CAPITAL AREA COUNCIL OF GOVERNMENTS
Investment Policy

1. Policy

It is the policy of the Capital Area Council of Governments (CAPCOG) 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 CAPCOG and conforming to all state and federal statutes governing the investment of public funds.

2. Scope

This investment policy applies to all financial assets of CAPCOG. These funds are accounted for in CAPCOG's Annual Financial Report and include General Funds, Special Revenue Funds and any new fund created by the Executive Committee, unless specifically exempted.

3. Prudence

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.

The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. Investment officers 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.

4. Training and Education

In accordance with the Public Funds Investment Act (Chapter 2256, Texas Government Code), the designated Investment Officer, or those personnel authorized to execute investment transactions, must attend periodic investment training. CAPCOG shall provide for periodic training in investments for investment personnel in order to ensure the quality and capability of CAPCOG investment officers in making investment decisions.

State law requires that training relating to investment responsibilities must be provided by an independent source. Approved sources are:

The Texas Municipal League
Texas State University
The University of North Texas Center for Public Management
The Government Finance Officers Association of Texas.

Personnel authorized to execute or approve investment transactions must receive at least 10 hours of investment training within each two-year period. Newly appointed investment officers must attain at least 10 hours of instruction relating to the officer's responsibility under the Act within 12 months after assuming investment duties.

5. Objectives

The primary objectives, in priority order, of CAPCOG's investment activities shall be:

- Safety: Safety of principal is the foremost objective of the investment program. Investments of CAPCOG shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

- Liquidity: CAPCOG's investment portfolio will remain sufficiently liquid to enable CAPCOG to meet all operating requirements which might be reasonably anticipated.

- Return on Investments: CAPCOG's investment portfolio shall be designed with the objective of attaining a rate of return throughout budgetary and economic cycles, commensurate with CAPCOG's investment risk constraints and the cash flow characteristics of the portfolio.

6. Delegation of Authority

Authority to manage CAPCOG's investment program is derived from the Public Funds Investment Act of 1987, as amended. Finance Director is authorized to act as Investment Officer, working under the direction of the Executive Director. Management responsibility for the investment program is hereby delegated to the Finance Director, who shall establish written procedures for the operation of the investment program consistent with this investment policy. Procedures should include reference to: safekeeping, PSA repurchase agreements, wire transfer agreements, banking service contracts and collateral/depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Finance Director. The Finance Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

7. Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the Executive Director any material financial interests in financial institutions that conduct business within this jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of CAPCOG, particularly with regard to the time of purchases and sales.

An investment officer shall file a disclosure statement with the Texas Ethics Commission and the Executive Committee if:

- The officer has a personal business relationship with a business organization offering to engage in an investment transaction with the entity shall file a statement disclosing that personal business interest.

- The officer is related within the second degree by affinity or consanguinity, as determined under Chapter 573, to an individual seeking to sell an investment to the investment officer's entity shall file a statement disclosing that relationship.

8. Authorized Financial Dealers and Institutions

The Finance Director will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker/dealers selected by credit worthiness who are authorized to provide investment services in the State of Texas. These may include "primary" dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (uniform net capital rule). No public deposit shall be made except in a qualified public depository as established by state laws.

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the Finance Director with the following: audited financial statements, proof of National Association of Security Dealers certification, trading resolution, proof of state registration, and completed broker/dealer questionnaire.

An annual review of the financial condition and registrations of qualified bidders will be conducted by the Finance Director.

A current audited financial statement is required to be on file for each financial institution and broker/dealer in which CAPCOG invests.

Investments shall only be made with those business organizations that have provided a written instruments executive by a qualified representative acknowledging that the business organization has:

a. Received and reviewed CAPCOG's investment Policy; and
b. Implemented reasonable procedures and controls in an effort to preclude investment transaction conducted between CAPCOG and the organization that are not authorized by this Investment Policy.

9. Authorized & Suitable Investments

CAPCOG is authorized to invest in the following types of securities, within the restrictions of the Public Funds Investment Act. CAPCOG is not required to liquidate investments that were authorized investments at the time of purchase:

- U.S. Government Obligations
- State of Texas Direct Obligations
- Certificates of Deposit
- Collateralized Mortgage Obligations (CMOs)
- Commercial Paper
- Repurchase Agreements
- Investment Pools

Only those investments listed in this section are authorized.

