

CHAPTER 32 - Investment Policy

32.100. Purpose. This Chapter applies to the investment of all operating funds of the City of Holts Summit, Missouri. Longer term funds, including investments of employees' retirement funds and proceeds from certain bond issues, are covered by a separate policy.

1. Pooling of Funds. Except for cash in certain restricted and special funds, the City of Holts Summit will consolidate cash balances from all funds to maximize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

2. External Management of Funds. Investment through external programs, facilities and professionals operating in a manner consistent with this Chapter will constitute compliance.

32.105. General Objectives. The primary objectives, in priority order, of investment activities shall be safety, liquidity, and yield:

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

A. Credit Risk. The City of Holts Summit will minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:

1) Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisors with which the City will do business.

2) Diversifying the portfolio so that potential losses on individual securities will be minimized.

B. Interest Rate Risk. The City of Holts Summit will minimize the risk that the market value of securities in the portfolio will fall due to changes in general interest rates, by:

1) Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity.

2) Investing operating funds primarily in shorter term securities.

2. Liquidity. The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is

accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity). A portion of the portfolio also may be placed in bank deposits or repurchase agreements that offer same day liquidity for short term funds.

3. Yield. The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core of investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

- A. A security with declining credit may be sold early to minimize loss of principal.
- B. A security swap would improve the quality, yield, or target duration in the portfolio.
- C. Liquidity needs of the portfolio require that the security be sold.

32.110. Standards of Care.

1. Prudence. The standard of care to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal liability for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion to the Board of Aldermen and the liquidity and the sale of securities are carried out in accordance with the terms of this policy.

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.

2. Ethics and Conflicts of Interest. Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the

investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of the City.

3. Delegation of Authority. Authority to manage the investment program is granted to the Board of Aldermen. Responsibility for the operation of the investment program is hereby delegated to the Board of Aldermen, who shall act in accordance with the established written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures should include references to: safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements, and collateral/depository agreements. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Board of Aldermen. The Board of Aldermen shall be responsible for all transactions undertaken.

32.115. Investment Transactions.

1. Authorized Financial Dealers and Institutions. A list will be maintained of financial institutions authorized to provide investment transactions. In addition, a list also will be maintained of approved security broker/dealers selected by creditworthiness as determined by the Board of Aldermen. These may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission (SEC) Rule 15C3-a (uniform net capital rule).

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

- A. Audited financial statements.
- B. Proof of National Association of Securities Dealers (NASD) certification.
- C. Proof of state registration.
- D. Completed broker/dealer questionnaire.
- E. Certification of having read and understood and agreeing to comply with the City's investment policy.

An annual review of the financial condition and registration of qualified financial institutions and broker/dealers will be conducted by the Board of Aldermen. From time to time, the Board of Aldermen may choose to invest in instruments offered by emerging or minority firms and community financial institutions. In such situations, a waiver to the criteria under this Section may be granted by the Board of Aldermen. All terms and relationships will be fully disclosed prior to purchase and will be reported to the Board of Aldermen of the City on a consistent basis. The Board of Aldermen should approve these types of investment purchases in advance.

2. Internal Controls. The Board of Aldermen is responsible for establishing and maintaining an internal control structure that will be reviewed annually with the City's independent auditor. The internal control structure shall be designed to ensure that the assets of the City are protected from loss, theft or misuse and to provide reasonable assurance that these

objectives are met. The concept of reasonable assurance recognizes that (1) the cost of control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits require estimates and judgments by management.

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. Avoidance of physical delivery securities.
- E. Clear delegation of authority to subordinate staff members.
- F. Written confirmation of transactions for investments and wire transfers.
- G. Development of a wire transfer agreement with the lead bank and third party custodian.

3. Delivery vs. Payment. All trades where applicable will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in eligible financial institutions prior to the release of funds. All securities shall be perfected in the name or for the account of the City and shall be held by a third party custodian as evidenced by safekeeping receipts.

32.120. Suitable and Authorized Investments.

1. Investment Types. In accordance with and subject to restrictions imposed by current statutes, the following list represents the entire range of investments that the City will consider and which shall be authorized for the investments of funds by the City.

