenance expenses, as outlined in the cost of service study. The reserve amount exceeds the GFOA's 45-day minimum working capital recommendation due to the cash cycle, with remittances concentrated in the second half of the fiscal year, and condition of infrastructure.

- Avalon Transit Fund – The Avalon Transit Fund is subsidized by the General Fund, as transit revenues are not sufficient to cover operations. No working capital target has been set for this fund as the financial buffer or cushion is provided by the General Fund.

## H. INVESTMENT POLICY

**Policy:**
It is the policy of the City of Avalon and Successor Agency to the ACIA (hereinafter collectively referred to as "City" or "City of Avalon") to invest public funds in a prudent manner which will provide in the following order; 1) the highest level of safety of funds, along with 2) liquidity of funds in order that daily cash flow demands are met and, finally, that 3) yield or investment return be maximized while conforming to all laws of the State of California regarding the investment of public funds.

In accordance with Section 53646 of the government Code, the Finance Director and City Treasurer will annually render to the City Council a Statement of Investment Policy. The Finance Director, City Treasurer, and City Manager shall review the policy on an annual basis for submission and approval by the City Council.

**Scope:**
The City/Agency Treasurer (hereinafter referred to as "Treasurer") is authorized to invest the City's funds in accordance with the California Government Code Sections 53601.1, 53602, and 53635. This investment policy applies to all financial assets of the City of Avalon. These funds are accounted for in the City's Comprehensive Annual Financial Report, which includes the following fund types:

- General Fund
- Special Revenue
- Debt Service
- Capital Projects
- Enterprise
- Internal Service
- Trust and Agency
- Any new fund created by the legislative body, unless specifically exempted

All monies entrusted to the Treasurer will be pooled in an actively managed portfolio except for the employee's retirement funds, which are administered separately and the proceeds of certain debt issues, which are managed and invested by trustees appointed under indenture agreements.

**Prudence:**
The actions of the Treasurer in the performance of his or her duties as manager of public funds shall be evaluated using the following prudent person standard applied in the context of managing the overall portfolio:

- 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.
- Investment officers acting in accordance with written procedures and the investment

policy 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.

**Objective:**

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

A. Safety - Safety of principal is the foremost objective of the investment program. Investments of the City shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The City shall seek to safeguard principal by a careful examination of credit risk and market risk of individual investments.

    1. Credit Risk - The chance that an issuer will be unable to make scheduled payments of interest and principal on an outstanding obligation. Another concern for investors is that the market's perceptions of a corporation's credit will cause the market value of a security to fall, even if default is not expected.

    2. Market Risk - The chance that the value of a security will decline as interest rates rise. In general, as interest rates fall, prices of fixed income securities rise. Similarly, as interest rates rise, prices fall. Market risk also is referred to as systematic risk or risk that affects all securities within an asset class similarly.

B. Liquidity - The City investment portfolio will remain sufficiently liquid to enable the City to meet all operating expenditure requirements, which might be reasonably anticipated. In order to maintain liquidity, no more than 50 percent of the portfolio will have maturity in excess of one (1) year.

C. Return on Investment - The City investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the City investment risk constraints and the cash flow characteristics of the portfolio. Whenever possible, consistent with risk limitations and prudent investment principles, the City shall make an effort to achieve returns at the market average rate of return. The market average rate of return is defined as the average return on six month US Treasury Bills.

**Delegation of Authority:**

The Treasurer has been authorized to undertake investment transactions on behalf of the City. This authority shall not pass to the Deputy Treasurer unless specifically authorized in writing by the Treasurer. Although the Treasurer has been authorized to undertake investment transactions, management responsibility for the City's investment program has been delegated to the Finance Department. The only officials authorized to undertake investment transactions on behalf of the City are the Treasurer, Finance Director, and City Manager. The actual disbursement of funds for the placement of individual investments undertaken by these three officials shall be subject to a second party approval by officers authorized to sign City checks and wire transfers: Mayor, City Manager, Chief Administrative Officer, and Certain Department Heads.

