



**CITY of NOVI CITY COUNCIL**

**Agenda Item B  
December 17, 2007**

**SUBJECT:** Approval of the revised *City of Novi Investment Policy* (to update List of Approved Financial Institutions) and the *Statement of Investment Policy, Objectives and Guidelines of the City of Novi Retiree Health Care Fund*

**SUBMITTING DEPARTMENT:** Finance/Treasury *650*

**CITY MANAGER APPROVAL:** *[Signature]*

Attached is the revised *City of Novi Investment Policy*. Please see page 15 for additions/deletions under List of Approved Financial Institutions.

We also are recommending your approval of the revisions to the attached *Statement of Investment Policy, Objectives and Guidelines of the City of Novi Retiree Health Care Fund*. This policy provides structure and guidance to the City administrative staff as well as the investment managers. The changes include updating the Actuary Information as well as the Asset Allocation Guidelines.

**RECOMMENDED ACTION:** Approval of the revised *City of Novi Investment Policy* (to update List of Approved Financial Institutions) and the *Statement of Investment Policy, Objectives and Guidelines of the City of Novi Retiree Health Care Fund*

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

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

## City of Novi

Oakland County  
MICHIGAN

# INVESTMENT POLICY

### 1.0 POLICY:

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

### 2.0 SCOPE:

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

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

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

### 3.0 PRUDENCE:

The standard of prudence to be applied by the investment officer shall be the "prudent person" rule which states; "Investments shall be made with judgment and care - under circumstances then prevailing - which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived." The prudent person rule shall be applied in the context of managing the overall portfolio. Investment officers acting in accordance with written procedures and exercising

due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price change, provided deviations from expectations are reported to the chief financial officer in a timely fashion and appropriate action is taken to control adverse developments.

#### 4.0 ETHICS AND CONFLICT OF INTEREST:

Officers and employees involved in the investment process shall refrain from personal business activity that would conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of the City of Novi.

#### 5.0 OBJECTIVES:

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

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

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

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

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

E) Maintain the Public's Trust - All participants in the investment process shall seek to act responsibly as custodians of the public trust. Investment officials shall recognize that the investment portfolio is subject to public review and evaluation. In addition, the overall investment program shall be designed and managed with a degree of professionalism worthy of the public trust. Investment officials shall also avoid any transaction that might knowingly impair public confidence in the City of Novi's ability to govern effectively. Investment officers should have sufficient knowledge of financial markets and investment

management, and should not be delegated to persons without proper credentials. Minimum credentials should include a four-year degree in finance or related area by an accredited college or university.

#### 6.0 DELEGATION OF AUTHORITY:

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

#### 7.0 QUALIFIED INSTITUTIONS:

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

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

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

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

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

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

## 8.0 INSTRUMENTS:

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

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

- (d) Investment pools organized under the surplus funds investment pool act, 1982 PA 367, 129.111 to 129.118.
  - (e) Obligations described in (a) through (g) if purchased through an interlocal agreement under the urban cooperation act of 1967, 1967(Ex Sess) P.A. 7, MCL 124.501 to 124.512.
- (G) The investment of Retiree Health Care funds pursuant to Act 149 PA 1999, as allowed under Section 13 of Public Act 314, in assets that are generally permissible for the investment of pension funds. This would include investments in equities and other financial instruments that provide historically higher returns in exchange for an increase in investment risk. Investment risk is defined here as risk in capital market fluctuating (loss of value), risk in investment return (fluctuations in income producing products), and the possible loss of capital (underlying assets becoming worthless).

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

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

- (A) Obligations of this state or any of its political subdivisions that at the time of purchase are rated as investment grade by not less than 1 standard rating service.
- (B) The investment pools organized under the local government investment pool act, 1985 PA 121, MCL 129.141 to 129.150.

