



**INVESTMENT POLICY
AND
INVESTMENT STRATEGIES**

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I. POLICY STATEMENT

It is the Policy of the Town of Pantego (the "Town") that the administration of its funds and the investment of those funds shall be handled at its highest public trust. Investments shall be made in a manner which will provide the maximum security of the principal through established limitations and diversification while meeting the daily cash flow needs of the Town and conforming to all applicable state statutes 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 Town Council who will formally approve any modifications. This Investment Policy, as approved, is in compliance with all state laws and statutes which govern the investments of public funds, including but not by way of limitation, the Public Funds Investment Act (PFIA), Chapter 2256, Government Code.

II. SCOPE

- A. This investment policy applies to all the financial assets and funds of the Town of Pantego and the Pantego Economic Development Corporation. The Town commingles its funds into one pooled investment portfolio for efficiency and maximum investment opportunity. These funds are defined in the Town's Annual Financial Report and include any new funds created by the Town unless specifically exempted by the Town Council and this Policy.

In addition to this Policy, the investment of bond proceeds and other bond funds (including debt service and reserve funds) shall be governed by and controlled by their governing ordinance and by the provisions of the Tax Reform Act of 1986, including all regulations and ruling 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 to expenditures for specific purposes.
 3. Debt Service Funds – including reserves and sinking funds to the extent not required by law or existing contract to be kept segregated and managed separately - and used to account for resources to be used for the payment of principal, interest and related costs on general obligation debt.
 4. Capital Projects 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.
 5. Enterprise Funds – used to account for operations that are financed and operated in a manner similar to private business enterprises.

6. Trust and Agency Funds – used to account for assets held by the Town in a trustee capacity or as an agent for individuals, private organizations, other governments, and/or other funds.
 7. Any new fund created by the Town unless specifically exempted from this policy by the Town or the law.
- C. Funds covered by this Policy and managed as separately invested assets as defined in PFIA 2256.002(9):
1. Bond Funds – funds established with the proceeds from specific bond issues when it is determined that segregating these funds from the pooled fund's 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 Town 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 specific purposes.
 3. Trust of Escrowed Funds – funds held outside the Town by a trust or escrow agent but belonging to the Town.

This Policy shall not govern funds, which are managed under separate investment programs in accordance with the PFIA 2256.004.

III. GENERAL OBJECTIVES

It is the policy of the Town that, giving due regard to the safety and risk investments, all available funds shall be invested in conformance with State and Federal Regulations, applicable Bond Ordinance requirements, adopted Investment Policy and adopted Investment Strategies. In accordance with the Public Funds Investment Act Section 2256.005(d), the following prioritized objectives (in order of importance) apply to each of the Town's investment strategies:

- A. Suitability – Understanding the suitability of the investment to the financial requirements of the Town is important. Any investment eligible in the Investment Policy is suitable for all Town funds.
- B. Safety of Principal – Preservation and safety of principal are the foremost objective of the Town. Investments of the Town shall be undertaken in a manner that seeks to insure preservation of capital in the overall portfolio.
- C. Liquidity – The Town's investment portfolio will be based on a cash flow analysis of cash needs and will remain sufficiently liquid to enable it to meet all operating requirements which might be reasonably anticipated. Liquidity shall be achieved by matching investment maturities with estimated cash flow requirements and by investing in securities with active secondary markets.
- 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 or less than a quarter of a percentage point shall define an efficient secondary market.

Diversification – Diversification of the portfolio will include diversification by maturity and market sector to protect against credit and market risk. The Town will diversify its investments in an effort to avoid incurring unreasonable and avoidable risks regarding specific security types or individual financial institutions.

- F. Yield – Attaining a competitive market yield, commensurate with the Town’s investment risk constraints and the cash flow characteristics of the portfolio, is the desired objective. The goal of the Town’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 in days. The yield of an equally weighted, six month Treasury Bill portfolio shall be the minimum yield objective or “benchmark”. 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.

Applicable tax exempt debt proceeds shall attempt to achieve a return equal to the above unless that return exceeds applicable arbitrage yield limit on the debt. In certain interest rate environments the Town may need to restrict yields in order not to exceed arbitrage limits.

IV. STANDARDS OF CARE

- A. Prudent Person Rule. The Town’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 PFIA Sec. 2256.006(a-b):

“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 capital and the probable income to be derived”.

Investment of funds shall be governed by the following investment objectives, in order of priority:

1. Preservation and safety of principal;
2. Liquidity; and
3. Yield.

The Investment Officers and those delegated investment authority under this Policy shall seek to act responsibly as custodians of the public trust. Investment participants shall avoid any transactions that might impair public confidence in the Town’s ability to govern effectively. The governing body recognizes that in a diversified portfolio, occasional measured losses due to market volatility are inevitable and must be considered within the context of the overall portfolio’s investment rate of return, provided that adequate diversification has been implemented.

In determining whether an Investment Officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration:

1. The investment of all funds, or funds under the entity's control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment; and
2. Whether the investment decision was consistent with the written investment policy of the Town.

