CITY OF WATAUGA, TEXAS

INVESTMENT POLICY

Approved February 23, 2015

POLICY

It is the policy of the City of Watauga (City) after allowing for the anticipated cash flow requirements in its bank accounts to meet daily needs and after giving due consideration to the safety and risk of investments, providing protection for both principal and liquidity, to invest public funds in a manner which will provide the highest investment return while conforming to all state and local statutes governing the investment of public funds. This Investment Policy is authorized by the City Council in accordance with Texas Government Code, Chapter 2256-Public Funds Investment, also cited as the Public Funds Investment Act (Act), to satisfy the statutory requirements to define, adopt, and review a written Investment Policy regarding the investment of its funds and funds under its control. The City Council shall review and adopt by resolution, its investment strategies and policy not less than annually. This is required even if there are no changes within the policy. Such an Investment Policy must be written, emphasize safety, address investment management and include types of authorized investments, maximum allowable stated maturity, maximum dollar-weighted average maturity, method to monitor the market price and credit ratings of investments , and requirements for settlement of transactions. The resolution shall state that the Policy has been reviewed and include record of changes made to either the Investment Policy or strategy.

SCOPE

This Policy applies to all funds or financial resources available for investment under the City's financial control and accounted for in the City of Watauga, Texas Comprehensive Annual Financial Report which includes the General Fund, Watauga Parks Development Corporation Sales Tax Fund, Crime Control and Prevention District Fund, Street Maintenance Fund, Library Donation Fund, Municipal Court Security Fund, Municipal Court Technology Fund, Juvenile Case Manager Fund, Traffic Safety Fund, Park Vista Fund, General Obligation Bond Debt Service Fund, Watauga Parks Development Corporation Revenue Bond Debt Service Fund, General Obligation Capital Project Fund, Watauga Parks Development Corporation Capital Projects Fund, Bunker Hill Capital Projects Fund, Water and Sewer Enterprise Fund, Drainage Utility Enterprise Fund, Utility Construction Fund and will include any new fund created by the City Council unless specifically exempt. These policies do not, however, govern funds that are managed under separate investment programs or trust agreements, such as retirement funds, pension funds, deferred compensation funds, and certain private donations that are maintained as required by Federal and State laws, other local policies, or donor stipulations. In addition to this Policy, bond funds (as defined by the Internal Revenue Service) shall be managed by their governing ordinances an all applicable State and Federal laws.

The City will consolidate cash balances from all applicable funds to optimize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles. Such earnings from investments will be used in a manner that best serves the public trust and interests of the City as deemed in the annual budget.

INVESTMENT OBJECTIVES

All investments shall be designed and managed in a manner responsive to the public trust and in compliance with all Federal, State and other legal requirements, including but not limited to the Act. The City shall manage and invest its available resources with four objectives, listed in order of priority: Safety, Liquidity, Public Trust, and Yield.

Safety

Safety of principal and the City's assets 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. To increase investment safety, the City strives to decrease or minimize credit and interest rate risk. Minimization of credit risk or the risk of loss due to the failure of an investment issuer or guarantor shall be done by the City by limiting investments to safe types, pre-qualifying financial institutions and broker/dealers, and diversifying the portfolio in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

Minimization of interest rate risk or the decrease in market value of investments in the City's portfolio due to changes in interest rates shall be done by the City through strong cash flow projections so that realized market value losses are reduced and through investments in shorter-term investments.

Liquidity

The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements that might be reasonably anticipated. Liquidity shall be achieved by matching investment maturities with forecasted cash flow requirements and by investing in securities with active secondary markets. A portion of the portfolio will also be placed in cash equivalent investments, which offer daily liquidity and may be utilized as a competitive yield alternative to fixed maturity investments.

Public Trust

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 capital as well as the probable income to be derived. All participants in the City's investment process shall seek to act responsibly as custodians of the public trust. Investment officials shall avoid any transaction that might impair public confidence in the City's ability to govern effectively.