A. United States Treasury Securities. The City may invest in obligations of the United States government for which the full faith and credit of the United States are pledged for the payment of principal and interest.

B. United States Agency Securities. The City may invest in obligations issued or guaranteed by any agency of the United States Government as described in Section 32.120.2.

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C. Repurchase Agreements. The City may invest in contractual agreements between the City and commercial banks or primary government securities dealers. The purchaser in a repurchase agreement (repo) enters into a contractual agreement to purchase U.S. Treasury and government agency securities while simultaneously agreeing to resell the securities at predetermined dates and prices.

D. Collateralized Public Deposits (Certificates of Deposit). Instruments issued by financial institutions which state that specified sums have been deposited for specified periods of time and at specified rates of interest. The certificates of deposit are required to be backed by acceptable collateral securities as dictated by State statute.

E. Bankers' Acceptances. Time drafts drawn on and accepted by a commercial bank, otherwise known as bankers' acceptances. The City may invest in bankers' acceptances issued by domestic commercial banks possessing the highest rating issued by Moody's Investor Services, Inc. or Standard and Poor's Corporation.

F. Commercial Paper. The City may invest in commercial paper issued by domestic corporations, which has received the highest rating issued by Moody's Investor Services, Inc. or Standard and Poor's Corporation. Eligible paper is further limited to issuing corporations that have total commercial paper program size in excess of five hundred million dollars (\$500,000,000).

2. Security Selection. The following list represents the entire range of United States Agency Securities that the City will consider and which shall be authorized for the investment of funds by the City. Additionally, the following definitions and guidelines should be used in purchasing the instruments.

A. U.S. Government Agency Coupon and Zero Coupon Securities. Bullet coupon bonds with no embedded options.

B. U.S. Government Agency Discount Notes. Purchased at a discount with maximum maturities of one (1) year.

C. U.S. Government Agency Callable Securities. Restricted to securities callable at par only with final maturities of five (5) years.

D. U.S. Government Agency Step-Up Securities. The coupon rate is fixed for an initial term. At coupon date, the coupon rate rises to a new, higher fixed term Restricted to securities with final maturities of five (5) years.

E. U.S. Government Agency Floating Rate Securities. The coupon rate floats off one index. Restricted to coupons with no interim caps that reset at least quarterly.

F. U.S. Government Mortgage Backed Securities. Restricted to securities with final maturities of five (5) years.

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3. Investment Restrictions and Prohibited Transactions. To provide for the safety and liquidity of the City's funds, the investment portfolio will be subject to the following restrictions:

A. Borrowing for investment purposes ("Leverage") is prohibited.

B. Instruments known as Structured Notes (e.g. inverse floaters, leveraged floaters, and equity-linked securities) are not permitted. Investment in any instrument, which is commonly considered a "derivative" instrument (e.g. options, futures, swaps, caps, floors, and collars), is prohibited.

C. Contracting to sell securities not yet acquired in order to purchase other securities for purposes of speculating on developments or trends in the market is prohibited.

D. No more than 5% of the total market value of the portfolio may be invested in bankers' acceptances issued by any one commercial bank and no more than 5% of the total market value of the portfolio may be invested in commercial paper of any one issuer.

4. Collateralization. Collateralization will be required on two types of investments: certificates of deposit and repurchase agreements. The market value (including accrued interest) of the collateral should be at least 100%.

For certificates of deposit, the market value of collateral must be at least 100% or greater of the amount of certificates of deposits plus demand deposits with the depository, less the amount, if any, which is insured by the Federal Deposit Insurance Corporation, or the National Credit Unions Share Insurance Fund.

All securities, which serve as collateral against the deposits of a depository institution, must be safe kept at a non affiliated custodial facility. Depository institutions pledging collateral against deposits must, in conjunction with the custodial agent, furnish the necessary custodial receipts within five business days from the settlement date.

The City shall have a depository contract and pledge agreement with each safekeeping bank that will comply with the Financial Institutions, Reform, Recovery, and Enforcement Act of 1989 (FIRREA). This will ensure that the City's security interest in collateral pledge to secure deposits is enforceable against the receiver of a failed financial institution.

