

CITY OF DENTON

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SECTION: FINANCE POLICIES	REFERENCE NUMBER: 403.06
SUBJECT: INVESTMENTS	INITIAL EFFECTIVE DATE: 02/17/1987
TITLE: INVESTMENT POLICY	REVISION DATE: 11/7/2017 11/4/2016

I. PURPOSE

It is the objective of the City of Denton to invest public funds in a manner which will provide maximum security and the best commensurate yield while meeting the daily cash flow demands of the City and conforming to all federal, state, and local statutes, rules, and regulations governing the investment of public funds. This Policy serves to satisfy the statutory requirements of defining and adopting a formal investment policy. The Policy and investment strategies shall be reviewed annually by the Audit/Finance Committee and City Council who will formally approve any modifications. This Investment Policy, as approved, is in compliance with the provisions of the Public Funds Investment Act of Tex. Gov't. Code Chapter 2256.

II. SCOPE

- A. This Investment Policy applies to the investment activities of the City of Denton, Texas. The specific funds cited hereafter in Section II(D), shall be excluded from this Investment Policy. All financial assets of all funds, including the General Fund and any other accounts of the City not specifically excluded in these policy guidelines are included. These funds are accounted for in the City's Comprehensive Annual Financial Report (CAFR). These funds, as well as others that may be created from time-to-time, shall be administered in accordance with the provisions of this Policy. All funds will be pooled for investment purposes except for those listed under Section II(C).

In addition to this Policy, the investment of bond proceeds and other bond funds (including debt service and reserve funds) shall be governed and controlled by their governing ordinance and by the provisions of the Tax Reform Act of 1986, including all regulations and rulings promulgated there under applicable to the issuance of tax-exempt obligations.

- B. Funds covered by this Policy and managed as a pooled fund group:
1. General Fund - used to account for resources traditionally associated with government, which are not required to be accounted for in another fund.
 2. Special Revenue Funds – used to account for the proceeds from specific revenue sources which are restricted or committed to expenditures for specific purposes other than debt service or capital projects.
 3. Debt Service Fund used to account for resources to be used for the payment of principal, interest and related costs on general obligation debt.
 4. Capital Project Funds – used to account for resources to enable the acquisition or construction of major capital facilities which are not financed by enterprise funds, internal service funds, or trust funds.

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5. Enterprise Funds – used to account for operations that are financed and operated in a manner similar to private business enterprises.
 6. Internal Service Funds – used to account for the cost of providing goods or services between City departments.
 7. Trust and Agency Funds – used to account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, other governments, and/or other funds.
 8. Bond Reserve Funds – funds set at prescribed levels by certain bond ordinances to pay principal and/or interest if required to prevent default.
 9. New funds available for investment by the City, such as (but not limited to) resources associated with Public Improvement Districts or Tax Increment Financing zones, unless specifically excluded herein.
- C. Funds covered by this Policy and managed as separately invested assets:
1. Bond Funds – funds established with the proceeds from specific bond issues when it is determined that segregating these funds from the pooled funds’ portfolio will result in maximum interest earning retention under the provisions of the Tax Reform Act of 1986.
 2. Endowment Funds – funds given to the City with the instructions that the principal is to remain intact, unless otherwise agreed to, and the income generated by the investments will be used for specified purposes.
 3. Trust, Escrowed Funds & Security Deposits – funds held outside the City by a trust, escrow agent, or other entity but belonging to the City.
- D. This Policy shall not govern funds, which are managed under separate investment programs in accordance with the Tex. Gov’t. Code Sec. 2256.004. Such programs currently include all funds related to employee retirement programs, other funds established by the City for deferred employee compensation, and certain private donations. The City shall and will maintain responsibility for these funds to the extent required by federal and state law, the City Charter, and donor stipulations. This Policy also does not apply to monies held in escrow to retire bonds which are subject to defeasance requirements stated under their respective bond ordinances.

III. INVESTMENT OBJECTIVES & STRATEGIES

It is the policy of the City that, giving due regard to the safety and risk of investments, all available funds shall be invested in conformance with state and federal regulations, applicable bond ordinance requirements, adopted Investment Policy and investment strategies.

In accordance with the Public Funds Investment Act, the following prioritized objectives (in order of importance) in accordance with the Tex. Gov’t. Code Sec. 2256.005(d) apply for each of the City’s investment strategies.

