

CITY OF TEXARKANA, TEXAS INVESTMENT POLICY



CITY OF TEXARKANA, TEXAS

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INTRODUCTION

The purpose of this document is to set forth specific investment policy and strategy guidelines for the City of Texarkana, Texas (the “City”) in order to achieve the goals of safety, liquidity, public trust, and yield for all investment activity. The City Council of the City shall review and adopt, by resolution, its investment strategies and policy not less than annually. The resolution shall include a record of changes made to either the Investment Policy or strategy. This Policy serves to satisfy the statutory requirement, specifically the Public Funds Investment Act and Public Funds Collateral Act, Texas Government Code Chapter 2256 and Chapter 2257 (the “PFIA” and “PFCA” respectively) to define, adopt, and review a formal investment strategy and policy.

INVESTMENT STRATEGY

The City maintains two distinct portfolios (the City and the Water Utilities Department), which independently utilize four specific investment strategy considerations, designed to address the unique characteristics of the fund groups represented in the portfolios:

- A. Investment strategies for operating funds and combined pools containing operating funds have as their primary objectives to preserve principal and assure that anticipated cash flows are matched with adequate investment liquidity. The secondary objective is to create a portfolio structure, which will experience minimal volatility during economic cycles. This may be accomplished by maintaining adequate liquid balances and utilizing high quality, short-to-medium term investments, which will complement each other in a ladder or barbell maturity structure, and can be easily liquidated if the need arises. Any investment authorized by this Policy is suitable for these funds. The dollar weighted average maturity of 365 days or less will be calculated using the stated final maturity date of each investment. The maximum stated final maturity shall

be three years. The yield objective shall be a comparable maturity rolling Treasury portfolio.

- B. Investment strategies for debt service funds shall have as the primary objectives the preservation of principal and the assurance of investment liquidity adequate to cover the debt service obligation on the required payment date. Investments purchased shall not have a stated final maturity date which exceeds the next unfunded debt service payment date. Any investment authorized by this Policy is suitable for these funds. The yield objective shall be a short-term, government portfolio local government pool.
- C. Investment strategies for debt service reserve funds shall have as the primary objectives to preserve principal and to generate a dependable revenue stream to the appropriate debt service fund from investments with a low degree of volatility. Investments shall be of high quality and, except as may be required by the bond ordinance specific to an individual issue, of short-to-intermediate term maturities. Maximum maturity shall be the shorter of the first call date or five years. Volatility shall be further controlled through the purchase of securities carrying the highest coupon available, within the desired maturity and quality range, without paying a premium, if at all possible. Any investment authorized by this Policy is suitable for these funds. The yield objective shall be a comparable maturity rolling Treasury portfolio.
- D. Investment strategies for special projects or special purpose fund portfolios will have as their primary objectives to preserve principal and to assure that anticipated cash flows are matched with adequate investment liquidity. These portfolios should include at least 10% in cash equivalent investments to allow for flexibility and unanticipated project outlays, and by utilizing high quality, short-to-medium term investments, which will complement each other in a laddered or barbell maturity structure, and can be easily liquidated if the need arises. Any investment authorized by this Policy is suitable for these funds. The stated final

maturity dates of securities held should not exceed the estimated project completion date. The yield objective shall be a comparable maturity rolling Treasury portfolio.

INVESTMENT POLICY

A. SCOPE

This Investment Policy applies to all financial assets of the City including the Water Utilities Department. These funds are accounted for in the City's Comprehensive Annual Financial Report (CAFR) and include:

- General Fund
- Special Revenue Funds
- Debt Service Funds
- Capital Projects Funds
- Proprietary Funds
- All Other Funds

This Policy shall not govern the Firemen's Relief and Pension Fund which is under the management and supervision of the City of Texarkana, Texas Firemen's Relief and Pension Fund Board of Trustees.

B. OBJECTIVES

The City shall manage and invest its cash with four objectives, listed in order of priority: Safety, Liquidity, Public Trust, and Yield. The safety of the principal invested always remains the primary objective. All investments shall be designed and managed in a manner responsive to the public trust and consistent with State and Local law.

The City shall maintain a comprehensive cash management program which includes collection of accounts receivable, vendor payment in accordance with invoice terms, and prudent investment of available cash. Cash management is defined as the process of managing monies in order to ensure maximum cash availability and maximum yield on short-term investment of pooled idle cash.

