CITY OF WEST ORANGE

INVESTMENT POLICY

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INTRODUCTION

The purpose of this document is to set forth specific investment policy and strategy guidelines for the City of West Orange in order to achieve the goals of safety, liquidity, diversification, yield and public trust for all investment activity. The City Council of the City of West Orange shall review its investment strategies and policy not less than annually. This policy conforms to all state laws and statutes which govern the investment of public funds, including but not by way of limitation Chapter 2256 Local Government Code, cited as the Public Funds Investment Act, "the Act," and Chapter 2257 of the Government Code, cited as the Public Funds "Collateral Act".

INVESTMENT STRATEGY

The City of West Orange maintains portfolios which utilize five specific investment strategy considerations designed to address the unique characteristics of the fund groups represented in the portfolios:

A. Investment strategies for operating funds and commingled pools containing operating funds have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. The secondary objective is to create a portfolio structure which will experience minimal volatility during economic cycles. This may be accomplished by purchasing high quality, short-to-medium-term securities which will complement each other in a laddered or barbell maturity structure. The maximum dollar weighted average maturity of six months or less will be calculated using the stated final maturity date of each security.

B. Investment strategy for debt service funds shall have as the primary objective the assurance of investment liquidity adequate to cover the debt service obligation on the required payment date. Securities purchased shall not have a stated final maturity date which exceeds the debt service payment date.

C. Investment strategies for debt service reserve funds shall have as the primary objective the ability to generate a dependable revenue stream to the appropriate debt service fund from high-quality securities with a low degree of volatility. Securities should be of high quality and, except as may be required by the bond ordinance specific to an individual issue, of short to intermediate-term maturities. Volatility shall be further controlled through the purchase of securities carrying the highest coupon available, within the desired maturity and quality range, without paying a premium, if at all possible. Such securities will tend to hold their value during economic cycles.

D. Investment strategies for special projects or special purpose fund portfolios will have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. These portfolios should include at least 10% in highly liquid securities to allow for flexibility and unanticipated project outlays. The stated final maturity dates of securities held should not exceed the estimated project completion date.

INVESTMENT POLICY

I. SCOPE

This investment policy applies to all financial assets of the City of West Orange and are reported in the City's Annual Comprehensive Financial Report (ACFR).

Any new funds created, unless specifically exempted by the governing body and this Policy, are to be included under the provisions of the policy.

II. OBJECTIVES

The City of West Orange shall manage and invest its cash with five objectives, listed in order of priority: Safety, Liquidity, Diversification, Yield and Public Trust. The safety of the principal invested always remains the primary objective. All investments shall be made in a manner which will provide the highest rate of return with the maximum security. All investments shall be designed and managed in a manner responsive to the public trust and consistent with State and Local law.

The City shall maintain a comprehensive cash management program which includes collection of accounts receivable, vendor payment 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 yield on short-term investment of pooled idle cash.

Safety

The primary objective of the City's investment activity is the preservation of capital and the safety of principal in the overall portfolio. Each investment transaction shall be conducted in a manner to avoid capital losses, whether they are from securities defaults or erosion of market value.

Liquidity

The City's investment portfolio shall be structured such that the City is able to meet all obligations in a timely manner. This shall be achieved by matching investment maturities with forecasted cash flow requirements and by investing in securities with active secondary markets.

Diversification

The portfolio shall be diversified by market sector and maturity in order to avoid market risk.

Yield

The City's cash management portfolio shall be designed with the objective of regularly exceeding the average rate of return on three-month U.S. Treasury Bills. The investment program shall seek to augment returns above this threshold consistent with risk limitations identified herein and prudent investment policies.

Public Trust

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 which might impair public confidence in the City's ability to govern effectively.

III. RESPONSIBILITY AND CONTROL

Investment Committee

An Investment Committee, consisting of the City Secretary/Treasurer and the Chief Financial Officer shall meet at least yearly to review this policy and propose any recommended amendments to the City Council. The Committee is also responsible for establishing and maintaining an internal control structure designed to reasonably assure that assets are protected from loss, theft or misuse.

