

CITY OF SAN MARCOS, TEXAS
OPERATING AND BOND FUNDS
INVESTMENT POLICY

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INVESTMENT POLICY – OPERATING AND BOND FUNDS

CITY OF SAN MARCOS FINANCE DEPARTMENT

I. POLICY

It is the policy of the City of San Marcos to invest public funds in a manner which will optimize interest earnings with maximum security while meeting the daily cash flow demands of the City and conforming to all state and local statutes governing the investment of public funds.

II. SCOPE

This Investment Policy (hereafter referred to as Policy) applies to all financial assets of the City except Reserve Funds which are longer in terms and represent different risk profiles. Reserve Funds are managed and controlled by a separate Investment Policy. These financial assets covered by this Policy are within funds that are accounted for in the Comprehensive Annual Financial Report and include:

1. General Fund
2. Special Revenue Funds
3. Capital Projects Funds
4. Debt Service Funds
5. Enterprise Funds
6. Trust and Agency Funds

and any new funds created by the City unless specifically exempted by the City Council and this Policy.

III. PRUDENCE

The standard of prudence to be used by investment officers and Finance Administrators shall be the “prudent person” standard and shall be applied in the context of managing an overall portfolio.

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.

IV. OBJECTIVES

All operating and bond funds will be pooled for investment purposes. The primary objectives, in priority order, of the City’s investment activities for all funds shall be:

1. **Safety:** Safety of principal is the foremost objective of the investment program. Investments of the City shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio.
2. **Liquidity:** The City’s investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements, which might be reasonably anticipated.
3. **Diversification:** In order to supplement the safety objective, diversification is needed to minimize credit and market risk and to reduce overall portfolio impact from potential losses on individual securities.
4. **Yield:** The City’s investment portfolio shall be designed with the objective of attaining a market rate of return in accordance with its designated benchmark which is based on the City’s cash

flow requirements throughout budgetary and economic cycles, commensurate with the City's investment risk constraints and the cash flow characteristics of the portfolio.

V. Strategy

The structure and management of the pooled City portfolio will address the varying needs, goals and objectives of each fund. Investment strategies for General Fund, Special Revenue Funds, Capital Projects Funds, Enterprise Funds, and Trust and Agency Funds are designed to assure that anticipated cash flows are matched with adequate liquidity in each fund. A secondary strategy is to create a portfolio structure that will experience minimal volatility during economic cycles. Both may be accomplished by purchasing high quality, short-to-medium term securities that will complement each other in a laddered structure and assure the marketability of those investments should liquidity needs arise. Investments are to be chosen in a manner that promotes diversity by market sector, credit and maturity. The maximum dollar weighted average maturity of the total portfolio to accomplish these goals will not exceed 18 months, dependent on market conditions.

Investment strategies will address the unique needs for Debt Service Funds to primarily assure investment liquidity adequate to cover the debt service obligation for each consecutive debt service payment. Investments shall progressively fund each succeeding debt service.

Effective cash management is recognized as essential to good fiscal management. Cash management is defined as the process of managing monies in order to ensure maximum cash availability to the City for investment use. The City shall maintain a comprehensive cash management program that includes collection of accounts receivable, prudent investment of its available cash, disbursement of payments in accordance with invoice terms and the management of banking services.

VI. DELEGATION OF AUTHORITY

Investment Officers

Management responsibility for the investment program is hereby delegated to the Director of Finance, the Accounting Manager, and Cash Management Accountant or staff accountant as designated by Director of Finance and they are therefore designated as the Investment Officers under the Act and by resolution of the City Council. The Investment Officer(s) shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

Investment Officers who are employees of the City acting in accordance with this standard, written procedures and the Policy and exercising due diligence shall be relieved of personal liability for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments. Investment Advisors / Managers acting under contract to the City are not relieved of personal responsibility.

