

## **I. GENERAL POLICY**

It is the policy of the City of Kerrville (the “City”) to administer its funds and the investment of those funds, as its highest public trust. The funds shall be invested in a manner, which provides for maximum safety of principal through risk management and diversification while meeting the City’s daily cash needs. The investment of the City’s funds should provide a reasonable investment return. The earnings from investment will be used in a manner that best serves the interests of the City, as determined by City Council.

The City shall administer its investment activities in conformance with the Public Funds Investment Act, Chapter 2256, Texas Government Code (the “Act”), the Public Collateral Act (Texas Government Code, Chapter 2257), and in conformance with other applicable state and federal laws, applicable bond requirements, and this investment policy (the “Policy”).

## **II. SCOPE**

This Policy governs the investment of all financial assets of the City as accounted for in the City’s Comprehensive Annual Financial Report (“CAFR”). This includes the financial assets of all funds reported in the CAFR other than the Kerrville Public Utility Board and Kerrville Joint Airport Board, both of which are set up and operated as entities separate from the City.

## **III. GOALS AND OBJECTIVES**

Investment of City funds is governed by the following investment objectives, in their order of priority:

- A. Safety** - Safety of principal is the foremost objective of the investment program of the City. Investment shall be undertaken in a manner that seeks to ensure the preservation of capital and avoids security defaults or erosion of market values.
- B. Liquidity** - The City’s investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements that are reasonably anticipated. Ongoing cash flow analysis will be used to identify changing liquidity needs. Demand deposits or other liquid investments should be maintained as a liquidity buffer for unanticipated expenses. To the extent possible, the City will attempt to match its investment maturities with anticipated liabilities and cash flow requirements. To reflect the cash flow requirements and risk tolerance levels of the City, the weighted average maturity of the overall City portfolio shall not exceed one (1) year.
- C. Diversification** - In order to minimize investment and market risk, the City will diversify its investments by market sector (security type) and maturity.
- D. Yield** - The City’s investment portfolio shall be designed with the objective of attaining a reasonable rate of return throughout budgetary and economic cycles, commensurate with the City’s investment risk constraints and the cash flow characteristics of the portfolio. The portfolio(s) risk shall be measured quarterly against a benchmark based on cash flow analysis and the authorized portfolio structure. The overall portfolio shall have a maximum weighted average maturity of one (1) year. To measure the overall risk of the portfolio, a benchmark of the six-month Treasury Bill shall be reported.

Effective cash management is recognized as essential to good fiscal management. The City shall maintain a cash management program, which includes collection of accounts receivable,

prudent investment of its available cash, disbursement of payments in accordance with invoice terms, and the management of banking services.

#### **IV. STRATEGY**

The City maintains one (1) commingled portfolio for City funds and its investment strategy incorporates the specific investment strategy considerations and the unique characteristics of the fund groups represented in the portfolio as follows:

- A.** The investment strategy for operating, enterprise, and special revenue funds has as its primary objective the assurance that anticipated liabilities are matched and adequate investment liquidity provided. The secondary objective is to create a portfolio structure which will experience minimal volatility. This may be accomplished by purchasing high credit quality securities in a laddered maturity structure that permits some extension for yield enhancement. The maximum dollar weighted average maturity of one (1) year or less will be calculated using the stated final maturity date of each security.
- B.** The investment strategy for debt service funds shall have as its primary objective the assurance of available funds adequate to fund the debt service obligations on a timely basis. Successive debt service dates will be fully funded before extension.
- C.** The investment strategy for reserve funds shall have as its primary objective the ability to generate a revenue stream.
- D.** The investment strategy for capital projects or capital project funds will have as its primary objective the assurance that anticipated cash flows are matched and provide adequate investment liquidity.
- E.** The investment strategy for Trust Funds with restricted corpus will have as its primary objective to grow the income used for specific purposes, as outlined in individual trust documents. The City acts as trustee for certain funds, the corpus of which is permanent and the income used for specific operating purposes. These are established as separate portfolios. Currently, the funds so structured include:

