

Exhibit “A”

CITY OF HERCULES

Statement of Investment Policy

INTRODUCTION

The City of Hercules (City) strives to maintain the level of investment of all funds as near 100% as possible through daily and projected cash flow determinations. Investments are made so maturities match or precede the cash needs of the City. The City will insure that principal invested is protected from loss while maintaining adequate cash availability and maximizing yield on invested funds.

The basic premise underlying the City's investment philosophy is to insure that money is always available when needed. A minimum amount of 10% of the adopted budget will always be maintained in immediately available investments, such as the State Treasurer Local Agency Investment Fund (LAIF) or other cash equivalents. This may include commercial paper, banker's acceptances, or new repurchase agreements.

The City's portfolio will be limited to an average life of three years or less. When the market warrants purchase of longer maturities to capture a higher rate of return, purchases will be limited to United States Treasury Notes and Bonds, Federal Agencies, Medium Term Notes, and Mortgage Backed Securities. No more than 1/3 of the portfolio will be invested in securities that have a final maturity greater than five years, and only then with the approval of Council.

The City will attempt to ladder the portfolio with staggered maturities so that a portion of the portfolio will mature each year. In addition, the economy and various markets are monitored carefully to assess the probable course of interest rates. In a market with low or increasing interest rates, the City will attempt to invest in securities with shorter maturities. This makes funds available for other investments when the interest rates are higher. When interest rates appear to be near a relative high rate, the City will attempt to purchase investments with medium to long-term maturities to lock in the higher rate of return. When interest rates are falling, the City will invest in securities with longer maturities to hold the higher rate for a longer period of time.

City will also take advantage of any new investment instrument that becomes eligible for municipal investment only after a detailed analysis of the investment, and its safety, liquidity and yield are completed.

The City's Investment Policy shall be adopted by the City Council. The policy shall be reviewed at least annually by the City Manager and Finance Director, and any modifications must be approved by City Council.

1.0 Policy

It is the policy of the City to invest public funds in a manner which will provide the greatest security with the maximum investment return while meeting the daily cash flow demands of the entity and conforming to all state and local statutes governing the investment of public funds. The authority governing investments for municipal governments is set forth in the California Government Code, Section 53600 et seq.

2.0 Scope

It is intended that this Investment Policy provide guidelines for all entities, funds and investment activities under the direct authority of the City organization including the City of Hercules (City), the Successor Agency formerly known as Hercules Redevelopment Agency (RDA), the Hercules Public Financing Authority (PFA), and other agency funds (such as West Contra Costa Integrated Waste Management Authority (WCCIWMA)).

3.0 Prudence

The City operates its pooled cash investments under the prudent investor rule. Investments shall be made with the judgment and care, under the circumstances then prevailing which investors 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. This affords the City a broad spectrum of investment opportunities as long as the investment is deemed prudent and is allowable under current legislation and the applicable laws of the State of California, and this investment policy. Investments will be made in a range of instruments to insure diversification of the City's portfolio and liquidity of assets in an emergency situation. It is the City's full intent, at the time of purchase, to hold all investments until maturity to ensure the return of all invested principal dollars.

The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. Investment officials acting in accordance with written procedures and the investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments. Future State of California legislative actions affecting this investment policy (adding further restrictions to the type, amount and length of investments) shall not apply to those investments held prior to the enactment of said legislation unless specifically identified in the legislative action.

4.0 Objective

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

4.1 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 objective will be to mitigate credit risk and interest rate risk.

- a. Credit Risk, which is the risk of loss due to the failure of the security issuer or backer, will be minimized by:
 - Limiting investments to the types of securities listed in Section 8.0 of this Investment Policy;
 - Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the City will do business in accordance with Section 7.0;
 - Diversifying the investment portfolio so that the impact of potential losses from any one type of security or from any one individual issuer will be minimized.
- b. Interest Rate Risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by:

- Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity;
- Investing funds primarily in shorter-term securities, money market mutual funds, or similar investment pools and limiting the average maturity of the portfolio in accordance with this policy as outlined in Section 15.0.

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

4.3 Return on Investments (Yield): The City's investment portfolio shall be designed with the objective of attaining a rate of return throughout budgetary and economic cycles, commensurate with the City's investment risk constraints and the cash flow characteristics of the portfolio. Securities shall generally be held until maturity with the following exceptions:

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

To meet these objectives, it is the City's policy to diversify its investment portfolio. To this end, the Treasurer or Finance Director, with City Manager approval, may from time to time make use of investment advisors in accordance with City policy. The City will strive to make investments that benefit the local area and promote community economic development when possible and when in the City's best interest.

5.0 Delegation of Authority:

Authority to manage the City's investment program is provided by an Ordinance of the Council as required by State law, and is now reauthorized by Resolution annually as required by law. On July 26, 1979 Council delegated responsibility (Ordinance No. 146) for the investment program to the Treasurer or Finance Director, who shall establish written procedures for the operation of the investment program consistent with this investment policy. Procedures should include reference to: safekeeping, repurchase agreements, wire transfer agreements, banking service contracts and collateral/depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Treasurer or Finance Director. The Treasurer or Finance Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials. All new investments (with the exception of State Fund (LAIF) transactions) will be reviewed and approved by the City Manager. Annually, Council will review and adopt by resolution the updated Investment Policy, in which Council will delegate responsibility for the investment program to the Treasurer or Finance Director.

6.0 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. Employees and investment officials shall disclose to the Treasurer or Finance Director any material interests in financial institutions that conduct business within this jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City, particularly with regard to the time of purchases and sales.