The Investment Officers, when acting in accordance with the written procedures and due diligence, shall not be held personally responsible for market price changes, provided that deviations from expectations are reported in a timely manner and that appropriate action is taken to control adverse market effects. The governing body of the investing entity retains ultimate responsibility as fiduciaries of the assets of the entity.

B. Delegation of Investment Authority

The Town Manager and Finance Director, acting on behalf of the Town, are designated as the Investment Officers of the Town and are responsible for management decisions and activities. The Investment Officers are also responsible for considering the quality and capability of staff, investment advisors, and consultants involved in investment management and procedures.

The Investment Officers shall develop and maintain written administrative procedures for the operation of the investment program which are consistent with this Investment Policy. The Investment Officers shall also designate a staff person as a liaison/deputy in the event circumstances require timely action and the Investment Officers are not available.

The Investment Officers shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials and staff. No officer or designee, shall engage in an investment transaction except as provided under the terms of this policy, the procedures established by the Finance Director and the explicit authorization by the Town Manager to withdraw, transfer, deposit and invest the Town's funds.

C. Internal Controls

The Investment Officers shall establish a system of written internal controls which will be reviewed annually with the independent auditors of the Town. The controls shall 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 of the Town. Controls deemed most important include: control of collusion, separation of duties, third party custodial safekeeping, avoidance of bearer-form securities, clear delegation of authority, specific limitations regarding securities losses and remedial action, written confirmation of telephone transactions,

minimizing the number of authorized investment officials, and documentation and rationale for investment transactions.

D. Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activities that could conflict with proper execution of the investment program or which could impair their ability to make impartial investment decisions. Investment Officers involved shall disclose in writing to the Town Council any financial interest in financial institutions that conduct business with the Town or any personal financial/investment position that could be related to the performance of the Town.

The Investment policy requires the investment officers to file a disclosure statement with the Texas Ethics Commission and the governing body if the investment officer has a personal business relationship or is related within the second degree of affinity or consanguinity to an individual or organization seeking to sell an investment to the Town. For purposes of this section, an investment officer has a personal relationship with a business organization if and as defined in PFIA 2256.005(i)(1-3):

1. The Investment officer 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 from the business organization exceed 10% of the investment officer's gross income for the previous year; or
3. The Investment officer has acquired from the business organization during the previous year investments with a book value of \$2,500 or more for the personal account of the investment officer.

E. Investment Training Requirements

Town of Pantego shall provide periodic training in investments for the investment personnel through courses and seminars offered by professional organizations and associations in order to insure the quality and capability of the Town's investment personnel making investment decisions in compliance with the PFIA 2256.005(b)(3).

All Investment Officers shall attend ten (10) hours of training within twelve (12) months of taking office or assuming duties and ten (10) hours in each succeeding two year period as defined in PFIA 2256.008. The training provider must be an independent source approved by Town Council or investment committee.

For purposes of this policy, an "independent source" from which investment training shall be obtained shall include a professional organization, an institute or higher learning or any other sponsor other than a business organization with whom the Town of Pantego may engage in an investment transaction. Such training shall include education in investment controls, credit risk, market risk, investment

strategies, and compliance with investment laws, including the Texas State Public Funds Investment Act.

F. Investment Committee

The Finance/Audit Committee shall function as the Town's Investment Committee. This Committee shall recommend strategies and guidelines for the percentage of the total portfolio that may be invested in securities other than U.S. Treasury Bills, U.S. Treasury Notes and Investment Pool(s). The recommendations of the Investment Committee will be presented to the Town Council for final approval.

V. **AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS**

All investments made by the Town will be made through either the Town's banking services or an authorized broker/dealer.

A. Depository – The Town Council shall, by ordinance, “select and designate one or more banking institutions as the depository for the monies and funds of the Town” in accordance with PFIA. At least every five years a depository shall be selected through the Town's banking services procurement process, which shall include a formal request for proposal (RFP). The selection of the 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 Town 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 Town. The Town Council will, at least annually, review, revise and approve a list of authorized/qualified broker/dealers along with this investment policy. These firms may include:

1. All primary government securities dealers; and
2. Those regional broker/dealers who qualify under Securities and Exchange Commission rule 15C3 (Uniform Net Capital Rule), and who meet other financial criteria standards in the industry.

A list of no less than three (3) and no more than five (5) authorized brokers/dealers will be established and maintained. These firms will be selected based on their competitiveness, participation in agency selling groups, and experience and background of the salesperson handling the account.

