Investment Policy & Strategy

Adopted September 3, 2019

Resolution #1178

I. Introduction

It is the policy of the City of Sulphur Springs to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the City and conforming to the statutes governing the investment of public funds. All investment activities conducted by the City shall be in accordance with this policy and applicable portions of the Public Funds Investment Act(the “Act”) located in Chapter 2256 of the Government Code of the State of Texas.

II. Scope

This investment policy applies to all financial assets of the City and any new funds created unless specifically exempted by the City Council and this Policy. These funds are reported in the City’s Comprehensive Annual Finance Report (CAFR) and include: General Fund, Special Revenue Funds, Capital Project Funds, Enterprise Funds, Debt Service Funds, and Internal Services Funds.

Except for cash in certain restricted and special funds, the City will consolidate cash and reserve balances from all funds to maximize investment earnings and to increase efficiencies with regard to investment pricing, safekeeping and administration.

III. Objectives

The primary objectives of the City of Sulphur Springs’ investment activities, listed in order of priority, shall be as follows:

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.

Liquidity: The City’s investment portfolio shall remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated. This shall be achieved by matching investment maturities with forecasted cash flow liabilities and maintain additional liquidity for unexpected liabilities.

Diversification: The investment portfolio shall be diversified by market sector and maturity as much as possible in order to avoid market risk.

Yield: Yield is of secondary importance compared to the safety and liquidity objectives described above. The benchmark for the City’s portfolio shall be the six-month U.S. Treasury or whichever treasury is closest to the portfolio’s Weighted Average Maturity. The investment program shall seek to augment returns above this threshold consistent with risk limitations identified herein and prudent investment policies.

IV. Investment Strategy

Except for cash in certain restricted and special funds, the City maintains one commingled portfolio for investment purposes which incorporates the specific uses and the unique characteristics of the funds in the portfolio. The investment strategy has as its primary objective assurance that anticipated liabilities are matched and adequate investment liquidity provided. The City shall pursue conservative portfolio management strategy. This may be accomplished by creating a laddered maturity structure with some extension for yield enhancement. The maximum maturity of any security will be thirty-six (36) months and the maximum dollar weighted average maturity of twelve (12) months will be calculated using the stated final maturity date of each security.

The investment strategy for debt service funds shall have as its primary objective the timely payment of debt service obligations. Successive debt service dates will be fully funded before any investment extensions are made.

Securities may be sold before they mature if market conditions present an opportunity for the City to benefit from the trade but the strategy will be primarily buy-and-hold.

V. Delegation of Responsibility

Authority: Authority to manage the investment program is designated to the City Manager and Finance Director, hereafter referred to as Investment Officers. The Investment Officers will not be held personally liable for any loss on the portfolio if all provisions of this policy have been followed.

Investment Officers and Training: Investment Officers shall attend at least one training session provided by an independent source, in accordance with the Act, within 12 months after assuming investment duties. Investment Officers shall attend eight hours of training every two successive fiscal years beginning at the first day of the fiscal year.

Investment Committee: An Investment Committee, consisting of the City Manager, Finance Director, and one (1) other Finance Department employee, shall meet quarterly to determine general strategies and to monitor investment results. The Investment Committee shall include in its discussions such topics as: performance reports, economic outlook, portfolio diversification, maturity structure, potential risk, and authorized brokers and dealers. The Investment Committee will review and approve the list of authorized broker/dealers at least annually.

City Council: The City Council holds ultimate fiduciary responsibility for the portfolio. It will receive and review investment reports and review and adopt the Investment Policy at least annually.

Internal Controls: The Investment Officers are responsible for establishing and maintaining an internal control structure designed to reasonably assure that assets of the City are protected from loss, theft, or misuse. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived, and, the valuation of costs and benefits requires ongoing estimates and judgments by management. The internal controls shall address the following points at a minimum:

- Control of collusion,
- Separation of transaction authority from accounting and record keeping,

- Custodial safekeeping,
- Clear delegation of authority,
- Written confirmation for all transactions, and
- Review, maintenance and monitoring of security procedures both manual and automated.