7.0 Authorized Financial Dealers and Institutions:

The Treasurer or Finance Director will maintain a list of financial institutions approved and authorized to provide investment services to the City. In addition, a list will also be maintained of approved security broker/dealers selected by credit worthiness to provide investment services to the City, and who are authorized to provide those services in the State of California. These may include "primary" dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (uniform net capital rule). No public deposit shall be made except in a qualified public depository as established by State laws.

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the Treasurer or Finance Director with the following:

- Audited Financial Statements;
- Proof of National Association of Security Dealers certification;
- Completed broker/dealer questionnaire;
- Certification of having read this investment policy, and meeting all of the requirements of this policy;
- Compliance with City of Hercules insurance requirements for professional services agreements for general, professional and automotive liability.

An annual review of the financial condition and registrations of qualified bidders will be conducted by the Treasurer or Finance Director. In addition, a current audited financial statement is required to be on file for each financial institution and broker/dealer with which the City invests, and each financial institution must be insured by the Securities Investor Protection Corporation (SIPC).

The City shall also be open to contracting investment management services for a portion of the portfolio. That portion of the portfolio shall be limited to longer-term investments of two years or longer. Any investment management firm contracted with shall meet the criteria established by the Treasurer or Finance Director. All investments made under contract will be purchased in the City's name and in accordance with the guidelines established by the City's investment policy.

8.0 Authorized and Suitable Investments

The City is empowered by State statute to invest in the following types of securities:

A. Securities of the U.S. Government

Securities of the U.S. Government include U.S. Treasury bills, notes and bonds.

U.S. Treasury Bills (T-Bills) - are issued by the U.S. Treasury and are available in maturities out to one year. They are non-interest bearing and sold on a discount basis. The face amount is paid at maturity.

U.S. Treasury Notes - are issued by the U.S. Treasury with maturities from two to ten years. They are issued in coupon form and many issues are also available in registered form. Interest is payable at six month intervals until maturity.

U.S. Treasury Bonds - are issued by the U.S. Treasury with maturities of ten years to thirty years. The City may purchase the interest and/or principal of a U.S. Treasury Bond. A principal only instrument is commonly called a "stripped" or "zero" coupon. Stripped coupons are

sold on a discount basis. The face amount is paid at maturity.

B. Securities of U.S. Government Agencies

The capital of U.S. government agencies was initially financed by the United States Treasury. As the agencies have grown and operated profitably over the years, the U.S. Treasury's investment has been replaced in large measure by private capital. At the present time, obligations of only a few agencies are backed by the full faith and credit of the U.S. Government. The obligations of all federal agencies described in the following sections are not guaranteed by the U.S. Government with the exception of Government National Mortgage Association, but are considered to be investments of the highest quality.

Federal Farm Credit Bank (FFCB) – created in 1971, this government sponsored institution issues debt instruments to meet the financial needs of farmers and the national agricultural industry. Discount notes are issued monthly with 6 and 9-month maturities. Discount notes pay interest at maturity. Longer-term debentures (2-5 years) are also issued. Debentures pay interest semi-annually on a 30/360-day basis. These issues enjoy an established secondary market.

Federal Home Loan Bank (FHLB) – established in 1932 after many bank failures, and updated in 1989 after savings and loan failures, it provides credit to member lending institutions such as savings and loan associations, cooperative banks, insurance companies and savings banks. The agency offers bonds in the public market with maturities of one year to ten years. These bonds are usually offered on a quarterly basis depending on the current demands of the housing industry. Interest is paid semi-annually on a 30/360-day basis.

Federal Home Loan Mortgage Corporation (FHLMC) - (Freddie Mac) is a publicly held government-sponsored enterprise created on July 24, 1970 pursuant to the Federal Home Loan Mortgage Corporation Act, Title III of the Emergency Home Finance Act of 1970, as amended. Freddie Mac's statutory mission is to provide stability in the secondary market for home mortgages, to respond appropriately to the private capital market and to provide ongoing assistance to the secondary market for home mortgages by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for home mortgage financing. Maturity can be for 1 year to 30 years. These loans can be either set at a fixed rate or variable rate. Principal and interest are paid monthly on a 30/360-day basis.

Federal National Mortgage Association (FNMA) - (Fannie Mae) is a quasi-public corporation chartered by an act of Congress in 1938 to assist the home mortgage market by purchasing mortgages insured by the Federal Housing Administration (FHA) and the Farmers Home Administration (also FHA), as well as those guaranteed by the Veterans Administration (VA). FNMA issues notes and bonds. Notes are issued with maturities of less than one year with interest paid at maturity. Bonds are issued for 15 and 30 year maturities with interest paid semi-annually. Interest is computed on a 30/360-day basis. There is a strong secondary market in these securities. A secondary market means these instruments are actively traded; they are bought and sold daily.

Government National Mortgage Association (GNMA) - (Ginnie Mae) is a wholly owned corporate instrumentality of the United States within the Department of Housing and Urban Development. A certificate collateralized by FHA/VA residential mortgages represents a share in a pool of FHA or VA mortgages. Ginnie Mae's are registered securities. Principal and interest are paid monthly and sent directly from the issuer of the pool,

usually a mortgage banker, to the City. Original maturities range from 12 to 30 years with a 7 to 12 year assumed average life. (Assumed average life is due to prepayments of mortgages).

Small Business Administration (SBA) Loans – created in 1953, the SBA is an independent agency of the United States government that furnishes financial and management assistance to small businesses. The SBA guarantees the principal portion of the loans it approves. The City can purchase the guaranteed portion of these loans. Maturity can be for 1 year to 30 years. These loans can be either set at a fixed rate or a variable rate that is usually tied to the prime rate. Principal and interest are paid monthly on a 30/360-day basis.