5. Repurchase Agreements. The securities for which repurchase agreements will be transacted will be limited to U.S. Treasury and government agency securities that are eligible to be delivered via the Federal Reserve's Fed wire book entry system. Securities will be delivered to the City's designated Custodial Agent. Funds and securities will be transferred on a delivery vs. payment basis.

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32.125. Investment Parameters.

1. Diversification. The investments shall be diversified to minimize the risk of loss resulting from over concentration of assets in specific maturity, specific issuer, or specific class of securities. Diversification strategies shall be established and periodically reviewed. At a minimum, diversification standards by security type and issuer shall be:

- A. U.S. treasuries and securities having principal and/or interest guaranteed by the U.S. Government ----- 100%
- B. Collateralized time and demand deposits ----- 100%
- C. U.S. Government agencies, and government sponsored enterprises ----- no more than 60%
- D. Collateralized repurchase agreements ----- 50%
- E. U.S. Government agency callable securities ---
no more than 30%
- F. Commercial Paper ----- no more than 30%
- G. Banker's Acceptances ----- no more than 30%

2. Maximum Maturities. To the extent possible, the City shall attempt to match its investments with anticipated cash flow requirements. Investments in bankers' acceptances and commercial paper shall mature and become payable not more than one hundred eighty days (180) from the date of purchase. All other investments shall mature and become payable not more than five (5) years from the date of purchase. The City shall adopt weighted average maturity limitations that should not exceed three (3) years and is consistent with the investment objectives.

Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio should be continuously invested in readily available funds such as in bank deposits or overnight repurchase agreements to ensure that appropriate liquidity is maintained to meet ongoing obligations.

32.130. Reporting.

1. Methods. The Board of Aldermen shall cause to be prepare an investment report at least quarterly, including a management summary that provides an analysis of the status of the current investment portfolio and transactions made over the last quarter. This management summary will be prepared in a manner that will allow the City to ascertain whether investment activities during the reporting period have conformed to the investment policy.

The report should be provided to the Board of Aldermen of the City. The report will include the following:

- A. Listing of individual securities held at the end of the reporting period.

B. Realized and unrealized gains or losses resulting from appreciation or depreciation by listing the cost and market value of securities over one year duration (in accordance with Government Accounting Standards Board (GASB) 31 requirements).

C. Average weighted yield to maturity of portfolio on investments as compared to applicable benchmarks.

D. Listing of investment by maturity date.

E. Percentage of the total portfolio which each type of investment represents.

2. Performance Standards. The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio should obtain a market average rate of return during a market/economic environment of stable interest rates. A series of appropriate benchmarks may be established against which portfolio performance shall be compared on a regular basis.

Commercial paper and bankers' acceptances must be reviewed monthly to determine if the rating level has changed. The commercial paper and bankers' acceptances should be reviewed for possible sale if the securities are downgraded below the minimum acceptable rating levels.

3. Marking to Market. The market value of the portfolio shall be calculated at least quarterly and a statement of the market value of the portfolio shall be issued at least annually to the Board of Aldermen. This will ensure that review of the investment portfolio, in terms of value and price volatility, has been performed.

APPENDIX B

SECURITIES ACCEPTABLE AS COLLATERAL TO SECURE DEPOSITS

The securities described below are hereby designated as acceptable collateral for state funds on deposit, as required by Section 30.270 RSMo (as amended).

The securities described below are designated as *acceptable collateral* for the deposit of City funds. The listing is not intended to serve as, and *should not be considered as a listing of legally authorized investment instruments*.