The external auditor shall provide an annual independent review of quarterly investment reports to assure compliance with state law, policies and procedures. The Finance Director or Adviser shall monitor 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 Finance Director 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. All prudent measures will be taken to liquidate an investment that is downgraded to less than the required minimum rating. The Finance Director shall monitor 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 shall immediately liquidate any brokered CD which is above the FDIC insurance level or secure collateral in another form.

VI. Prudence

The standard of prudence to be used by investment officers shall be the “prudent person” rule, which states:

> “Investments shall be made with judgement and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in management of their own affairs, not for speculation, but for investment, considering the probably safety of their capital as well the probable income to be derived.”

The “prudent person” rule shall be applied in the context of managing an overall portfolio. The investment officer acting in accordance with written procedures and the investment policy and exercising due diligence shall be relieved of personal responsibility 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.

VII. Ethics and Conflicts of Interest

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

VIII. Financial Counter-Parties

Depository: At least every five years a banking services depository shall be selected through a formal request for proposal (RFP) process in accordance with the Texas Government Code 105.017. In selecting a depository, the services, cost of services, credit worthiness, earnings potential, and collateralization by the institutions shall be considered.

The depository contract will provide for collateral if balances exceed the FDIC insurance balance per tax identification number.

Other Banking Institutions: The City may purchase certificates of deposit or place interest bearing accounts with other banking institutions that are not the depository. This will be done through a less formal process than the banking service depository contract. All deposits in any banking institution shall be insured or collateralized at all times in accordance with this policy.

Security Broker/Dealers: All broker/dealers who desire to transact business with the City must supply the following documents will be maintained by the Investment Committee.

- Financial Industry Regulatory Authority (FINRA) certification and CRD #
- Proof of Texas State Securities registration
- Policy review certification
- Completed broker/dealer questionnaire

Each counter-party must be provided a copy of the current Investment Policy and certify to a review stating understanding of the Policy and that controls are in place to assure only Policy approved investments will be sold to the City.
A list of qualified broker/dealers will be reviewed, revised and adopted at least annually by Investment Committee.

IX. Authorized Investments

Assets of the City may be invested only in the following instruments as further defined by the Act. If changes are made to the Act, they will not be authorized until this Policy is modified and adopted by the City Council. All investment transactions will be made on a competitive basis. The City is not required to liquidate investments that were authorized investments at the time of purchase.

A. Obligations of the United States Government, its agencies and instrumentalities with a maximum stated maturity of three (3) years to exclude mortgage backed securities.
B. Fully insured or collateralized depository certificates of deposit of banks doing business in Texas, with a maximum maturity of two (2) years guaranteed or insured

by the Federal Deposit Insurance Corporation or its successor or collateralized in accordance with this Policy.

C. Fully FDIC insured brokered certificate of deposit securities in any US state delivered versus payment to the City's safekeeping depository with a maximum maturity of one year. Before purchase, the Investment Officer or Adviser must verify the FDIC status of the bank on www.fdic.gov to assure that the bank is FDIC insured.
D. FDIC insured or collateralized interest bearing and money market accounts from any FDIC insured bank in Texas.
E. Fully collateralized, direct repurchase agreements purchased through a primary government securities dealer, as defined by the Federal Reserve with a maximum maturity of six months. A Bond Market Association Master Repurchase Agreement and independent third party safekeeping are required. A flex repurchase agreement used for bond funds may exceed two years but must match the expected expenditure schedule of the bonds.
F. AAA-rated, constant-dollar Local Government Investment Pools as defined by the Act and authorized by City Council which strive to maintain a $1 net asset value
G. AAA-rated, SEC registered money market mutual funds which strive to maintain a $1 net asset value, as defined by the Act.
H. Obligations of state and local governments in the US with a minimum A rating from a nationally recognized rating agency with a stated maturity not to exceed two years.
I. A1/P1 commercial paper rated by two nationally recognized rating agencies with a maximum maturity of 90 days.