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

## 9.0 INVESTMENT POOLS

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

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

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

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

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

#### 11.0 DIVERSIFICATION:

It is the objective of the City of Novi to diversify its investment portfolios. Assets held in the common cash fund and other investment funds shall be diversified to eliminate the risk of



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

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

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

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

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

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

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

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

#### 13.0 INTERNAL CONTROLS:

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

#### 14.0 PERFORMANCE STANDARDS:

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

#### 15.0 INVESTMENT PROCEDURES

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

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

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

#### 16.0 REPORTING REQUIREMENTS:

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

Schedules will include a listing of securities currently held at the end of the reporting period, final maturity of each investment, earnings rate by security, book value, amortized value

and market value if applicable, and percentage of portfolio by security type. Also included will be the average weighted days to maturity of the entire portfolio that will be used as the comparison against the established benchmark.

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

#### 17.0 GLOSSARY OF TERMS

Please see Appendix A

#### 18.0 EFFECTIVE DATE:

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

## Appendix A

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

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

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

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

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

**List of Approved Financial Institutions**

**Banks:**

Chase  
National City Bank  
LaSalle Bank/Bank of America  
Comerica Bank  
TCF  
~~Republic Bank~~  
Charter One Bank  
Fifth Third Bank  
Flagstar Bank  
Huntington Bank  
Citizens Republic Bank (formally know as Citizens Bank)  
Franklin Bank  
Macomb Community Bank  
Mercantile Bank of ~~West~~ Michigan  
The Private Bank  
MetrobankCitizens First (formally known as Metrobank)  
Michigan Heritage

**Other Financial Service Institutions**

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



| Redline Version as of December 17, 2007

**STATEMENT OF INVESTMENT POLICY,  
OBJECTIVES & GUIDELINES**

**Of the**

**CITY OF NOVI  
RETIREMENT HEALTH CARE FUND**

# Statement of Investment Policy, Objectives, and Guidelines City of Novi, Retiree Health Care Fund

## A. GENERAL INFORMATION

The City of Novi Retiree Health Care Fund was established to provide for the retirement health care benefits for covered retirees and their beneficiaries. The Fund is financed by contributions from the City and investment earnings. Distributions from the Fund are to pay for the medical insurance premiums and for investment and administrative expenses.

|                      |       |   |
|----------------------|-------|---|
| Federal Tax ID#      | ..... | 38-6032551  |
| Fund Fiscal Year End | ..... | June 30 <sup>th</sup>   |
| Primary Contacts     | ..... | Kathy Smith-Roy, Finance Director/Treasurer<br>Beverly Valente, Assistant Treasurer |

## B. SCOPE OF THIS INVESTMENT POLICY

This statement reflects the investment policy, objectives and guidelines ("Investment Policies"), which the City of Novi (City Council and Administration) currently considers appropriate for the City of Novi Retiree Health Care Fund.

## C. PURPOSE OF THIS INVESTMENT POLICY STATEMENT

This statement of Investment Policies is set in order to:

- Establish a long-term strategic investment plan for the Fund. Including, but not limited to, evaluating the City's risk tolerance and determining a long-term asset allocation policy consistent with the long-term investment objectives, financial needs and circumstances of the Fund and the City.
- Define and assign the responsibilities of all involved parties.
- Establish a clear understanding for all involved parties of the investment goals and objectives of the City of Novi Retiree Health Care Fund assets.
- Offer guidance and limitations to all Investment Managers regarding the investment of City of Novi Retiree Health Care Fund assets.
- To monitor and evaluate the performance of the Fund's assets as a whole and each investment manager.
- Manage City of Novi Retiree Health Care Fund assets according to prudent standards as described herein under the "General Investment Policy."

This document will identify and present a set of Investment Policies which will serve to provide guidance to any Investment Management Consultant(s) and/or Investment Manager(s). The policy is intended to be sufficiently specific to be meaningful, yet flexible enough to be practical. This document is intended to supplement the *City of Novi Investment Policy*, and provide additional guidance for the management of the investments of the City of Novi Retiree Health Care Fund.

