

INVESTMENT POLICY

I. POLICY

It is the policy of the South East Texas Regional Planning Commission (SETRPC) that after allowing for the anticipated cash flow requirements of the SETRPC and giving due consideration to the safety and risk of investment, all available funds shall be invested in conformance with these legal and administrative guidelines, seeking to optimize interest earnings to the maximum extent possible.

Effective cash management is recognized as essential to good fiscal management. Investment interest is a source of revenue to SETRPC funds. The SETRPC's investment portfolio shall be designed and managed in a manner designed to maximize this revenue source, to be responsive to public trust, and to be in compliance with legal requirements and limitations.

Investments shall be made with the primary objectives of:

- * **Safety** and preservation of principal
- * Maintenance of sufficient **liquidity** to meet operating needs
- * **Public trust** from prudent investment activities
- * Optimization of **interest earnings** on the portfolio

II. PURPOSE

The purpose of this investment policy is to comply with SETRPC Executive Committee policy and Chapter 2256 of the Government Code ("Public Funds Investment Act"), which requires each public entity to adopt a written investment policy regarding the investment of its funds and funds under its control. The Investment Policy addresses the methods, procedures and practices that must be exercised to ensure effective and judicious fiscal management of the SETRPC's funds.

III. SCOPE

This Investment Policy shall govern the investment of all financial assets of the SETRPC. These funds are accounted for in the SETRPC's Comprehensive Annual Financial Report (CAFR) and include:

- General Fund
- Special Revenue Funds

- Trust and Agency Funds, to the extent not required by law or existing contract to be kept segregated and managed separately
- Any new fund created by the SETRPC, unless specifically exempted from this Policy by the Executive Committee or by law.

The SETRPC may consolidate cash balances from all or some funds to maximize investment earnings. Investment income may be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

This Investment Policy shall apply to all transactions involving the financial assets and related activity for all the foregoing funds. However, this policy does not apply to the assets administered for the benefit of the SETRPC by outside agencies under deferred compensation programs.

IV. INVESTMENT OBJECTIVES

The SETRPC shall manage and invest its cash with four primary objectives, listed in order of priority: **safety, liquidity, public trust, and yield, expressed as optimization of interest earnings.** The safety of the principal invested always remains the primary objective. All investments shall be designed and managed in a manner responsive to the public trust and consistent with state and local law.

The SETRPC shall maintain a comprehensive cash management program, which includes collection of account receivables, vendor payments in accordance with invoice terms, and prudent investment of available cash. Cash management is defined as the process of managing monies in order to insure maximum cash availability and maximum earnings on short-term investment of idle cash.

Safety [PFIA 2256.005(b)(2)]

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit and interest rate risk.

- Credit Risk and Concentration of Credit Risk – The SETRPC will minimize credit risk, the risk of loss due to the failure of the issuer or backer of the investment, and concentration of credit risk, the risk of loss attributed to the magnitude of investment in a single issuer, by:
 - Limiting investments to the safest types of investments
 - Pre-qualifying the financial institutions and broker/dealers with which the SETRPC will do business
 - Diversifying the investment portfolio so that potential losses on individual issuers will be minimized.

- Interest Rate Risk – the SETRPC will manage the risk that the interest earnings and the market value of investments in the portfolio will fall due to changes in general interest rates by limiting the maximum weighted average maturity of the investment portfolio to 365 days. The SETRPC will, in addition,:
 - Structure the investment portfolio so that investments mature to meet cash requirements for ongoing operations, thereby avoiding the need to liquidate investments prior to maturity.
 - Invest operating funds primarily in demand deposits, certificates of deposit, shorter-term securities, money market mutual funds, or local government investment pools functioning as money market mutual funds.
 - Diversify maturities and staggering purchase dates to minimize the impact of market movements over time.

Liquidity [PFIA 2256.005(b)(2)]

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that investments mature concurrent with cash needs to meet anticipated demands. Because all possible cash demands cannot be anticipated, a portion or the entire portfolio will be invested in demand deposits, shares of money market mutual funds or local government investment pools that offer same-day liquidity. In addition, a portion of the portfolio may consist of securities with active secondary or resale markets.

Public Trust

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

Yield (Optimization of Interest Earnings) [PFIA 2256.005(b)(3)]

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above.

V. RESPONSIBILITY AND CONTROL

Delegation of Authority [PFIA 2256.005(f)]

In accordance with SETRPC policy and the Public Funds Investment Act, the Executive Committee designates the Director of Finance and the Controller as the SETRPC's Investment Officers. An Investment Officer is authorized to execute investment transactions on behalf of the SETRPC. No person may engage in an investment transaction

or the management of SETRPC funds except as provided under the terms of this Investment Policy as approved by the Executive Committee. The investment authority granted to the investing officers is effective until rescinded by the Executive Committee.