Yield

The City's investment portfolio shall be designed with the objective of attaining a rate of return throughout budgetary and economic cycles, commensurate with the City's investment risk constraints and the cash flow characteristics of the portfolio. Return on investment is of secondary importance compared to the safety, liquidity and public trust objectives described above. The core of investments is limited to relatively low risk investments in anticipation of earning a fair return relative to the risk being assumed. The yield of an equally weighted, rolling six-month Treasury bill portfolio shall be the minimum yield objective or "benchmark". A secondary objective will be to obtain a yield equal to or in excess of a local government investment pool or money market mutual fund. Weighted Average Yield to Maturity will be the portfolio performance standard.

STANDARDS OF CARE

Delegation of Authority

The City Manager, the Director of Finance, and Assistant Director of Finance are the Investment Officers of the City and are responsible for investment decisions and activities. The Investment Officers may delegate the day-to-day administrative duties to other persons authorized to perform investment activities for the City, or he/she may perform the duties him or herself. The City Manager will retain ultimate responsibility for investment decisions.

The Investment Officer(s) are responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City 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 the cost of a control should not exceed the benefits likely to be derived.

In conjunction with the annual audit, the City's outside auditor will review the internal control structure.

Training Requirements

The Investment Officer(s) are required to attend at least one training session relating to the Officers responsibility under the Act within 12 months after assuming duties receiving at least ten hours of Act-related instruction. Afterwards, the City shall provide at least ten hours of investment training not less than once in a two-year period that begins on the first day of the fiscal year and consists of two consecutive fiscal years after that date for the Investment Officer(s) and/or his/her delegate(s).This Policy approves courses and seminars offered by: the *Government Finance Officers Association of Texas, the Government Treasurers Organization of Texas, the Texas Municipal League, the North Central Texas Council of Governments*, the International City Manager Association, *the University of North Texas, the Texas State University, or the American Institute of Certified Public Accountants* in order to insure the equality and capability of the City's investment personnel making investment decisions in compliance with the Act. The training must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with the Act.

The City shall also encourage those who may perform daily activities with the City investments to attend such training although they are not listed specifically as Investment Officers of the City.

<u>Prudent Person Rule</u>

As set forth in the Act, Investment Officers shall use the standard of prudence with the "Prudent Person Rule". "Investments shall be made with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived (2256.006(a))."

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

1. The investment of all funds, or funds under the entity's control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment; and

2. Whether the investment decision was consistent with the written Investment Policy of the entity (Public Funds Investment Act 2256.006(b))."

Investment officials acting in accordance with written procedures and the Investment Policy and exercising due diligence shall be relieved of personal responsibilities for an individual investment's credit risk or market price change, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

Ethics and Conflict of Interest

Investment Officers and other employees involved in the investment process shall refrain from personal business activities that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. According to the Act, a personal business relationship with a business exists if one of the following three (3) items applies:

1. The Investment Officer owns 10 percent or more of the voting stock or shares of the business organization or owns $5,000 or more of the fair market value of the business organization.

2. Funds received by the Investment Officer from the business organization exceed 10 percent of the Investment Officer's gross income for the previous year.

3. The Investment Officer has acquired from the business organization during the previous year investments with a book value of $2,500 or more for the personal account of the Investment Officer.

Investment Officer(s) must file a disclosure statement with the Texas Ethics Commission and the City Council if an officer has a personal business relationship with a business organization offering to engage in an investment transaction with the City or the Officer is related within the second degree by affinity or consanguinity, as determined under Chapter 573 of the Texas Government Code, to an individual seeking to transact investment business with the entity.

Special attention should also be given the City's Standards of Conduct-Officers and Employees in Code of Ordinances Section 9.202 (1) and (2):

"No Officer or employee of the City shall:

1. Have a financial interest, direct or indirect, in any contract with the city nor shall be financially interested, directly or indirectly, in the sale to the city of any land, or rights or interest in any land, materials, supplies or service. The "financial interest" contemplated under this article requires that the officer or employee receive an actual financial benefit from the transaction with the city. An actual financial benefit from the transaction shall not include:

    A. An ownership in the entity transacting with the city where the ownership interest is less than one (1) percent of the entity.
    B. Compensation or benefits as an employee, officer, or director of the entity transacting business within the city where such

compensation is not affected by the entity's transaction with the City.