- C. Signed Investment Policy Certification Form. Investments shall only be made with those business organizations, including money market mutual funds and local government investment pools, that have provided the Town with a written instrument, executed by a qualified representative of the firm, acknowledging that the business organization has:
1. Received and reviewed the Town's Investment Policy; and
 2. Implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the Town and the organization that are not authorized by the Town's Investment Policy, except to the extent that this authorization is dependent on an analysis of the makeup of the Town's entire portfolio or requires an interpretation of subjective investment standards. PFIA 256.005(k-l).
- D. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the investment officers with the following:
1. Audited financial statements;
 2. Proof of National Association of Securities Dealers (NASD) certification, unless it is a bank;
 3. Resumes of all sales representatives who will represent the financial institution or broker/dealer firm in dealings with the Town, and
 4. Any other document that should help evaluate the financial institution's and broker/dealers' soundness such as rating agency reports, review of call reports and analysis of management profitability, capitalization and assets quality.
- E. Financial/Investment Advisor – The Town may retain the services of an investment advisory firm registered under the Investment Advisers Act of 1940 or with the State Securities Board to assist in the review of cash flow requirements, the formulation of investment strategies, and the execution of security purchases, sales and deliveries. The investment advisory contract with the Town may not be for a term longer than two years and its renewal or extension must be approved by the Town Council by ordinance or resolution as required by PFIA 2256.003(b). If the Town has contracted with an investment advisor, the advisor shall be responsible for performing financial due diligence on the Town's behalf. On an annual basis, the advisor will provide the Town with a list of its authorized broker/dealers as well as the written instrument above.

VI. SAFEKEEPING AND CUSTODY OF INVESTMENT ASSETS

- A. As specified in PFIA 2256.005(b)(4)(E), the laws of the State of Texas and prudent treasury management require that all purchased securities be bought on a delivery versus payment (DVP) basis and be held in safekeeping by an independent third party financial institution, or the Town's designated banking services depository. Funds shall not be wired or paid until verification has been made that the correct security was received by the safekeeping bank. The only exception to DVP settlement shall be wire transactions for money market funds and government

investment pools. The safekeeping or custody bank is responsible for matching up instructions from the Town's investment officers or an investment settlement with what is wired from the broker/dealer, prior to releasing the Town's designated fund for a given purchase.

- B. All safekeeping arrangements shall be approved by the Investment Officers and an agreement of the terms executed in writing. The third party custodian shall be required to issue safekeeping receipts to the Town or its agent a listing of each specific security, rate, description, maturity, par amount, CUSIP number and other pertinent information. Each safekeeping receipt will be clearly marked that the security is held for the Town or pledge to the Town.
- C. All securities pledged to the Town for certificates of deposit or demand deposits shall be held by an independent third party bank doing business in the State of Texas. The safekeeping bank may not be within the same holding company as the bank from whom the securities are pledged.

VII. SUITABLE AND AUTHORIZED INVESTMENTS

- A. Acceptable investments under this policy shall be limited to the investments authorized by PFIA listed in Sections 2256.009-2256.016 and 2256.019-2256.0201 and as shown below:
 - 1. Obligations, including letters of credit, of the United States or its agencies and instrumentalities;
 - 2. Direct obligations of the State of Texas or its agencies and instrumentalities;
 - 3. Collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States;
 - 4. Obligations fully guaranteed or insured by the Federal Deposit Insurance Corporation (FDIC) or by the explicit full faith and credit of the United States;
 - 5. Obligations of states, agencies, counties, cities and other political subdivisions of any state rated not less than A or its equivalent;
 - 6. Bonds issued, assumed, or guaranteed by the State of Israel.

If additional types of securities are approved for investment by public funds by state statute, they will not be eligible for investment by the Town until this policy has been amended and the amended version approved by the Town Council.

- B. Investment instruments **not** authorized for purchase by the Town of Pantego, including those specifically prohibited by PFIA 2256.009(b)(1-4), include:
 - 1. Obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and bears no interest, such as banker's acceptances;

2. Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest, such as mutual funds;
3. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and
4. Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in the market index.

C. **Authorized Investments:**

1. Certificates of Deposit and Share Certificates – authorized investment if the certificate is issued by a depository institution that has its main office or a branch office in the State of Texas and is (1) guaranteed or insured, (2) collateralized, or (3) secured in any other manner provided by law. (PFIA 2256.010)
2. Repurchase agreements – is an authorized investment if (1) has a defined termination date, (2) is secured by obligations in Section 2256.009(a)(1) and (3) requires third-party safekeeping and (4) is placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in the State of Texas.
 - Repurchase agreement means a simultaneous agreement to buy, hold for a specified time, and sell back at a future date.
 - Reverse security repurchase agreement may not exceed 90 days.
 - Investments acquired must mature no later than the expiration in the reverse security repurchase agreement.
3. Securities Lending Program – to qualify as an authorized investment under PFIA 2256-0115:
 - The value of the securities loaned under the program must not be less than 100% collateralized, including accrued income;
 - A loan under this program must allow for termination at any time;
 - Must be secured by cash, letters of credit or securities described in PFIA 2256.009;
 - Collateral must be (1) pledge, (2) held in the Town's name and (3) be deposited with a third party.
 - A loan made under this program must be placed through a primary dealer or a financial institution doing business in the State of Texas.
 - An agreement to lend securities executed under this section must have a term of one (1) year or less.
4. Bankers' Acceptances – authorized investment under PFIA 2256.012 if it has a stated maturity of 270 days or fewer; will be liquidated in full at maturity; is eligible for collateral for borrowing from a Federal Reserve Bank; and is accepted by a U.S. bank rated no less than A-1 or P-1 or an equivalent rating by at least one nationally recognized credit rating.