Other U.S. government securities available to the City for investment purposes include: Student Loan Marketing Association (SLMA or Sallie Mae), Aid for International Development (AID), and debentures of Tennessee Valley Authority (TVA). However, these instruments are not offered on a regular basis and do not offer the same liquidity as the before mentioned instruments.

C. Time Deposits and Certificates of Deposit (CD)

Time Deposits can be placed with commercial banks, savings associations, or federal or state credit unions. A time deposit is a receipt for funds deposited in a financial institution for a specified period of time at a specified rate of interest. Generally, their length of time is from 3 months to 2 years, although they can legally go as long as 5 years. Denominations can be any agreed upon amount and interest is normally calculated using actual number of days on a 360-day year and paid monthly. Deposits of \$100,000 (commonly referred to as Jumbo C.D.'s) per institution are insured by the Federal Deposit Insurance Corporation (FDIC), and Certificates of Deposit can be supported by either 110% U.S. Government agency notes or 150% mortgages currently held by the bank or savings and loan. An institution must meet the following criteria to be considered by the City:

- The institution must maintain a net worth to asset ratio of at least 3% and a positive earnings record.
- The maximum deposit in any single institution will not exceed \$100,000, and the City will not deposit funds in federally insured industrial loan companies.
- The institution must be in compliance with the Financial Institution Reform Recovery and Enforcement Act (FIRREA) capital ratio requirements for risk-based, tangible, and core capital.
- The institution must make available a current FDIC call report (banks) or FHLB report. A call report presents the solvency of the institution to the agency with oversight responsibility of that institution.

D. Negotiable Certificates of Deposit

A Negotiable Certificate of Deposit is a form of Certificate of Deposit that has been an important money market instrument since 1961 when commercial banks began issuing them and a secondary market developed to provide liquidity. Federal or state chartered United States banks, savings associations, credit unions, or branches of state licensed foreign banks can issue these instruments. Since these certificates of deposit can be traded in the secondary market, they are negotiable instruments, hence their name - negotiable certificate of deposit. They are supported only by the strength of the institution from which they are purchased. Interest is paid semi-annually computed on a 30/360-day basis. The City's maximum investment in any single institution will be \$100,000, and no more 30% of the City's money can be invested in these

instruments. Maturities range from 3 months to 5 years. Investments in Negotiable Certificates of Deposit will only be made in United States institutions taking into consideration their asset size, their profitability, and their financial stability prior to placing the investment.

E. Banker's Acceptance Notes (BA)

A banker's acceptance is a unique credit instrument used to finance both domestic and international transactions. As a money market instrument, it is an attractive short-term investment. When a bank "accepts" such a time draft or bill of exchange, it becomes, in effect, a predated certified check payable to the bearer at some future, specified date. Little risk is involved because the commercial bank assumes primary liability once the draft is accepted, and for the bank, the draft is secured by the goods or merchandise that was financed. Banker's acceptances are frequently in odd amounts. Maturities normally range from 30 up to 180 days. Banker's acceptances are sold at a discount. This means the face amount is received at maturity. The City can have no more than 40% of its money in BA's and no more than 30% of its money in any single institution. The City will purchase BA's only from the 100 largest banks in the world and from the 100 largest United States banks according to asset size. The profitability of the financial institution as well as its financial stability is also taken into account prior to placing the investment.

F. Commercial Paper

Commercial paper is the trade name applied to unsecured promissory notes issued by finance and industrial companies to raise funds on a short-term basis. Commercial paper can be purchased on an interest bearing or discount basis. Interest bearing instruments pay interest semi-annually. Discounted instruments pay interest at maturity. The City will invest in commercial paper only if the yields are attractive, and if the paper is rated 'P-1', or equivalent, by Moody's Investor Service, Inc. (Moody's) and/or 'A-', or equivalent, by Standard & Poor's (S&P) and/or 'F-1' or equivalent, by Fitch Financial Services, Inc. (Fitch) rating services. The issuing corporation has to be organized and operating within the United States, have total assets of \$500 million, and have an 'A' or higher rating on any long term debt that it might have issued. Maturities range from 30 to 270 days, however the City will not invest beyond 180 days, and interest is computed on a 30/360-day basis. While the law allows up to 25% (and 40% in certain situations) of the City's money to be invested in these instruments, no more than 15% of the City's money will be invested in commercial paper, and will represent no more than 10% of the outstanding paper of an issuing corporation. If the issuer has issued long-term debt, it must be rated 'A' without regard to modifiers.

G. Medium Term Notes

In recent years, this financing mechanism has grown, providing capital to the private sector, and diminishing the negotiable certificate of deposit market. The trend towards medium term notes is related to buyer and seller flexibility and convenience. Medium term notes are defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, and issued by corporations organized and operating within the United States or by depository institutions licensed by the U.S. or any state and operating within the U.S. The notes are issued on any given date and mature on a negotiated date. They generally range from 2 to 5 years in maturity. This market provides an excellent alternative to Negotiable C.D.'s. While the law allows investment in medium term notes with a rating of 'A', the City will only purchase Medium Term Notes with credit ratings of 'AA' or better by a nationally recognized rating agency, and with maturities of 5 years or less. Their interest is calculated on a 30/360-day basis like

Agency bonds. Interest is paid semi-annually. There will be no more than 30% of the City's money invested in this type of investment, and no more than 15% in any single corporation.