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- A. *Suitability* – Understanding the suitability of the investment to the financial requirements of the City is important. Any investment eligible in the Investment Policy is suitable for all City funds.
- B. *Safety* – Preservation and safety of principal are the primary objectives of the Investment Policy. All investments will be in high quality securities with no perceived default risk.
- C. *Liquidity* – The City’s investment portfolio will remain sufficiently liquid to meet operating requirements that might be reasonably anticipated. Liquidity shall be achieved by matching investment maturities with forecasted cash flow requirements and by investing in securities with active secondary markets. Short-term investment pools and money market mutual funds provide daily liquidity and may be utilized as a competitive investment alternative to fixed income instruments.
- D. *Marketability* – Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash requirement. Historical market “spreads” between the bid and offer prices of a particular security type of less than a quarter of a percentage point shall define an efficient secondary market.
- E. *Diversification* – Investment maturities shall be staggered to provide cash flow based on the anticipated needs of the City. Diversifying the appropriate maturity structure will reduce market cycle risk.
- F. *Yield* – Attaining a competitive market yield, commensurate with the City’s investment risk constraints and the cash flow characteristics of the portfolio, is the desired objective. The goal of the City’s investment portfolio is to regularly meet or exceed the average rate of return on U.S. Treasury bills at a maturity level comparable to the portfolio’s weighted average maturity in days. The yield of an equally weighted, rolling twelve month moving average of a one year U.S. Treasury bill portfolio shall be the minimum yield objective or “benchmark”. One year U.S. Treasury bill information is derived from the Federal Reserve Statistical Release H.15 for constant maturities. A secondary objective will be to obtain a yield equal to or in excess of a local government investment pool or money market mutual fund.

The first measure of success in this area will be the attainment of enough income to offset inflationary increases. Although steps will be taken to obtain this goal, the City’s staff will follow the “Prudent Person” statement relating to the standard of care that must be exercised when investing public funds as expressed in the Tex. Gov’t. Code Sec. 2256.006(a-b). The Investment Officers shall avoid any transactions that might impair public confidence in the City’s ability to govern effectively. The governing body recognizes that in adequately diversifying the maturity structure within the portfolio to meet the City’s expenditure needs, occasional measured unrealized losses due to market volatility and rising interest rates are inevitable, and must be considered within the context of the overall portfolio’s investment return. The prudence of the investment decisions shall be measured in accordance with the tests set forth in the Tex. Gov’t. Code Sec. 2256.006(b).

IV. INVESTMENT STRATEGY FOR SPECIFIC FUND GROUPS

In order to better diversify, maximize interest earnings and otherwise meet stated objectives, fund groups may be combined into one or more internal investment pools. Although fund monies may be combined into a single asset portfolio, proportional fund ownership will be accounted for separately. The City maintains separate portfolios for some individual funds or groups of funds (as listed under

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Section II) that are managed in accordance with the terms of this Policy and by the corresponding investment strategies listed below.

- A. *Investment Pool Strategy* – The City’s Investment Pool is an aggregation of the majority of City funds which includes tax receipts, enterprise fund revenues, fine and fee revenues, ~~reserve funds for outstanding utility system revenue bonds~~, as well as some, but not necessarily all, bond proceeds, grants, gifts and endowments. This portfolio is maintained to meet anticipated daily cash needs for the City’s operations, capital projects and debt service. In order to ensure the ability of the City to meet obligations and to minimize potential liquidation losses, the dollar-weighted average stated maturity of the investment pool shall not exceed 1.5 years or 550 days. The objectives of this portfolio are to:
1. Ensure safety of principal by investing in only high quality securities for which a strong secondary market exists.
 2. Ensure that anticipated cash flow needs are matched with adequate investment liquidity.
 3. Limit market and credit risk through diversification.
 4. Attain the best feasible yield commensurate with the objectives and restrictions set forth in this Policy by actively managing the portfolio to meet or exceed the twelve month moving average yield on a one year U.S. Treasury bill as derived from the Federal Reserve Statistical Release H.15 for constant maturities.
- B. *Bond Funds Strategy* - Occasionally, separate non-pooled portfolios are established with the proceeds from bond sales in order to maximize earnings within the constraints of arbitrage regulations. The objectives of the portfolios are to:
1. Ensure safety of principal by investing in only high quality securities for which a strong secondary market exists.
 2. Ensure that anticipated cash flow needs are matched with adequate investment liquidity.
 3. Limit market and credit risk through diversification.
 4. Attain the best feasible yield commensurate with the objectives and restrictions set forth in this Policy and the bond ordinance by actively managing the portfolio to meet or exceed the bond yield.
- C. *Endowment Fund Strategy* - Funds received as gifts to the City with instructions that the income generated by the investment of said funds be used for specified purposes are invested as separate non-pooled portfolios in order to maximize return. The objectives of the portfolios are to:
1. Ensure safety of principal by investing in only high quality securities for which a strong secondary market exists.
 2. Ensure that anticipated cash flow needs are matched with adequate investment liquidity.