5. Commercial Paper – authorized investment under PFIA 2256.013 if the commercial paper has a stated maturity of 270 days or fewer and is rated not less than A-1 or P-1 or an equivalent rating by at least two nationally recognized credit rating agencies, or one credit rating agency and an irrevocable bank letter of credit.
6. Mutual Funds
 - a. A *no-load money market mutual fund* is an authorized investment under PFIA 2256.014 **if**:
 1. Is registered with and regulated by the Securities Exchange Commission (SEC);
 2. Has a dollar-weighted average stated maturity of 90 days or fewer; and
 3. Includes in its investment objectives the maintenance of a stable net asset value of one dollar for each share.
 - b. A *no-load mutual fund* is an authorized investment under this section **if**:
 1. Is registered with the SEC;
 2. Has an average weighted maturity of less than two years;
 3. Is invested exclusively in approved obligations;
 4. Is continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than AAA or its equivalent; and
 5. Conforms to the requirement set forth in PFIA 2256.016(b-c) relating to the eligibility of investment pools to receive and invest funds of investing entities.
 - c. An entity is **not** authorized by this section to:
 1. Invest in the aggregate more than 15 percent of its monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service, in mutual funds described above;
 2. Invest any portion of bond proceeds, reserves and funds held for debt service, in mutual funds described above; or
 3. Investing entity may not own more than 10 percent of the mutual fund's total net assets.
7. Guaranteed Investment Contracts – authorized investment for bond proceeds under PFIA 2256.015 if the guaranteed investment contract:
 - Has a defined termination date;
 - Is secured by obligations described in PFIA 2256.009(a)(1);
 - Is pledged to the entity and deposited with the entity or with a third-party selected and approved by the entity;
 - Term may not exceed 5 years from date of bond issuance, excluding reserves and debt service funds;
 - To be eligible as an authorized investment: (1) it must be specifically authorized when authorizing bond, (2) requires at least 3 bids from separate providers, (3) the entity must purchase the highest yielding guaranteed investment contract for which a qualifying bid is received, (4) must take into account the reasonably expected drawdown schedule for the bond proceeds to be invested, and (5) must have reasonable administrative costs expected to be paid to third parties in connection with the guaranteed investment contract.

8. Investment Pools – An entity may invest its funds and funds under its control through an eligible investment pool if the governing body of the entity by rule, order, ordinance, or resolution, as appropriate, authorizes investment in that particular pool. 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. 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.

To be eligible to receive fund from an invest funds on behalf of the Town, 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 PFIA 2256.016. Investments will be made in a local government investment pool only after a thorough investigation of the pool and approval by the Town Council which shall at least annually review, revise and adopt the local government investment pool(s) list.

The Town 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 PFIA 2256.021. However, if it is determined by the Investment Committee that the Town will benefit from holding the securities to maturity to recapture its initial investment then the Investment Officers may act accordingly. The Town is not required to liquidate investments that were authorized investments at the time of purchase. (PFIA 2256.017)

VIII. COLLATERALIZATION

A. Market Value

In order to anticipate market changes and provide a level of additional security for all funds, the market value of collateral will be maintained at 102% of total principal and accrued interest for cash balances in excess of the Federal Deposit Insurance Corporation (FDIC) or National Credit Union Share Insurance Fund (NCUSIF) insurance coverage. The Town's depository will be contractually liable for monitoring and maintaining the collateral and margins at all times. The depository or custodian will also provide monthly reports to the Town detailing the collateral and including current market values. Only an authorized Town representative will approve and release all pledged collateral.

Collateral will be pledged under the terms of a written third-party depository agreement executed under the terms of the Financial Institutions Resource and Recovery Enforcement Act (if the custodian is the Federal Reserve the Town will execute a Circular 7 form). The agreement will be approved by resolution of the bank's board or loan committee.

B. Collateral Substitution

Collateralized investments often require substitution of collateral. The safekeeping bank must contact the City for approval and settlement. The substitution will be approved if its value is equal to or greater than the required collateral value.

C. Collateral Reduction

Should the collateral's market value exceed the required amount, the Safekeeping bank may request approval from the Town to reduce collateral. Collateral reductions may be permitted only if the collateral's market value exceeds the required amount.

D. Letters of Credit

Letters of credit are acceptable collateral for Certificates of Deposit. Upon the discretion of the Town, a letter of credit can be acceptable collateral for Town funds held by the Town's bank depository.

E. Subject to Audit – All collateral shall be subject to inspection and audit by the Town Manager, or designee, as well as the Town's independent auditors.