2. Participate in a vote or decision on any matter in which the Officer or employee has a direct or indirect financial interest or in which a relative of the Officer or employee has a direct or indirect financial interest. It is expressly provided herein that an investment or ownership in a publicly held company in an amount less than three thousand, five hundred dollars ($3,500.00) does not constitute a prohibited financial interest under this article."

AUTHORIZED DEPOSITORY FINANCIAL INSTITUTIONS

A qualified primary depository shall be selected through the City's banking services procurement process, which shall include solicitation of proposals as required under Chapter 105 of the Local Government Code. The centralization of depository services is designed to maximize investment capabilities while minimizing service costs. The selection of a primary depository shall be based on the financial institution offering the most favorable terms and conditions at the least possible cost, while adhering to the guidelines and provisions within the request for proposal. In selecting a primary depository, the City shall give consideration to the financial institution's credit characteristics, financial history, service capabilities, location within City limits or within a ten (10) mile radius of the City limits, and costs for required services. The City's primary depository contract shall be for three years with an option to extend for an additional two years upon mutual agreement of the depository and the City. Specialized services may be contracted for by the City with another financial institution or company if the depository cannot provide such service or charges more than the same service with little or no appreciable benefit.

The City may also establish agreements with other financial institutions under separate contract for additional deposit services. Such deposits will only be made after the financial institution has completed and returned the required written instruments and depository pledge agreements. No deposit shall be made except in a qualified public depository as established by State Law.

SELECTION OF INVESTMENT BROKER/DEALERS AND ADVISORS

Selection of Investment Advisors and Broker/Dealers will be performed by the Investment Officer(s), with ratification and approval by the City Council. The selected firms shall provide timely transaction confirmations and monthly portfolio reports. Prospective Broker/Dealers shall provide financial and other information as requested by the Investment Officer(s) sufficient to evaluate their fiscal condition and ability to service the City. The Investment Officer(s) will establish criteria to evaluate Investment Advisors and Broker/Dealers, including:

1.) Adherence to the City's policies and strategies,
2.) Investment performance and transaction pricing within accepted risk constraints,
3.) Responsiveness to the City's request for services, information and open communication,
4.) Understanding of the inherent fiduciary responsibility of investing public funds,
5.) Similarity in philosophy and strategy with the City's objectives, and
6.) References from other public entities in Texas.

The Investment Officers shall, at least annually, review, revise, and adopt a list of qualified broker/dealers authorized to engage in securities transactions with the City. The City Council will annually approve the list of those qualified broker/dealers authorized to engage in investment transactions with the City (Sec. 2256.025).

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

APPROVED INVESTMENT PROVIDERS AND INVESTMENT ADVISORS

Broker/Dealers, Local Government Investment Pools, Money Market Mutual Funds, Financial Institutions, Investment Advisors, and other business organizations eligible to transact investment business with the City shall be presented a written copy of this Investment Policy. Additionally, the qualified representative or equivalent of the business organization seeking to transact investment business shall execute a Certificate as shown in Appendix "A", or a Certification similar in form, to the effect that the qualified representative has:

1.) Received and thoroughly reviewed this Investment Policy, and

2.) Acknowledged that their organization has implemented reasonable procedures and controls in an effort to preclude imprudent investment transactions between itself and the City that are not authorized by this Investment Policy, except to the extent that this authorization is dependent on an analysis of the makeup of the City's entire portfolio or requires and interpretation of subjective investment standards.

The City may not engage in an investment transaction with a business organization prior to receiving this written acknowledgment completed by the organization.

Competitive Environment

It is the policy of the City to provide a competitive environment for all individual security purchases and sales, financial institution deposits, and money market mutual fund and local government investment pool selections. The Investment Officers shall develop and maintain procedures for ensuring competition in the investment of the City's funds.

AUTHORIZED AND SUITABLE INVESTMENTS

Investments described below are authorized by the Act as eligible securities for the City. City funds governed by this Policy may be invested in the following types of securities:

1.) Obligations of the United States or its agencies and instrumentalities.