Investment advisors / managers under contract to the City may also be designated as Investment Officers by the City Council. A contracted Investment Advisor / Manager will perform the investment responsibilities of the Investment Officer. The investment management firm selected to transact investment business on behalf of the City will be provided a copy of this Policy to assure that they are familiar with the goals and objectives of the investment program. All key investment professionals of the investment management firm will be required to return a signed copy of the Certification by Business Organization substantially in the form provided as Appendix B. The investment management firm, which will act in a fiduciary capacity, must be registered with the Securities and Exchange Commission under the Investment Advisor's Act of 1940. The Investment Advisor / Manager will be required to manage the City's funds in accordance with the laws of the State of Texas, and Investment Policies and procedures established by the City.

In accordance with the Act, Investment Officers shall attend investment training session no less than once every two years receiving not less than 8 hours of instruction relating to investment responsibilities. A newly

appointed Investment Officer must attend a training session of at least 10 hours of instruction within twelve months of the date the officer took office or assumed investment officer duties. The investment training sessions shall be provided by an independent source approved and authorized to issue PFIA training certification. For purposes of this Policy, an "independent source" from which investment training shall be obtained shall include a professional organization, an institution of higher education or any other sponsor authorized to issue PFIA training certification..

Investment Committee

An Investment Committee consisting of the Finance and Audit committee members, and Accounting Manager is established to review quarterly reports and Policy changes as well as advise the City Council on investment matters. The Investment Committee shall, at least annually or as required by market conditions, review, revise, and adopt a list of authorized broker/dealers that may engage in investment transactions with the City based on the annual review of the financial condition and registrations of dealers and institutions conducted by the Investment Officer(s) (in accordance with this Policy).

VII. INVESTMENT PROCEDURES

The Investment Officer(s) shall establish reasonable commercial written procedures for the operation of the investment program consistent with this Policy. The procedures should include to safekeeping, repurchase agreements, wire transfer agreements, banking service contracts and collateral/depository agreements. No person may engage in an investment transaction except as provided under the terms of this Policy and the procedures established by the Investment Officer(s). Investment Committee will make the recommendation when to contract with an Investment Advisor / Manager firm depending on market conditions and review / analysis of contract cost versus investment portfolio return.

All investment purchases will be executed using the competitive bidding process and settled on a delivery versus payment (DVP) basis. A minimum of three competitive offers on the purchase/sale of every security will be obtained or approval from an Investment Committee officer on a competitive offer due to market conditions and time constraints. All investment purchases will be executed in compliance with the Internal Revenue Service's Fair Market Rules.

VIII. ETHICS AND CONFLICTS OF INTEREST

Investment officers and employees involved in the investment process shall refrain from any 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 officers shall disclose in writing to the City Manager any material financial interests in financial institutions that conduct business with the City, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City's portfolio. Investment officers involved in the investment process with personal business relationships or relatives within the second degree of affinity or consanguinity seeking to sell investments/securities to the City shall disclose the relationship and file a statement with the Texas Ethics Commission and the City Council. Personal business relationships are defined in the Act.

IX. AUTHORIZED BROKER/DEALERS AND FINANCIAL INSTITUTIONS

The objective of safety requires that the City transact business with financially strong broker/dealers and financial institutions. Therefore, financial broker/dealers and institutions shall be subject to a screening process by the Investment Officers and/or City contracted Investment Advisor / Manager to eliminate those dealers and institutions that lack economic viability or whose past practices put the safety of public capital at risk.

The Investment Advisor / Manager under contract will observe the instructions of the City with respect to broker/dealers who are approved to execute transactions involving the City's Managed Funds and in the

absence of such instructions will engage broker/dealers which the Advisor / Manager reasonably believes to be reputable, qualified and financially sound.

These broker/dealers may include “primary” dealers or regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule). Authorized dealers and institutions shall provide proof of Financial Institutions Regulatory Authority (FINRA) certification, an annual audited financial statement, and a completed broker/dealer questionnaire.

Additional financial institutions may be used for time or demand deposits designed for investment purposes (i.e. not as the primary depository of the City). These institutions may be approved by the Investment Officer(s) on an ongoing basis to accommodate the need for timely action. Action by the Investment Committee is not required before use of such institutions. Each financial institution will provide policy certification and execute a depository agreement. The City may utilize third-party rating agencies in order to assess the overall financial strength of potential depositories.