Delegation of Authority and Training

Authority to manage the City's investment program is derived from the approval of the City Council. The City Secretary/Treasurer is designated as Investment Officer of the City and is responsible for investment decisions and activities. The Mayor is designated as the Chief Financial Officer of the City. The Investment Officer and Chief Financial Officer shall each attend training relating to the officer's responsibility as mandated under the Public Funds Investment Act (Government Code §2256.008.)

Internal Controls

The Investment Officer 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 Investment Officer 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:

A. Control of collusion.
B. Separation of transaction authority from accounting and record keeping.
C. Custodial safekeeping.
D. Clear delegation of authority to subordinate staff members.
E. Written confirmation of all transactions

Prudence

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. Investment of funds shall be governed by the following objectives, in order of priority:

A. Preservation and safety of principal;
B. Liquidity;
C. Diversification; and
D. Yield

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

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

B. Whether the investment decision was consistent with the written investment policy of the City.

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

Ethics and Conflicts of Interest

City staff involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair the ability to make impartial investment decisions. City staff shall disclose to the City Council any material financial interests in financial institutions that conduct business with the City and they shall further disclose positions that could be related to the performance of the City's portfolio. City staff shall subordinate their personal financial transactions to those of the City, particularly with regard to timing of purchases and sales.

An Investment Officer of the City who has a personal business relationship with an organization seeking to sell an investment to the City 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 City shall file a statement disclosing that relationship. A statement required under this subsection must be filed with the Texas Ethics Commission and the governing body of the entity.

IV. REPORTING

Quarterly Reporting

The Investment Officer shall submit a quarterly investment report of investment transactions for all funds, pursuant to §2256.023 of the Public Funds Investment Act.

Annual Report

Within 60 days of the end of the fiscal year, Investment Officer shall present an annual report on the investment program and investment activity. This report may be presented as a component of the fourth quarter report to the Mayor and City Council.

Methods

The quarterly investment report shall include a succinct management summary that provides a clear picture of the status of the current investment portfolio and transactions made over the last quarter. This management summary will be prepared in a manner which will allow the City to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report will be provided to the Mayor and City Council. The report will include the following:

A. A listing of individual securities held at the end of the reporting period.

B. Listing of securities by maturity date.

C. Statement of compliance of the City's investment portfolio with State Law and the investment strategy and policy approved by the City Council.

V. INVESTMENT PORTFOLIO

Active Portfolio Management

The City shall pursue an active versus a passive portfolio management philosophy. That is, securities may be sold before they mature if market conditions present an opportunity for the City to benefit from the trade. The Investment Officer will routinely monitor the contents of the portfolio, the available markets, and the relative value of competing instruments, and will adjust the portfolio accordingly.

Investments

Assets of the City of West Orange may be invested in the following instruments; provided, however, that at no time shall assets of the City be invested in any instrument or security not authorized for investment under the Act, as the Act may from time to time be amended.

I. Authorize

A. Obligations, including letters of credit, of the United States or its agencies and instrumentalities;

B. Direct obligations of the State of Texas or its agencies and instrumentalities;

C. 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;

D. Other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of the State of Texas or the United States or their respective agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation (FDIC) or by the explicit full faith and credit of the United States;

E. Obligations of states, agencies, counties, cities and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than “A” or its equivalent; ~~and~~

F. Bonds issued, assumed or guaranteed by the State of Israel; and

G. Local government investment pools organized and operating in compliance with this policy and whose investment philosophy is consistent with this policy and the City’s ongoing investment strategy.

II. Not Authorized

The City's authorized investments options are more restrictive than those allowed by State law. State law specifically prohibits investment in the following investment securities.

A. Obligations whose payments represent~~s~~ the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal (Interest-Only CMO);

B. Obligations whose payments represent~~s~~ the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest (Principal-Only CMO);

C. Collateralized Mortgage Obligations (CMOs) that have a stated final maturity date of greater than 10 years; and

D. Collateralized Mortgage Obligations whose interest rates are determined by an index that adjusts opposite to the changes in a market index (Inverse Floater CMO).