Quality and Capability of Investment Management [PFIA 2256.005(b)(3)]

The SETRPC shall provide periodic training in investments for the designated investment officers and other investment personnel through courses and seminars offered by professional organizations, associations, and other independent sources in order to insure the quality and capability of investment management in compliance with the Public Funds Investment Act.

Training Requirement (PFIA 2256.008)

In accordance with the SETRC policy and the Public Funds Investment Act, designated Investment Officers shall attend an investment training session no less often than once every two years commencing October 1, 1997 and shall receive not less than 10 hours of instruction relating to investment responsibilities. A newly appointed Investment Officer must attend a training session of at least 10 hours of instruction within twelve months of the date the officer took office or assumed the officer's duties. The investment training session shall be provided by an independent source approved by the Executive Committee (*Note: a designated investment committee may approve the independent source of training*). For purposes of this policy, an "independent source" from which investment training shall be obtained shall include a professional organization, an institution of higher education or any other sponsor other than a business organization with whom the SETRPC may engage in an investment transaction.

Internal Controls (Best Practice)

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

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

- Control of collusion.
- Separation of transactions authority from accounting and record keeping.
- Custodial safekeeping.
- Avoidance of physical delivery securities.
- Clear delegation of authority to subordinate staff members.

- Written confirmation for telephone (voice) transactions for investments and wire transfers.
- Development of a wire transfer agreement with the depository bank or third party custodian.

Prudence (PFIA 2256.006)

The standard of prudence to be applied by the Investment Officer shall be the “prudent investor” rule. This rule states that “Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.” In determining whether an Investment Officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration:

- The investment of all funds, or funds under the SETRPC’s control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment.
- Whether the investment decision was consistent with the written approved investment policy of the SETRPC.

Indemnification (Best Practice)

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

Ethics and Conflicts of Interest [PFIA 2256.005(i)] and [SETRPC Business Ethics and Conduct Policy and Conflict of Interest Policy]

Officers and employees involved in the investment process shall refrain from personal business activity that would conflict with the proper execution and management of the investment program, or that would impair their ability to make impartial decisions. Employees and Investment Officers shall disclose any material interests in financial institutions with which they conduct business. 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 which business is conducted on behalf of the SETRPC.

An Investment Officer of the SETRPC who has a personal business relationship with an organization seeking to sell an investment to the SETRPC shall file a statement disclosing

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

VI. SUITABLE AND AUTHORIZED INVESTMENTS

Portfolio Management

The SETRPC currently has a “buy and hold” portfolio strategy. Maturity dates are matched with cash flow requirements and investments are purchased with the intent to be held until maturity. However, investments may be liquidated prior to maturity for the following reasons:

- An investment with declining credit may be liquidated early to minimize loss of principal.
- Cash flow needs of the SETRPC require that the investment be liquidated.

Investments [PFIA 2256.005(b)(4)(A)]

SETRPC funds governed by this policy may be invested in the instruments described below, all of which are authorized by Chapter 2256 of the Government Code (Public Funds Investment Act). Investment of SETRPC funds in any instrument or security not authorized for investment under the Act is prohibited. The SETRPC will not be required to liquidate an investment that becomes unauthorized subsequent to its purchase.

I. Authorized

1. Obligations of the United States of America, its agencies and instrumentalities.
2. Demand deposits and Certificates of Deposit issued by a depository institution organized under Texas law, the laws of another state, or federal law, that has its main office or a branch office in Texas. The demand deposits and certificates of deposit must be guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or secured by obligations in a manner and amount as provided by law for the deposits of the SETRPC.
3. Fully collateralized direct repurchase agreements with a defined termination date secured by obligations of the United States or its agencies and instrumentalities. These shall be pledged to the SETRPC, held in the SETRPC’s name, and deposited at the time the investment is made with the SETRPC or with a third party selected and approved by the SETRPC. Repurchase agreements must be purchased through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in

Texas. A Master Repurchase Agreement must be signed by the bank/dealer prior to investment in a repurchase agreement. All repurchase agreement transactions will be on a delivery vs. payment basis. Securities received for repurchase agreements must have a market value greater than or equal to 102 percent at the time funds are disbursed. (Sweep Accounts and/or Bond Proceeds)

4. Money Market Mutual funds that: 1) are registered and regulated by the Securities and Exchange Commission, 2) have a dollar weighted average stated maturity of 90 days or less, 3) seek to maintain a net asset value of \$1.00 per share, and 4) are rated AAA by at least one nationally recognized rating service.
5. Local government investment pools, which 1) meet the requirements of Chapter 2256.016 of the Public Funds Investment Act, 2) are rated no lower than AAA or an equivalent rating by at least one nationally recognized rating service, and 3) seek to maintain a \$1.00 net asset value, and 4) are authorized by resolution by the Executive Committee.