The depository, or its brokerage subsidiary, from which the City obtains banking services including safe-keeping, will not be used for brokerage services in order to perfect ownership on delivery versus payment settlement. The bank may be used for time deposits but all time deposits will be bid competitively.

X. AUTHORIZED AND SUITABLE INVESTMENTS

Authorized investments shall be limited to the instruments listed below as authorized and further described by the Act.

1. Obligations of the United States, its agencies and instrumentalities, not to exceed two years to the stated final maturity, excluding mortgage-backed securities.
2. Direct obligations of the State of Texas or its agencies and instrumentalities, not to exceed two years to the stated final maturity;
3. Other obligations, the principal of and interest of which are unconditionally guaranteed or insured by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities, not to exceed two years to the stated final maturity;
4. Obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent, not to exceed two years to the stated final maturity;
5. Fully insured or collateralized certificates of deposit or share certificates, issued by state and national banks or credit unions, not to exceed two years to the stated final maturity that are:
 - a. Guaranteed or insured by the Federal Deposit Insurance Corporation or the National Credit Union Association, or other federal agency, or successors; or
 - b. Collateralized to 102% in accordance with this Policy (Section XI).
6. Fully collateralized direct repurchase agreements having a defined termination date, collateralized in accordance with this Policy, safe-kept with an independent third party approved by the City, with an executed master repurchase agreement, and placed through a primary government securities dealer, as defined by the Federal Reserve, or a bank doing business in Texas, not to exceed 90 days to the stated maturity;

Flexible repurchase agreements (flex repos) are authorized for investment of bond proceeds, if collateralized in accordance with this Policy, safe-kept with an independent third party approved by the City, with an executed master repurchase agreement, and placed through a primary government securities dealer, as defined by the Federal Reserve. The term of the flex

repo may exceed two years but not exceed the anticipated expenditure schedule of the bond proceeds and no party involved with the issuance of the debt shall be involved with the funds reinvestment.

7. Investment Pools as defined and regulated by the PFIA.
8. Commercial paper rated not less than A1/P1 or its equivalent by two nationally recognized rating agencies and not to exceed 270 days to stated final maturity.
9. AAA-rated, SEC registered money market funds as described in Sec. 2256.014 of the PFIA.
10. FDIC insured brokered certificate of deposit securities from banks in any US state, delivered versus payment to the City's safekeeping depository, not to exceed one year to maturity. Before purchase the Investment Officer or adviser must verify the FDIC status of the bank on www.2fdic.gov.idasp/main_bankfind/asp to assure that the bank is FDIC insured.

XI. COLLATERALIZATION

Pledged Collateral

Collateralization is required on time and demand deposits. In order to anticipate market changes and provide a level of security for all funds, the collateralization margin level will be maintained at a minimum of 102% of deposits plus accrued. The counter party shall be made contractually liable for monitoring and maintaining the collateral and required margins at all times. Collateral shall be priced at least monthly. The custodian shall provide the required periodic reports directly to the City.

Owned Collateral

Repurchase agreements shall be collateralized to 102% of principal and accrued interest. The counter party shall be made contractually liable for monitoring and maintaining the collateral and required margins at all times. Collateral shall be priced daily. The Custodian shall provide the required periodic reports directly to the City.

Authorized Collateral

Collateral shall be limited to the following:

- Obligations of the US Government, its agencies and instrumentalities to include mortgage-backed securities which pass the bank test.
- Obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent.

Collateral will always be held by an independent third party with whom the City has a current custodial agreement. A clearly marked evidence of ownership (report or receipt) must be supplied to the City and retained. The right of collateral substitution is granted with prior City approval.

XII. SAFEKEEPING

Safekeeping function will be provided by the City's banking services depository or a PFIA approved Safekeeping service contracted in conjunction to the City's banking services depository agreement. In order to ensure protection for City owned securities, the City requires delivery versus payment procedures for all transactions, except pools, money market funds and time deposits, which have no book entry delivery.

All security transactions, including collateral for repurchase agreements shall be conducted on a delivery versus payment (DVP) basis to the City's depository or a City approved third party custodian. Securities will be held by a third party custodian approved by the Investment Officer(s) and evidenced by proof of

ownership (original safekeeping receipts).