H. Local Agency Investment Fund (LAIF) demand deposits

The Local Agency Investment Fund was established by the State to enable local agency treasurer or chief fiscal officer to place funds in a pool for investment (California Government Code Section 16429.1 et seq.). The LAIF has been particularly beneficial to those jurisdictions with small portfolios. Each agency is limited to an investment of \$40 million per account. The City uses this investment vehicle for short-term liquidity, investment, and yield when rates are declining. Funds are available on demand and interest is paid quarterly. Presently, the City maintains two regular LAIF accounts (one for the City and one for the RDA) and one bond proceeds LAIF accounts (2003A).

I. Repurchase Agreement (Repo)

Closely associated with the functioning of the Federal funds market is the negotiation of repurchase agreements or repo's. Banks may buy temporarily idle funds from a customer by selling them U.S. Government or other securities with a contractual agreement to repurchase the same security on a future date determined by negotiation. For the use of funds, the customer receives an interest payment from the bank; the interest rate reflects both the prevailing demand for Federal funds and the maturity of the repo. Repurchase Agreements are usually executed for \$100,000 or more. A Master Repurchase Agreement is required with each firm with which the City enters into repurchase agreements. The City will enter into repurchase agreements only with primary dealers of the Federal Reserve Bank of New York. Only U.S. Treasury securities or Federal Agency securities, as described in A. and B. above, will be acceptable collateral. The City will require physical delivery of the securities backing the repo to its safekeeping agent. The institution from which the City purchases a repo must transfer on an ongoing basis sufficient securities to compensate for changing market conditions and to insure that the market value of securities is valued at 110 percent or greater (102% is required by statute) of the funds borrowed against those securities. The market value of the underlying securities for any repo with a term greater than one day must be reviewed on a weekly basis, and market value must be calculated each time there is a substitution of collateral. Generally, maturities range from 1 to 90 days with interest paid at maturity, and may not exceed one year. The City will only invest in repos for 30 days or less.

J. Reverse Repurchase Agreement

A Reverse Repurchase Agreement, on the other hand simply reverses the above process of purchasing repurchase agreements. The City, in effect, sells a particular security to a firm for a stated period of time, not to exceed 92 days. Interest is paid at maturity. The City pays the firm interest on the cash it receives while receiving the interest on original security. The City will in turn purchase a short-term security yielding a higher rate of interest (generally of lower quality than the original investment). Reverse repurchase agreements may also be used to alleviate a temporary cash shortage. The City of Hercules will never utilize the reverse repurchase agreement in order to meet its cash needs. Reinvestment of reverse repurchases will be in securities of shorter or equal maturities to a reverse repurchase agreement. This investment tool cannot exceed 20% of the investment portfolio. The City will seldom, if ever, use this investment vehicle.

K. Mutual Funds/Money Market Mutual Funds

Money Market Mutual Funds are shares issued by diversified management companies who invest in the securities and obligations as authorized by subdivisions (a) to (j), inclusive, or subdivisions (m) or (n) of Government Code Section 53601 and comply with the investment restrictions of Article 2 (commencing with Section 53630 of the California Government Code), OR, who invest in money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940. To be eligible for investment pursuant to this subdivision, these companies shall either: (1) attain the highest ranking or the highest letter and numerical rating provided by not less than two nationally recognized rating services, or (2) have an investment adviser registered with the Securities and Exchange Commission with not less than five year's experience investing in the securities and obligations as authorized by subdivisions (a) to (j), inclusive, or subdivisions (m) or (n) of Government Code section 53601, and with assets under management in excess of five hundred million dollars (\$500,000,000). The purchase price of shares purchased pursuant to this subdivision shall not include any commission that these companies may charge and shall not exceed 20 percent of the investment portfolio.

L. Insured or Passbook Savings Accounts

These accounts must be insured by FDIC and will not exceed \$100,000 per account.

M. Other Eligible Investments

There are other legal investment instruments that the City chooses not to use presently. They include: bonds issued by the City; bonds, notes or registered warrants issued by the State of California; bonds, notes, warrants or other evidence of indebtedness of other California local agencies; and a few other investment vehicles. None of these investment vehicles can have more than a 5 year maturity

9.0 Ineligible Investments

Any security type or structure not specifically approved by this policy is hereby specifically prohibited. Specifically, derivatives are not eligible investment instruments. A derivative is defined as any security where the value is linked to, or derived from, an underlying asset or benchmark. The City will not use such derivatives as range notes, dual index notes, inverse floating rate notes, leveraged notes, or notes linked to lagging indices or to long-term indices, nor will the City invest in interest-only strips that are derived from a pool of mortgages, or any security that could result in zero interest accrual if held to maturity. This policy does not preclude the use of callable securities, as they do not fall within the definition of a derivative as described herein. Investments such as stocks are also prohibited.

10.0 Other Investment Pools

There are a number of investment pools or investment Joint Powers Authorities available to the City other than LAIF. A thorough investigation of any investment pools that the City might be interested in shall be conducted prior to any City investment. The City currently uses the Local Agency Investment Fund (LAIF), established by the State to enable local agency treasurer or chief fiscal officer to place funds in a pool for investments, and also participates in one other investment pool. The investigation of any pool shall include the following:

- A description of eligible investment securities, and a written statement of investment policy and objectives (i.e. are reserves, retained earnings, etc. utilized by the pool and is the pool

- eligible for bond proceeds and/or will it accept such proceeds);
- A description of interest calculations and distribution methods, and how gains and losses are treated;
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited;
- A description of who may invest in the program;
- A description of how deposits and withdrawals will be made, how often they are allowed and any minimum or maximum limitations;
- A reporting schedule for receiving statements and portfolio activity;
- A description of how any reserves, retained earnings, etc. are utilized by the pool;
- A fee schedule, and method of assessment;
- A policy statement on the eligibility or acceptance of a deposit of bond proceeds in the pool.