IX. INVESTMENT PARAMETERS

A. Bidding Process for Investments

It is the Policy of the Town of Pantego to require at least 3 competitive bids or offers for all investment transactions (securities and CD's) except for:

1. Transactions with money market mutual funds and local government investment pools (which are deemed to be made at prevailing market rates); and
2. Treasury and agency securities purchased at issue through an approved broker/dealer.

B. Maximum Maturities

The maximum maturity for each fund group and instrument is set forth in the investment strategies under the Investment Strategies section of this Policy.

C. Maximum Dollar-Weighted Average Maturity

Under most market conditions, the composite portfolio will be managed to achieve a one (1) year or less dollar-weighted average maturity. However, under certain market conditions investment officers may need to shorten or lengthen the average life or duration of the portfolio to protect the Town. The maximum dollar-weighted average maturity based on the stated final maturity, authorized by this investment policy for the composite portfolio of the Town is two (2) years.

D. Diversification

It is the policy of the Town to diversify its investment portfolio. Invested funds shall be diversified to minimize risk or loss resulting from over-concentration of assets in a specific maturity, specific issuers, or specific class of securities. Diversification strategies shall be established and periodically reviewed. At a minimum, diversification standards by security type and issuer shall be:

<u>Security Type</u>	<u>Max % of Portfolio</u>
U.S. Treasury obligations	100%
U.S. Government agencies and instrumentalities	not to exceed 75%
Fully insured or collateralized CDs	not to exceed 30%
Limitation by individual bank	not to exceed 15%
Repurchase agreements	100%
Money market funds	not to exceed 75%
Local government Investment Pools	100%
Maximum percent ownership of pool	10%

The Investment Officer shall be required to diversify maturities. The Investment Officer, to the extent possible, will attempt to match investment with anticipated cash flow requirements. Matching maturities with cash flow dates will reduce the need to sell securities prior to maturity, thus reducing market risk.

Investments in eligible investment pools are “diversified” by the very nature of their inclusion in a very large and active pool of investments. Consequently, concentrations of investment pools represent a lower risk than concentrations in such individual instrument as agency discount notes or certificates of deposit.

The Investment officers shall review diversification strategies and establish or confirm guidelines on at least an annual basis regarding the percentages of the total portfolio that may be invested in securities other than U.S. Government obligations.

X. INVESTMENT STRATEGIES

- A. General. The Town will group investment instruments into a number of “pool investment groups”. These groups will reflect characteristics of maturity limits, diversity and liquidity, commensurate with the underlying purpose for which investments are intended to ultimately fund. Under this approach various individual investment instruments will comprise the total pool type. Individual funds will share equity interest in the assets and earnings of each pool (or pools), equal to their proportionate contributions to the pool (or pools). A pooled investment approach should provide several advantages including yield enhancement, improved diversity and improved liquidity, over a system that seeks to procure specific investment instruments for specific fund types and financial resources.
- B. Basic Pool Requirements. The Town requires the following basic types of pools:
 - a. Short Term/Operating Funds – Most of the Town’s fund types contain operating capital required to finance the particular activities for which the fund is responsible. Cash flows are reasonably predictable but occasional circumstances may require unforeseen or unpredicted cash requirements. Financial resources for this category should be maintained at relatively short levels. The weighted average maturity of operating funds may not exceed one (1) year.

This pooled investment group includes the total of cash and investment available for current operations plus all required operating reserves of the following fund types:

- General Fund
- Debt Service Funds
- Special Revenue Funds
- Enterprise Funds

A key investment strategy for operating funds is to assure that anticipated cash flows are matched with adequate investment liquidity. Diversification among authorized investment options is not restricted and will be determined and approved by the Investment Committee and Town Council in light of existing market conditions.

- b. Long term/Non Operating Funds – Various fund types may contain financial assets in excess of the amounts necessary to fund the sum of operating costs and operating reserves. Other financial assets may be designated for projects schedule to be implemented beyond the current operating period. The pool structured to invest these assets will require longer maximum maturity limit than the operating pool. The size of the pool may vary widely over time. The pool will expand rapidly with the receipt of bond fund proceeds and contract as the capital is used for project construction.

The primary revenue source of this pooled investment group is bond proceeds (which are typically subject to arbitrage yield limitations). This category also includes any amount of cash and investments in excess of the estimated required operating reserves in the general fund, enterprise funds or debt service funds. The maximum weighted average maturity of the portfolio shall not exceed two (2) years. Diversification among authorized investment options is not restricted and will be determined and approved by the Investment Committee and Town Council in light of existing market conditions.

- c. Yield/Restricted Funds – Proceeds from bond issuances subject to arbitrage restrictions may necessitate yield restrictions under some market conditions. Length of investment maturity may be dependent on market conditions as well as cash flow needs.

The Investment strategy for these funds is to limit investment yields to arbitrage ceilings. The maximum weighted average maturity of an individual investment shall not exceed two (2) years. Diversification among authorized investment options is not restricted and will be determined and approved by the Investment Committee and Town Council in light of existing market conditions.