Holding Period

The City of West Orange intends to match the holding periods of investment funds with liquidity needs of the City. In no case will the average maturity of investments of the City's operating funds exceed one year. The maximum final stated maturity of any investment shall not exceed five years.

Investments in all funds shall be managed in such a way that the market price losses resulting from interest rate volatility would be offset by coupon income and current income received from the volume of the portfolio during a twelve-month period.

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

Risk and Diversification

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

A. Risk of issuer default is controlled by limiting investments to those instruments allowed by the Act, which are described herein.

B. Risk of market price changes shall be controlled by avoiding over-concentration of assets in a specific maturity sector, limitation of average maturity of operating funds investments to one year, and avoidance of over-concentration of assets in specific instruments other than U. S. Treasury Securities and Insured or Collateralized Certificates of Deposits.

C. Risk of illiquidity due to technical complications shall be controlled by the selection of securities dealers as described herein.

VI. SELECTION OF BANKS AND DEALERS

Depository

A depository shall be selected through the City's banking services procurement process, and in accordance with Chapter 105 of the Texas Local Government Code. Efforts will be made to obtain at least three competitive proposals. In selecting a depository, the credit worthiness of bidding institutions shall be considered, and the Investment Officer shall conduct a comprehensive review of prospective depositories' credit characteristics and financial history.

Investment Transactions

The qualified representative of the financial institution offering to engage in an investment transaction with the City shall execute a written instrument in a form acceptable to the City and the financial institution substantially to the effect that the financial institution has:

A. received and reviewed the City's Investment Policy; and

B. acknowledged that the financial institution has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the City and the financial institution 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 of the City's entire portfolio or requires an interpretation of subjective investment standards.

The Investment Officer of the City may not acquire or otherwise obtain any authorized investment described in the Investment Policy of the City from a person who has not delivered to the City the instrument required above.

Certificates of Deposit

Banks seeking to establish eligibility for the City's competitive certificate of deposit purchase program shall submit for review annual financial statements, evidence of federal insurance and other information as required by the Investment Officer.

Securities Dealers

For brokers and dealers of government securities, the City shall select only those dealers reporting to the Market Reports Division of the Federal Reserve Board of New York, also known as the "Primary Government Security Dealers", unless a comprehensive credit and capitalization analysis reveals that other firms are adequately financed to conduct public business. Investment officials shall not knowingly conduct business with any firm with whom public entities have sustained losses on investments. All Securities dealers shall provide the City with references from public entities which they are currently serving.

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the following as appropriate:

* audited financial statements
* proof of National Association of Securities Dealers (NASD) certification
* proof of state registration
* completed broker/dealer questionnaire
* certification of having read the City's investment policy signed by a registered principal of the organization
* acknowledgement that the organization has implemented reasonable procedures and controls in an effort to preclude imprudent investment activities arising out of investment transactions conducted between the City and the organization.

An annual review of the financial condition and registration of qualified bidders will be conducted by the Investment Officer.

VII. SAFEKEEPING AND CUSTODY

Insurance or Collateral

All deposits and investments of City funds other than direct purchases of U.S. Treasuries or Agencies shall be secured by pledged collateral. Total market value of collateral will equal 102% of time and demand deposits at all times. Bank will be responsible for monitoring and maintaining collateral margins on a daily basis. Evidence of the pledged collateral shall be maintained by the Investment Officer or a third-party financial institution. Repurchase agreements shall be documented by a specific agreement noting the collateral pledge in each agreement. Collateral shall be reviewed monthly to assure that the market value of the pledged securities is adequate. All pledged securities must be “pledged to the City of West Orange, Texas.”

Safekeeping Agreement

Collateral pledged to secure deposits of the City shall be held by a safekeeping institution in accordance with a Safekeeping Agreement which clearly defines the procedural steps for gaining access to the collateral should the City of West Orange determine that the City's funds are in jeopardy. The safekeeping institution, or Trustee, shall be the Federal Reserve Bank or an institution not affiliated with the firm pledging the collateral. The safekeeping agreement shall include the signatures of authorized representatives of the City of West Orange, the firm pledging the collateral, and the Trustee.