1. Safety

The primary objective of the City's investment activity is the preservation of principal in the overall portfolio. Each investment transaction shall be conducted in a manner to avoid principal losses, whether from investment defaults or erosion of market value.

2. Liquidity

The City's investment portfolio shall be structured such that the City is able to meet all obligations in a timely manner. This shall be achieved by maintaining adequate cash equivalent balances, matching investment maturities with forecasted cash flow requirements, and by investing in securities with active secondary markets.

3. Public Trust

All participants in the City's investment process shall seek to act responsibly as custodians of the public trust. Investment Officers shall avoid any transaction which might impair public confidence in the City's ability to govern effectively.

4. Yield

The City's cash management portfolio shall seek to augment returns above this threshold consistent with risk limitations identified herein and prudent investment policies.

C. RESPONSIBILITY AND CONTROL

1. Investment Committee

An Investment Committee, consisting of one City Council Member appointed by the Mayor, City Chief Executive Officer/Manager (or his designee), Chief Financial Officer (City), Director of Finance (Water Utilities Department), Accounting/Human Resources Manager (Water Utilities Department), and Assistant Chief Financial Officer (City) shall meet as needed to determine operational strategies and to monitor results. The Investment Committee shall include in its deliberation such topics as: performance

reports, economic outlook, portfolio diversification, maturity structure, potential risk to the City's funds, authorized broker/dealers, eligible investment training sources, and the target rate of return on the investment portfolio.

2. Delegation of Authority and Training

Authority to manage the City's investment program is derived from the City Charter. The Chief Financial Officer and Assistant Chief Financial Officer are designated as Investment Officers and are responsible for investment decisions and activities for the City portfolio. The Director of Finance and Accounting/Human Resources Manager are designated as Investment Officers and are responsible for investment decisions and activities for the Water Utilities Department portfolio. The Chief Financial Officer and Director of Finance shall establish written procedures for the operation of their respective investment program, consistent with this Investment Policy. In order to ensure qualified and capable investment management, the Investment Officers shall attend training sessions relating to the Officer's responsibility under the PFIA within 12 months after assuming duties and receive at least 10 hours of training, and additional training sessions not less than once every two year period that begins on the first day of the City's fiscal year and consists of the two consecutive fiscal years after that date and receive at least 8 hours of training. Independent sources for such training shall be approved by the Investment Committee.

3. Internal Controls

The Chief Financial Officer and Director of Finance, or their respective designee, are responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Accordingly, the Chief Financial Officer and Director of Finance shall establish a process for annual independent review by an external auditor in conjunction with the annual audit, to assure compliance with policies and procedures. The internal controls shall address the following points:

- A. Control of collusion.
- B. Separation of transaction authority from accounting and record keeping.
- C. Custodial safekeeping.
- D. Avoidance of physical delivery securities.
- E. Clear delegation of authority to subordinate staff members.
- F. Written confirmation for telephone (voice) transactions for investments and wire transfers.

4. Prudence

The standard of prudence to be applied by the Investment Officers 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.” In determining whether an Investment Officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration:

- A. The investment of all funds, or funds under the City’s control, over which the Officer had responsibility rather than a consideration as to the prudence of a single investment.
- B. Whether the investment decision was consistent with the written Investment Policy of the City.

An Investment Officer, acting in accordance with written procedures and exercising due diligence, shall not be held personally responsible for a specific investment's credit risk or market price changes, provided that these deviations are reported immediately and that appropriate action is taken to control adverse developments.

5. Ethics and Conflicts of Interest

Investment Officers shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair the ability to make impartial investment decisions. Investment Officers shall disclose to the City Manager any material financial interest in financial institutions that conduct business with the City and they shall further disclose positions that could be related to the performance of the City's portfolio. Investment Officers shall subordinate their personal financial transactions to those of the City, particularly with regard to timing of purchases and sales.

An Investment Officer of the City who has a personal business relationship with an organization seeking to sell an investment to the City shall file a statement disclosing that personal business interest. An Investment Officer who is related within the second degree by affinity or consanguinity to an individual seeking to sell an investment to the City shall file a statement disclosing that relationship. A statement required under this subsection must be filed with the Texas Ethics Commission and the City Council.