Delivery versus Payment: All securities shall be purchased on a delivery versus payment (DVP) settlement basis. Funds shall not be released until receipt of the security by the City's approved custodian. The custodian shall provide the City with proof of ownership or claim by an original document delivered to the City.

X. Investment 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. The maximum limits for diversification will be:

- US Obligations 80%
- US Agencies/Instrumentalities 80%
- Certificates of Deposit 40%
- Municipal & State Obligations 40%
- Repurchase Agreements 40%
- Flex in CIP Funds 100%
- Local Government Investment Pools 100%
- Money Market Funds 90%

XI. Reporting

The Investment Officers shall submit a quarterly investment report to Council in accordance with the Act. The reports shall summarize investment strategies employed in the most recent quarter and fully describe investment securities, maturities, risk characteristics, and investment return for the quarter. The report will include the following:

- A full description of individual securities held at the end of the reporting period based on amortized value,
- Unrealized gains or losses,
- Overall change in market value during the period as a measure of volatility,
- Weighted average yield of the portfolio and its applicable benchmarks,
- Earnings for the period,
- Analysis of the total portfolio by market sector and maturity, and
- Statement of compliance of the investment portfolio with the Act and the Investment Policy of the City.

Market prices for the calculation of market value will be obtained from independent sources. Marketing to market will be done at least quarterly.

XII. Collateral, Safekeeping, and Custody

Time and Demand Deposits Pledged Collateral: All City time and demand deposits shall be secured above FDIC coverage by pledged collateral. In order to anticipate market changes and provide a level of security for all funds, collateral will be maintained and monitored by the depository at 102% of market value of principal and accrued interest on the deposits. The bank shall review collateral at least weekly to assure that the market value of the pledged securities is maintained at 102% or more.

Collateral pledged to secure deposits shall be held by an independent financial institution outside the holding company of the depository in accordance with a safekeeping agreement signed by authorized representatives of the City, the Depository, and the custodian (with the exception of the Federal Reserve as Custodian).

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

Authorized Collateral: The City shall accept only the following securities as collateral for time and demand deposits or repurchase agreements:

A. FDIC insurance coverage.
B. Obligations of the United States, its agencies or instrumentalities, or other evidence of indebtedness of the United States guaranteed as to principal and interest including CMO which pass the bank test.
C. Obligations, the principal and interest on which, are guaranteed or insured by the State of Texas.

D. Obligations of other states or of a county, city or other political subdivision of a state having been rated as investment grade (investment rating no less than “A” or its equivalent) by two nationally recognized rating agencies.
E. Letter of Credit from the FHLB.

Safekeeping: All purchased securities are to be cleared to the City’s safekeeping agent on a delivery versus payment (DVP) basis. All safekeeping arrangements shall be approved by the Investment Committee and an agreement of the terms executed in writing. The independent third party custodian shall be required to issue safekeeping receipts to the City listing each specific security, rate, description, maturity, CUSIP number, and other pertinent information.

XIII. INVESTMENT POLICY ADOPTION

The City of Sulphur Springs Investment Policy and investment strategies shall be reviewed and adopted by resolution of the City Council no less than annually. The approving resolution must include the changes made to the Policy.