XIII. DIVERSIFICATION

Diversification of the overall portfolio will be maintained in accordance with the following diversification limits.

| <u>Security Type</u> | <u>Maximum % of Portfolio</u> |
|---|-------------------------------|
| US Government Treasury Obligations | 100% |
| US Government Agencies and Instrumentalities | 80% |
| Municipal Instruments | 50% |
| Certificates of Deposit | 43 30% |
| Issued by institution | 20% |
| Repurchase Agreements | 30% |
| Flex repurchase agreements for bond proceeds | 100% |
| Constant dollar <u>Local Government</u> Investment pools | |
| 100% | |
| Ownership of the pool | 10% |
| Commercial Paper | 34 0% |
| Limit per commercial paper issuer | 10% |
| Money Market Mutual Fund | 50% |
| Ownership of the fund | 10% |

XIV. INTERNAL CONTROLS

The Investment Officer(s) shall establish a system of written internal controls that will be reviewed annually with the City or independent auditor of the City along with quarterly investment reports. The controls will be designed to prevent loss of public funds due to fraud, employee error, misrepresentation by third parties, unanticipated market changes, or imprudent actions by employees, contracted investment managers or financial counterparties of the City.

Loss of Rating

The Investment Officer or investment adviser / manager shall monitor, on no less than a weekly basis, the credit rating on all authorized investments in the portfolio based upon independent information from a nationally recognized rating agency. If any security falls below the minimum rating required by Policy, the Investment Officer or adviser shall notify the City Manager of the loss of rating, conditions affecting the rating and possible loss of principal with liquidation options available, within two weeks after the loss of the required rating.

Monitoring FDIC Status

The Investment Officer or Investment Adviser / manager shall monitor, on no less than a weekly basis, the status and ownership of all banks issuing brokered CDs owned by the City based upon information from the FDIC. If any bank has been acquired or merged with another bank in which brokered CDs are owned, the Investment Officer or Adviser shall immediately liquidate any brokered CD which places the City above the FDIC insurance level.

XV. PERFORMANCE STANDARDS

The investment portfolio shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and cash flow needs of the City. A benchmark for performance of the portfolio will be included in the quarterly reports based on the portfolio's maximum weighted average maturity of 360 days. The periodic total return of the six-month

U.S. Treasury Bill will be used as the City's operating benchmark.

XVI. REPORTING

The Investment Officer(s) shall provide the Investment Committee and City Council quarterly investment reports as required by the Act ~~and a monthly report to the Investment Committee~~. The reports will reflect both detail and summary information enabling the reader to determine the value and risk associated with the portfolio. Market values for the report will be derived from an independent source.

A management report will be included with the quarterly investment report. The management report should include comments on the fixed income markets and economic conditions, discussions regarding diversification, allocation restrictions on investments, possible changes in the portfolio structure going forward and thoughts on investment strategies.

XVII. CASH MANAGEMENT PROGRAMS AND ACTIVITIES

The Department of Finance is committed to the overall success of the City's cash management programs. These programs address a variety of cash management issues, including:

1. The design and implementation of reliable and effective cash flow forecasting methodologies to assist Finance Department personnel and Investment Officer(s) in the determination of the amounts of cash available for investment, the time period for which the funds may be invested with a reasonable level of confidence, and a measure of the volatility of specific cash forecasts, which will allow viable determination of the required liquidity.
2. The design and implementation of appropriate "revenue-acceleration programs", aimed at enhancing the speed at which monies are collected and deposited by the City and the elimination of bad debt expense/write-offs.
3. The design and implementation of suitable "controlled disbursement" programs, which will ensure that the City's expenses are met in timely manner, but not in such a way as to jeopardize the earning capacity of the City's portfolio.
4. The utilization of modern and efficient techniques and technology for the physical movement of money, taking advantage of technological and operational procedures.
5. The design and implementation of banking relationships which are both favorable to the City and responsive to the day-to-day requirements of the City's complex financial operations.
6. The design of investment policies and procedures to ensure the total safety of all funds while allowing the City to maximize its interest earnings.
7. The design and implementation of appropriate policies and procedures with regard to the proper and effective use of the City's municipal credit authority.