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3. Limit market and credit risk through diversification.
 4. Attain the best feasible yield commensurate with the objectives and restrictions set forth in this Policy.
- D. *Trust, Escrowed Funds & Security Deposit Strategy* - Funds that are held outside the City by a trust, escrow agent, or as a security deposit, but belonging to the City are governed by their respective trust, escrow, or security deposit agreement and are subject to the provisions of this Policy. The objectives of the portfolios are to:
1. Ensure safety of principal by investing in only high quality securities for which a strong secondary market exists.
 2. Ensure that anticipated cash flow needs are matched with adequate investment liquidity.
 3. Limit market and credit risk through diversification.
 4. Attain the best feasible yield commensurate with the objectives and restrictions set forth in this Policy and the trust, escrow, or security deposit agreement.

V. INVESTMENT COMMITTEE

Members – The Investment Committee will consist of the City Manager, Deputy City Manager, ~~Assistant City Manager for Finance, Assistant City Manager for Utilities~~, Director of Finance, Assistant Director of Finance, City Controller, City Auditor, Treasury Administrator, and the City's investment advisor. The investment advisor and City Auditor ~~is~~are a non-voting members. When needed, the City Attorney will act as a legal advisor to the Investment Committee.

Scope – The Investment Committee shall meet at least quarterly to determine general strategies, investment guidelines, and to monitor results. Included in its deliberations will be such topics as: economic outlook, portfolio diversification, maturity structure, potential risk to the City's funds, authorized broker/dealers (if applicable) and depository institutions, as well as the target rate of return on the investment portfolio.

Procedures - The ~~Treasury Administrator~~Investment Committee shall provide meeting summations to all members. Any two members of the Investment Committee may request a special meeting, and four members shall constitute a quorum. A quorum may be achieved by a member designating a substitute participant to serve in his or her absence. That substitute participant will not be granted voting rights. The Investment Committee shall establish its own rules of procedures.

VI. RESPONSIBILITY AND STANDARD OF CARE

- A. *Delegation & Training* – The management responsibility for the investment program is delegated to the Director of Finance. The primary individual who shall be involved in investment activities will be his designee. The designee may delegate the day to day activities to a responsible individual(s) who has received the appropriate training required by state statute. The Director of Finance and department designees will use this Policy as the primary guideline for the City's investment program, procedures, and internal control issues. The ~~Director of Finance~~Assistant City Manager who oversees financial operations and the Assistant Director of Finance are designated as the Investment Officers, pursuant to Tex.

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Gov't. Code Sec. 2256.005(f). Accordingly, the Investment Officers and persons authorized to execute investment transactions shall attend at least one training session relating to their responsibilities under the Public Funds Investment Act within 12 months after assuming duties and receive no less than 10 hours of instruction relating to investment functions. Thereafter, eight hours of investment training is required in every two year period that begins on the first day of the fiscal year and consists of the two consecutive fiscal years after that date. The training must include education in investment controls, security risks, strategy risks, market risks, and compliance with the Public Funds Investment Act. The investment training session shall be provided by an independent source approved by the Investment Committee. For purposes of this policy, an "independent source" ~~for from which~~ investment training ~~shall be obtained~~ shall include a professional organization, an institute of higher learning or any other sponsor other than a business organization with whom the City may engage in an investment transaction. Thus, these independent sources will be training sessions sponsored, accredited or endorsed by the Government Treasurers Organization of Texas (GTOT), Center For Public Management at the University of North Texas (UNT), Government Finance Officers Association of Texas (GFOAT), Texas Municipal League (TML), North Central Texas Council of Governments (NCTCOG), Association of Public Treasurers United States & Canada (APT US & C), and Government Finance Officers' Association (GFOA).

No persons may engage in investment transactions except as provided under the terms of this Policy. The ~~Director of Finance Assistant City Manager~~ shall require an annual compliance review by an external auditor that will consist of an audit of management controls on investments, adherence to the City's Investment Policy and a review of the quarterly investment reports. The reviews will provide internal control by assuring compliance with policies and procedures. The Assistant City Manager, Director of Finance, Mayor, City Council, City Manager and other Finance Department employees shall be personally indemnified in the event of investment loss provided the Investment Policy has been followed.

- B. *Conflicts of Interest* – All participants in the investment process shall seek to act responsibly as custodians of public assets. 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. Investment Committee members shall be required to complete an annual ethics statement noting any known conflicts of interest as outlined in Section VI(C) below.
- C. *Disclosure* – Anyone involved in investing City funds shall file with the Investment Committee a statement disclosing any personal business relationship with a business organization offering to engage in investment transactions with the City or is related within the second degree by affinity or consanguinity, as determined under the Tex. Gov't. Code Ch. 573, to an individual seeking to transact investment business with the City. A disclosure statement must also be filed with the Texas Ethics Commission and the City Council. An Investment Officer or other employee has a personal business relationship with a business organization if any one of the following three conditions is met:
 - 1. The Investment Officer or employee owns 10% or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization.
 - 2. Funds received by the Investment Officer or employee from the business organization exceed 10% of the investment officers gross income for the prior year.

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3. The Investment Officer or employee has acquired from the business organization during the prior year investments with a book value of \$2,500 or more for their personal account.