#### **D. ACTUARIAL INFORMATION**

The following information has been provided by Gabriel, Roeder, Smith and Company, and is published in the ~~June 30, 2002~~ July 1, 2007 Actuarial Report:

|                                     |                               |
|-------------------------------------|-------------------------------|
| Actuarial valuation of assets:      | <u>\$2,829,0127,992,415</u>   |
| Actuarial valuation of liabilities: | <u>\$48,392,00318,829,286</u> |
| Funded ratio:                       | <u>1542.4%</u>                |
| Actuarial discount rate:            | 8%                            |
| Number of active employees:         | 245                           |
| Number of retired participants:     | <u>3343</u>                   |

#### **E. RESPONSIBILITIES OF INVESTMENT MANAGERS**

*The City intends to utilize separately managed accounts with various investment management firms, however mutual or other commingled funds may be used from time to time to implement the investment strategy of the Fund, where practical. For mutual and other commingled funds, the prospectus or Declaration of Trust documents of the fund(s) will govern the investment policies of fund investments.*

##### **Fiduciary Responsibilities**

Each investment manager is expected to manage the Fund's assets in a manner consistent with the investment objectives, guidelines and constraints outlined in this statement and in accordance with applicable laws. This would include discharging responsibilities with respect to the Fund consistent with "Prudent Investor" standards, and all other fiduciary responsibility provisions and regulations. The Fund's assets will be managed by experienced investment management firms.

Each investment manager shall:

- Obtain and maintain bonds and other surety agreements sufficient in amount to comply with all applicable laws and to protect the interests of the City. The investment manager shall provide proof of such insurance and amounts of coverage to the City's Treasurer's Department on an annual basis;
- At all times be registered as an investment advisor under the Investment Advisers Act of 1940 (where applicable); and
- Acknowledge in writing that they are a fiduciary with respect to the assets they manage.

### **Security Selection/Asset Allocation**

- Except as noted below, each investment manager shall have the discretion to determine their portfolio's individual security selections;
- Each investment manager has been delegated responsibility for establishing and maintaining the asset allocation strategy for their individual portfolio. It is expected however, that each investment manager will utilize a stable asset allocation strategy and not engage in market-timing asset allocation decisions. The performance of each investment manager is measured versus a fully invested market index, or combination of market indexes, representative of the investment manager's investment style, asset allocation and risk level;
- The asset allocation strategy for each investment manager's portfolio can deviate from the overall Fund's asset allocation, however, the City's Treasury Department is responsible for monitoring the aggregate asset allocation, and may re-balance to the target allocation on a periodic basis.

### **Proxy Voting**

Each investment manager is responsible and empowered to exercise all rights, including voting rights, as are required through the purchase of securities, where practical. Each investment manager shall vote proxies according to their established Proxy Voting Guidelines. A copy of those guidelines, and/or a summary of proxy votes shall be provided to the City upon request. The City's Treasury Department is responsible for voting any proxies received from Investment Companies retained in the Fund and for any other "Self-Directed" investments.

### **F. INVESTMENT MANAGEMENT OBJECTIVES**

The priority listing of investment objectives is as follows:

1. Preservation of Capital - Consistent with their respective investment styles and philosophies, investment managers should make reasonable efforts to preserve capital, understanding that losses may occur in individual securities.
2. Risk Aversion - Understanding that risk is present in all types of securities and investment styles, the City recognizes that some risk is necessary to produce long-term investment results that are sufficient to meet the City of Novi Retiree Health Care Fund's objectives. However, the investment managers are to make reasonable efforts to control risk, and will be evaluated regularly to ensure that the risk assumed is commensurate with the given investment style and objectives.

3. Diversification of Assets – Investments of the City of Novi Retiree Health Care Fund shall be so diversified as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.
4. Liquidity of Assets – Cash is to be employed productively at all times, by investment of short term cash equivalents to provide safety, liquidity, return, and restructuring of the City of Novi Retiree Health Care Fund portfolio to meet the City of Novi Retiree Health Care Fund's changing needs over time.
5. Adherence to Investment Discipline - Investment managers are expected to adhere to the investment management styles for which they were hired. Investment managers will be evaluated regularly for adherence to investment discipline.