D. REPORTING

1. Quarterly Reporting

The Chief Financial Officer shall submit a quarterly investment report in compliance with the PFIA and signed by all Investment Officers.

2. Annual Report

Within a reasonable time after the end of the fiscal year, the Chief Financial Officer shall present an annual report on the investment program and investment

activity. This report may be presented as a component of the fourth quarter report to the City Manager and City Council.

3. Methods

The quarterly investment report shall include a succinct management summary that provides a clear picture of the status of the current investment portfolio and transactions made over the last quarter. This management summary will be prepared in a manner which will allow the City to ascertain whether investment activities during the reporting period have conformed to the Investment Policy. The report will be prepared in compliance with the PFIA. The report will be provided to the City Manager and City Council. The report will include the following:

- A. A listing of individual investments held at the end of the reporting period. This list will include the name of the fund or pooled group fund for which each individual investment was acquired.
- B. Unrealized gains or losses resulting from appreciation or depreciation by listing the beginning and ending book and market value of securities for the period. Market values shall be obtained from financial institutions or portfolio reporting services independent from the investment provider.
- C. Additions and changes to the market value during the period.
- D. Fully accrued interest for the reporting period.
- E. Average weighted yield to maturity of portfolio on City investments as compared to applicable benchmarks.
- F. Listing of investments by maturity date.
- G. The percentage of the total portfolio which each type of investment represents.

- H. Statement of compliance of the City's investment portfolio with State Law and the Investment Strategy and Policy approved by the City Council.

In conjunction with the annual audit, a formal annual review of these reports will be performed by an independent auditor with the results reported to the City Council as part of the overall audit report.

E. INVESTMENT PORTFOLIO

1. Active Portfolio Management

The City shall pursue an active versus a passive portfolio management philosophy. That is, investments may be sold or redeemed before they mature if market conditions present an opportunity for the City to benefit from the trade. The Investment Officers will routinely monitor the contents of the portfolio, the available markets, and the relative value of competing instruments, and will adjust the portfolio accordingly.

2. Performance

It is the City's policy to purchase investments with maturity dates coinciding with cash flow requirements. Using this strategy, the City attempts to purchase the highest yielding allowable investments available at the time of purchase. The City shall encourage a competitive environment for all investment activities including investment pool and mutual fund selections, financial institution deposit placements, securities transactions, and other investment-related proceedings. Weighted-average-yield-to-maturity shall be the portfolio's performance measurement standard.

3. Investments

Assets of the City may be invested in the following instruments; provided, however, that at no time shall assets of the City be invested in any instrument or security not authorized at the time of purchase for investment under the PFIA, as the PFIA may from time to time be amended. The City is not required to liquidate investments that were authorized investments at the time of purchase. All prudent

measures will be taken to liquidate an investment that is downgraded to less than the required minimum rating.

a). Authorized

1. Obligations issued, guaranteed, or insured by the United States of America, its agencies and instrumentalities, which have a liquid market with a readily determinable market value, including the Federal Home Loan Banks.
2. Direct obligations of the State of Texas, its agencies and instrumentalities.
3. Other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of this State or the United States or their respective agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States.
4. Obligations of the States, agencies thereof, Counties, Cities, and other political subdivision of any state having been rated as investment quality by a nationally recognized investment rating firm, and having received a rating of not less than "A" or its equivalent.
5. Certificates of Deposit, and other forms of deposit, of state and national banks, savings banks, or state or federal credit unions that has a main or branch office in Texas, guaranteed or insured by the Federal Deposit Insurance Corporation (or its successor) or the National Credit Union Share Insurance Fund (or its successor), or secured by obligations described in G. 3. Collateral Defined, or as authorized by the PFIA. Bids/quotes for certificates of deposit may be

solicited in the following ways: orally, in writing, electronically, or in any combination of the above methods.