XVIII. INVESTMENT POLICY ADOPTION

The City's Investment Policy shall be annually reviewed and adopted by resolution of the City Council. Any modifications made thereto must be noted in the approving Resolution.

APPENDIX A

Broker / Dealer Questionnaire & TX PFIA Certification

APPENDIX B

PFIA

APPENDIX C
CITY OF SAN MARCOS
INVESTMENT PROCEDURES

I. PURPOSE

The purpose of these procedures is to assist Finance Department staff with day-to-day investment operations and assign responsibilities. These procedures are an outline, with individual items to be added or deleted as necessary or appropriate.

II. CASH REVIEW

The City Investment Officer(s) must review the cash balances and investment portfolio at least daily, or as needed. Items to be reviewed should include:

- All balances and float amounts at contracted depository bank.
- All maturing investments.
- All incoming wires, bond sales and other anticipated receipts.
- All outgoing wires, bond and coupon payments (debt service) and other anticipated cash disbursements.

III. INVESTMENT SELECTION

The City Investment Officer(s) determines how much of the cash balance is available for investment and selects the maximum maturity date.

The Investment Officer(s) and/or the contracted Investment Advisor / Manager will review market conditions in conjunction with approved brokers to search for suitable investments.

Information including the following is used to determine optimal maturity to take advantage of current and expected interest rate environments:

- Market information (yield analysis, spread analysis, and future expectations)
- General trends of economic statistics.
- Input from independent data services (Bloomberg, Reuters, etc.)

IV. PURCHASING AND INVESTMENT

The Policy requires establishment and approval of an authorized broker/dealer list with whom the City may transact business. The broker/dealer questionnaire helps provide the following evaluation:

- Financial condition, strength and capability to fulfill commitments.
- Overall reputation with other broker/dealers and investors.
- Regulatory status of the broker/dealer.
- Background and expertise of the individual representative.

The City investment officer(s) and/or the contracted Investment Adviser / Manager will contact an appropriate number of broker/dealers for offers based on market evaluation, Investment Policy and collateral limitations, and cash flow information given

The following will be determined with the broker/dealer:

- Settlement basis – i.e. cash (same day), regular (next day), or when-issued (issue date) if a new agency issue.
- Amount available for investment,
- Type of security to be purchased excluded.
- Targeted maturity, or maturity range.

If choosing an investment pool as the preferred investment vehicle, the Council resolution and authorized individuals (PIN) resolutions must be in place prior to purchase and at any reasonable time thereafter. All pool transactions are initiated and controlled by City Investment Officer(s)

All investment purchases will be executed using the competitive bidding process. A minimum of three competitive offers on the purchase of every security will be obtained or approval from an Investment Committee officer on a competitive offer due to market conditions and time constraints. All investment purchases will be executed in compliance with the Internal Revenue Service's Fair Market Rules.

Before concluding the transaction, the City investment officer(s) and/or the Investment Adviser / Manager verifies the following:

- The security meets all cash flow and Policy criteria.
- The security structure including any imbedded options such as call provisions or coupon adjustments.
- Yield calculations and settlement amounts.
- Total purchase cost (including accrued interest).

And,

- Advises the successful provider that their offering has been selected for purchase.
- Notifies any unsuccessful broker/dealers. Best price may be disclosed.

Prior to settlement date, the City Investment Officer and/or Investment Adviser /Manager and broker/dealer exchange and review the following settlement instructions to ensure prompt, and uninterrupted settlement.

- Name of third-party safekeeping agent.
- ABA number of safekeeping agent.
- Safekeeping account number.
- Amount of transaction.
- Settlement date.
- CUSIP number of security, if applicable.

V. SETTLEMENT AND FOLLOW-THROUGH

The City Investment Officer and/or the Investment Adviser / Manager will obtain a written trade ticket for the City's records and the safekeeping agent

City follow-up procedures may include:

- Internal provision of receipt or disbursement of funds.
- Internal transfer or wiring of funds.
- Validation of written "safekeeping receipt".
- Immediate notification by the adviser if a fail has occurred.