## G. INVESTMENT RETURN OBJECTIVES

In order to meet its obligations, the investment objective of the City of Novi Retiree Health Care Fund is to emphasize total return; that is, the aggregate return from capital appreciation and dividend and interest income.

The *primary* investment return objective shall be:

**Long-Term Growth of Capital** – To emphasize long-term growth of principal while avoiding excessive risk. Short-term volatility will be tolerated inasmuch as it is consistent with the volatility of a comparable market index.

The *secondary* investment return objective shall be:

**Income and Growth** - To achieve a balanced return of current income and modest growth of principal.

## H. Performance Objectives

The City's Treasurers Department will monitor the performance of the fund. The City's Treasurers Department will evaluate each investment manager's contribution toward meeting the investment objectives outlined below over a three-to-five-year time period and a full market cycle, unless otherwise noted.

**Style Index:** Over a given market cycle, (typically defined as 3 to 5 years), the time weighted total rate of investment return should exceed, for the total fund, an appropriately designed custom benchmark. The custom benchmark is based on the fund's and investment manager's investment style, actual asset allocations, and constructed with appropriate indices given the asset mix (i.e. 20% Russell 1000 Growth Index, 20% Russell 1000 Value Index, 5% Russell 2000 Growth Index, 5% Russell 2000 Value Index, 3% S&P 500 Index, 3% S&P 400 index, 40% LB Agg Bond Index, 2% REIT Index, 1% PSCI Index, 1% 90 Day T-Bill.)

**Secondary Performance Targets:**

1. The real return goal (return after adjusting for inflation) for the Fund assets is **3.0%**. Inflation shall be measured by the U.S. All Urban Consumers Price Index ("CPI"); and
2. The Fund is expected to outpace the style index return measured on a compound average annual return basis after the deduction of investment management fees and annualized over a three-to-five-year rolling time period and a full market cycle.

**I. Risk Tolerance**

Investment theory and historical capital market return data suggests that, over long periods of time, there is a relationship between the level of risk assumed and the level of return that can be expected in an investment program. In general, higher risk (i.e. volatility of return) is associated with higher return.

Given this relationship between risk and return, a fundamental step in determining the investment policy for the Fund is the determination of an appropriate risk tolerance. The Investment Committee examined two important factors that affect the City's risk tolerance:

**Financial Ability** to accept risk within the investment program and,

**Willingness** to accept return volatility.

Positive factors that contribute to a higher risk tolerance are:

- The financial strength of the City provides the ability to withstand some uncertainty in changes in funding cost of the Fund;
- Contributions to the Fund are determined during the budget process based on recommended actuary percentages of payroll, and other financial considerations, and thus are generally known in advance and stable from year-to-year;
- The City's willingness to accept short-term volatility in the market value of the Fund and in the funding ratio for the sake of earning higher long-term returns; and
- The long-term time horizon available for investment provides the opportunity to benefit from the opportunities for growth that may accrue to a patient investment strategy.

Offsetting these factors are:

- The cash flow requirements of the Fund are on-going, thus requiring the Fund to maintain sufficient liquidity to finance required distributions;
- The medical cost inflation rate has historically been significantly higher and more volatile than the overall inflation rate of the US economy. This implies greater uncertainty in future costs of this Fund; and
- Cyclical economic activity can significantly influence the finances of the City and its financial ability to fund large unexpected contributions.

**J. INVESTMENT GUIDELINES**

**1. Permitted Securities**

(a). Cash Equivalents

- ◆ Treasury Bills
- ◆ Money Market Funds
- ◆ STIF Funds
- ◆ Commercial Paper
- ◆ Banker's Acceptances
- ◆ Repurchase Agreements
- ◆ Certificates of Deposit

(b). Fixed Income Securities

- ◆ U.S. Government and Agency Securities
- ◆ Corporate Notes and Bonds
- ◆ Mortgage Backed Bonds
- ◆ Fixed Income Securities of Foreign Governments and Corporations
- ◆ Convertible Notes and Bonds

