City of Philadelphia

CITY TREASURER'S OFFICE

Investment Policy

City of Philadelphia
Investment Policy
January 2023

I. INTRODUCTION

This investment policy establishes guidelines for the administration and management of all City investments except for the City's Municipal Pension Fund and the Philadelphia Gas Works (PGW) Retirement Reserve Fund, the PGW OPEB Trust, and the PGW worker's Compensation Reserve Fund. Investments covered under this investment policy include all operating, capital, debt service, and debt service reserve accounts of the City's General Fund, Water Department, Department of Aviation, and Philadelphia Gas Works. City investments need to conform to all legal requirements including applicable provisions of the City Code and City bond resolutions. This policy is meant to supplement the requirements of these existing policies. All investments will be judged by the standards of this policy. Activities that violate the spirit and intent will be deemed to be contrary to the policy.

This policy has been adopted by the Investment Committee, which consists of the Director of Finance (or designee), the City Treasurer (or designees), and a representative each from the Water Department, Department of Aviation, and the Philadelphia Gas Works, for their respective proceeds.

The Investment Committee shall meet at least once annually to review the Investment Policy and make any necessary updates.

II. DELEGATION OF AUTHORITY

The City Treasurer and representatives from the Water Department, Department of Aviation, and the Philadelphia Gas Works meet quarterly with the investment managers to review portfolio results. The Director of Finance meets at least annually with the City Treasurer (or designee) to monitor portfolio results, ensure the adequacy of maturity restrictions, and perform other duties deemed necessary.

The City Treasurer is responsible for the oversight of the relationship between the City and its investment managers and for reviewing the investment manager's performance on a regular basis. The City Treasurer's staff reviews the investment holdings reports monthly and ensures that money managers indicate in writing on a monthly basis that they are in full compliance with City investment policies. In addition, City Treasurer's staff communicates any changes in the City's investment policies to the investment managers and reports all transactions to the City's Accounting Division within the Office of the Director of Finance.. PGW has historically managed its own operating funds and has retained the delegation of authority for these funds.

The City Treasurer generally attempts to group related accounts by risk tolerance and cash flow patterns for each manager. The Investment Committee may from time to time assign new accounts to existing managers, relieve a manager of responsibility for one or all of its existing accounts, and/or add new managers.

III. PRUDENCE

Investment officials in the management of the City's funds should use the "prudent person" rule; i.e. investments should 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 in regard to speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived. Portfolio managers (internal or external) acting in accordance with this policy and/or any written procedures pertaining to the administration and management of the City's funds and who exercise the proper due diligence, shall be relieved of personal responsibility for any individual security's credit risk or market price change, provided that these deviations are reported immediately to the City Treasurer and that appropriate action is taken to control and prevent further adverse developments.

IV. INVESTMENT OBJECTIVES

Investment of the funds covered in this policy shall be governed by the following investment objectives, in order of priority:

<u>Preservation of Principal</u>
Safety of principal is the primary objective of the investment program. Investment of the City's funds should be undertaken in a manner that seeks to ensure the preservation of capital for each portfolio of funds.

<u>Liquidity</u>
The City's investment portfolio should remain sufficiently liquid to enable the City to meet all payment requirements of the City, including but not limited to payroll, accounts payable, capital projects, debt service and other payments as communicated by the City Treasurer's Office.

<u>Return on Investments</u>
The City's investment portfolio shall be designed with the objective of maximizing return commensurate with the City's investment risk constraints and the cash flow characteristics of the portfolio. Return on investment, while important, is subordinate to the safety and liquidity objectives described above.

V. AUTHORIZED AND SUITABLE INVESTMENTS

Section 19-202 of the Philadelphia Code entitled "Authorized Investments" authorizes the Director of Finance, the City Treasurer, and the City Controller to invest money in the City Treasury which is not required for immediate use in specific securities. Investments described below are authorized by the City Code and are allowable under this Investment Policy:

- Bonds or notes of the United States Government.

- United States Treasury Obligations including Separate Trading of Registered Interest and Principal of Securities (STRIPS); receipts indicating an undivided interest in such United States Treasury Obligations; and stripped coupons held under book-entry with the New York Federal Reserve Bank.

- Obligations of United States government-sponsored agencies listed below:

    - Government National Mortgage Association (GNMA)
    - Federal National Mortgage Association (FNMA)
    - Federal Home Loan Mortgage Corporation (FHLMC)
    - Federal Farm Credit System
    - Federal Home Loan Bank
    - Resolution Funding Corporation
    - Tennessee Valley Authority

- Collateralized banker's acceptances and certificates of deposit denominated in U.S. dollars and issued by a City Code authorized depository. Certificates of deposit must be secured by acceptable collateral with a total market value equal to 102% of the deposit.