- D. *Prudence* – The standard of prudence to be used by the investment officials shall be the “Prudent Person Rule”, as set forth in Tex. Gov’t. Code Sec. 2256.006, and will be applied in the context of managing an overall portfolio: “Investments shall be made with judgment and care under prevailing circumstances, that a person of prudence, discretion and intelligence would exercise in the management of the person’s own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.”

Investment officials acting in accordance with the Investment Policy and exercising due diligence shall be relieved of personal responsibilities for an individual security’s credit risk or market price change, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments. In determining whether an investment official has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration the investment of all funds over which the official had responsibility rather than consideration as to the prudence of a single investment and whether the investment decision was consistent with the City’s Investment Policy.

- E. *Reporting*

Quarterly – Not less than quarterly, the Director of Finance shall submit to the City Manager, Mayor and City Council a written report of the City’s investment transactions within one hundred twenty (120) days of the preceding reporting period. The report shall: 1) describe in detail the investment position of the City as of the end of the reporting period, 2) be prepared jointly by all Investment Officers, 3) be signed by each Investment Officer, 4) contain a summary statement, prepared in compliance with generally accepted accounting principles, of each pooled fund group including a) beginning market value for the reporting period; b) additions and changes to the market value during the period; c) ending market value for the period; and d) fully accrued interest for the reporting period, 5) state the book value and market value of each separately invested asset at the beginning and end of the reporting period by type of asset and fund type invested, 6) state the maturity date of each separately invested asset that has a maturity date, 7) state the account or fund or pooled fund group for which each individual investment was acquired, and 8) state the compliance of the investment portfolio as it relates to the investment strategy expressed in the Investment Policy and with relevant provisions of the Tex. Gov’t. Code Ch. 2256.

Annually - The City Council shall review and approve the Investment Policy and investment strategies at least annually and be documented by rule, order, ordinance or resolution which shall include any changes made.

Compliance Audit – The City’s external independent auditor will conduct an annual review of the quarterly reports in conjunction with the annual financial audit. The results of the audit will be reported to City Council. The audit will also review compliance with management controls on investments and adherence to this Policy.

- F. As recommended by the Texas State Library and Archives Commission, the guidelines of retaining records for five years from the applicable fiscal year end should be followed for

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investment funds other than bond proceeds. Since the City manages the majority of its investments, including bond funds, using an internal pool consisting of combined fund groups, records shall be retained in accordance with the Administrative Policy No. 403.07 "Debt Service Management." The Director of Finance shall oversee the filing and/or storing of investment records.

- G. Market prices for all public fund investments will be obtained and monitored through the use of Interactive Data Inc., an on-line data service or a similarly qualified successor agency or experienced competitor.

VII. SUITABLE AND AUTHORIZED INVESTMENT SECURITIES

- A. *Active Portfolio Management* – The City intends to pursue an active versus a passive investment management philosophy. That is, securities may be sold before they mature if market conditions present an opportunity for the City to benefit from the trade. (Refer to Section VIII of this Policy.) In addition, the Investment Officers may at times restrict or prohibit the purchase of specific types of investments or issuers due to current market conditions.

The City shall take all prudent measures consistent with this Investment Policy to liquidate an investment that no longer meets the required minimum rating standards, as per the Tex. Gov't. Code Sec. 2256.021. However, if it is determined by the Investment Committee that the City would benefit from holding the securities to maturity to recapture its initial investment then the Investment Officers may act accordingly. The City is not required to liquidate investments that were authorized investments at the time of purchase. (Tex. Gov't. Code Sec. 2256.017)

- B. *Authorized Investments & Maximum Maturities* – City funds governed by this Policy may be invested in the instruments described below, all of which are authorized by the Public Funds Investment Act.
1. Direct obligations of the United States of America, its agencies and instrumentalities and maturing in less than five years.
 2. Other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the United States of America, or any obligation fully guaranteed or insured by the Federal Deposit Insurance Corporation and maturing in less than five years.
 3. Direct obligations of the State of Texas or its agencies thereof, Counties, Cities and other political subdivisions rated as to investment quality by a nationally recognized investment rating firm not less than AA or its equivalent and maturing in less than three years.
 4. Other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the State of Texas, rated as to investment quality by a nationally recognized investment rating firm not less than AA or its equivalent and maturing in less than three years.
 5. Fully insured or collateralized certificates of deposit/share certificates issued by state and national banks or savings bank or a state or federal credit union (having its main or branch office in Texas) guaranteed or insured by the Federal Deposit Insurance

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Corporation or its successor or the National Credit Union Share Insurance Fund or its successor. Any uninsured portion of collateralized certificates of deposit must be secured by obligations in accordance with Section XII herein. Banks or credit unions offering collateralized certificates of deposit/share certificates, or are proposing a standby letter of credit as security for deposits, must be pre-approved by the Investment Committee. Certificates of deposits/share certificates fully insured by the Federal Deposit Insurance Corporation or National Credit Union Share Insurance Fund (including successor organizations) do not require prior approval by the Investment Committee. Both insured and collateralized instruments, including those backed by a standby letter of credit, must mature in less than three years.