(c). Equity Securities

- ◆ Common Stocks
- ◆ American Depository Receipts (ADRs) of Non-U.S. Companies
- ◆ Stocks of Non-U.S. Companies (Ordinary Shares)
- ◆ Preferred Stock
- ◆ Convertible Preferred Stocks

(d). Other Assets

- ◆ Mutual Funds, which invest in securities as allowed in this document.
- ◆ Real Estate Securities (i.e. equity REITs, mortgage REITs, CMO or mortgage-related securities REITs, Health Care REITs, and equities of real estate operating companies)
- ◆ International Securities

## 2. Asset Allocation Guidelines

In line with the return objectives and risk parameters of the Fund, the mix of assets should be generally maintained as follows (percentages are of the market value of the Fund):

|   | <u>Minimum</u> | <u>Maximum</u> | <u>Target</u> |
|---|----------------|----------------|---------------|
| <b>Domestic Large/Medium Cap Equities: 30% to 55%</b> |                |                |               |
| Domestic Large Cap Equities (growth & value)          | 30%            | 55%            | 40-50%        |
| <b>Domestic Small/Medium Cap Equities: 5% to 30%</b>  |                |                |               |
| Domestic Small/Mid Cap Equities (growth & value)      | 5%             | 20%            | 10-15%        |
| International Equity                                  | 5%             | 15%            | 5-10%         |
| <b>Total Equity</b>                                   | <b>50%</b>     | <b>70%</b>     | <b>60%</b>    |
| <u>Real Estate</u>                                    | <u>0%</u>      | <u>5%</u>      | <u>2-5%</u>   |
| Investment Grade Fixed Income                         | 20%            | 30%            | 25-30%        |
| Cash/Cash Equivalents                                 | 5%             | 15%            | 10%           |

After giving consideration to the City of Novi Retiree Health Care Fund's potential short-term liquidity requirements, the City of Novi Retiree Health Care Fund shall maintain no more than a maximum of 10% of total assets in cash or cash equivalents.

### **3. Diversification Requirements**

To minimize the risk of large losses, each investment manager shall maintain adequate diversification in their portfolio. Subject to the constraints outlined in this policy, each investment manager shall have the discretion to determine their portfolio's individual security selections.

In order to achieve a prudent level of portfolio diversification, the securities of any one company should not exceed 5% of the total fund, and no more than 20% of the total fund should be invested in any one industry. The total allocation to treasury bonds and notes may represent up to 100% of the City of Novi Retiree Health Care Fund's aggregate bond position and treasury securities may represent up to 60% of the total fund.

### **4. Prohibited Transactions**

Prohibited transactions include those identified at Michigan Compiled Laws 38.1133(5) and those specifically identified below:

Short Selling  
Margin Transactions  
Agency Cross Trades

## **K. PROCEDURAL GUIDELINES**

1. The Investment Manager will:
  - a) Provide monthly portfolio appraisals including the market value and cost of all assets as well as the estimated annual level of interest and dividend income.
  - b) Meet periodically, at not less than once each year with the City of Novi staff to review the portfolio under supervision, discuss the investment outlook for the economy and securities markets, and indicate anticipated portfolio changes.
  - c) Provide written information of security transactions.
2. The City of Novi will notify the Investment Manager of:
  - a) Any changes in the Investment Policies and procedures noted above.
  - b) Provide information regarding significant anticipated changes in cash flow and/or cash flow needs.



## L. INVESTMENT MANAGER PERFORMANCE REVIEW AND EVALUATION

The investment performance of total portfolios, as well as asset class components, will be measured against commonly accepted performance benchmarks. Consideration shall be given to the extent to which the investment results are consistent with the Investment Policies. The City intends to evaluate the portfolio(s) over at least a three-year period, but reserves the right to terminate an Investment Manager for any reason including, without limitation, the following:

1. Investment performance, which is significantly less than anticipated given the discipline employed, and the risk parameters established, or unacceptable justification of poor results.
2. Failure to adhere to any aspect of these Investment Policies, including communication and reporting requirements as well as their investment management agreement.
3. Significant qualitative or quantitative changes to the Investment Manager's organization.