2.) Direct obligations of the State of Texas or its agencies.

3.) Other obligations, the principal of and interest on which are unconditionally guaranteed or insured by the State of Texas or the United States or its agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States.

4.) Obligations of states, agencies, counties, cities, and other political subdivisions of any state having been rated as to investment quality by a nationally recognized investment rating firm and having received a rating of not less than A or its equivalent.

5.) Financial institution deposits that, are issued by a state or national bank that a) has its main office or a branch office in Texas and is guaranteed or insured by the Federal Deposit Insurance Corporation or its successor, b) is secured by obligations in a manner and amount provided by law and this Policy for deposits of the City, or c) is executed through a depository institution or approved broker that has its main office or a branch office in Texas that meets the requirements of the Act.

6.) No-load money market mutual funds that are registered with the Securities and Exchange Commission, and no-load mutual funds which are continuously rated AAA by at least one nationally recognized rating service and follow practices authorized by the Act, are authorized investments per the Act, if:

(a) the no-load mutual fund has an average weighted maturity of less than two years, and is invested exclusively in obligations approved by Section 2256.014 (a)-(c) of the Act

(b) the City has not invested more than 15% of its monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service, in the mutual funds described above; and

(c) the City has not invested any portion of its bond proceeds and reserves and funds held for debt service, in mutual funds described above; and

(d) the City has not invested funds under its control, including bond proceeds and reserves and other funds held for debt service, in any one mutual fund described above in an amount that exceeds 10% of the total assets of the mutual fund.

7.) Eligible Investment Pools as defined in Section 2256.016 provided that:

(a) investment in the particular pool has been authorized by the City Council;

(b) the pool shall have furnished the Investment Officer(s) an offering circular containing the information required by Section 2256.016(b);

(c) the pool shall furnish to the Investment Officer(s) investment transaction confirmations with respect to all investments made with it;

(d) the pool shall furnish to the Investment Officer(s) monthly reports that contain the information required by Section 2256.016(c);

(e) any pool that is created to function as a money market mutual fund must continuously maintain a stable net asset value of one dollar ($1.00),

(f) the pool's investment philosophy and strategy are consistent with this Policy and the City's ongoing investment strategy; and

(g) the pool provides evidence of credit rating no lower than "AAA" or "AAA-m" by at least one nationally recognized credit rating service,

(h) an investment pool must make available an annual audited financial statement,

(i) if the investment pool operates an Internet website, the information required by section 2256.016(b),(c)(2), and (f) must be posted on the website,

(j) an investment pool in advertising investment rates must include either all levels of return based on breakpoints provided or state the lowest possible level of return based on the smallest level of funds invested if an investment pool offers fee breakpoints based on fund balances invested.

8.) Fully collateralized direct repurchase agreements having a defined termination date that is no later than 270 days from the delivery date, secured by cash or direct obligations of the U.S. or its agencies and instrumentalities, pledged with a third party selected or approved by the political entity, and placed through a primary government securities dealer, and as otherwise defined by the Act. Each issuer of repurchase agreements must sign a copy of a Master Repurchase Agreement, or similar mutually acceptable agreement.

9.) Commercial paper as defined in Section 2256.013 is allowed provided that paper has a stated maturity of 270 days or less from the issuance date and is rated not less than A-1 or P-1 or an equivalent rating by at least two nationally recognized credit rating agencies or one nationally recognized credit rating agency and is fully secured by an irrevocable letter of credit issued by a bank organized and existing under the laws of the United States or any State.

The City shall take all prudent measures that are consistent with this Investment Policy to liquidate any investment that does not have or is down-graded to less than the minimum rating stated herein. On a quarterly basis, the Investment Officers will monitor the rating of all investments held by the City. However, as stated in Section 2256.017, the City is not required to liquidate investments that were authorized investments at the time of purchase.

UNAUTHORIZED INVESTMENTS

The following investments are specifically prohibited by State Law:

1.) Obligations whose payment represents the coupon payment on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal.