- Commercial paper with a stated maturity of 397 days or less which is rated P1 by Moody's or A1+ by Standard & Poor's. The senior long-term debt of the commercial paper issuer, or the entity providing an explicit guarantee, must be rated not lower than 'A2' by Moody's or 'A' by Standard & Poor's. Asset backed commercial paper (ABCP), which does not have a long-term rating, is an allowable investment if it meets the short-term rating requirements but is only allowed up to the ABCP sublimit listed under Section VII, Diversification Requirements.

- General obligation bonds of corporations rated 'Aa2' or better by Moody's or 'AA' or better by Standard & Poor's, with a final maturity of two years or less**.**

- Collateralized mortgage obligations and pass-through securities directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States and with a final maturity of two years or less. The rating must be no lower than 'Aa2' by Moody's or 'AA' by Standard & Poor's. Investment managers purchasing these securities must prepare monthly reports indicating cost, market value and final maturity. If market values fall 5% below cost, a written report must be filed with the City Treasurer describing the reasons for the decline in value and outlining the steps if any that are needed to correct the situation.

- Money market mutual funds, as defined by the Securities and Exchange Commission. Money market funds must have assets over $15 billion, have the highest rating from Moody's, S&P, and Fitch, and contain only government securities.

- Repurchase agreements which are fully collateralized in bonds or notes of the United States government pledged to the City and held in the City's name and deposited at the time the investment is made with an entity or a third party selected and approved by the City. The market value of the collateral shall be at least 102% of the funds being disbursed. A Master Repurchase Agreement must be signed between the City and the primary dealer or financial institution that is the counterparty to the repurchase trading before any repurchase trading can begin. The Master Repurchase Agreement must detail acceptable types of collateral, standards for collateral custody and control, collateral valuation and initial margin, marking to market, and margin calls, condition for agreement termination, and acceptable methods for delivery of securities and collateral. The maximum maturity for repurchase agreements is 30 days.

- Obligations of the Commonwealth of Pennsylvania or any municipality or other political subdivision of the Commonwealth with a final maturity of two years or less and a rating of at least 'A' by Moody's or Standard & Poor's, provided that the entity has no NSRO rating lower than 'A'.

- Investments in U.S. treasury and U.S. agency floating rate securities are allowed. The maturity limitation is two years and ten days from the trade date.

Note: Next bullet point applies only to the managed consolidated cash account.

- The purchase of overnight maturities of commercial paper (CP) will be temporarily excluded from the 30% restriction on such purchases as is stated in the City's Investment Policy with the caveat that the total amount of CP as defined and overnight CP will not exceed 50% of the "Total Consolidated Cash Portfolio".

All references to specific rating requirements are requirements at the time of purchase. If after purchase, ratings decline below the thresholds set forth, the Investment Manager must bring this to the attention of the City Treasurer in writing and provide a recommendation as to whether the security should be held or sold.

All references to maturity limitations are from the trade date. If not otherwise noted, the maturity limitation for all investments is two years and ten days from the trade date.

Authorized investments for Sinking Fund Reserve Portfolios are dictated by the First Class City Revenue Bond Act and specific Bond Indentures and include any investment vehicle permitted for any state agency**.** The maturity limitation for all Sinking Fund

Reserve investments is three years from the trade date; however, all maturity restrictions for specific asset classes noted above will still apply. These are: commercial paper with a stated maturity of 397 days or less; general obligation bonds of corporations with a final maturity of two years or less**; c**ollateralized mortgage obligations and pass-through securities directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States with a final maturity of two years or less; repurchase agreements with a maximum maturity of 30 days.

VI. INVESTMENT RESTRICTIONS

For the avoidance of doubt, **this policy specifically prohibits the following**:

- Any investment not listed under Authorized and Suitable Investments;
- Leverage the portfolio, i.e. lending or selling City-owned securities with an agreement to buy them back after a stated period of time (reverse repurchase agreements from the perspective of the City);
- Purchase securities on margin;
- Make short sales of securities, maintain short positions, or purchase or sell puts, calls, straddles and spreads or any combinations thereof;
- Make investments for the purpose of exercising control or management of an issuer;
- Mortgage, pledge, hypothecate or in any manner transfer as security any securities owned or held;
- Invest in securities (except for repurchase agreements) with legal or contractual restrictions on resale or for which no readily available market exists;
- Act as an underwriter of securities;
- Buy or sell any authorized investment when it is a party or any related or affiliated party in the transaction on both sides.
- Invest funds in any derivatives;
- Invest funds in any security whose yield or market value does not follow the normal swings of interest rates. Examples of these types of securities include, but are not limited to: structured notes, floating rate (excluding US Treasury and US agency floating rate securities) or inverse floating rate instruments, securities that could result in zero interest accrual if held to maturity, and mortgage derived interest and principal only strips.