Investment managers shall be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative or quantitative factors that may impact their ability to achieve the desired investment results in conformance with these Investment Policies.

| *Approved by the Novi City Council on:* September 12, 2005 December 17, 2007

**Clean Version for December 17, 2007**

**STATEMENT OF INVESTMENT POLICY,  
OBJECTIVES & GUIDELINES**

**Of the**

**CITY OF NOVI  
RETIREMENT HEALTH CARE FUND**

# Statement of Investment Policy, Objectives, and Guidelines City of Novi, Retiree Health Care Fund

## A. GENERAL INFORMATION

The City of Novi Retiree Health Care Fund was established to provide for the retirement health care benefits for covered retirees and their beneficiaries. The Fund is financed by contributions from the City and investment earnings. Distributions from the Fund are to pay for the medical insurance premiums and for investment and administrative expenses.

Federal Tax ID# ..... 38-6032551  
Fund Fiscal Year End ..... June 30<sup>th</sup>  
Primary Contacts ..... Kathy Smith-Roy, Finance Director/Treasurer  
Beverly Valente, Assistant Treasurer

## B. SCOPE OF THIS INVESTMENT POLICY

This statement reflects the investment policy, objectives and guidelines ("Investment Policies"), which the City of Novi (City Council and Administration) currently considers appropriate for the City of Novi Retiree Health Care Fund.

## C. PURPOSE OF THIS INVESTMENT POLICY STATEMENT

This statement of Investment Policies is set in order to:

- Establish a long-term strategic investment plan for the Fund. Including, but not limited to, evaluating the City's risk tolerance and determining a long-term asset allocation policy consistent with the long-term investment objectives, financial needs and circumstances of the Fund and the City.
- Define and assign the responsibilities of all involved parties.
- Establish a clear understanding for all involved parties of the investment goals and objectives of the City of Novi Retiree Health Care Fund assets.
- Offer guidance and limitations to all Investment Managers regarding the investment of City of Novi Retiree Health Care Fund assets.
- To monitor and evaluate the performance of the Fund's assets as a whole and each investment manager.
- Manage City of Novi Retiree Health Care Fund assets according to prudent standards as described herein under the "General Investment Policy."

This document will identify and present a set of Investment Policies which will serve to provide guidance to any Investment Management Consultant(s) and/or Investment Manager(s). The policy is intended to be sufficiently specific to be meaningful, yet flexible enough to be practical. This document is intended to supplement the *City of Novi Investment Policy*, and provide additional guidance for the management of the investments of the City of Novi Retiree Health Care Fund.

#### **D. ACTUARIAL INFORMATION**

The following information has been provided by Gabriel, Roeder, Smith and Company, and is published in the July 1, 2007 Actuarial Report:

|                                     |              |
|-------------------------------------|--------------|
| Actuarial valuation of assets:      | \$7,992,415  |
| Actuarial valuation of liabilities: | \$18,829,286 |
| Funded ratio:                       | 42.4%        |
| Actuarial discount rate:            | 8%           |
| Number of active employees:         | 245          |
| Number of retired participants:     | 43           |

#### **E. RESPONSIBILITIES OF INVESTMENT MANAGERS**

*The City intends to utilize separately managed accounts with various investment management firms, however mutual or other commingled funds may be used from time to time to implement the investment strategy of the Fund, where practical. For mutual and other commingled funds, the prospectus or Declaration of Trust documents of the fund(s) will govern the investment policies of fund investments.*

##### **Fiduciary Responsibilities**

Each investment manager is expected to manage the Fund's assets in a manner consistent with the investment objectives, guidelines and constraints outlined in this statement and in accordance with applicable laws. This would include discharging responsibilities with respect to the Fund consistent with "Prudent Investor" standards, and all other fiduciary responsibility provisions and regulations. The Fund's assets will be managed by experienced investment management firms.