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

COLLATERALIZATION

Consistent with the requirements of the Public Funds Investment Act and the Public Funds Collateral Act, the City requires that all bank deposits shall be federally insured or collateralized with eligible securities. This pledged collateral will have a market value equal to or no less than 102% of the deposits plus accrued interest less an amount insured by the FDIC. Evidence of the pledged collateral must be provided to and reviewed by the Director of Finance and will be retained by the City. Evidence of collateral is reviewed annually by the City's independent auditor in conjunction with the annual audit.

Financial institutions serving as City Depositories will be required to sign a Depository Agreement with the City. The Agreement shall define the City's rights to the collateral in case of default, bankruptcy, or closing, and shall establish a perfected security interest in compliance with Federal and State regulations, including:

1.) the Agreement must be in writing;

2.) the Agreement has to be executed by the Depository and the City contemporaneously with the acquisition of the assets;

3.) the Agreement must be approved by the Depository's Board of Directors or loan committee, and a copy of the meeting minutes must be delivered to the City; and,

4.) the Agreement must be part of the Depository's "official record" continuously since its execution.

Repurchase agreements must also be secured in accordance with State Law. Each counter party to a repurchase transaction is required to sign a copy of **The Bond Market** Association Master Repurchase Agreement, or mutually acceptable agreement. An executed copy of the Agreement must be on file before the City will enter into any transactions with a counter party.

Monitoring Collateral Adequacy

The City requires monthly reports with market values of pledged securities from all financial institutions with which the City has bank deposits, certificates of deposit, money market account deposits, or other secured investments. The Investment Officer(s) will monitor adequacy of collateralization monthly.

Weekly monitoring by the Investment Officer(s) of all collateral underlying repurchase agreement is required. More frequent monitoring may be necessary during periods of market volatility.

Collateral Substitution

Financial institution deposits, collateralized certificates of deposit, and repurchase agreements often require substitution of collateral. Any repurchase provider or financial institution requesting substitution must contact the Investment Officer(s) for approval and settlement. The substituted security's value will be calculated and substitution approved if its value is equal to or greater than the required security level. Substitution is allowable for all transactions, but should be limited, if possible, to minimize potential administrative problems and transfer expense. The Investment Officer(s) may limit substitution and assess appropriate fees if substitution becomes excessive or abusive.

Collateral Reductions

Should the collateral's market value exceed the required amount, any repurchase provider or financial institution may request approval from the Investment Officer(s) to reduce collateral. Collateral reductions may be permitted only if the City's records indicate that the collateral's market value exceeds the required amount. The Investment Officer(s), or a designee, must provide written notification of the decision to the bank or the safekeeping agent holding the security prior to any security release.

SAFEKEEPING AND CUSTODY

The City shall contract with a bank or banks for the safekeeping of securities either owned by the City as part of its investment portfolio or as part of its depository and repurchase agreements. All collateral securing bank deposits must be held by third-party banking institution ("Custodian") acceptable to and under contract with the City, or by the Federal Reserve Bank. The securities purchased under a repurchase agreement must be delivered to a third-party custodian with whom the City has established a safekeeping agreement ("Safekeeping Agent").

All security transactions, including collateral for repurchase agreements entered into by the City shall be conducted on a delivery-verses-payment (DVP) basis. By so doing, City funds are not released until the City has received, through the Safekeeping Agent, the securities purchased. The security shall be held in the name of the City or held on behalf of the City. The Safekeeping Agent and Custodian's records shall assure the notation of the City's ownership of or explicit claim on the securities. The original copy of all receipts and monthly reports shall be delivered to the City by the Safekeeping Agent or Custodian.

INVESTMENT PARAMETERS

Diversification

The City will diversify its investments by security type and investment maturity. Diversification by investment type shall be established by the following maximum percentages of investment type to the total investment portfolio:

a.)	U.S. Government Securities	100%
b.)	Financial Institution Deposits	100%
c.)	Eligible Investment Pools	100%
d.)	States, Agencies, Counties, Cities and Other	50%
e.)	Repurchase Agreements	50%
f.)	Money Market Mutual Funds	50%
g.)	Commercial Paper	10%

Maximum and Weighted Average Maturity

In order to minimize risk of loss due to interest rate fluctuations, investment maturities will not exceed the anticipated cash flow requirement of the funds. The City intends to match the holding periods of investment funds with liquidity need of the City. The maximum final stated maturity of any investment shall not exceed five years. All long-term maturities will be intended to cover long-term liabilities. In addition, no less than ten percent (10%) of the funds in the portfolio will be in cash equivalent investments at all times. The entire portfolio will have a weighted average maturity of one (1) year or less. This weighted average will be calculated using the stated final maturity dates of each investment.