- Invest more than 25% of funds in securities of a particular industry other than U.S. Government securities or agency securities.

- Invest funds in non-dollar denominated securities and foreign government bonds

- Invest funds in any companies owned, controlled by, or acting on behalf of countries on the US Office of Foreign Asset Control (OFAC) sanctions list.

VII. DIVERSIFICATION REQUIREMENTS

It is the policy of the City to diversify its investments portfolios. Portfolio diversification is employed as a way to control risk. Investments shall be diversified as to maturities and as to kind of investments to minimize the risk of loss which might result from over concentration of assets in a specific maturity, in a specific kind of security or from a specific issuer or industry.

Security and Issuer Diversification is as follows:

Authorized Investment Instrument	**Percent of Portfolio Allowed**	**Percent of Portfolio per Issuer**	**Percent of Outstanding Securities per Issuer**
U.S. Government	100%	100%	**NA**
U.S. Treasury	100%	100%	**NA**
Repurchase Agreements	25%	10%	**NA**
U.S. Agencies and Instrumentalities	100%	33%	**NA**
Money Market Mutual Funds	25%	10%	3%
Commercial Paper	30%	3%	3%
Corporate Bonds	30%	3%	3%
Commonwealth of PA and subdivisions of Commonwealth of PA	15%	3%	3%
Banker's Acceptances and Certificates of Deposit	15%	3%	3%
Collateralized Mortgage Obligations and Passthrough Securities	5%	3%	3%

For the avoidance of doubt, debt backed by the Federal Deposit Insurance Corporation (FDIC) under the debt guarantee program, the principal and interest of which are unconditionally backed by the full faith and credit of the United States Government, should be included under the agency limitations.

Commonwealth managed state investment pools, with the highest ratings from either S&P or Moody's, will be counted towards the money market mutual fund limitations related to diversification.

Asset Backed Commercial Paper is a subset of commercial paper listed above and can be invested up to 10% of the portfolio which will be counted towards the 30% commercial paper limitation as long as the final maturity does not exceed 90 days.

Accounts with values under $2 million can be kept 100% in a money market mutual fund composed of governmental obligations, including treasuries and agencies.

VIII. SAFEKEEPING AND CUSTODY GUIDELINES

The City selects custodian banks that are members of the Federal Reserve System to hold its investments. Custodial banks are generally different institutions than the investment managers assigned to any given account. Delivery of the applicable investment documents (i.e. contracts, securities, and safekeeping receipts) to the City's custodian is required for all investments. For secured transactions, such as repurchase agreements, either the title to or a perfected security interest in the securities, along with any necessary transfer documents, must be transferred to the custodian. Such transactions will always be done on a delivery-versus-payment (DVP) basis. Safekeeping procedures of the custodian shall be reviewed annually by independent auditors and a copy of their report shall be supplied to the City for review.

IX. MONITORING INVESTMENTS

Those responsible for the day-to-day management of City funds shall review trading activity on a daily basis. The holdings reports shall be reviewed monthly by the City Treasurer's Office.

X. PORTFOLIO REVIEWS

The investment managers shall meet with the City, including the Treasurer and a representative from the Water Department, Department of Aviation, the Philadelphia Gas Works, and appropriate City agencies at least quarterly to review investment results. A general agenda for these meetings should include (but is not limited to):

- A review of investment results net of fees achieved over the last three quarters, one year, three years, and five years compared with the assigned benchmark;

- The manager's current outlook for the financial markets over the next six through twelve months;

- The manager's internal investment policies that have been adopted in response to these market expectations;

- The appropriateness of the present portfolio given the market expectations, internal policy, and the City's requirements;

- A review of the City's guidelines including the assigned benchmark relative to any constraints which the manager feels are limiting its ability to respond to developments within the markets in a manner considered most appropriate given the investment objectives; and

- A review of the previous year cash inflows and outflows for each account and discussion of the upcoming year's cash flow forecasts.