All prudent measures will be taken to liquidate an investment that is downgraded to less than the required minimum rating. (*PFIA 2256.021*)

II. **Not Authorized [PFIA 2256.009(b)(1-4)]**

Investments including interest-only or principal-only strips of obligations with underlying mortgage-backed security collateral, collateralized mortgage obligations with an inverse floating interest rate or a maturity date of over 10 years are strictly prohibited.

VII. INVESTMENT PARAMETERS

Maximum Maturities [PFIA 2256.005(b)(4)(B)]

The longer the maturity of investments, the greater their price volatility. Therefore, it is the SETRPC's policy to concentrate its investment portfolio in shorter-term securities in order to limit principal risk caused by changes in interest rates.

The SETRPC attempts to match its investments with anticipated cash flow requirements. The SETRPC will not directly invest in securities maturing more than two (2) years from the date of purchase; however, the above described obligations, certificates, or agreements may be collateralized using longer dated investments.

Because no secondary market exists for repurchase agreements, the maximum maturity shall be 120 days except in the case of a flexible repurchase agreement for bond proceeds.

The maximum maturity for such an investment shall be determined in accordance with project cash flow projections and the requirements of the governing bond ordinance.

The composite portfolio will have a weighted average maturity of 365 days or less. This dollar-weighted average maturity will be calculated using the stated final maturity dates of each security. [PFIA 2256.005(b)(4)(C)]

Diversification [PFIA 2256.005(b)(3)]

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

- Limiting investments to avoid overconcentration in investments from a specific issuer or business sector (excluding U.S. Treasury securities, demand deposits and certificates of deposit that are fully insured and collateralized in accordance with state and federal law).
- Limiting investment in investments that have higher credit risks (example: commercial paper),
- Investing in investments with varying maturities, and
- Continuously investing a portion of the portfolio in readily available funds such as local government investment pools (LGIPs), demand deposits, money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

The following maximum limits, by instrument, are established for the SETRPC's total portfolio:

1. <u>U.S. Treasury Securities</u>	<u>100%</u>
2. <u>Agencies and Instrumentalities</u>	<u>85%</u>
3. <u>Certificates of Deposit</u>	<u>100%</u>
4. <u>Repurchase Agreements*</u>	<u>20%</u>
5. <u>Money Market Mutual Funds</u>	<u>50%</u>
6. <u>Authorized Pools</u>	<u>50%</u>
7. <u>Depository bank (demand deposits)</u>	<u>100%</u>

*Excluding flexible repurchase agreements for bond proceeds investments

VIII. SELECTION OF BANKS AND DEALERS

Depository (SETRPC By-Laws Article IX Finance)

In accordance with SETRPC By-Laws at least every 5 years a Depository shall be selected through the SETRPC's banking services procurement process, which shall include a formal request for proposal (RFP). The selection of a depository will be determined by competitive bid and evaluation of bids will be based on the following selection criteria:

- The ability to qualify as a depository for public funds in accordance with state law.
- The ability to provide requested information or financial statements for the periods specified.
- The ability to meet all requirements in the banking RFP.
- Complete response to all required items on the bid form
- Lowest net banking service cost, consistent with the ability to provide an appropriate level of service.
- The credit worthiness and financial stability of the bank.

Authorized Brokers/Dealers (PFIA 2256.025)

The SETRPC shall, at least annually, review, revise, and adopt a list of qualified broker/dealers and financial institutions authorized to engage in securities transactions with the SETRPC. Those firms that request to become qualified bidders for securities transactions will be required to provide a completed broker/dealer questionnaire that provides information regarding creditworthiness, experience and reputation and a certification stating the firm has received, read and understood the SETRPC's investment policy and agree to comply with the policy. Authorized firms may include primary dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (Uniform Net Capital Rule), and qualified depositories. All investment providers, including financial institutions, banks, money market mutual funds, and local government investment pools, must sign a certification acknowledging that the organization has received and reviewed the SETRPC's investment policy and that reasonable procedures and controls have been implemented to preclude investment transactions that are not authorized by the SETRPC's policy. [PFIA 2256.005(k-l)]

Competitive Bids (Best Practice)

It is the policy of the SETRPC to require competitive bidding for all individual security purchases and sales except for: a) transactions with money market mutual funds and local government investment pools b) demand deposits with the SETRPC's Depository and c) treasury and agency securities purchased at issue through an approved broker/dealer or financial institution. The Director of Finance shall develop and maintain procedures for ensuring competition in the investment of the SETRPC's funds.

Delivery vs. Payment [PFIA 2256.005(b)(4)(E)]

Securities shall be purchased using the **delivery vs. payment** method with the exception of investment pools, demand deposits and mutual funds. Funds will be released after notification that the purchased security has been received.