6. Fully collateralized direct repurchase agreements with a defined termination date secured by cash or obligations of the United States or its agencies and instrumentalities. Securities purchased must be pledged to the City, held in the City's account, and deposited at the time of the investment with the City, and placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in Texas. Such agreements may include direct security repurchase agreements and reverse security repurchase agreements with terms of 90 days or less after the delivery date. Funds received by the City under a reverse security agreement shall be used to acquire additional authorized investments, but those investments must mature no later than the expiration date stated in the reverse security repurchase agreement.
7. Local Government Investment Pools, if the pool is specifically approved by the Council and the pool invests only in investments authorized by the PFIA. A pool must be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service. In order to be eligible to receive City funds a pool must comply with all PFIA requirements.
8. "Money Market" mutual funds that have a rating of AAA by at least one nationally recognized rating firm and are "no-load" funds. A "money market" mutual fund must maintain a \$1.00 share value and include only short-term, highly liquid, and relatively low risk debt instruments. Must be registered with and regulated by the Securities and Exchange Commission. The City cannot own more than 10% of the mutual fund's total assets.

9. Guaranteed Investment contracts are allowed investments for bond proceeds only, if such contracts have a defined termination date, are secured by U.S. Government direct or agency obligations approved by the PFIA, in an amount equal to the bond proceeds, if security is pledged to the City and deposited with the City or a third party, and if the investment term is limited to five years from the date of bond issuance. In addition, specific provisions under PFIA Section 2256.015(c) 1-5 must be met to allow investment in these contracts.

b. Not Authorized

The City's authorized investment options are more restrictive than those allowed by State law. State law specifically prohibits investment in the following investment securities, or investment in specific instruments at levels higher than those 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) Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years.
- 4) Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

4. Holding Period

The City intends to match the holding periods of investment funds with liquidity needs of the City.

5. Risk and Diversification

The City recognizes that investment risks can result from issuer defaults, market price changes or various technical complications leading to temporary illiquidity. Risk is controlled through portfolio diversification which shall be achieved by the following general guidelines:

- a) Risk of issuer default is controlled by limiting investments to those instruments allowed by the PFIA, which are described herein.
- b) Risk of market price changes shall be controlled by avoiding over-concentration of assets in a specific maturity sector, maintenance of adequate liquidity, and limitation of appropriate average maturity.
- c) Risk of temporary illiquidity shall be controlled by monitoring the rating of each issuer, as applicable, at least quarterly, and taking all prudent measures that are consistent with this Policy to liquidate an investment that does not have the minimum rating.

F. SELECTION OF FINANCIAL INSTITUTIONS AND BROKER/DEALERS

1. Depository

In compliance with State legislation, a Primary Depository shall be selected through the City's banking services procurement process, which shall include a formal request for application (RFA). In selecting a Primary Depository, the credit worthiness of institutions shall be considered, and the Chief Financial Officer shall conduct a comprehensive review of prospective depositories' credit characteristics and financial history. In addition, the City may establish non-primary banking relationships based on deposit and unique service capabilities.

Institutions seeking to establish eligibility for the City's depository shall submit for review financial statements, evidence of federal insurance and other information as required by the Chief Financial Officer.

Any institution designated as a depository by the City will provide collateral in accordance with this Policy and applicable State law. The City reserves the right, in its sole discretion, to accept or reject any form of insurance or collateralization pledged towards depository deposits. Institutions serving as a depository will be required to sign a Depository/Collateral Agreement with the City. The collateralized deposit portion of the Agreement shall define the City's rights to the collateral in case of default, bankruptcy, or closing and shall establish a perfected security interest in compliance with Federal and State regulations, including:

- The agreement must be in writing;
- The agreement has to be executed by the Depository and the City contemporaneously with the acquisition of the asset;
- The agreement must be approved by the Board of Directors or designated committee of the Depository and a copy of the meeting minutes must be delivered to the City; and
- The agreement must be part of the Depository's "official record" continuously since its execution.

2. Broker/Dealers

For broker/dealers, the City shall select only those dealers reporting to the Market Reports Division of the Federal Reserve Board of New York, also known as the "Primary Government Security Dealers", unless analysis reveals that other firms are adequately financed to conduct public business. All broker/dealers shall provide the City with references from public entities which they are currently serving. The Investment Committee shall adopt and annually review a list of

qualified broker/dealers authorized to engage in investment transactions with the City.

All investment providers, financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the following, as appropriate:

- audited financial statements
- proof of Financial Industry Regulatory Authority (FINRA) certification
- proof of state registration
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Additionally, the qualified representative or equivalent of the Local Government Investment Pool or discretionary Investment Advisor firm (i.e. business organization) shall execute a Certificate to the effect that the qualified representative has:

1.) Received and thoroughly reviewed this Investment Policy, and

2.) Acknowledged that their business organization has implemented reasonable procedures and controls in an effort to preclude imprudent investment transactions between itself and the City that are not authorized by this 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 and interpretation of subjective investment standards or relates to investment transactions of the City that are not made through accounts or other contractual arrangements over which the business organization has accepted discretionary investment authority.