Investment performance will be evaluated at each quarterly meeting. Each manager should maintain investment performance net of fees above the assigned benchmark for each quarter and for one year, three year, and five year performance. Any deviance from benchmark should be closely evaluated to determine if the money manager is using appropriate investments and strategies. A manager's failure to be above the benchmark for three successive quarters merits probationary status. A manager's failure to meet the benchmark for four successive quarters should generally result in termination. Upon further review, the City may grant further quarters for improvement to take place.

Benchmarks are set by the City Treasurer's Office based on duration and risk profile of the account.

.

XI. SELECTION OF MONEY MANAGERS

The City through a competitive Request for Proposal (RFP) process, shall establish a pool of eligible investment managers to manage City funds. Money managers shall be selected from this pool on as needed basis to replace existing money managers or to manage new funds which arise from time to time.

Process for Manager Selection

Upon identification that funds are available for investment, the City Treasurer's Office's Cash Manager will notify the Investment Committee.

The Investment Committee will develop a recommendation regarding the number of managers necessary as well as manager allocations. The Investment Committee will submit recommendations to the Director of Finance for consideration and approval.

The Investment Committee will consider the following factors when establishing the investment manager pool and determining allocations within the approved pool of eligible managers:

<u>Competitive pricing structure</u>

- The management of investments entails costs, and such costs reduce the funds available to the City. The City Treasurer's Office desires to minimize the impact of such fees on the overall return.

Manager performance, experience, and quality of service

- The Investment Committee will consider manager performance against benchmarks, demonstrated expertise, quality of service, and overall experience with the manager.

Existing portfolio allocations

- The Investment Committee will evaluate existing allocations and number of overall managers necessary to provide services in accordance with the Investment Policy. The Investment Committee desires to have a suitable number of managers to properly diversify and guard against business, investment, and associated risks. This is balanced by a desire to avoid an excessive number of managers which may unnecessarily increase costs and require additional monitoring.

Commitment to diversity and local managers

- The City Treasurer's Office desires to increase participation from minority, women, and disabled-owned firms (M/W/DBEs) and local-owned investment managers with a presence in Philadelphia.
- The Investment Committee shall evaluate proposed manager allocations with consideration to overall diversity and inclusion goals in addition to the Investment Policy criteria.
- The Investment Committee shall consider certified M/W/DBE firms from the list of approved managers when evaluating investment manager allocation opportunities.

XII. INTERNAL CONTROLS

The Treasurer shall establish internal controls governing the administration and management of investments covered under this policy and these controls shall be documented in writing. Such controls shall be designed to prevent and control losses of City funds arising from fraud, employee error, misrepresentation by third parties, and imprudent actions by any personnel. Many of the controls applicable to the investment of City funds by the money managers are listed in the investment manager contracts. An annual process of independent review shall be conducted by the City Controller.

XIII. CONFLICT OF INTEREST

Investment Committee members and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the management of City cash and investments, or which could impair their ability to make impartial decisions. Employees shall follow the City's Integrity Office and Board of Ethics rules and procedures. Employees shall notify the City Treasurer of any potential conflicts that may relate to their work on the investment committee.

Glossary of Terms

This glossary is for reference only. Investment guidelines and restrictions are included in the preceding Investment Policy.

Agency: A debt security issued by an agency or instrumentality of the United States. Agencies are backed by each particular agency or instrumentality of the United States with a market perception that there is an implicit government guarantee.

Asset-Backed Security: A security backed by notes or receivables against assets other than real estate. Examples are autos, credit cards, and equipment.

Benchmark: A comparative base for measuring the performance or risk tolerance of an investment portfolio. A benchmark should represent the persistent and prominent characteristics of a portfolio, taking into account metrics such as duration, investment type, and asset allocation.

Bond: A long-term debt instrument of a government or corporation promising payment of the original investment plus interest by a specified future date.

Certificate of Deposit (CD): A debt instrument issued by financial institutions that will pay interest, periodically or at maturity, and principal when it reaches maturity. Maturities range from a few weeks to several years.

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.

Commercial Paper: An unsecured short-term promissory note issued by corporations, with maturities typically ranging from 1 to 397 days, and usually transacts at a discount with no coupon payments. Payment comes at maturity.

Corporate Security: A debt obligation issued by a corporation.

Credit Quality: The measurement of the financial strength of a bond issuer. This measurement helps an investor to understand an issuer's ability to make timely interest payments and repay the loan principal upon maturity. Generally, the higher the credit quality of a bond issuer, the lower the interest rate paid by the issuer because the risk of default is lower. Credit quality ratings are provided by nationally recognized rating agencies.