- d. Debt Service Reserve Funds – These reserves are usually specifically defined in terms of amount and size. Bond covenants typically require that reserve balances be maintained with a third party financial institution or paying agent. These institutions invest deposited reserves on behalf of the Town and indirectly

on the behalf of investors in whose interest the reserves are established. In such instances, the Town may contract with such parties who will operate in the capacity of an investment advisor. These relationships will be approved by the Town Council. The Investment advisors will be confined to the particular instruments and parameters specified as appropriate for this pool of funds.

A primary investment strategy for debt service funds is to provide income to the reserve portions of revenue bonds. Because investments may be subject to arbitrage yield restrictions, the secondary investment strategy is to attempt to invest at a yield equal to the arbitrage limit applicable to the reserves. The maximum maturity of an individual investment may not exceed ten (10) years. Diversification among authorized investment options is not restricted and will be determined and approved by the Investment Committee and Town Council in light of existing market conditions.

- e. Interest and Sinking Fund Reserve – These funds are usually specifically defined in terms of amount and size. The primary investment strategy for debt service sinking funds is to match investment maturities with debt service payment requirements. The maximum maturity of an individual investment shall not exceed five (5) years unless a specific longer maturity is legally required. Diversification among authorized investment options is not restricted and will be determined and approved by the Investment Committee and Town Council in light of existing market conditions.

XI. PERFORMANCE EVALUATION AND REPORTING

- A. Reporting. The Investment Officers shall submit an investment report at least quarterly to the Town Council (PFIA 2256.023) containing sufficient information to permit and informed outside reader to evaluate the performance of the investment program and consistent with the Act's statutory requirements. All reports shall be in compliance with the Act. At a minimum the report shall include:
 - 1. Description of each investment and depository position,
 - 2. Book and market values at the end of the reporting period,
 - 3. Be signed by all investment officers of the entity,
 - 4. Changes to the market value and accrued interest during the period,
 - 4. The maturity date of each separately invested asset,
 - 5. The account, fund, or pooled group fund for which investment was acquired,
 - 6. The earnings for the period and
 - 7. The overall yield for the portfolio in comparison to its benchmark yield for the period.
- B. Marking to Market. The market value of the portfolio must be determined at least quarterly and included in the quarterly investment reports. Market prices for all public fund investments will be obtained and monitored through the use of a third party independent pricing source or by an on-line financial data service.

- C. Annual Compliance Audit. If the Town invests in other than money market mutual funds, investment pools or accounts offered by its depository bank in the form of certificates of deposit, or money market accounts or similar accounts, the reports prepared by the Investment Officers under this section shall be formally reviewed at least annually by an independent auditor, and the result of the review shall be reported to the governing body by that auditor.

The Town shall, in conjunction with its annual financial audit, perform a compliance audit of management controls on investments and adherence to the Town's Investment Policy.

- D. Monitoring. The Investment officer 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 and/or approved broker/dealer. If any security falls below the minimum rating required by Policy, the investment officer shall immediately solicit bids for and sell the security, if possible, regardless of a loss of principal.
- E. Policy Considerations. The Town's Investment Policy and investment strategies shall be reviewed, revised and adopted annually by the Town Council. A written resolution approving that review will be passed and recorded by the Town Council.

GLOSSARY OF INVESTMENT POLICY TERMS

Accrued Interest – The accumulated interest due on a bond as of the last interest payment made by the issuer.

Agency – A debt security issued by a federal or federally sponsored agency. Federal agencies are backed by the full faith and credit of the U.S. Government.

Arbitrage – The simultaneous purchase and sale of an asset in order to profit from a difference in the price (profiting from the mispricing in the market). Arbitrage exists as a result of market inefficiencies; it provides a mechanism to ensure prices do not deviate substantially from fair value for long periods of time.

Banker's Acceptance – A short-term debt instrument issued by a firm that is guaranteed by a commercial bank. Banker's acceptances are issued by firms as part of a commercial transaction. These instruments are similar to T-Bills and are frequently used in money market funds. Banker's acceptances are traded at a discount from face value on a secondary market, which can be an advantage because the banker's acceptance does not need to be held until maturity. The date of maturity typically ranges from between 30 and 180 days from the date of issue. Banker's acceptances are considered to be relatively safe investments, since the bank and the borrower are liable for the amount that is due when the instrument matures.

Bid – The anticipated price at which a buyer is willing to purchase a security or commodity.

Bond covenant – A legally binding term of an agreement between a bond issuer and a bond holder. Bond covenants are designed to protect the interest of both parties. Bond covenants may include restrictions on the issuer's ability to take on additional debt, requirements that the issuer provide audited financial statement to bond holders and limitations on the issuer's ability to make new capital investments. A common penalty for violating a bond covenant is the downgrading of a bond's rating, which could make it less attractive to investors and increase the issuer's borrowing costs.

Book value – The value at which a security is carried on the inventory lists or other financial records of an investor. The book value may differ significantly from the security's current value in the market.