11.0 Bond Trust Agreements

The City shall direct the investments of debt proceeds and reserve funds held by a trustee/fiscal agent/paying agent or the City. Such direction shall be in keeping with the terms and conditions as stated by the trust agreements or by applicable law or by the policies set forth in this document. In addition to the acceptable investment instruments listed above, bond and note proceeds may be invested in the following manner: (i) Guaranteed Investment Contracts (GIC's) with an investment provider rated 'A' or better with downgrade protection; (ii) Repurchase agreements with financial institutions or banks insured by the FDIC or FSLIC, or any broker dealer with "retail customers" which falls under the jurisdiction of the Securities Investors Protection Corporation (SIPC), provided that: (a) the over-collateralization is at one hundred two percent (102%), computed weekly, consisting of such securities as described in this section, and items A. and B. under section 8.0 'Authorized and Suitable Investments'; (b) a third party custodian, the Trustee or the Federal Reserve Bank shall have possession of such obligations; (c) the Trustee or the City shall have perfected a first priority security interest in such obligations; and (d) failure to maintain the requisite collateral percentage will require the Trustee to liquidate the collateral; (iii) Forward Delivery or Forward Purchase Agreements with underlying securities of the types outlined in A., B. and F. of section 8.0 'Authorized and Suitable Investments' above; (iv) Any other investment instrument that is allowed by State law and which complies with requirements imposed by bond insurance or rating agencies. When practical, a minimum of three competitive bids must be solicited by the Treasurer or Chief Fiscal Officer.

12.0 Collateralization

Collateralization will be required on two types of investments: certificates of deposit and repurchase (and reverse repurchase) agreements. Deposits of \$100,000 (commonly referred to as Jumbo C.D.'s) per institution are insured by the government (FDIC) and Certificates of Deposit can be supported by either 110% U.S. Government treasury or agency notes or 150% mortgages currently held by the bank or savings and loan.

13.0 Safekeeping and Custody

To protect against fraud, embezzlement or losses caused by collapse of an individual securities dealer, securities purchased with City funds that are in a negotiable, bearer, registered, or nonregistered format, shall require delivery of said securities to a City designated third party bank trust department for custody and safekeeping, including those purchased for the City by financial advisors, consultants, or managers administering any of the City's funds. The third party bank will

act as agent for the City under the terms of a custody agreement. All trades executed by a dealer will settle delivery vs. payment (DVP) through the City's safekeeping agent. The securities will be delivered by book entry, by physical delivery, or by third party custodial agreement. The transfer of securities to the counterparty bank's customer book entry account may be used for book-entry delivery. The counterparty bank's trust department or separate safekeeping department may be used for the physical delivery of the security if the security is held in the name of the City.

To insure the safety and internal accounting controls necessary to establish a stable and accurate investment system, the City uses an investment confirmation document. This document is prepared by Treasury personnel, and signed off on by Accounting personnel and the City Manager when appropriate. Copies are also distributed to the City accounting division, Treasury investment file, and the institutions with which the order to transfer funds was placed (vendor and safekeeping). This transaction control document, or "Treasury Confirmation Form", contains information regarding the type of investment; amount invested; interest rate; purchase and maturity dates; and any delivery instructions. This confirmation is matched to the Broker's Confirmation and held in the Treasury's file until the security is sold or matures.

When securities mature, are called or are sold, or when interest is received and accumulates to more than \$5,000, without exception, the City's safekeeping agent (currently U.S. Bank) must send the proceeds to the City's primary bank (currently Pinole Branch of The Merchants Bank) and shall be deposited to the City's checking account.

14.0 Diversification

The City operates its investment pool with many State and self-imposed constraints. It does not buy stocks and it does not speculate. Currently Government Code Section 53600 (ET seq) restricts the City portfolio to:

- 30% in Negotiable Certificates of Deposit.
- 40% in Bankers Acceptance Notes, not to exceed 180 days in maturity.
- 25% in Commercial Paper, not to exceed 270 days in maturity.
- 30% in Medium Term Notes.
- 20% in Money Market Mutual Funds.
- 20% in Reverse Repurchase Agreements

These restrictions primarily apply to short-term investments and are interpreted to apply at the time of investment. If, as the portfolio mix changes over time, a particular segment exceeds these restrictions the prudent investor rule shall apply.

The City will be selective in purchasing long-term negotiable certificates of deposit and medium term notes, placing such an investment only with stable institutions.

15.0 Maximum Maturities

To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. The City will normally operate a portfolio with a dollar weighted average life of three years or less. This is to insure liquidity and the ability to move with changing markets and interest rate movements.

No investments shall be made in instruments with maturities greater than five (5) years without specific Council approval. Exception: Mortgage Backed Securities, such as Federal Home Loan

Mortgage Corporation (Freddie Mac), Federal National Mortgage Association (Fannie Mae) and Government National Mortgage Association (Ginnie Mae), which have maturities greater than five (5) years and not more than 30 years, may be purchased. While the final maturity on these investments is greater than five (5) years, the return of principal and interest is received on a monthly basis (as mortgages are being paid, refinanced, and pre-paid), therefore minimizing the investment risk. At no point, will investments with maturities greater than five (5) years exceed 20% of the portfolio value.

16.0 Internal Control

The Treasurer or Finance Director shall establish a system of internal controls, which shall be documented in writing. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, and misrepresentation by third parties, unanticipated changes in financial markets or imprudent actions by employees and officers of the City. Controls deemed most important include: control of collusion, segregation of duties, separating transaction authority from accounting and recordkeeping, custodial safekeeping, clear delegation of authority, written confirmation of telephone transactions, minimizing the number of authorized investment officials, documentation of transactions and strategies, and code of ethical standards. In addition, whenever possible, pre-formatted wire transfers will be used to transfer funds to preauthorized accounts, and an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures.