In addition to the City's authority to invest funds in certificates of deposit and share certificates stated above, an investment in certificates of deposit made in accordance with the following conditions is an authorized investment under Tex. Govt. Code Sec. 2256.010(b): (1) the funds are invested by the City through a clearing broker registered with the Securities and Exchange Commission (SEC) and operating pursuant to SEC rule 15c3-3 (17 C.F.R. Section 240.15c3-3) with its main office or branch office in Texas and selected from a list adopted by the Investment Committee as required by Section 2256.025; or a selected depository institution that has its main office or a branch office in this state; (2) the selected broker or depository institution arranges for the deposit of the funds in certificates of deposit in one or more federally insured depository institutions, wherever located for the account of the City; (3) the full amount of the principal and accrued interest of each of the certificates of deposit is insured by the United States or an instrumentality of the United States; (4) the selected broker or depository institution acts as custodian for the City with respect to the certificates of deposit issued for the account of the City.

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6. Interest bearing bank savings deposits issued by state and national banks or savings bank or a state or federal credit union (having a main or branch office in Texas) that are guaranteed or insured by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund (or successor organizations). Included also are collateralized interest bearing savings deposits that have secured the uninsured portion of deposits with obligations in accordance with Section XII herein. Offering banks of both insured and collateralized savings accounts, including those backed by a standby letter of credit, require prior approval by the Investment Committee.

In addition to the City's authority to invest funds in savings deposits as described above, an investment in savings accounts in accordance with the following conditions is an authorized investment under Tex. Govt. Code Sec. 2256.009(a) : (1) the funds are invested by the City through a clearing broker registered with the Securities and Exchange Commission (SEC) and operating pursuant to SEC rule 15c3-3 (17 C.F.R. Section 240.15c3-3) with its main office or branch office in Texas and selected from a list adopted by the Investment Committee as required by Section 2256.025; or a selected depository institution that has its main office or a branch office in this state; (2) the selected broker or depository institution arranges for the savings deposits in one or more federally insured depository institutions, wherever located for the account of the City; (3) the full amount of the principal and accrued interest of each of the savings accounts is insured by the United States or an instrumentality of the United States; (4) the selected broker or depository institution acts as custodian for the City with respect to the savings deposits issued for the account of the City.

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~~6.7.~~ Fully collateralized repurchase agreements provided the City has on file a signed Master Repurchase Agreement, approved by the City Attorney, which details eligible collateral, collateralizations ratios, standards for collateral custody and control, collateral valuation, and conditions for agreement termination. The repurchase agreement must have a defined termination date and be secured by obligations in accordance with Section XII of this Policy. It is required that the securities purchased by the City be assigned to the City, held in the City's name and deposited at the time the investment is made with the City or with a third party selected and approved by the City. Repurchase agreements must be purchased through a primary government securities dealer, as defined by the Federal Reserve or a financial institution doing business in this State and the termination date must be 30 days or less. An exception to the 30 days or less termination date may be made with respect to bond proceeds. The City may specifically authorize in the bond ordinance investments in repurchase agreements, such as a flexible repurchase agreement, with maturities in excess of 30 days subject to any required approvals from bond insurers.

~~7.8.~~ Commercial paper that has a stated maturity of 270 days or less from the date of issuance and is rated not less than A-1 or P-1 or an equivalent rating by at least two nationally recognized rating agencies.

~~8.9.~~ Public (local) fund investment pools with a dollar weighted average maturity of 60 days or less. The pool must be approved through resolution by the City Council to provide services to the City and be continuously rated no lower than Aaa or AAAM or at an equivalent rating by at least one nationally recognized rating service. A public funds investment pool created to function as a money market mutual fund must mark to market daily and stabilize at a \$1 net asset value. The City may not invest an amount that exceeds 10 percent of the total assets of any one local government investment pool.

To be eligible to receive funds from and invest funds on behalf of the City, an investment pool must furnish to the Investment Officer or other authorized representative an offering circular or other similar disclosure instrument that contains information required by the Tex. Gov't. Code Sec. 2256.016. Investments will be made in a local government investment pool only after a thorough investigation of the pool and approval by the Investment Committee which shall at least annually review, revise and adopt the local government investment pool(s).