1. Marketable Treasury securities of the United States.
2. The following debt securities of the State of Missouri and its state authorities:
 - General obligation debt securities issued by the State of Missouri.
 - Revenue bonds issued by the Missouri Board of Public Buildings or Department of Natural Resources.
 - Revenue bonds of the Missouri Housing Development Commission, Missouri Health and Education Facilities Authority, Missouri Higher Education Loan Authority, Missouri Environmental Improvement and Energy Resources Authority, Missouri Agricultural and Small Business Development Authority, Missouri Industrial Development Board, or state-owned educational institutions, so long as any of the above are rates "A" or better by Moody's or Standard & Poor's (M1 on notes), or are secured by a federal agency guarantee (directly or through guaranteed loans).
3. General obligation bonds of any city in this state having a population of not less than two thousand.
4. General obligation bonds of any county of this state.
5. General obligation bonds, approved and registered, of any school district situated in this state.
6. General obligation bonds, approved and registered, of any special road district in this state.
7. General obligation state bonds of any of the 50 states.
8. Debt securities of the Federal Farm Credit System.
9. Debt securities of the Federal Home Loan Banks (FHLB) (excluding Zeros).
10. Other debt securities guaranteed by the United States or its agencies or instrumentality's, as follows:
 - a. Debt securities of the Federal National Mortgage Association (FNMA).
 - b. Debt securities of the Student Loan Marketing Association (SLMA).
 - c. Debt securities of the Government National Mortgage Association (GNMA).
 - d. Debt securities of the Federal Home Loan Mortgage Corporation (FHLMC) (excluding FHLMC Mortgage Cash Flow Obligations).
 - e. Guaranteed Loan Pool Certificates of the Small Business Administration (SBA).
 - f. Federal Home Administration insured notes (CBOs).
 - g. Public housing notes and bonds ("project notes and bonds") issued by public housing agencies, guaranteed as to the payment of principal and interest by the government of the United States or any agency or instrumentality thereof.
 - h. Debt securities of the Resolution Funding Corporation (REFCORP).All pledges of pass-through mortgage-backed securities will be valued at 90% of market value. SBA pool certificates and Collateralized Mortgage Obligations will be valued at 75% of market value. The only Collateralized Mortgage Obligations (CMO) the City will accept are Planned Amortization Class (PAC) Collateralized Mortgage Obligations that have a weighted average life not to exceed three years and pass the FFIEC High Risk Stress Test. No Strips or Zeros are acceptable.
11. Bonds of any political subdivision established under the provisions of Section 30, Article VI, of the Constitution of Missouri.
12. Tax anticipation notes issued by any county of class one in Missouri.

13. Surety bonds issued by an insurance company licensed under the laws of the State of Missouri whose claims-paying ability is rated in the highest category by Duff & Phelps, A.M. Best, Standard & Poor's, or Moody's. The face amount of such surety bond shall be at least equal to the portion of the deposit to be secured by the surety bond.
14. An irrevocable standby letter of credit issued by a Federal Home Loan Bank possessing the highest rating issued by at least one nationally recognized statistical rating agency.

Unless noted otherwise, the market value of collateral must be 100% or greater of the amount of state time deposits (including interest to maturity) plus demand deposits with the depository, less the amount, if any, which is insured by the Federal Deposit Insurance Corporation, or the National Credit Unions Share Insurance Fund. All securities pledged as collateral by the depository will be held by the Missouri State Treasurer, in a segregated account. All collateral pledged must be delivered in bearer form, book-entry form, or in the case of fully registered certificates, placed into the nominee name of the custodian.

APPENDIX B GLOSSARY

As used in this Chapter, the following terms shall mean:

1. Annual Review. For the purpose of reviewing authorized financial dealers and institutions, annual review requires an investment officer to ensure that the financial dealer or institution is in compliance with the City's established procedures.
2. Banker's Acceptance (BA). A short-term financial instrument that is the unconditional obligation of the accepting bank. Banker's acceptances, or BAs, arise from transactions involving the import, export, transit, or storage of goods - domestic as well as international

transit. For investors, it is important to realize that the underlying transaction that gives rise to a BA is almost completely irrelevant to the credit quality or the liquidity of the instrument. The actual BA is created at a late stage in the underlying transaction when a bank accepts its obligation to pay the holder of the accepted draft. In other words, when the transaction becomes a BA it becomes an unconditional obligation of the accepting bank. From an investor's point of view, a BA is a bank obligation that has at least the same credit strength as any CD issued by the same bank. In fact, BAs are typically stronger than CDs because in addition to the credit strength of the accepting bank they are backed by the credit strength of a drawer; an endorsing bank, if one is involved in the transaction; and usually by the pledge of documents representing ownership of the trade goods and insurance on the goods. BAs do not, however, carry federal deposit insurance. BAs are considered safe, liquid, short-term money market investments.