The Treasurer is responsible for ensuring compliance with the City's investment policies and for ensuring that strong internal controls are in place through the oversight of the Finance Director.

**Ethics and Conflicts of Interest:**

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. The Treasurer, Finance Director, and all investment employees are required to file annual disclosure statements as required by the Fair Political Practices Commission (FPPC), thus shall disclose to the City Clerk any material financial interests in financial institutions that conduct business within the jurisdiction, and they shall further disclose any large personal financial investment positions that could be related to the performance of the City investment portfolio.

During the course of the year, if there is an event subject to disclosure that could impair the ability of the Treasurer, Finance Director, or any investment employee to make impartial decisions, the City Manager shall be notified in writing within 10 days. All City Council members, Mayor, City Treasurer, Finance Director, and any investment employees are limited on the receipt of honoraria, gifts, and gratuities from advisors, brokers, dealers, bankers, or other persons with whom the City Treasury conducts business. The permitted approved maximum value of these items is $50.00.

**Authorized Financial Dealers and Institutions:**

The City shall transact business only with issuers, banks, savings and loans, and registered investment securities dealers. The purchase of any investment, other than those purchased directly from the issuer, shall be purchased either from an institution licensed by the State of California as a broker/dealer, as defined in Section 25004 of the Corporations Code, who is a member of the National Association of Securities Dealers (NASD), or a member of a Federally regulated securities exchange, a National or State-Chartered Bank, a Federal or State Association (as defined by Section 5102 of the Financial Code), or a brokerage firm designated as a Primary Government Dealer by the Federal Reserve Bank. The Treasurer's staff shall investigate all institutions that wish to do business with the City/Agency, in order to determine if they are adequately capitalized, make markets in securities appropriate to the City/Agency's needs and agree to abide by the conditions set forth in the City of Avalon/Successor Agency to ACIA Investment Policy and provide a current audited financial statement.The Treasurer will maintain a list of financial institutions authorized to provide investment services to the City.

**Authorized and Suitable Investments**

The State of California Government Code Sections 16429.1, 53601, et seq. limits the investment vehicles available to local agencies. The City of Avalon's Investment Policy further restricts the permitted investments to those listed below.

- State Treasurer's Local Agency Investment Fund (LAIF) - Government Code Section 16429.1 authorizes each local government agency to invest with no maximum limit as of January 1, 2019 in this investment program administered by the California State Treasurer. Money invested with LAIF is pooled with State money in order to earn the maximum rate of return possible in a manner consistent with sound investment practices. Furthermore, LAIF provides daily liquidity, therefore, there is no final stated maturity for this investment category. *Investments in LAIF shall not exceed $60 million total ($30 million each for the City and the Successor Agency to ACIA).*