~~9.10.~~ A Securities and Exchange Commission (SEC) registered, no load U.S. government money market mutual fund which has a dollar weighted average stated maturity of 60 days or less and whose investment objectives includes the maintenance of a stable net asset value of \$1 for each share. ~~Furthermore, it must be rated not less than Aaa, AAAM or an equivalent rating by at least one nationally recognized rating service.~~ A rating will not be required of money market mutual funds that invest exclusively in U.S. government securities or a combination of U.S. government securities and repurchase agreements backed by U.S. government securities. The City must be provided with a prospectus and other information required by the SEC Act of 1934 or the Investment Company Act of 1940. This ~~can may~~ be supplied either through website access or in hard copy form. The City may not invest an amount that exceeds 10 percent of the total assets of any one fund. Investments will be made in a money market mutual fund only after a thorough investigation of the fund and approval by the Investment Committee which shall, at least annually, review, revise and adopt the money market mutual fund(s).

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- C. *Denton Municipal Electric (DME) Authorized Investments* – DME engages in the distribution and sale of electric energy to the public and, in accordance with Tex. Gov’t Code Sec. 2256.0201, may enter into a hedging contract and related security and insurance agreements in relation to fuel oil, natural gas, coal, nuclear fuel, and electric energy to protect against loss due to price fluctuations. “Hedging” is defined by the buying and selling of futures, options or similar contracts and related transportation costs of the aforementioned commodities as a protection against adverse price movements. A hedging transaction must comply with the regulations of the Commodity Futures Trading Commission and the Securities and Exchange Commission.

A payment received under a hedging contract or related agreement in relation to fuel supplies or fuel reserves is a fuel expense, and, thus, DME may credit any amounts received against fuel expenses.

The City Council may set and review policies regarding hedging transactions, as per Tex. Gov’t. Code Sec. 2256.0201(c).

- D. *Prohibited Investments* – The City’s authorized investment options are more restrictive than those allowed by state law. Furthermore, this Policy specifically prohibits investment in the securities listed below:

1. Obligations, whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal.
2. Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest.
3. All collateralized mortgage obligations.
4. Reverse repurchase agreements.

- E. *Diversification* – It is the policy of the City to diversify its investment portfolios. The diversification will protect interest income from the volatility of interest rates and the avoidance of undue concentration of assets in a specific maturity sector; therefore, portfolio maturities shall be staggered. In establishing specific diversification strategies, the following general policies and constraints shall apply:

1. Risk of market price volatility shall be controlled through maturity diversification and by controlling unacceptable maturity extensions and a mismatch of liabilities and assets. The maturity extension will be controlled by limiting the weighted average maturity of the internal investment pool portfolio to 550 days. All long-term maturities will be intended to cover long-term liabilities. In addition, at least 5 percent of the funds in the investment pool portfolio will be liquid at all times. Investment pool liquidity, which consists of immediately available funds, is defined as shares in a local government investment pool and money market mutual fund, as well as bank demand and savings deposit balances. Although there is no maximum defined portfolio liquidity position, it is the intent of this Policy to seek out higher yielding alternative investments in accordance with the prioritized objectives of preservation and safety of principal,

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meeting liquidity needs and yield enhancement as stated throughout the Public Funds Investment Act.

2. The Investment Committee shall establish strategies and guidelines for the percentage of the total portfolio that may be invested in U.S. Treasury securities, federal agencies/instrumentalities, repurchase agreements, insured/collateralized certificates of deposit and other securities or obligations. The Investment Committee shall conduct a quarterly review of these guidelines, and shall evaluate the probability of market and default risk in various investment sectors as part of its considerations.
3. Risk of principal loss in the portfolio as a whole shall be minimized by diversifying investment types according to the following limitations based on book values:

<u><i>Investment Type</i></u>	<u><i>% of Portfolio</i></u>
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• U.S. Government Treasury Notes/Bills & Obligations	100%
• U.S. Government Agencies & Instrumentalities	100%
• State of Texas Obligations, Agencies & Local Gov't.	15%
• Local Government Investment Pools (Gov't Securities)	50%
• Local Government Investment Pools (Prime Securities)	15%
• Repurchase Agreements	20%
• <u>Certificates of Deposit (insured/collateralized/SLOC*)</u>	<u>35%</u>
• <u>Savings Deposits (insured/collateralized/SLOC*)</u>	<u>15%</u>
• U.S. <u>Government</u> Money Market Mutual Funds	<u>35%</u> 50%
• Callable U.S. Agencies/Instrumentalities	20%
• Commercial Paper	15%

By Institution:

Repurchase Agreements	No more than 15%
Collateralized Certificates of Deposit	No more than 15%
SLOC* Backed Certificates of Deposit	No more than 15%
Commercial Paper	No more than 5%
All Other (except U.S. Treasuries)	No more than 35%

*Standby Letter of Credit

4. Purchases of securities with stated maturities greater than the maximum authorized under Section VII(B) require prior City Council approval.

VIII. SALE OF SECURITIES

The City's policy is to hold all securities to maturity. However, securities may be sold to minimize the potential loss of principal on a security whose credit quality has declined, to swap into another security which would improve the quality, yield or target duration of the portfolio or to meet unanticipated liquidity needs. A horizon analysis is required for each swap proving benefit to the City before the trade decision is made, and will be held in the file for record keeping.