##### **1. Butt-Holdsworth Memorial Library Endowment Fund Trust**

The principal (restricted corpus) is not to be used for any ongoing expenditures. These funds are to be managed within the parameters of the City's adopted Investment Policy, but, as a trust, additional applicable provisions under the Trust Code are incorporated by reference (The Texas Trust Code, Subtitle B, Title 9, Property Code) extending investment alternatives with this policy for those funds. The longer term needs of the funds require a strategy focused on high-credit quality intermediate term securities which will protect the corpus and generate a reasonable stream of income on an annual basis. The income goals and needs of the trust extend the parameters for these funds to include mutual funds and electronically traded funds. The fixed income portion of the trust portfolio will maintain a maximum weighted average maturity of two (2) years and the maximum stated maturity for any security will be three (3) years. The risk benchmark for the fixed income portion of the fund will be the two-year US Treasury Note for the comparable period.

The City shall pursue an active versus a passive portfolio management strategy. That is, securities may be sold before they mature if market conditions present an opportunity for the City to benefit from the trade. The City's Investment Officers or Advisor will monitor the contents of the portfolio, the available markets, and the relative value of competing instruments to adjust the portfolio in response to market conditions.

## **V. INVESTMENT OFFICERS**

The Chief Financial Officer, Assistant Finance Director, and Accounting Manager are authorized to administer the investment activities of the City and, are designated as "Investment Officers" for the purposes of this Policy. City Council may designate one or more additional qualified employees or an SEC registered Investment Advisor, as Investment Officer(s). The designation of additional Investment Officers shall be by City Council Policy adoption and/or award of contract. Authority and designation as an Investment Officer is effective until rescinded by the City, expiration of the officer's term, or until termination of employment. Investment Officers shall be familiar with this Policy. No Investment Officer may engage in an investment transaction except as provided under the terms of this Policy and the procedures established by the Chief Financial Officer. A trading resolution is established by adoption of this Policy authorizing any Investment Officer to engage in investment transactions and open City designated accounts for time and demand deposits on behalf of the City. The persons so authorized to transact business are also authorized to approve wire transfers used in the process of investing.

## **VI. TRAINING**

All Investment Officers shall comply with training requirements under state law.

## **VII. STANDARD OF CARE**

The standard of care to be used by the Investment Officer (s) shall be the "prudent person standard" and shall be applied in the context of managing the overall portfolio, rather than a consideration as to the prudence of a single investment; and whether the investment decision was consistent with this Policy. The standard states:

All 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 their own affairs, not for speculation but for investment, considering the probable safety of the capital and the probable income to be derived.

Investment Officer(s) acting in accordance with the Policy and exercising due diligence, shall be relieved of personal liability for an individual security's credit risk or market price change, provided that deviations from expectations are reported in a timely manner and appropriate action is taken to control adverse developments.

An Investment Officer shall refrain from personal business activity that could conflict with proper execution of the investment program or that could impair their ability to make impartial investment decisions. An Investment Officer who has a personal business relationship with a business organization offering to engage in an investment transaction with the City shall file a statement disclosing that personal business interest to the City and the Texas Ethics Commission.

## **VIII. STANDARD OF ETHICS**

An Investment Officer shall act as custodians of the public trust and shall refrain from any transaction that might involve a conflict of interest, the appearance of a conflict of interest, or any activity that might otherwise discourage public confidence.

## **IX. AUTHORIZED PROFESSIONAL SERVICES AND INVESTMENTS**

The City recognizes that all investment decisions regarding the City's portfolio are the responsibility of the City Council, which directs its Investment Officers. Thus, all Investment Advisors and brokers/ dealers conducting business with the City shall make every reasonable effort to adhere to the spirit, philosophy, and specific terms of this Policy. All Investment Advisors and brokers/dealers shall avoid recommending or suggesting transactions outside the spirit, philosophy, and specific terms of this Policy and toward that end, shall adhere to the following:

- A. Brokers/Dealers** - A list of not less than five (5) authorized brokers/dealers shall be maintained to assure a competitive process. See Exhibit A for a list of approved brokers/dealers. Investment Officers will establish the criteria, monitor the service, and evaluate the brokers/dealers based on their:
1. Adherence to the City's policies and strategies;
  2. Responsiveness to the City's requests for service and information;
  3. The quality of communications; and
  4. Understanding of the inherent fiduciary responsibility of public funds.
- B. Information/Qualifications** - All broker/dealers will be furnished with a copy of the current investment policy. Financial Institutions and brokers/dealers who desire to transact business with the City must supply the following documents to the Investment Officer or Investment Advisor (as applicable):
1. Current year audited financial statements;
  2. Financial Institutions Regulatory Agency (FINRA) certification and FINRA's Central Depository Registration (CRD) number; and
  3. Proof of Texas State Securities registration.
  4. Brokers/dealers shall also provide timely trade documentation and confirmations. In order to perfect delivery versus payment, no authorized brokers/dealers or their affiliated bank will be used for safekeeping.
- C. Certification** - Before transacting any business with the City, an Investment Officer or Investment Advisor shall provide information as required by the investment officers and receive a copy of the current policy. Each investment pool in which the City participates will be provided with a current copy of the Investment Policy and an authorized representative of the pool shall, in writing to the City, certify substantially to the effect that:
1. The pool has received and reviewed the Policy; and
  2. The pool has implemented reasonable procedures and controls to preclude investments with the City not authorized by the Policy.

Note: If material changes are made to the Policy, an updated copy shall be provided to all authorized broker/dealers and pools.

- D.** Investment Advisor - Investment Advisors shall be required to be registered with the U.S. Security and Exchange Commission and shall provide their SEC ADV Form to the City on an annual basis.

## **X. AUTHORIZED INVESTMENTS**

Authorized investments under this Policy shall be limited to the instruments listed below as further described by the Act.

- A.** Obligations of the United States Government, its agencies and instrumentalities, excluding mortgage backed securities, with a stated final maturity not to exceed two (2) years. In trust funds the stated maturity is not to exceed three (3) years.
- B.** Fully collateralized or FDIC insured depository certificates of deposit (CD) from banks doing business in Texas with a final stated maturity not to exceed eighteen (18) months. Funds shall be collateralized in accordance with the Policy and governed by a written agreement that complies with federal and state regulations for properly securing a pledged security interest.
- C.** FDIC insured brokered certificates of deposit securities from a bank in any US state, delivered versus payment to the City's safekeeping agent, not to exceed one (1) year to maturity. Before purchase, the Investment Officer must verify the FDIC status of the bank to assure that the bank is FDIC insured.
- D.** Fully insured share certificates from credit unions in Texas not to exceed eighteen (18) months to stated maturity and insured by the National Credit Union Share Insurance Fund or its successor.
- E.** Commercial paper rated A1/P1 or its equivalent by two (2) nationally recognized rating agencies and with a final stated maturity not to exceed one hundred eighty five (185) days from the date of issuance.
- F.** AAA-rated SEC registered money market mutual funds which strives to maintain a \$1 net asset value and complies with SEC Rule 2a-7.
- G.** Constant-dollar, AAA-rated (or equivalent) rated Texas Local Government Investment Pools, approved by resolution of the City Council which strive to maintain a \$1 net asset value and complies with the Act. The City investment in any investment pool shall not exceed 5 percent of the total assets of the pool.
- H.** Fully insured or collateralized interest bearing accounts of any bank in Texas. Fully collateralized or insured demand deposit accounts at authorized City depositories, under the provisions of a written collateral/depository agreement
- I.** State and municipal obligations of any state rated not less than A by two (2) nationally recognized rating agencies and with a stated maturity not to exceed two (2) years. The stated maturity for "trust funds" is not to exceed three (3) years.
- J.** Fully collateralized repurchase agreements transacted with a primary securities dealer as defined by the Federal Reserve, under a written master repurchase agreement, with

a defined termination date, secured by obligations as defined by this Policy held by an independent third party custodian approved by the City, and with a stated final maturity not to exceed ninety (90) days.