CREDIT RATINGS INTERPRETATION

SHORT-TERM DEBT RATINGS			
MOODY'S	**S&P**	**FITCH**	**RATINGS INTERPRETATION FOR CREDIT**
P-1	A-1+	F1+	STRONGEST QUALITY
	A-1	F1	STRONG QUALITY
P-2	A-2	F2	GOOD QUALITY
P-3	A-3	F3	MEDIUM QUALITY

LONG-TERM DEBT RATINGS			
MOODY'S	**S&P**	**FITCH**	**RATINGS INTERPRETATION FOR CREDIT**
Aaa	AAA	AAA	STRONGEST QUALITY
Aa1	AA+	AA+	STRONG QUALITY
Aa2	AA	AA	
Aa3	AA-	AA-	
A1	A+	A+	UPPER MEDIUM QUALITY
A2	A	A	
A3	A-	A-	
Baa1	BBB+	BBB+	MEDIUM QUALITY
Baa2	BBB	BBB	
Baa3	BBB-	BBB-	
Ba1	BB+	BB+	SPECULATIVE
Ba2	BB	BB	
Ba3	BB-	BB-	
B1	B+	B+	LOW
B2	B	B	
B3	B-	B-	
Caa	CCC+	CCC	POOR
-	CCC	-	HIGHLY SPECULATIVE TO DEFAULT
-	CCC-	-	
Ca	CC	CCC	
C	-	-	
-	-	DDD	
-	-	DD	
-	D	D	

Credit Risk: The risk to an investor that an issuer will default in the payment of interest and/or principal on a security; and the risk of loss of all or part of the investment due to the failure of the security issuer or backer.

Current Yield (Current Return): A yield calculation determined by dividing the annual interest received on a security by the current market price of that security.

Diversification: A process of investing assets among a range of security types by sector, maturity, and quality rating.

Duration: A measure of the timing of the cash flows, such as the interest payments and the principal repayment, to be received from a given fixed-income security. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity. The duration of a security is a useful indicator of its price volatility for given changes in interest rates.

Federal Deposit Insurance Corporation (FDIC): The FDIC preserves and promotes public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions for at least $250,000; by identifying, monitoring, and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system when a bank or thrift institution fails.

Floating Rate Securities: A bond whose interest rate is adjusted according to the interest rates of other financial instruments. These instruments provide protection against rising interest rates but pay lower yields than fixed rate notes.

Government Securities: An obligation backed by the full faith and credit of the U.S. government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market.

Interest Rate Risk: The potential for investment losses that can be triggered by a move upward in the prevailing rates for new debt instruments. If interest rates rise, for instance, the value of a bond or other fixed-income investment in the secondary market will decline.

Liquidity: The amount of a portfolio or an asset that can be converted easily and quickly into cash.

Market Value: Current market price of a security.

Maturity: The date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder.

Money Market: Typically refers to short-term debt instruments (bills, commercial paper, discount notes, etc.).

Money Market Fund: Mutual funds that invest solely in money market instruments (short-term debt instruments, such as Treasury bills, commercial paper, bankers' acceptances, repos, and federal funds).

Municipal Bond: A municipal bond is a debt security issued by a local government, such as county, state, city, special improvement district, to finance its capital expenditures, including the construction of highways, bridges, or schools. Municipal bonds can issue taxable or tax-exempt from federal, state, and local taxes.

Mutual Fund: A mutual fund is a professionally managed investment fund that pools money from many investors to purchase securities. These investors may be retail or institutional in nature. Mutual funds have advantages and disadvantages compared to direct investing in individual securities.

Nationally Recognized Statistical Rating Organization (NRSRO): A credit rating agency that issues credit ratings that the U.S. Securities and Exchange Commission (SEC) permits other financial firms to use for certain regulatory purposes. The most recognized NRSROs are Fitch, Moody's, and Standard and Poor's.

Portfolio: Collection of securities held by an investor.

Principal: The face value or par value of a debt instrument. This also may refer to the amount of capital invested in a given security.

Repurchase Agreement (Repo or RP): An agreement of one party to sell securities at a specified price to a second party and a simultaneous agreement of the first party to repurchase the securities at a specified price or at a specified later date.

Reverse Repurchase Agreement (Reverse Repo): An agreement of one party to purchase securities at a specified price from a second party and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified date.

Structured Notes: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, etc.) and corporations, which have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

Yield: The current rate of return on an investment security generally expressed as a percentage of the security's current price.