10. Collateralization
CAPCOG requires that all uninsured collected balances plus accrued interest, if any, in depository accounts be secure in accordance with the requirements of Title 10. General Government, Subtitle F. State and Local Contracts and Fund Management, Chapter 2257 Collateral for Public Funds. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be 102% of market value of principal and accrued interest.

Collateral will always be held by an independent third party with whom CAPCOG has a current custodial agreement. A clearly marked evidence of ownership report must be available to CAPCOG and retained. The right of collateral substitution is granted, if approved by CAPCOG.

11. Safekeeping and Custody
All security transactions, including collateral for repurchase agreements, entered into by CAPCOG shall be conducted on a delivery-versus-payment (DVP) basis. Securities will be held by a third party custodian designated by the Finance Director and evidenced by safekeeping receipts

12. Diversification
CAPCOG will diversify its investments by security type and institution. With the exception of U.S. Treasury securities and authorized pools, no more than 50% of CAPCOG's total investment portfolio will be invested in a single security type or with a single financial institution.

13. Maximum Maturities
To the extent possible, CAPCOG will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, CAPCOG will not directly invest operating funds in securities maturing more than two years from the date of purchase.

Reserve funds may be invested in securities exceeding three years if the maturity of such investments are made to coincide as nearly as practicable with the expected use of the funds.

14. Internal Control
The Finance Director is charged with the responsibility of including a market report on investment activity and returns for independent review by an external auditor. This review must include a compliance audit of management controls on investment and adherence to the investment policy.

15. 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 the cash flow needs.

Investment performance is continually monitored and evaluated by the Finance Director. The Finance Director shall monitor, on no less than a monthly basis, the credit rating on investments in the portfolio requiring a rating based upon information from a nationally recognized rating agency. If any security falls below the minimum rating required by Policy, the Investment Officer shall immediately sell the security, if possible, regardless of a loss of principal.

Market Yield (Benchmark): The basis used to determine whether market yields are being achieved shall be the six-month U.S. Treasury Bill.

The Finance Director shall determine the market value of each investment at least quarterly and at a time as close as practicable to the closing of the reporting period for investments. Such values shall be included on the quarterly investment reports. The following methods shall be used:

1. Certificates of deposits shall be valued at their face value plus any accrued but unpaid interest.
2. Shares in money market mutual funds and investment pools shall be valued at par plus any accrued but unpaid interest.
3. Other investment securities may be valued in any of the following ways:
    a. the lower of two bids obtained from securities broker/dealers for such security;
    b. the average of the bid and asked prices for such investment security as published in the Wall Street Journal; or
    c. the bid price published by any nationally recognized security pricing service.

16. <u>Reporting</u>

The Finance Director will prepare and deliver a report on investment activity and returns to CAPCOG's Executive Committee on a quarterly basis. Reports will include performance, market sector breakdown number of trades, weighted average maturity, and interest earnings. Reports will comply with the provisions of the Public Funds Investment Act, as amended.

Quarterly reports shall be reviewed by an independent auditor during the audit of CAPCOG's Annual Financial Report.

17. <u>Investment Policy Adoption and Review</u>

CAPCOG's investment policy shall be adopted by CAPCOG's Executive Committee. The Executive Committee shall review the policy annually and any modifications made thereto must be approved by the Executive Committee.

Glossary

AGENCIES: Federal agency securities.

ASKED: The price at which securities are offered.

(BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill as well as the issuer.

BID: The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See Offer.

BROKER: A broker brings buyers and sellers together for a commission.

BUSINESS ORGANIZATION: Investment pool or an investment management firm under contract to manage the entity's portfolio with discretionary authority.

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.

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 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. 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 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 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 $250,000 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 to 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 (HUD). 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 influencing the volume of bank credit 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 the FHA, VA or FMHM mortgages. The term "passthroughs" is often used to describe Ginnie Maes.

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: A written contract covering all future transactions between the parties to repurchase--reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate that underlying securities in the event of default by the seller-borrower.

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 instrument (bills, commercial paper, bankers acceptances, etc.) are issued and traded.

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked and Bid.

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 who 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. In some states the law requires that a fiduciary, such as a trustee may invest money only in a list of securities selected by the custody state—the so-called legal list. In other states the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

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 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.

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.

SEC RULE 15C3-I: See Uniform Net Capital Rule.

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 BOND: Long-term U.S. Treasury securities having initial maturities of more than 10 years.

TREASURY NOTES: 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.

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 called 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.

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 for 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.