GLOSSARY of COMMON TREASURY TERMINOLOGY

Agencies: Federal agency securities.
Asked: The price offered for securities.
Broker: A broker brings buyers and sellers together for a commission paid by the initiator of the transaction or by both sides; he does not position. In the money market, brokers are active in markets in which banks buy and sell money and in interdealer markets.
Certificate of Deposit (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.
Collateral: Securities, evidence of deposit or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.
Comprehensive Annual Financial Report (CAFR): The official annual report for the City of Sulphur Springs. It includes combined statements and basic financial statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.
Coupon: (a) the annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date.
Dealer: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.
Debenture: A bond secured only by the general credit of the issuer.
Delivery versus Payment: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt (also called free). Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.
Discount: The difference between the cost price of a security and its value at maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.
Discount Securities: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g., U.S. Treasury bills.
Diversification: Dividing investment funds among a variety of securities offering independent returns.
Federal Credit Agencies: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g., S&L's, small business firms, students, farmers, farm cooperatives, and exporters.
Federal Deposit Insurance Corporation (FDIC): A federal agency that insures bank deposits, currently up to $100.00 per deposit.
Federal Funds Rate: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.
Federal Home Loan Banks (FHLB): The institutions that regulate and lend savings and loan associations. The Federal Home Loan Banks play a role analogous to that played by the Federal Reserve Banks vis-a-vis member commercial banks.
Federal National Mortgage Association (FNMA): FNMA, like GNMA, was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development, H.U.D. It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.
Federal Open Market Committee (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open-market as a means of influencing the volume of bank credit and money.
Federal Reserve System: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C. 12 regional banks and about 5,700 commercial banks that are members of the system.
Government National Mortgage Association (GNMA or Ginnie Mae): Securities guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government, Ginnie Mae securities are backed by FHA, VA or FMHM mortgages. The term pass-through is often used to describe Ginnie Mae.

Liquidity: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.
Local Government Investment Pool (LGIP): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.
Market Value: The price at which a security is trading and could presumably be purchased or sold.
Master Repurchase Agreement: To protect investors, many public investors will request that repurchase agreements be preceded by a master repurchase agreement between the investor and the financial institution or dealer. The master agreement should define the nature of the transaction, identify the relationship between the parties, establish normal practices regarding ownership and custody of the collateral securities during the term of the investment, provide remedies in the case of default by either party and clarify issues of ownership. The master repurchase agreement protects the investor by eliminating the uncertainty of ownership and hence, allowing investors to liquidate collateral if a bank or dealer defaults during the term of the agreement.
Maturity: The date upon which the principal or stated value of an investment becomes due and payable.
Money Market: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.
Open Market Operations: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.
Portfolio: Collection of securities held by an investor.
Primary Dealer: A group of government securities dealers that submit daily reports of market activity and positions and monthly financial statements to the Federal
Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC) registered securities broker dealers, banks and a few unregulated firms.
Prudent Person Rule: An investment standard. 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.
Qualified Public Depositories: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.
Rate of Return: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.
Repurchase Agreement (RP or REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money that is, increasing bank reserves.
Safekeeping: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.
SEC Rule 15C3-1: See uniform net capital rule.
Secondary Market: A market made for the purchase and sale of outstanding issues following the initial distribution.
Securities & Exchange Commission: Agency created by Congress to protect investors in securities transactions by administering securities legislation.
Treasury Bills: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months or one year.
Treasury Bonds: Long-term U.S. Treasury securities having initial maturities of more than ten years.
Treasury Notes: Intermediate term coupon bearing U.S. Treasury securities having initial maturities from one to ten years.
Yield: The rate of annual income return on an investment, expressed as a percentage. (a) Income Yield is obtained by dividing the current dollar income by the current market price of the security. (b) Net Yield or Yield to Maturity

is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

Uniform Net Capital Rule: Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also call net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

RESOLUTION # 1178
A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF SULPHUR SPRINGS ADOPTING THE CITY OF SULPHUR SPRINGS INVESTMENT POLICY

WHEREAS, state law requires an annual review and adoption of an investment policy which contains specific requirements as outlined in State Government Code 2256.005, and

WHEREAS, the City of Sulphur Springs maintains an ongoing program of investing municipal funds,

THEREFORE LET IT BE RESOLVED, that the Council of the City of Sulphur Springs has reviewed and hereby adopts the "City of Sulphur Springs Investment Policy" as attached.

Passed and approved this 3rd day of September, 2019

Norman R. Sanders

Norman R. Sanders, Mayor

Gale Roberts

Gale Roberts, City Secretary