Certificate of Deposit (CD) – A savings certificate entitling the bearer to receive interest; a promissory note issued by a bank. It is a time deposit that restricts holders from withdrawing funds on demand. Although it is still possible to withdraw the money, this action will often incur a penalty. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination. CDs are generally issued by commercial banks and are insured by the FDIC. The term of a CD generally ranges from one month to five years.

Collateralization – Process by which a borrower pledges securities, property or other deposits for the purpose of securing the repayment of a loan and/or security.

Collateralized Mortgage Obligations (CMO's) – A type of mortgage backed security in which principal repayments are organized according to their maturities and into different classes based on risk. A collateralized mortgage obligation is a special purpose entity that receives the mortgage repayments and owns the mortgages it receives cash flows from (called a pool). The mortgages serve as collateral, and are organized into classes based on their risk profile. Income

received from the mortgages is passed to investors based on a predetermined set of rules, and investors receive money based on the specified slice of mortgages invested in.

Commercial paper – An unsecured short-term promissory note issued by corporations, with maturities ranging from 2 to 270 days.

Coupon rate – The annual rate of interest received by an investor from the issuer of certain types of fixed-income securities. Also known as the “interest rate.”

Delivery Versus Payment (DVP) – A type of securities transaction in which the purchaser pays for the securities when they delivered either to the purchaser or his/her custodian.

Discount – The amount by which the par value of a security exceeds the price paid for the security.

Diversification – A process of investing assets among a range of security types by sector, maturity, and quality rating.

Fair value – The amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Federal Funds (Fed Funds) – Funds placed in Federal Reserve banks by depository institutions in excess of current reserve requirements. These depository institutions may lend fed funds to each other overnight or on a longer basis. They may also transfer funds among each other on a same-day basis through the Federal Reserve banking system. Fed funds are considered to be immediately available funds.

Government Securities – An obligation of the U.S. government backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market. See “Treasury Bills, Notes and Bonds.”

Guaranteed Investment Contract – Insurance contract that guarantees the owner principal repayment and a fixed or floating interest rate for a predetermined period of time. Guaranteed investment contracts are typically issued by insurance companies and marketed to institutions that qualify for favorable tax status under federal laws. These products provide institutions with guaranteed returns.

Interest rate – See “Coupon Rate.”

Internal Controls – An internal control structure designed to ensure that the assets of the entity are protected from loss, theft or misuse. The internal control structure is 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 judgment by management. Internal controls should address the following points:

1. Control of collusion – Collusion is a situation where two or more employees are working in conjunction to defraud their employer.
2. Separation of duties – By separating the person who authorizes or performs the transaction from the people who record or otherwise account for the transaction, a separation of duties is achieved.
3. Custodial safekeeping – Securities purchased by any bank or dealer including appropriate collateral (as defined by state law) shall be placed with an independent third party for custodial safekeeping.

4. Avoidance of physical delivery securities – Book entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.
5. Clear delegation of authority to subordinate staff members – Subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.
6. Written confirmation of transactions for investments and wire transfers – Due to the potential for error and improprieties arising from telephone and electronic transactions, all transactions should be supported by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and if the safekeeping institution has a list of authorized signatures.
7. Development of a wire transfer agreement with the lead bank and third party custodian – The designated official should ensure that an agreement will be entered into and will address the following points: control, security provisions, and responsibilities of each party making and receiving wire transfers.

Investment Policy – A concise and clear statement of the objectives and parameters formulated by an investor or investment manager for a portfolio of investment securities.

Letter of Credit – A letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase.

Liquidity – An asset that can be converted easily and quickly into cash.

Local Government Investment Pool (LGIP) – An investment by local governments in which their money is pooled as a method for managing local funds.

Mark-to-market – The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

Market risk – The risk that the value of a security will rise or decline as a result of changes in market conditions.

Market value – Current market price of a security.

Maturity – The date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder. See "Weighted Average Maturity."

Money Market Mutual Fund – Mutual funds that invest solely in money market instruments (short-term instruments, such as Treasury bills, commercial paper, bankers' acceptances, repos, and federal funds).

Mutual Fund – An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. Mutual funds are regulated by the Investment Company Act of 1940 and must abide by the following Securities Exchange Commission (SEC) disclosure guidelines:

1. Report standardized performance calculations.

2. Disseminate timely and accurate information regarding the fund's holdings, performance, management and general investment policy.
3. Have the fund's investment policies and activities supervised by a board of trustees, which are independent of the adviser, administrator, or other vendor of the fund.
4. Maintain the daily liquidity of the fund's shares.
5. Value their portfolios on a daily basis.
6. Have all individuals who **sell** SEC-registered products licensed with a self-regulating organization (SRO) such as the National Association of Securities Dealers (NASD).
7. Have an investment policy governed by a prospectus which is updated and filed by the SEC annually.

National Association of Securities Dealers (NASD) – A self-regulatory organization (SRO) of brokers and dealers in the over-the-counter securities business. Its regulatory mandate includes authority over firms that distribute mutual fund shares as well as other securities.