Each investment manager shall:

- Obtain and maintain bonds and other surety agreements sufficient in amount to comply with all applicable laws and to protect the interests of the City. The investment manager shall provide proof of such insurance and amounts of coverage to the City's Treasurer's Department on an annual basis;
- At all times be registered as an investment advisor under the Investment Advisers Act of 1940 (where applicable); and
- Acknowledge in writing that they are a fiduciary with respect to the assets they manage.

### **Security Selection/Asset Allocation**

- Except as noted below, each investment manager shall have the discretion to determine their portfolio's individual security selections;
- Each investment manager has been delegated responsibility for establishing and maintaining the asset allocation strategy for their individual portfolio. It is expected however, that each investment manager will utilize a stable asset allocation strategy and not engage in market-timing asset allocation decisions. The performance of each investment manager is measured versus a fully invested market index, or combination of market indexes, representative of the investment manager's investment style, asset allocation and risk level;
- The asset allocation strategy for each investment manager's portfolio can deviate from the overall Fund's asset allocation, however, the City's Treasury Department is responsible for monitoring the aggregate asset allocation, and may re-balance to the target allocation on a periodic basis.

### **Proxy Voting**

Each investment manager is responsible and empowered to exercise all rights, including voting rights, as are required through the purchase of securities, where practical. Each investment manager shall vote proxies according to their established Proxy Voting Guidelines. A copy of those guidelines, and/or a summary of proxy votes shall be provided to the City upon request. The City's Treasury Department is responsible for voting any proxies received from Investment Companies retained in the Fund and for any other "Self-Directed" investments.

## **F. INVESTMENT MANAGEMENT OBJECTIVES**

The priority listing of investment objectives is as follows:

1. Preservation of Capital - Consistent with their respective investment styles and philosophies, investment managers should make reasonable efforts to preserve capital, understanding that losses may occur in individual securities.
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In order to meet its obligations, the investment objective of the City of Novi Retiree Health Care Fund is to emphasize total return; that is, the aggregate return from capital appreciation and dividend and interest income.

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### **Secondary Performance Targets:**

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2. The Fund is expected to outpace the style index return measured on a compound average annual return basis after the deduction of investment management fees and annualized over a three-to-five-year rolling time period and a full market cycle.

## **I. Risk Tolerance**

Investment theory and historical capital market return data suggests that, over long periods of time, there is a relationship between the level of risk assumed and the level of return that can be expected in an investment program. In general, higher risk (i.e. volatility of return) is associated with higher return.

Given this relationship between risk and return, a fundamental step in determining the investment policy for the Fund is the determination of an appropriate risk tolerance. The Investment Committee examined two important factors that affect the City's risk tolerance:

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**Willingness** to accept return volatility.

Positive factors that contribute to a higher risk tolerance are:

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- Contributions to the Fund are determined during the budget process based on recommended actuary percentages of payroll, and other financial considerations, and thus are generally known in advance and stable from year-to-year;
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## **J. INVESTMENT GUIDELINES**

### **1. Permitted Securities**

#### **(a). Cash Equivalents**

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## 2. Asset Allocation Guidelines

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| Investment Grade Fixed Income                         | 20%            | 30%            | 25-30%        |
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### **4. Prohibited Transactions**

Prohibited transactions include those identified at Michigan Compiled Laws 38.1133(5) and those specifically identified below:

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Margin Transactions  
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## **K. PROCEDURAL GUIDELINES**

### **1. The Investment Manager will:**

- a) Provide monthly portfolio appraisals including the market value and cost of all assets as well as the estimated annual level of interest and dividend income.
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- a) Any changes in the Investment Policies and procedures noted above.
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## L. INVESTMENT MANAGER PERFORMANCE REVIEW AND EVALUATION

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2. Failure to adhere to any aspect of these Investment Policies, including communication and reporting requirements as well as their investment management agreement.
3. Significant qualitative or quantitative changes to the Investment Manager's organization.

Investment managers shall be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative or quantitative factors that may impact their ability to achieve the desired investment results in conformance with these Investment Policies.

*Approved by the Novi City Council on:* \_\_\_\_\_ December 17, 2007 \_\_\_\_\_