The City may not engage in an investment transaction with a business organization prior to receiving this written acknowledgment completed by the organization.

G. SAFEKEEPING AND CUSTODY

1. Insurance or Collateral

All non-insured deposits and repurchase agreement investments of City funds shall be secured as required by State legislation. In order to anticipate market changes and provide a level of security for all funds, the minimum collateralization level will be 102% of market value of principal plus accrued interest on the deposits or repurchase agreement investments less any amount insured. Evidence of the pledged collateral shall be maintained by the Chief Financial Officer or Director of Finance (for their respective portfolios), or a third party financial institution. Repurchase agreements shall be documented by a specific agreement noting the eligible collateral pledge in each agreement. Collateral shall be reviewed at least monthly to assure that the market value of the pledged securities is adequate.

2. Custodial Agreement

Collateral pledged to secure deposits of the City shall be held by a custodian institution in accordance with a Custodial Agreement which clearly defines the procedural steps for gaining access to the collateral should the City determine that the City's funds are in jeopardy. The custodian institution shall be the Federal Reserve Bank or an institution not affiliated with the firm pledging the collateral.

3. Collateral Defined

The City shall accept only the following as collateral:

- a) FDIC and NCUSIF insurance coverage.

- b) A bond, certificate of indebtedness, or note of the United States or its agencies and instrumentalities, or other evidence of indebtedness that is guaranteed as to the principal and interest by the United States or its agencies and instrumentalities.
- c) Obligations, the principal and interest on which are unconditionally guaranteed or insured by the State of Texas or its agencies and instrumentalities.
- d) A bond of a county, city or other political subdivision of the State of Texas having been rated as investment grade (investment rating no less than “A” or its equivalent) by a nationally recognized rating agency, with a remaining maturity of ten (10) years or less.

The use of a letter of credit issued to the City by a Federal Home Loan Bank may be considered by the City to meet the required bank depository collateral requirements.

4. Subject to Audit

All collateral shall be subject to inspection and audit by the City or the City’s independent auditors.

5. Delivery vs. Payment

Securities shall be purchased using the delivery versus payment method. That is, funds shall not be wired or paid until verification has been made that the correct security was received by the City or its safekeeping agent. The security shall be held in the name of the City or held on behalf of the City. The safekeeping agent’s records shall assure the notation of the City’s ownership of or explicit claim on the securities. The original copy of all safekeeping receipts shall be delivered to the City.

H. INVESTMENT POLICY ADOPTION

The City Investment Policy shall be adopted by resolution of the City Council. The Investment Committee shall review the Policy for effectiveness on an annual basis and any modifications will be recommended for approval to the City Council. The City Council shall review and approve these investment policies and strategies not less than annually.

APPENDIX A

SAMPLE INVESTMENT POLICY CERTIFICATION FORM

As required by Texas Government Code 2256.005(k)

CITY OF TEXARKANA, TEXAS

THE STATE OF TEXAS

COUNTY OF BOWIE

BEFORE ME, the undersigned authority, on this day personally appeared the person whose name is subscribed below, who, being by me first duly sworn, upon oath deposed and said:

My name is _____. I am a Qualified Representative of _____ (the "Business Organization"). This Statement is provided to meet the requirements of the Public Funds Investment Act.

I hereby certify that:

- 1. I have reviewed the City's Investment Policy;
2. The Business Organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the City of Texarkana and the Business Organization that are not authorized by the City's Investment Policy, except to the extent that the Business Organization has not made an analysis of the make-up of the City's entire portfolio or has not engaged in any interpretation of subjective investment standards or requires and interpretation of subjective investment standards or relates to investment transactions of the City that are not made through accounts or other contractual arrangements over which the business organization has accepted discretionary investment authority; and
3. The statements, representations and declarations made in this document are true and correct.

Qualified Representative

SWORN TO AND SUBSCRIBED BEFORE ME, this the _____ day of _____, 20_____.

Notary Public in and for the State of Texas