IX. CUSTODIAL CREDIT RISK MANAGEMENT

Safekeeping and Custodial Agreements

The SETRPC shall contract with a bank or banks for the safekeeping of securities either owned by the SETRPC as part of its investment portfolio or held as collateral to secure demand or time deposits. Securities owned by the SETRPC shall be held in the SETRPC's name as evidenced by safekeeping receipts of the institution holding the securities.

Collateral for deposits will be held by a third party custodian designated by the SETRPC and pledged to the SETRPC as evidenced by safekeeping receipts of the institution with which the collateral is deposited. Original safekeeping receipts shall be obtained. Collateral may be held by the depository bank's trust department, a Federal Reserve bank or branch of a Federal Reserve bank, a Federal Home Loan Bank, or a third party bank approved by the SETRPC.

Collateral Policy (PFCA 2257.023)

Consistent with the requirements of the Public Funds Collateral Act, it is the policy of the SETRPC to require full collateralization of all SETRPC funds on deposit with a depository bank, other than investments. 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 on the deposits or investments less an amount insured by the FDIC. At its discretion, the SETRPC may require a higher level of collateralization for certain investment securities. Securities pledged as collateral shall be held by an independent third party with whom the SETRPC has a current custodial agreement. The Director of Finance is responsible for entering into collateralization agreements with third party custodians in compliance with this Policy. The agreements are to specify the acceptable investment securities for collateral, including provisions relating to possession of the collateral, the substitution or release of investment securities, ownership of securities, and the method of valuation of securities. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the SETRPC and retained. Collateral shall be reviewed at least monthly to assure that the market value of the pledged securities is adequate.

Collateral Defined

The SETRPC shall accept only the following types of collateral:

- Obligations of the United States or its agencies and instrumentalities
- Direct obligations of the state of Texas or its agencies and instrumentalities
- Collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States
- Obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized rating firm not less than A or its equivalent with a remaining maturity of ten (10) years or less
- A surety bond issued by an insurance company rated as to investment quality by a nationally recognized rating firm not less than A
- A letter of credit issued to the SETRPC by the Federal Home Loan Bank

Subject to Audit

All collateral shall be subject to inspection and audit by the Director of Finance or the SETRPC's independent auditors.

X. PERFORMANCE

Performance Standards

The SETRPC's investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio shall be designed with the objective of obtaining a rate of return through budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow requirements of the SETRPC.

Performance Benchmark (*Best Practice*)

It is the policy of the SETRPC to purchase investments with maturity dates coinciding with cash flow needs. Through this strategy, the SETRPC shall seek to optimize interest earnings utilizing allowable investments available on the market at that time. Market value will be calculated on a quarterly basis on all securities owned and compared to current book value. The SETRPC's portfolio shall be designed with the objective of regularly meeting or exceeding the average rate of return on U.S. Treasury Bills at a maturity level comparable to the SETRPC's weighted average maturity in days.

XI. REPORTING (*PFIA 2256.023*)

Methods

The Investment Officer shall prepare an investment report on a quarterly basis that summarizes investment strategies employed in the most recent quarter and describes the portfolio in terms of investment securities, maturities, and shall explain the total investment return for the quarter.

The quarterly investment report shall include a summary statement of investment activity prepared in compliance with generally accepted accounting principals. This summary will be prepared in a manner that will allow the SETRPC to ascertain whether investment activities during the reporting period have conformed to the Investment Policy. The report will be provided to the Executive Committee. The report will include the following:

- A listing of individual securities held at the end of the reporting period.
- Unrealized gains or losses resulting from appreciation or depreciation by listing the beginning and ending book and market value of securities for the period.
- Additions and changes to the market value during the period.
- Average weighted yield to maturity of portfolio as compared to applicable benchmark.
- Listing of investments by maturity date.
- Fully accrued interest for the reporting period
- The percentage of the total portfolio that each type of investment represents.
- Statement of compliance of the SETRPC's investment portfolio with state law and the investment strategy and policy approved by the Executive Committee.

An independent auditor will perform a formal annual review of the quarterly reports with the results reported to the Executive Committee [*PFIA 2256.023(d)*].

Monitoring Market Value [*PFIA 2256.005(b)(4)(D)*]

Market value of all securities in the portfolio will be determined on a quarterly basis. These values will be obtained from a reputable and independent source and disclosed to the Executive Committee quarterly in a written report.

XII. INVESTMENT POLICY ADOPTION [*PFIA 2256.005(e)*]

The SETRPC's investment policy shall be adopted by resolution of the Executive Committee. It is the SETRPC's intent to comply with state laws and regulations. The SETRPC's investment policy shall be subject to revisions consistent with changing laws, regulations, and needs of the SETRPC. The Executive Committee shall adopt a resolution stating that it has reviewed the policy and investment strategies annually, approving any changes or modifications.