17.0 Performance Standards

The investment portfolio shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with the City's investment risk constraints and its cash flow needs.

Market Yield (Benchmark): The City's investment strategy is passive. Passive investment portfolio management generally indicates that the Treasurer or Chief Fiscal Officer will purchase an instrument and hold it to maturity, and then reinvest the monies. Although the City's investment strategy is passive, this will not restrict the Treasurer or Chief Fiscal Officer from evaluating when swaps are appropriate or if the sale of an instrument is prudent prior to final maturity. Given this strategy, the basis used by the Treasurer or Chief Fiscal Officer to determine whether market yields are being achieved shall be the Local Agency Investment Fund (LAIF).

18.0 Reporting

The Treasurer or Finance Director will issue a quarterly report, for the City Manager's and the Council's review, of the City's current investment portfolio, detailing the investment instrument, the issuer's name, the purchase date, the maturity date, the purchase price, the face yield, the yield on cost, the face or par value, the current market value, and the source of the market value. While the report is prepared on a monthly basis, and available for review on request, it will only be formally presented quarterly. The report will state compliance of the portfolio to the statement of investment policy, or manner in which the portfolio is not in compliance. It will also include a description of funds, investment or programs that are under the management of contracted parties, and will include a statement denoting the ability of the City to meet its expenditure requirements for the next six months.

Periodically, the long-term investments will be reviewed in order to determine if it is advantageous to sell those securities and purchase others. The review will consider current market conditions

and various spread relationships among security types. Additionally, a statement will be issued indicating the findings of the analysis. The monitoring of the conditions set forth in this policy statement is the responsibility of the Treasurer or Finance Director and his/her delegate.

In accordance with Government Accounting Standard Board (GASB) Statement No. 31, "Accounting and Financial Reporting for Certain Investments", as of June 30th of each Fiscal Year the City will report all investments in excess of one year at market value. Any change in the value of the investments will be recognized on an annual basis, as part of interest income.

19.0 Investment Policy Adoption

The City's investment policy is required to be adopted by resolution. The policy shall be reviewed annually by staff to ensure that it is consistent with the objectives of preservation of principal, liquidity and yield, and its relevance to current law and financial and economic trends. The policy will be submitted to the City Council for review and approval of any modifications made thereto.

Exhibit “A”

City of Hercules Summary of Eligible Investments

Type of Issue	Original Maturities	Interest Payments	U.S. Gov’t. Guaranteed?
U.S. Treasury Bills	91 day and 182 day bills auctioned each Monday for settlement on Thursday.	Issued at a discount from par. Paid at maturity.	Yes
	52 week bills auctioned every fourth Thursday for settlement on the following Thursday.	Discount is based on the actual number of days on a 360 day basis. Paid at maturity.	
U.S. Treasury Notes	2 to 10 years.	Paid semi-annual based on the actual days in the month and half-year.	Yes
U.S. Treasury Bonds	10 to 30 years.	Paid semi-annual based on the actual days in the month and half-year.	Yes
Strips or Zeros	10 to 30 years.	Issued at a discount from par. Paid at maturity on a 30/360 day basis.	Yes
FFCB (Federal Farm Credit Bank)	6 and 9 month offered monthly.	Paid at maturity on a 30/360 day basis.	No
	Debentures are issued with 2 to 5 years maturities.	Paid semi-annually on a 30/360 day basis.	No
FHLB (Federal Home Loan Bank)	Bonds of maturities from 1 to 10 years.	Paid semi-annually on 30/360 day basis.	No
FHLMC (Federal Home Loan Mortgage Corporation)	30 year final with 12 year assumed average life.	Principal and interest paid monthly on a 30/360 day basis.	No
FNMA (Federal National Mortgage Association)	Discount notes are issued with maturities less than one year.	Issued at a discount from par. Paid at maturity on a 30/360 day basis.	No
	15 year and 30 year mortgage-backed securities with a 7 and 15 year assumed average life.	Principal and interest paid semi-annually on a 30/360 day basis.	No

Exhibit “A”

**City of Hercules
Summary of Eligible Investments**

Type of Issue	Original Maturities	Interest Payments	U.S. Gov’t. Guaranteed?
GNMA (Government National Mortgage Association)	Various maturities from 12 to 30 years with an assumed average life of 7 to 12 years.	Principal and interest paid monthly on a 30/360 day basis.	Yes
SBA(Small Business Administration)	Loans to Small Businesses. The principal portion of the loan is guaranteed by the SBA. 1 to 30 years.	Principal and interest paid monthly. On a 30/360 day basis. Can be a fixed or variable rate which is usually tied to prime rate.	No
CD (Certificate of Deposit)/Time Deposits	Normally 3 months to 2 years, but can go 5 years.	Paid monthly on an actual/360 day basis.	No
NCD (Negotiable Certificates of Deposit)	3 months to 5 years. Some issues have quarterly floating rates.	Paid semi-annually. Floaters pay quarterly.	No
BA Notes (Banker's Acceptance Notes)	30 to 180 days.	Issued at a discount from par. Paid at maturity.	No
Commercial Paper	Unsecured promissory note issued by finance and industrial companies to raise short term capital. Generally 30 to 270 days.	Can be interest bearing or a discounted note. If interest bearing, paid semi-annually. If discounted, paid at maturity.	No
MTN (Medium Term Notes)	2 to 5 years. Extended maturity commercial paper.	Paid semi-annually on a 30/360 day basis.	No
LAIF (Local Agency Investment Fund) State Pool	Funds are available on demand. Investments are restricted by Government Code, the same as the City is.	Paid quarterly.	No