By Fund Groups

Maturity guidelines by fund are as follows:

a.) Operating Funds - The weighted average days to maturity for the operating fund portfolio shall be 365 days or less and the maximum allowable maturity shall be two years.

b.) Debt Service Funds - Debt Service Funds shall be invested to ensure adequate funding for each consecutive debt service payment. The Investment Officer shall invest in such a manner as not to exceed an "unfunded" debt service date with the maturity of any investment. Any unfunded debt service date is defined as a coupon or principal payment date that does not have cash or investment securities available to satisfy said payment.

c.) Debt Service Reserve Funds - Market conditions, Bond Resolutions constraints and Arbitrage compliance will be considered when formulating Reserve Fund strategy. Maturity limitation shall generally not exceed the call provisions of the Bond Ordinance and shall not exceed the final maturity of the bond issue. All Debt Service Reserve Fund investment maturities shall not exceed five years.

d.) Special Project, Special Purpose, and Capital Improvement Funds - The investment maturity of bond proceeds shall generally be limited to the anticipated cash flow requirements. City funds that are considered "bond proceeds" for arbitrage purposes will be invested using a more conservative approach than the standard investment strategy when arbitrage rebate rules requiring refunding excess earnings. All earnings in excess of the allowable arbitrage earnings will be segregated and made available for any necessary payments to the U.S. Treasury.

INVESTMENT STRATEGY

The City maintains one portfolio in which all funds under the City's control are pooled for investment purposes. In order to minimize risk of loss due to interest rate fluctuations, investment maturities will not exceed the anticipated cash flow requirements of the funds. Investment guidelines by fund-type are as follows:

1. General, Enterprise, or Operating-type Funds, and the Pooled Fund

Suitability – Any investment eligible in the Investment Policy is suitable for General, Enterprise, or Operating Funds, and the Pooled Fund.

Safety of Principal – All investments shall be of high quality with no perceived default risk. Market price fluctuations will occur. However, managing the weighted average days to maturity of each fund's portfolio to less than 365 days and restricting the maximum allowable maturity to two years will minimize the price volatility of the portfolio.

Marketability – Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash flow requirement. Historical market “spreads” between the bid and offer prices of a particular security-type of less than a quarter of a percentage point will define an efficient secondary market.

Liquidity – General, Enterprise, or Operating-type Funds, and the Pooled Fund require the greatest short-term liquidity of any of the fund-types. Short-term cash equivalent investments will provide daily liquidity and may be utilized as a competitive yield alternative to fixed maturity investments.

Diversification – Investment maturities should be staggered throughout the budget cycle to provide cash flow based on the anticipated operating needs of the City. Diversifying the appropriate maturity structure up to the two-year maximum will reduce interest rate risk.

Yield – Attaining a competitive market yield for comparable security-types and portfolio restrictions is the desired objective. The yield of an equally weighted, rolling six-month Treasury Bill portfolio will be the minimum yield objective.

2. Debt Service Funds

Suitability – Any investment eligible in the Investment Policy is suitable for the Debt Service Funds.

Safety of Principal – All investments shall be of high quality with no perceived default risk. Market price fluctuations will occur. However, by managing Debt Service Funds maturities to not exceed the debt service payment schedule the market risk of the overall portfolio will be minimized.

Marketability – Securities with active and efficient secondary markets are not necessary as the event of an unanticipated cash flow requirement is not probable.

Liquidity – Debt Service Funds have predictable payment schedules. Therefore, investment maturities should not exceed the anticipated cash flow requirements. Investment pools and money market mutual funds may provide a competitive yield alternative for short-term fixed maturity investments.