- Los Angeles County Investment Pool (LACIP) - Government Code Section 27133: Money invested with the Los Angeles County Investment Pool is pooled with County money in order to earn the maximum rate of return possible in a manner consistent with sound investment practices.
- United States Treasury Bills, Notes, and Bonds or those for which the full faith and credit of the United States are pledged for payment of principal and interest. In accordance with Government Code Section 53601, purchase of this category shall not exceed five years to maturity. There is no percentage limit in this category.
- Federal Government Obligations - Government Code Section 53601: The City may invest in Federally sponsored agency securities including obligations issued by the Government National Mortgage Association (GNMA), the Federal Farm Credit Bank System (FFCB), the Federal Home Loan Bank Board (FHLB), the Federal Home Loan Mortgage Corporation (FHLMC), the Student Loan Mortgage Administration (SLMA), and the Federal National Mortgage Association(FNMA)). The "prudent investor" rule shall apply for a single agency name, as U.S. Government backing is implied rather than guaranteed. There is no percentage limitation of the funds that can be invested in this category. Although a five-year maturity limitation is applicable.
- Negotiable Certificates of Deposit (CDs) - As authorized in Government Code Section 53601(i), no more than 30 percent of the agency's money may be invested in negotiable certificates of deposit issued by a nationally or state- chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a state-licensed branch of a foreign bank. All purchases must be fully insured by the FDIC or fully collateralized. A five-year maturity limitation is applicable.
- Municipal Bonds issued by the State of California and other States in accordance with Code Section 53601, to the extent that the principal amount invested in all funds of this type does not exceed Five Hundred Thousand Dollars ($500,000). A five-year maturity limitation is applicable.
- Money Market Mutual Funds (with $1 net asset value) - Investments in money market mutual funds, according to 53601(l) and 53601.6(b) shall, 1) be restricted to those funds that have attained the highest ranking or highest letter and numerical rating provided by not less than two National Recognized Statistical Rating Organizations (NRSROs), 2) retain an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years of experience managing their specific category of fund and have assets under management in excess of $500,000,000. A further restriction is that the purchase price of shares of the mutual funds shall not exceed twenty percent (20%) of the local agency's surplus funds.

**Collateralization**

Collateralization will be required on all Demand Accounts and Uninsured Time Deposits. Demand Accounts and Uninsured Time Deposits with banks and savings and loans shall be collateralized in the manner prescribed by law for depositories accepting municipal investment funds.

**Confirmation**
Receipts for confirmation of purchase of authorized securities should include the following information: trade date, par value, rate, price, yield, settlement date, description of securities purchased, agency's name, net amount due, and third party custodial information. These are minimum information requirements.

**Safekeeping of Securities**
In accordance with Government Code Section 53601, all securities owned by the City shall be held in safekeeping by the City's custodial bank or a third party bank trust department, acting for the City under the terms of a custody agreement. All securities will be received and delivered using standard Delivery-Versus Payment procedures, which ensures that securities are deposited with the third party custodian prior to release of funds. A third party custodian as evidenced by safekeeping receipts will hold securities. Investments in LAIF or money market mutual funds are undeliverable and are not subject to delivery or third party safekeeping.

**Diversification**
The City will diversify its investments by security type and institution. With the exception of US Treasury securities and authorized pools (LAIF and LACIP), no more than 50% of the entity's total investment portfolio will be invested in a single security type or with a single financial institution.

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

**Internal Control**
The Treasurer shall establish an annual process of indepenCIP Detaident review by an external auditor. This review will provide assurances on internal controls through compliance with policies and procedures.

**Performance Standards**
The investment portfolio will be designed to obtain the highest rate, with the greatest security and liquidity consistent with the cash flow requirements of the City, but at no less rate on the date of investment than the rate being paid by the Local Agency Investment Fund (LAIF).

**Reporting**
Under the provision of Section 53646 of the California Government code, the Treasurer shall render a report to the City Council and the City Manager containing detailed information on all securities, investments, and moneys of the City. The report will be submitted on at least a quarterly basis and provided to the City Council within 30 days following the end of the quarter or reporting period.

The report will contain the following information on the Portfolio that is subject to this investment policy:

1. The type of investment, name of the issuer, date of maturity, return on investments, activity, par and cost in each investment;
2. The weighted average maturity of the investments;
3. Description of any investments, including loans and security lending programs that are under the management of contracted parties;
4. The market value and source of the valuation;
5. A description of the compliance with the statement of investment policy; and a statement denoting the City's ability to meet its anticipated expenditure requirements for the next six (6) months.

**Investment Policy and Adoption**
The above investment policy is adopted by resolution of the City of Avalon and the Successor Agency to the Avalon Community Improvement Agency. According to Section 53646, the Treasurer shall review the policy on an annual basis and the City Council and the Successor Agency to the Avalon Community Improvement Agency members shall consider at a public meeting and approve any modifications made thereto.