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IX. COMPETITIVE BIDDING

It is the policy of the City to require competitive bidding for all individual security purchases and sales, as well as for certificates of deposit. Exceptions include:

- A. Transactions with money market mutual funds and local government investment pools which are deemed to be made at prevailing market rates.
- B. Treasury and agency securities purchased as new issues through an approved broker/dealer, financial institution or investment advisor.
- C. Automatic overnight “sweep” transactions with the City’s depository bank.
- D. Interest bearing savings deposits deemed to be made at prevailing market rates.

At least three bids or offers must be solicited for all other transactions involving individual securities. The City’s investment advisor is also required to solicit at least three bids or offers when transacting trades on the City’s behalf. In situations where the exact security is not offered by other broker/dealers, offers on the closest comparable investment may be used to establish a fair market price for the security. In the case of a certificate of deposit purchase, at least two other offers should be solicited to provide a comparison. When few, if any, banks wish to participate then staff may use another authorized investment of similar maturity for evaluation purposes. The quotes may be accepted orally, in writing, electronically, or any combination of these methods. The Investment Committee may approve exceptions on a case by case basis or on a general basis in the form of guidelines. These guidelines shall take into consideration the investment type, maturity date, amount and potential disruptiveness to the City’s investment program.

X. ARBITRAGE

The Tax Reform Act of 1986 provided limitations restricting the City’s investment of tax-exempt bond proceeds. Revised arbitrage rebate provisions require that the City compute earnings on investment from each issue of bonds on an annual basis to determine if a rebate is required. To determine the City’s arbitrage position, the City is required to perform specific calculations relative to the actual yield earned on the investment of the funds and the yield that could have been earned if the funds had been invested at a rate equal to the yield on the bonds sold by the City. The rebate provision states that periodically (not less than once every five years, and not later than sixty days after maturity of the bonds), the City is required to pay the U.S. Treasury a rebate of excess earnings based on the City’s positive arbitrage position. The Tax Reform restrictions require precision in the monitoring and recording facets of investments as a whole, and particularly as they relate to yields and computations so as to insure compliance. Failure to comply may dictate that the bonds become taxable, retroactively from the date of issuance.

The City’s investment position, relative to the revised arbitrage restrictions, is the continued pursuit of maximizing yield on applicable investments while ensuring the safety of capital and liquidity. It is fiscally prudent to continue the maximization of yield and rebate excess earnings, if necessary.

XI. SELECTION OF BANKS, BROKER/DEALERS AND INVESTMENT ADVISORS

- A. *Depository* – City Council shall, by ordinance, “select and designate one or more banking institutions as the depository for the monies and funds of the City” in accordance with the requirement of Tex. Loc. Gov’t. Code Ch. 105. At least every five years a depository shall

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be selected through the City's banking services procurement process, which shall include a formal request for proposal (RFP). The selection of a depository will be determined by a competitive process and evaluated on the following criteria:

1. Qualified as a depository for public funds in accordance with state and local laws.
 2. Provided requested information or financial statements for the periods specified.
 3. Complied with all requirements in the banking RFP.
 4. Completed responses to all required items on the proposal form.
 5. Offered lowest net banking service cost, consistent with the ability to provide an appropriate level of service.
 6. Met credit worthiness and financial standards.
- B. *Investment Broker/Dealers* – If the City has not retained an investment advisor, then the Investment Committee shall be responsible for adopting the list of qualified brokers/dealers and financial institutions authorized to engage in investment transactions with the City. Authorized firms may include primary dealers or regional broker/dealers that qualify under SEC Rule 15C3-1 (uniform net capital rule) and qualified depositories as established by the Tex. Loc. Gov't. Code Ch. 105. The Investment Committee shall base its evaluation of security broker/dealers and financial institutions upon:
1. Financial condition, strength and capability to fulfill commitments.
 2. Overall reputation with other broker/dealers or investors.
 3. Regulatory status of the broker/dealer.
 4. Background and expertise of the individual representatives.
 5. Ability to provide additional advisory services.

The Investment Committee must annually review, revise, and adopt the list of qualified broker/dealers authorized to engage in investment transactions with the City. Investment Officers, or their authorized representatives, shall not conduct business with any firm with whom public entities have sustained realized losses on investments or whose name the Investment Committee has removed from an approved list.

- C. *Investment Advisor* – The City may retain the services of an investment advisory firm registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or with the State Securities Board to assist in the review of the investment policy, cash flow requirements, the formulation of investment strategies, the execution of security purchases, sales and deliveries, as well as attend quarterly investment meetings, provide periodic security valuations, market updates, and to generally service the investment needs of the City. The investment advisor will also be responsible for performing broker/dealer financial due diligence on the City's behalf and provide a list of its authorized broker/dealers on an annual basis. The City, however, retains ultimate responsibility as fiduciary of its assets. The investment advisory contract may not be for a term longer than two years and its renewal or

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extension must be approved by the City Council by ordinance or resolution as required by the Tex. Gov't. Code Sec.2256.003(b).