3. Bond Proceeds. The money paid to the issuer by the purchaser or underwriter of a new issue of municipal securities. These moneys are used to finance the project or purpose for which the securities were issued and to pay certain costs of issuance as may be provided in the bond contract.
4. Broker. A party who brings buyers and sellers together. Brokers do not take ownership of the property being traded. They are compensated by commissions. They are not the same as dealers; however, the same individuals and firms that act as brokers in some transactions may act as dealers in other transactions.
5. Callable Bond. A bond that the issuer has the right to redeem prior to maturity. Some callable bonds may be redeemed on one call date while others have multiple call dates. Some callable bonds may be redeemed at par while others can only be redeemed at a premium.
6. Certificate of Deposit (CD). A deposit of funds, in a bank or savings and loan association, for a specified term that earns interest at a specific rate or rate formula. They may be for terms as short as one week or as long or longer than ten years.
7. Commercial Paper. Unsecured, short-term promissory notes issued by corporations for specific amounts and with specific maturity dates. Firms with lower ratings or firms without well-known names usually back their commercial paper with guarantees or bank letters of credit. Commercial paper may be sold on a discount basis or may bear interest. Terms can be as short as one day and usually do not exceed 270 days.
8. Custodial Agent. An entity that holds collateral for deposits with financial institutions, investment securities, or securities underlying repurchase agreements.
9. Delivery vs. Payment (DVP). The simultaneous exchange of securities and cash. The safest method of settling either the purchase or sale of a security. In a DVP settlement, the funds are wired from the buyer's account and the security is delivered from the seller's account in simultaneous, interdependent wires.
10. GASB 31. Statement No. 31 of the Governmental Accounting Standards Board: Accounting and Financial Reporting for Certain Investments and for External Investment pools, establishes accounting standards for securities owned by governmental entities.
11. Government Accounting Standards Board (GASB). An accounting industry organization; part of the Financial Accounting Foundation. GASB issues statements of accounting standards that define and govern GAAP for state and local government entities in the United States.
12. Mark to Market. The process of restating the carrying value of an asset or liability to equal its current market value.
13. Market Value. The price at which a security is trading and presumably could be purchased or sold at a particular point in time.

14. Maturity. The date on which the principal or stated value of an investment becomes due and payable.
15. Operating funds. Includes all investable funds of the City with the exception of bond proceeds, retirement funds and self-insurance funds. Investable funds shall include all fund balances and surplus funds.
16. Par Value. The amount of principal which must be paid at maturity. Also referred to as the face amount of a bond, normally quoted in \$1,000 increments per bond.
17. Repurchase Agreement (RP). A form of secured, short-term borrowing in which a security is sold with a simultaneous agreement to buy it back from the purchaser at a future date. The purchase and sales agreements are simultaneous, but the transactions are not. The sale is a cash transaction while the return purchase is a forward transaction since it occurs at a future date. The seller/borrower pays interest to the buyer at a rate negotiated between the parties. Rates paid on repo's are short-term money market interest rates and are completely unrelated to the coupon rate paid on the instrument being purchased. Informally known as repos.
18. Safekeeping. An arrangement under which a third party holds securities or other valuable under safe, controlled conditions. A safekeeping arrangement is evidenced by a safekeeping receipt.
19. Swap. The sale of one or more securities in order to purchase one or more different securities with the proceeds from the sale. Bond swaps usually take advantage of changes in market conditions or more favorable investment characteristics. For example, swaps are often done to lengthen or shorten maturities when investors change their outlook for future rates.
20. US Treasury Obligations. Debt obligations of the United States Government sold by the Treasury Department in the forms of Bills, Notes, and Bonds. Bills are short-term obligations that mature in one year or less and are sold on the basis of a rate of discount. Notes are obligations that mature between one year and ten years. Bonds are long-term obligations that generally mature in ten years or more.