Exhibit "A"

**City of Hercules
Summary of Eligible Investments**

Type of Issue	Original Maturities	Interest Payments	U.S. Gov't. Guaranteed?
Repurchase Agreements	Negotiated. A short term investment transaction with a contractual agreement to repurchase the same securities at a future date. In essence, the City loans the Bank money for a specified time collateralized by marketable securities. Terms are from 1 to 90 days.	Paid at maturity.	No
Reverse Repurchase Agreements	Negotiated. This transaction is the mirror image of the repurchase agreement. Instead of the City loaning the Bank money, the Bank loans the City funds. The City then "repurchases" securities with matched maturities to the end of the contract. Terms are from 1 to 90 days.	Paid at maturity.	No
Mutual Funds/ Money Market Mutual Funds	Funds are available on demand. Shares issued by a diversified management company.	Paid monthly.	No
Other Investment Pools	Funds are available on demand.	Paid quarterly.	No

GLOSSARY OF TERMS

AGENCIES: Federal agency securities

ASKED: Asked is the price at which securities are offered. See **BID** and **OFFER**.

ARBITRAGE: Transactions by which securities are bought and sold in different markets at the same time for the sake of the profit arising from a yield difference in the two markets.

BANKERS ACCEPTANCE (BA): A draft of bill or exchange by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer. In addition to the guarantee by the bank, the transaction is identified with a specific commodity. The sale of the underlying goods will generate the funds necessary to liquidate the indebtedness. BA's are usually created to finance the import and export of goods, the shipment of goods within the United States, and the storage of readily marketable staple commodities. BA's have the backing of both the bank and pledged commodities with no known principal loss in over 70 years.

BID: The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See **ASKED** and **OFFER**.

BOND PROCEEDS: The money paid to the issuer by the purchaser, or underwriter, of a new issue of municipal securities. These moneys are used to finance the project or purpose for which the securities were issued and to pay certain costs of issuance as may be provided for in the bond documents.

BROKER: A broker brings buyers and sellers together for a commission.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate, which is insured up to \$100,000 by FDIC. If a CD is liquidated before the specified period of time, there is a penalty

assessed, usually the forfeiture of interest earnings.

COLLATERAL/COLLATERALIZATION:

Securities, evidence of deposit or other property that a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

COMMERCIAL PAPER: An unsecured promissory note of Industrial corporations, utilities and bank holding companies. The notes are in bearer form and are backed by unused credit from major banks. There is a secondary market for commercial paper and an investor may sell them prior to maturity.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual financial report for the City of Hercules. It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, and a detailed Statistical Section.

COUPON: The annual rate of interest a bond's issuer promises to pay the bondholder on the bond's face value. It can also be a certificate attached to a bond evidencing interest due on a payment date.

CREDIT RISK: Defined as the risk of loss due to failure of the issuer of a security, and shall be mitigated by investing in investment grade securities and by diversifying the investment portfolio so that the failure of any one issuer does not unduly harm the City's capital base and cash flow.

CURRENT YIELD: The interest paid on an investment expressed as a percentage of the current price of the security.

CUTODY/CUSTODIAN: A banking service that provides safekeeping for the individual

securities in a customer's investment portfolio under a written agreement which also calls for the bank to collect and pay out income, to buy, sell, receive and deliver securities when ordered to do so by the customer.

DEALER: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his/her own account.

DEBENTURE: A bond secured only by the general credit of the issuer.

DEFEASED BOND ISSUE: These are debt issues that have sufficient money to retire outstanding debt when due so that the agency is released from the contracts and covenants in the bond documents.

DELIVERY VERSUS PAYMENT (DVP): There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

DERIVATIVES: Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying index or security, and may include a leveraging factor. Also can be financial contracts based upon notional amounts whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities or commodities).

DISCOUNT: The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Discount securities are non-interest bearing money market instruments that are issued at a

discount and redeemed at maturity for full face value, e.g. U.S. Treasury Bills.

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent returns.

FEDERAL CREDIT AGENCIES: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g., S&L's, small business firms, students, farmers, farm cooperatives, and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to \$100,000 per deposit.

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks) that lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The mission of the FHLB's is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

FEDERAL HOME LOAN MORTGAGE CORPORATION (FHLMC or Freddie Mac): Created in July of 1970 pursuant to the Federal Home Loan Mortgage Corporation Act, FHLMC is a publicly held government sponsored enterprise. Its mission is to provide stability in the secondary market for home mortgages, to respond appropriately to the private capital market, and to provide ongoing assistance to the secondary market for home mortgages by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for home mortgage financing.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA or Fannie Mae):

FNMA, like GNMA, was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC):

Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market and a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, DC, 12 regional banks and about 5,700 commercial banks that are members of the system.

GENERALLY ACCEPTED ACCOUNTING PRINCIPALS (GAAP):

GAAP are the standards established by the National Council on Governmental Accounting which establishes the *minimum* requirements for a fair presentation of financial data in external financial reports. GAAP also assures a degree of comparability in financial reporting among different governments.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB):

The accounting standards body, associated with the Financial Accounting Foundation (FAF), which prescribes standard accounting practices for governmental units.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae):

Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. The security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FMHM mortgages. The term "passthroughs" is often used to describe Ginnie Mae's.

INTEREST RATE: The annual yield earned on an investment, expressed as a percentage.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow, and reasonable size can be done at those quotes.