Diversification – Market conditions influence the attractiveness of fully extending maturity to the next "unfunded" payment date. Generally, if investment rates are anticipated to decrease over time, the City is best served by locking in most investments. If the interest rates are potentially rising, then investing in shorter and larger amounts may provide advantage. At no time shall the debt service schedule be exceeded in an attempt to bolster yield.

Yield – Attaining a competitive market yield for comparable security-types and portfolio restrictions is the desired objective. The yield of an equally weighted, rolling six-month Treasury Bill portfolio shall be the minimum yield objective.

3. Debt Service Reserve Funds

Suitability – Any investment eligible in the Investment Policy is suitable for the Debt Service Reserve Funds. Bond resolution and loan documentation constraints and insurance company restrictions may create specific considerations in addition to the Investment Policy.

Safety of Principal – All investments shall be of high quality with no perceived default risk. Market price fluctuations will occur. However, by managing Debt Service Reserve Fund maturities to not exceed the call provisions of the borrowing will reduce the investment's market risk if the City's debt is redeemed and the Reserve Fund liquidated. No stated final investment maturity shall exceed the shorter of the final maturity of the borrowing or five years. Annual market-to-market requirements or specific maturity and average life limitations within the borrowing's documentation will influence the attractiveness of market risk and influence maturity extension.

Marketability – Securities with less active and efficient secondary markets are acceptable for Debt Service Reserve Funds.

Liquidity – Debt Service Reserve Funds have no anticipated expenditures. The Funds are deposited to provide annual debt service payment protection to the City's debt holders. The funds are "returned" to the City at the final debt service payment. Market conditions and arbitrage regulation compliance determine the advantage of investment diversification and liquidity. Generally, if investment rates exceed the cost of borrowing, the City is best served by locking in investment maturities and reducing liquidity. If the borrowing costs cannot be exceeded, then current market conditions will determine the attractiveness of locking in maturities or investing shorter and anticipated future increased yields.

Diversification – Market conditions and the arbitrage regulations influence the attractiveness of staggering the maturity of fixed rate investments for Debt Service Reserve Funds. At no time shall the final debt service payment date of the bond issue be exceeded in an attempt to bolster yield.

Yield – Achieving a positive spread to the applicable borrowing cost is the desired objective. Debt Service Reserve Fund portfolio management shall operate within the limits of the Investment Policy's risk constraints.

4. Special Project, Special Purpose or Capital Improvement Funds

Suitability – Any investment eligible in the Investment Policy is suitable for Capital Improvement Funds.

Safety of Principal – All investments will be of high quality with no perceived default risk. Market price fluctuations will occur. However, by managing Capital Improvement Funds to not exceed the anticipated expenditure schedule, the market risk of the overall portfolio will be minimized. No stated final investment maturity shall exceed the shorter of the anticipated expenditure schedule.

Marketability – Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash flow requirement. Historical market "spreads" between the bid and offer prices of a particular security-type of less than a quarter of a percentage point will define an efficient secondary market.

Liquidity – Most capital improvement programs have reasonably predictable draw down schedules. Therefore, investment maturities should generally follow the anticipated cash flow requirements. Investment pools and money market mutual funds will provide readily available funds generally equal to one month's anticipated cash flow needs, or a competitive yield alternative for short-term fixed maturity investments.

Diversification – Market conditions and arbitrage regulations influence the attractiveness of staggering the maturity of fixed rate investments for bond proceeds. Generally, if investment rates exceed the applicable cost of borrowing, the City is best served by locking in most investments. If the cost of borrowing cannot be exceeded, then current market conditions will determine the attractiveness of diversifying maturities or investing in shorter and larger amounts. At no time shall the anticipated expenditure schedule be exceeded in an attempt to bolster yield.

Yield – Achieving a positive spread to the cost of borrowing is the desired objective within the limits of the Investment Policy's risk constraints. The yield of an equally weighted, rolling six-month Treasury Bill portfolio will be the minimum yield objective for non-borrowed funds.