Collateral Defined

The City of West Orange shall accept only the following securities as collateral:

A. FDIC insurance coverage.

B. A bond, certificate of indebtedness, or Treasury Note of the United States, or other evidence of indebtedness of the United States that is guaranteed as to principal and interest by the United States.

C. Obligations, the principal and interest on which, are unconditionally guaranteed or insured by the State of Texas.

D. A bond of the State of Texas or of a county, city or other political subdivision of the State of Texas having been rated as investment grade (investment rating no less than "A" or its equivalent) by a nationally recognized rating agency with a remaining maturity of ten (10) years or less.

E. Subject to Audit

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

Delivery vs. Payment

All security transactions, including collateral for repurchase agreements, entered into the by the City, Treasury Bills, Notes, Bonds and Government Agencies' securities shall be conducted on a delivery vs. payment method. That is, funds shall not be wired or paid until verification has been made that the correct security was received by the Trustee. The security shall be held in the name of the City or held on behalf of the City. The Trustee's records shall assure the notation of the City's ownership of or explicit claim on the securities. The original copy of all safekeeping receipts shall be delivered to the City.

VIII. INVESTMENT POLICY ADOPTION

The City of West Orange investment policy shall be adopted by the City Council. It shall be reviewed by the governing body not less than annually, who shall adopt a written instrument by resolution stating that it was reviewed and either renewed without change, or amended, recording any changes made.

GLOSSARY of COMMON TREASURY TERMINOLOGY

Agencies: Federal agency securities.

Annual Comprehensive Financial Report (ACFR): The official annual report for the City of West Orange. It includes five combined statements and basic financial statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

Asked: The price at which securities are offered.

Bid: The price offered for securities.

Broker: A broker brings buyers and sellers together for a commission paid by the initiator of the transaction or by both sides; he does not position. In the money market, brokers are active in markets in which banks buy and sell money and in interdealer markets.

Certificate of Deposit (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

Collateral: Securities, evidence of deposit or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

Coupon: (a) The annual rate of interest that a bond 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.

Delivery versus Payment: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt (also called free). Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

Discount: The difference between the cost price of a security and its value at maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

Discount Securities: Non-interest-bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g., U.S. Treasury bills.

Diversification: Dividing investment funds among a variety of securities offering independent returns.

Federal Deposit Insurance Corporation (FDIC): A federal agency that insures bank deposits, currently up to $100,000 per deposit.

Federal Funds Rate: The rate of interest at which Federal funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

Federal Home Loan Banks (FHLB): The institutions that regulate and lend to savings and loan associations. The Federal Home Loan Banks play a role analogous to that played by the Federal Reserve Banks vis-à-vis member commercial banks.

Liquidity: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

Market Value: The current face or par value of an investment multiplied by the net selling price of the security as quoted by a recognized market pricing source quoted on the valuation date.

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

Money Market: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

Portfolio: Collection of securities held by an investor.

Prudent Person Rule: An investment standard – Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

Qualified Public Depositories: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

Rate of Return: The yield obtainable on a security based on its current market price. This may be the amortized yield to maturity on a bond or the current income return.

Repurchase Agreement (RP or REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money, that it, increasing bank reserves.

Safekeeping: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

Secondary Market: A market made for the purchase and sale of outstanding issues following the initial distribution.

Securities & Exchange Commission: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

Treasury Bills: A non-interest-bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months or one year.

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

Treasury Notes: Intermediate-term coupon bearing U.S. Treasury securities having initial maturities from one-to-ten years.

Yield: The rate of annual return on an investment, expressed as a percentage.

(a) Income Yield is obtained by dividing the current dollar income by the current market price of the security.

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

Uniform Net Capital Rule: Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15:1; also called Net Capital Rule or 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 included cash and assets easily converted into cash.