LOCAL AGENCY INVESTMENT FUND:

The Local Agency Investment Fund (LAIF) was established by the State of California to enable local agency treasurer or chief fiscal officers to place idle funds in a pool for investments. The LAIF has been particularly beneficial to those jurisdictions with small portfolios. Each account is limited to an investment of \$40.0 million. Bond proceeds accounts are limited to the amount of the proceeds from a specific debt issue. Funds placed in regular accounts have same day liquidity while funds placed in bond proceed accounts have 30-day liquidity.

LOCAL GOVERNMENT INVESTMENT POOLS:

These are investment pools that range from LAIF to County pools to Joint Power Investment Authorities (JPIA's). The

funds invested in these pools are not subject to the same SEC rules applicable to money market mutual funds.

MARKET RISK: Defined as market value fluctuation due to overall changes in the general level of interest rates, and shall be mitigated by limiting the maximum maturity of any one security to five years, structuring the portfolio based on historic and current cash flow analysis thereby eliminating the need to sell securities prior to maturity, and avoiding the purchase of long term securities for the sole purpose of short term speculation.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold at a particular point in time.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase—reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date upon which the principal or stated value of an investment becomes due and payable.

MEDIUM TERM NOTES (MTN): Unsecured promissory notes issued by corporations operating in the United States.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

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

NEGOTIABLE CERTIFICATES OF DEPOSIT (NCD): Negotiable CD's are

issued at a specific rate for a specified period of time and are insured up to \$100,000 by the FDIC. A Negotiable CD can be bought and sold any time during its life at whatever price the market is willing to pay.

NOTE: A written promise to pay a specified amount to a certain entity on demand or on a specified date.

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See **ASKED** and **BID**.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

PAR VALUE: The amount of principal that must be paid at maturity. It is also referred to as the face amount of a bond.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

PRINCIPAL: The face value or par value of a debt instrument, or the amount of capital invested in a given security.

PROSPECTUS/OFFICIAL STATEMENT: A legal document that must be provided to any prospective purchaser of a new security

offering registered with the SEC, which typically includes information on the issuer, the issuer's business, the proposed use of proceeds, the experience of the issuer's management, and certain certified financial statements.

PRUDENT PERSON RULE OR STANDARD:

An investment standard of conduct where a person acts with care, skill, prudence, and diligence when investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing funds. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state--the so-called legal list. In other states the trustee may invest in a security if it is one that would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

PURCHASE DATE: The date in which a security is purchased for settlement either on that or a later date.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad-valorem taxes under the laws of this state, which has segregated, for the benefit of the commission, eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond the current income return.

REPURCHASE AGREEMENT (REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and

the terms of the agreement are structured to compensate him for this. Dealers use Repos extensively to finance their positions. Exception: When the Fed is said to be doing Repos, it is lending money, increasing bank reserves.

REVERSE REPURCHASE AGREEMENT (REVERSE REPO):

Technically called matched sales-purchase agreements, reverse repos are essentially the mirror image of a repo. The investor is the owner of the collateral, and the bank or dealer is the lender of money. All other aspects remain identical. The investor must arbitrage or re-invest the money received on the transaction into another security for a positive return. The new investment must be secure from default, yet of lesser quality to create a spread. Furthermore, the new investment must mature coincidentally with the Reverse Transaction, or a cash shortage may occur.

SAFEKEEPING: A service to customers provided by institutions for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection. The institution serves as an agent, custodian or trustee.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES AND EXCHANGE

COMMISSION (SEC): Agency created by Congress to protect investors in securities transactions by administering securities legislation.

SEC RULE 15C3-1: See Uniform Net Capital Rule below.

STRUCTURED NOTES: These are notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and corporations that have imbedded options (e.g. call features, step-up coupons, floating rate coupons, or 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.

STUDENT LOAN MARKETING ASSOCIATION (SLMA or Sallie Mae): A publicly traded stock corporation that guarantees student loans traded in the secondary market. It was established by federal decree in 1972 to increase availability education loans to college and university students made under the federally sponsored Guaranteed Student Loan Program and the Health, Education Assistance Loan Program. Known as Sallie Mae, it purchases student loans from originating financial institutions and provides financing to state student loan agencies. It also sells short and medium term notes.

TREASURY BILLS (T-BILLS): A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, and one year.

TREASURY BONDS: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of 10 years or more.

TREASURY NOTES: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

TRUSTEE, TRUST COMPANY, OR TRUST DEPARTMENT OF A BANK: A financial institution with trust powers, which acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond documents. Trust departments also provide custodial/safekeeping services.

UNDERWRITER: A dealer who purchases a new issue of municipal securities for resale.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission requirement that

member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

UNITED STATES GOVERNMENT AGENCIES (AGENCIES): Instruments issued by various United States Government Agencies most of which are secured only by the credit worthiness of the particular agency.

UNITED STATES TREASURY SECURITIES (TREASURIES): These are direct obligations of the United States Government issued by the Treasury via an auction process. These issues include 1, 2, 3, 5 and 10-year notes and 10 - 30 year bond issues. The auctions occur monthly, mid-quarterly, and quarterly.

WEIGHTED AVERAGE MATURITY: This is the average maturity of all of the securities that comprise a portfolio that is typically expressed in days or years.

YIELD: The rate of annual income return on an investment, expressed as a percentage. INCOME YIELD is obtained by dividing the current dollar income by the current market price for the security. NET YIELD or YIELD TO MATURITY is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

YIELD CURVE: A graphic representation that shows the relationship, at a given point in time, between yields and maturity for bonds that are identical in every aspect except maturity.