- K.** This authorization includes flexible repurchase agreements (“flex repos”) to be utilized only in the investment of bond proceeds with a stated final maturity not to exceed the expenditure plan on the bond proceeds.
- L.** Applicable to a trust fund only, domestic mutual funds and Electronically Traded Funds (EFT) with a minimum three star rating by Morningstar. These should represent no more than 60% of the total trust portfolio.

Investments donated to the trust need not be authorized by this policy and may be held by the trust. If liquidated, reinvestment of the proceeds must comply with this policy.

#### **XI. DELIVERY VERSUS PAYMENT**

All security transactions shall be settled on a delivery versus payment (DVP) basis in order to ensure that the City has total control of its investments and its funds at all times.

#### **XII. COMPETITIVE BIDDING**

All investment transactions, including certificates of deposit, shall be made on a competitive basis to assure that the City is receiving fair market prices. Bids may be solicited orally, in writing, electronically, or in any combination of those methods.

#### **XIII. MONITORING CREDIT RATINGS**

The Investment Officer or Investment Advisor shall monitor, on no less than a monthly basis, the credit rating or fund rating on all authorized investments in the portfolio based upon independent information from a nationally recognized rating agency. If any security(s) falls below the minimum rating required by this Policy, the Investment Officer or Advisor shall notify the Chief Financial Officer of the loss of rating, conditions affecting the rating, and possible loss of principal with liquidation options available, to determine liquidation options within five (5) business days after the loss of the required rating.

#### **XIV. MONITORING FDIC STATUS**

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

#### **XV. COLLATERALIZATION**

Consistent with state law requirements, the City shall require collateral market value equal to 102 percent of total deposits including accrued interest on all repurchase agreements and all time and demand deposits above the limits of federal insurance on City funds.

## **XVI. TIME AND DEMAND DEPOSITS- PLEDGED COLLATERAL**

Financial institutions serving as City depositories will be required to execute a depository agreement with the City outlining, among other conditions, collateral conditions and limitations. The agreement shall define the City's rights to the collateral in case of default, bankruptcy, or closing. Collateral authorized by the City will be limited to the following:

- A.** Obligations of the US Government, its agencies and instrumentalities, including mortgagebacked securities, which pass the Federal Reserve bank test
- B.** Obligations of any US state, their agencies and instrumentalities, and municipalities rated A or better by two (2) nationally recognized rating agencies

Collateral pledged to the City must be maintained with a market value margin of 102 percent of the total time or demand amounts being collateralized including accrued interest. The banking institution shall be held contractually liable for monitoring and maintaining the required margins daily. All collateral shall be held by an independent third party banking institution outside the holding company of the pledging bank. A clearly marked evidence of ownership must be provided to the City for all securities pledged and must clearly state that the security is pledged to the City. Substitution of collateral shall only be made after prior written approval by the City.

The pledging institution shall be responsible for providing a monthly report, preferably from the custodian, on pledged collateral listing at a minimum, the security description, CUSIP, par value, maturity, and current market value.

## **XVII. REPURCHASE AGREEMENT- OWNED COLLATERAL**

Collateral under a master repurchase agreement is owned by the City under a buy-sell transaction. It will be held by an independent third party safekeeping agent approved by the City under an executed Bond Market Association Master Repurchase Agreement. Collateral with a market value totaling 102 percent of the principal and accrued interest is required and the counter-party is responsible for the monitoring and maintaining of collateral and margins at all times.

## **XVIII. SAFEKEEPING OF CITY-OWNED SECURITIES**

All securities shall be settled on a delivery versus payment basis and be held in safekeeping by an independent third party financial institution approved by the City. The City shall contract with its banking services depository or another financial institution(s) as safekeeping agent for the safekeeping of any securities owned by the City. The designated safekeeping agent will be responsible for the clearing and safekeeping of all security trades and will provide a monthly report of holdings. All securities held by the safekeeping agent on behalf of the City shall be evidenced by a safekeeping receipt.