- D. *Compliance* – A qualified representative from any firm offering to engage in investment transactions with the City is required to sign a written instrument upon receiving and reviewing a copy of the Investment Policy. Investments shall only be made with those business organizations (including ~~money market mutual funds~~, local government investment pools, and investment advisory firms) which have provided the City with this written instrument executed by a qualified representative of the firm, acknowledging that the business organization has:

1. Received and reviewed the City's Investment Policy.
2. Implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the City and the organization that are not authorized by the Investment Policy, except to the extent that this authorization is dependent on an analysis of the makeup of the City's entire portfolio or requires an interpretation of subjective investment standards.

It will be at the Treasury Administrator's discretion to accept any additional caveats to the above stated required acknowledgements. The written compliance document must, at a minimum, conform to Tex. Gov't. Code Sec. 2256 (k) as amended.

XII. COLLATERALIZATION, SAFEKEEPING AND CUSTODY

- A. *Collateralization* - The City requires that all uninsured collected balances plus accrued interest, if any, in depository accounts be secured in accordance with the requirements of state law. Financial institutions serving as City depositories will be required to sign a depository agreement with the City which details eligible collateral, collateralization ratios, standards for collateral custody and control, collateral valuation, rights of substitution and conditions for agreement termination. This requirement is applicable to both demand and savings deposits.

The City requires that all securities purchased under the terms of a repurchase agreement be assigned to the City in accordance with state law. Dealers and financial institutions wishing to transact repurchase agreements with the City will be required to sign a Master Repurchase Agreement which details eligible collateral, collateralization ratios, standards for collateral custody and control, collateral valuation, rights of substitution, and conditions for agreement termination.

The City requires that all uninsured certificates of deposit plus accrued interest held with a depository be secured in accordance with the requirements of state law. Financial institutions will be required to sign a written depository and security agreement which stipulates eligible collateral, collateralization ratios, standards for collateral custody and control, collateral valuation, rights of substitution, and conditions for agreement termination.

Collateral will always be held by an independent third party with which the City has a current custodial agreement and shall be reviewed at least monthly to ensure that the market value of the pledged securities is adequate. All deposits and investments of City funds (other than direct security purchases, money market mutual funds and local government investment pools) shall be secured by pledged collateral set at no less than 102 percent of the market value of the

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principal and accrued interest on the deposits or investments, less an amount insured by FDIC. Eligible collateral to secure the City's deposits include:

1. Direct obligations of the United States government.
2. Other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the United States government.
3. Direct obligations of agencies or instrumentalities of the United States government, including standby letters of credit.
4. Cash

The City will reject adjustable rate mortgages (ARMs), collateralized mortgage obligations (CMOs), step-ups, variable rate instruments (except U.S. Treasury variable rate instruments), or securities that are not found on common pricing systems.

- B. *Safekeeping and Custody* – Safekeeping and custody of the City's investment securities shall be in accordance with state law. All security transactions, except local government investment pool and money market mutual fund transactions, shall be conducted on a delivery versus payment (DVP) basis. Investment securities will be held by a third party custodian designated by the City, and be required to issue safekeeping confirmation notices clearly detailing that the securities are owned by the City.

Safekeeping and custody of collateral pledged to the City shall be in accordance with state law. Collateral will be held by a third party custodian designated by the City. The custodian is required to issue safekeeping confirmation notices clearly showing that the securities are pledged to the City.

- C. *Subject to Audit* – All collateral shall be subject to inspection and audit by the Director of Finance, or designee, as well as the City's independent auditors.

XIII. MANAGEMENT AND INTERNAL CONTROLS

Controls shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by employees or Investment Officers of the City.

Controls and managerial emphasis deemed most important that shall be employed include the following:

Imperative Controls

- Custodian safekeeping confirmation notices records management
- Avoidance of bearer-form securities
- Documentation of investment bidding events
- Written confirmation of telephone transactions

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- Reconcilements and comparisons of security confirmation notices with the investment records
- Compliance with Investment Policy
- Verification of all interest income and security purchase and sell computations

Controls Where Practical

- Control of Collusion
- Separation of duties
- Separation of transaction authority between accounting and record-keeping
- Clear delegation of authority
- Accurate and timely reports
- Validation of investment maturity decisions with supporting cash flow data
- Adequate training and development of Investment Officers and staff authorized to execute investment transactions
- Review of financial conditions of all broker/dealers and depository institutions
- Access to information about market conditions, changes and trends that require adjustments to investment strategies.

XIV. INVESTMENT POLICY ADOPTION

The Investment Policy shall be formally approved and adopted by resolution of the City Council and reviewed annually in accordance with the provisions of the Public Funds Investment Act of the Texas Government Code Chapter 2256.