REPORTING

Not less than quarterly, the Investment Officer(s) shall prepare and submit to the City Council, a written, signed, investment report demonstrating a list of investment transactions for the preceding reporting period, in accordance with the Act. Reports will include, but not be limited to, the following:

1.) For each pooled fund group: a beginning book value and market value, book and market value additions and changes, and ending book and market value.
2.) The book value and market value of each investment at the beginning and end of the period by type of asset and fund type invested.
3.) The maturity date of each investment.
4.) Statement of compliance of the portfolios as it relates to the investment strategy.

Detailed and summary reports will be prepared jointly and presented to the City Council and Mayor not less than quarterly. Reports will comply with Section 2256.023, at a minimum.

Quarterly reports will be formally reviewed at least annually by an independent auditor and reported to the City Council once the City invests in items other than money market mutual funds, investment pools, or accounts offered by its depository bank in the form of CD's or money market accounts.

MONITORING OF THE MARKET VALUE OF INVESTMENTS AND COLLATERAL

The Investment Officer(s) shall determine the market value of each investment and of all Collateral pledged to secure deposits of City funds at least quarterly and at a time as close as practicable to the closing of the reporting period for the investments. The City shall utilize reliable sources independent of the investment provider. Such values shall be included on the investment report.

INTERNAL CONTROLS

Investment Officer(s) shall establish a system of internal controls, which shall be designed to prevent losses of public funds arising from fraud, employee error, unanticipated changes in financial markets, or imprudent actions by employees. Pertinent controls include custodian safekeeping receipts records management, documentation of investment bidding activities, written confirmations of oral transactions, reconciliation records, training requirement documentation, and compliance with investment policies. Where practical, the City should emphasize control of collusion, separation of duties, clear delegation of duties, accurate and timely reports, and staying informed about market conditions, changes and trends. In conjunction with the City's annual financial audit, the independent external auditor will assure compliance with the management controls on investments and adherence to investment policies.

INVESTMENT POLICY ADOPTION

The City's Investment Policy, which includes strategies for each fund, shall be adopted by resolution of the City Council. The Policy shall be reviewed annually and any modifications thereto must be approved by the City Council. This adoption by resolution is required even if there are no changes within the Policy.

APPENDIX "A" – Sample Certification

I hereby certify that I have personally read and understand the Investment Policy and master repurchase agreement (if applicable), conditions of the City of Watauga, Texas. I further acknowledge that reasonable procedures and controls designed to fulfill those objectives and conditions have been implemented. Therefore, this firm will preclude investment transactions between itself and the City of Watauga that are not authorized by the City's Investment Policy, except to the extent that this authorization is dependent on an analysis of the makeup the City's entire portfolio or requires an interpretation of subjective investment standards, thus protecting the City's credit or market risk.

All sales personnel of this firm dealing with the City of Watauga's account(s) have been informed and will be routinely informed of the City's investment horizons, limitations, strategy and risk constraints, whenever we are so informed by the City.

This firm pledges due diligence in informing the City of foreseeable risks associated with financial transactions connected to this firm.

I further acknowledge that no investment transaction shall occur between this firm and the City, until the City of Watauga receives this consent form, completed by the firm's qualified representative.

____
FIRM

____
SIGNATURE OF QUALIFIED FIRM REPRESENTATIVE

____
PRIMARY REPRESENTATIVE: NAME/TITLE
(please print)

____
DATE

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.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specified maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property that a borrower pledges to secure repayment of a loan. Also refer to securities pledged by a bank to secure deposits of public moneys.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the City of Watauga. It includes five combined 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-VERSES-PAYMENT (DVP): There are two methods of delivery of securities: delivery-verses-payment and delivery-verses-receipt. Delivery-verses-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 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 $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 with 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 rate 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 Bank 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, DC 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 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 a reasonable trade size can be done at the quoted prices.

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 the underlying securities in the event of default by the seller-borrower.

MONEY MARKET: The date upon which the principal or stated value of an investment becomes due and payable.

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 sate—the so—called legal list. In other states the trustee may invest in security if it is one that 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 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 RFPs 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 AND EXCHANGE COMMISSION: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

SEC RULE 15C3-1: 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 NOTES: A non-interest bearing 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 to 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.