## **XIX. DIVERSIFICATION**

Diversification by security types shall be established by the following maximum percentages of investment type to the total City investment portfolio (excluding Trust Funds):



A. Obligations of the US Government	90%
B. Constant Dollar Texas Investment Pools	90%
C. Obligations of US Agencies/Instrumentalities	90%
D. Depository Certificates of Deposit (CD)	90%
E. Money Market Mutual Funds	70%
F. State and municipal Obligations	25%
G. Brokered Certificate of Deposit (CD) Securities	20%
H. Commercial Paper	20%
I. Limitation by banking institution	15%
J. Credit Union Share Certificates	10%
K. Limitation by Issuer	10%
L. Limitation by ownership in fund	5%
M. Limitation by ownership in fund	5%

Maximum percentages listed above are to be based on the portfolio's amortized book value at the time of purchase.

## XX. INTERNAL CONTROL

The Chief Financial Officer shall maintain a system of internal controls over the investment activities of the City and his/her subordinate employees. The controls shall be designed to address fraud, employee error, misrepresentation by third parties, unanticipated market changes, and imprudent actions. Controls deemed most important include: control of collusion, separation of duties, custody and safekeeping, delegation of authority, securities losses, and remedial actions, and documentation on all transactions. The City's internal controls over investment activities and quarterly investment reports shall be reviewed annually by the City's independent auditor as part of the annual audit process. Any irregularities or suggestions for improvement shall be reported to the City Council.

## XXI. CASH FLOW FORECASTING

Cash flow forecasting is a control designed to protect and sustain cash flow requirements of the City. The Investment Officer shall maintain a cash flow forecasting process designed to monitor and forecast cash positions of investment purposes.

## XXII. REPORTING

Not less than quarterly, the Chief Financial Officer shall report to the City Council regarding the City's investment activities for the quarter in compliance with the Act. The reports shall contain sufficient information to permit an informed outside reader to evaluate the performance of the investment program and be prepared in accordance with the Act. Market prices for market value calculations shall be obtained from independent sources. The quarterly report shall be signed by the Investment Officer and Investment Advisor as applicable.

## XXIII. DEPOSITORIES

The City will designate one banking institution through a competitive process as its central banking services provider at least every five (5) years. In selecting a depository, the services, cost of services, credit worthiness, earnings potential, and collateralization of each financial



institution shall be considered. This institution will be used for normal banking services including disbursement, deposits, and safekeeping of securities. A depository agreement(s), executed in accordance with FIRREA (Financial Institutions Resource and Recovery Enforcement Act), shall be established before funds are transferred. Other banking institutions from which the City may purchase depository certificates of deposit (CD) will also be designated as depositories and must execute a written depository (collateral) contract in accordance with the provisions of this Policy if funds exceed FDIC insurance limits.

#### **XXIV. POLICIES AND STRATEGY REVIEW**

City Council shall review and adopt an investment policy and strategy annually in conjunction with the adoption of the budget. Additional changes to the Policy can be adopted by City Council as needed. The adopting resolution shall reference any changes made to the Policy.

The City's investment activities shall be reviewed annually by the City's independent auditors as part of the annual audit process. The objective of the review shall be to ascertain compliance of the City's investment activities with the investment policy, investment strategy, and applicable laws. Any irregularities shall be reported to the City Council through a report as prescribed by the audit engagement agreement.

**EXHIBIT A****AUTHORIZED BROKER / DEALERS**

- 1. Bank of America Merrill Lynch**
- 2. Piper Jaffray**
- 3. FTN Financial**
- 4. Intl F.C. Stone**
- 5. Mizuho Securities**
- 6. Morgan Stanley**
- 7. Mutual Securities**
- 8. Raymond James**
- 9. RBC Capital Markets**
- 10. Stifel Nicolaus**
- 11. Williams Group**
- 12. Cantor Fitzgerald**
- 13. BOK Financial**
- 14. Oppenheimer & Co., Inc.**