Net Asset Value – The market value of one share of an investment company, such as a mutual fund. This figure is calculated by totaling a fund's assets which includes securities, cash, and any accrued interest earnings, subtracting this from the fund's liabilities and dividing this total by the number of shares outstanding. This is calculated once a day based on the closing price of each security in the fund's portfolio. (Total assets – liabilities/Number of shares outstanding)

No Load Fund – A mutual fund which does not levy a sales charge on the purchase of its shares.

Nominal Yield – The stated rate of interest that a bond pays its current owner, based on par value of the security. It is also known as the "coupon," "coupon rate," or "interest rate."

Offer – An indicated price at which market participants are willing to sell a security or commodity. Also referred to as the "Ask price."

Par – Face value or principal value of a bond, typically \$1,000 per bond.

Premium – The amount by which the price paid for a security exceeds the security's par value.

Primary Market – A market that issues new securities on an exchange. Companies, governments and other groups obtain financing through debt or equity based securities. Primary markets are facilitated by underwriting groups, which consists of investment banks that will set a beginning price range for a given security and then oversee its sale directly to investors. Also known as "New Issue Market" (NIM).

Prime rate – A preferred interest rate charged by commercial banks to their most creditworthy customers. Many interest rates are keyed to this rate.

Principal – The face value or par value of a debt instrument. Also may refer to the amount of capital invested in a given security.

Prospectus – A legal document that must be provided to any prospective purchaser of a new securities offering registered with the SEC. This can include information on the issuer, the issuer's business, the proposed use of proceeds, the experience of the issuer's management and certain certified financial statements.

Prudent Person Rule – An investment standard outlining the fiduciary responsibilities of public funds investors relating to investment practices.

Repurchase Agreement (Repo) – An agreement of one party to sell securities at a specified price to a second party and a simultaneous agreement of the first party to repurchase the securities at a specified price or at a specified later date.

Reverse Repurchase Agreement (Reverse Repo) - An agreement of one party to purchase securities at a specified price from a second party and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified date.

Safekeeping – Holding of assets, such as securities, by a financial institution.

Secondary Market – A market where investors purchase securities or assets from other investors, rather than from issuing companies themselves. The national exchanges, such as the New York Exchange and the NASDAQ are secondary markets. In any secondary market trade, the cash proceeds go to an investor rather than to the underlying company/entity directly. In the primary market prices are often set beforehand, whereas in the secondary market only basic forces like supply and demand determine the price of the security.

Security – A financial instrument that represents: an ownership position in a publicly traded corporation (stock), a creditor relationship with a governmental body or a corporation (bond), or rights to ownership as represented by an option. A security is a fungible, negotiable instrument that represents some type of financial value.

Securities Lending – The act of loaning a stock, derivative, other security to an investor firm. Securities lending requires the borrower to put up collateral, whether cash, security or a letter of credit. When a security is loaned, the title and the ownership are also transferred to the borrower. The borrower hopes to profit by selling the security and buying it back at a lower price. Since ownership has been transferred temporarily to the borrower, the borrower is liable to pay any dividends out to the lender.

Serial Bond – A bond issue, usually a municipality, with various maturity dates scheduled at regular intervals until the entire issue is retired.

Share Certificates – A share certificate is a written document signed on behalf of a corporation, and serves a legal proof of ownership of the number of share indicated. Also refer to as “stock certificate.”

Sinking Fund – Money accumulated on a regular basis in a separate custodial account that is used to redeem debt securities or preferred stock issues.

Treasury Bills – Short-term U.S. government non-interest bearing debt securities with maturities of no longer than one year and issued in minimum denominations of \$10,000. Auctions of three- and six-month bills are weekly, while auctions of one-year bills are monthly. The yields on these bills are monitored closely in the money markets for signs of interest rate trends.

Treasury Notes – Intermediate U.S. government debt securities with maturities of one to 10 years and issued in denominations ranging from \$1,000 to \$1 million or more.

Treasury Bonds (T-bills) – Long-term U.S. government debt securities with maturities of ten years or longer and issued in minimum denominations of \$1,000. Currently the longest outstanding maturity for such securities is 30 years.

Uniform Net Capital Rule – SEC Rule 15C3-1 outlining capital requirements for broker/dealers.

Weighted Average Maturity (WAM) – The average maturity of all the securities that comprise a portfolio. According to the SEC rule 2a-7, the WAM for SEC registered money market mutual funds may not exceed 90 days and no one security may have a maturity that exceeds 397 days.

Yield – The current rate of return on an investment security generally expressed as a percentage of the security's current price.

Yield-to-call (YTC) – The rate of return an investor earns from a bond assuming the bond is redeemed (called) prior to its nominal maturity date.

Yield-to-maturity – The rate of return yielded by a debt security held to maturity when both interest payments and the investor's potential capital gain or loss are included in the calculation of return.

Zero-coupon Securities – Security that is issued at a discount and makes no periodic interest payments. The rate of return consists of a gradual accretion of the principal of the security and is payable at par upon maturity.