**Glossary:**

Bankers' Acceptance - A draft or bill or exchange accepted by a bank or trust company. The accepting institution, as well as the issuer, guarantees payment of the bill.

Bonds - A debt obligation of a firm or public entity. A bond represents the agreement to repay the debt in principal and, typically, in interest on the principal.

Broker - A person or firm that acts as an intermediary by purchasing and selling securities for others rather than for his or its own account.

Cash Flow - A comparison of cash receipts (revenues) to required payments (debt service, operating expenses, etc.).

Certificate of Deposit - A short-term, secured deposit in a financial institution that usually returns principal and interest to the lender at the end of the loan period. Certificates of Deposit (CDs) differ in terms of collateralization and marketability. Those appropriate to the public agency investing include Negotiable Certificates of Deposit and Non-Negotiable Certificates of Deposit.

Collateralization - Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

Coupon - The annual rate of interest that a bond's issuer promises to pay the bond holder on the bond's face value; a certificate attached to a bond evidencing interest due on a payment date.

Dealer - Someone who acts as a principal in all transactions, including underwriting, buying, and selling securities, including from his/her own account.

Discount - The difference between the par value of a security and the cost of the security, when the cost is below par. Investors purchase securities at a discount when return to the investor (yield) is higher than the stated coupon (interest rate) on the investment.

Diversification - Dividing investment funds among a variety of securities offering independent return.

Federal Credit Agencies - Agencies of the Federal Government set up to supply credit to various classes of institutions and individuals (e.g. savings and loans, small business firms, students, farmers, farm cooperative, and exporters).

Federal deposit Insurance Corporation (FDIC) - A Federal agency that insures bank deposits, currently up to $250,000 per institution.

Fiduciary - An individual who holds something in trust for another and bears liability for its safekeeping.

Liquidity - The measure of the ability to convert an instrument to cash on a given date at full face or par value.

Local Agency Investment Fund - A voluntary investment fund open to government entities and certain non-profit organizations in California that is manage by the State Treasurer's Office.

Local Government Investment Pool - Investment pools that range from the State Treasurer's Office Local Agency Investment Fund (LAIF) to county pools, to Joint Powers Authorities (JPAs). These funds are not subject to the same SEC rules applicable to money market mutual funds.

Market Value - The price at which a security is trading and presumably could be purchased or sold at a particular point in time.

Maturity - The date on which the principal or stated value of an investment becomes due and payable.

Money Market Mutual Funds - Mutual funds that invest exclusively in short-term money market instruments. MMF's seek the preservation of capital as a primary goal while maintaining a high degree of liquidity and providing income representative of the market for short term investments.

Municipal Notes, Bonds, and Other Obligations - Obligations issued by state and local governments to finance capital and operating expenses.

Mutual Funds - An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments.

Portfolio - Combined holding of more than one stock, bond, commodity, real estate investment, cash equivalent, or other asset. The purpose of a portfolio is to reduce risk by diversification.

Prudent Person Standard - A standard of conduct where a person acts with care, skill, prudence, and diligence when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing funds. The test of whether the standard is being met is if a prudent person acting in such a situation would engage in similar conduct to ensure that investments safeguard principal and maintain liquidity.

Rate of Return - For fixed-rate securities, it is the coupon or contractual dividend rate divided by the purchase price, which is also the current yield.

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

Securities and Exchange Commission (SEC) - The Federal Agency responsible for supervising and regulating the securities industry.

US Treasury Obligations - Debt obligations of the US Government sold by the Treasury Department in the forms of bills, notes, and bonds. Bills are short-term obligations that mature in one year or less and are sold at a discount. Notes are obligations that mature between one year and ten years. Bonds are long-term obligations that generally mature in ten years or more.

Weighted Average Maturity (WAM) - The average maturity of all the securities that comprise a portfolio, typically expressed in days or years.

Yield - The current rate of return on an investment security generally expressed as a percentage of the securities current price.