TOWN OF PROSPER

PROSPER IS A PLACE WHERE EVERYONE MATTERS

TOWN OF PROSPER, TEXAS

and

PROSPER ECONOMIC DEVELOPMENT CORPORATION

INVESTMENT POLICY

APRIL 8, 2014

INVESTMENT POLICY

Table of Contents

PREFACE

The Town of Prosper and the Prosper Economic Development Corporation are separately chartered, governed, and operated entities. Each ENTITY adheres to its own governing documents and the Public Funds Investment Act. Each ENTITY additionally seeks to safely and effectively manage the funds under its control. To achieve those requirements, the governing body of each ENTITY has legally adopted this Investment Policy.

Throughout this Investment Policy, the two entities shall be singularly referred to as “ENTITY” and collectively referred to as “PROSPER.”

It is the policy of PROSPER that, giving due regard to the safety and risk of investment, all available funds shall be invested in conformance with State and Federal Regulations, applicable Bond Resolution requirements, adopted Investment Policy and adopted Investment Strategy.

Effective cash management is recognized as essential to good fiscal management. Aggressive cash management and effective investment strategy development will be pursued to take advantage of interest earnings as viable and material revenue to all PROSPER funds. PROSPER’s portfolio shall be designed and managed in a manner responsive to the public trust and consistent with this policy.

Investments shall be made with the primary objectives of:

- Preservation of capital,
- Safety of PROSPER funds,
- Maintenance of sufficient liquidity,
- Maximization of return within acceptable risk constraints, and
- Diversification of investments.

I. PURPOSE

A. Formal Adoption

This Investment Policy is authorized by PROSPER in accordance with Chapter 2256, Texas Government Code, the Public Funds Investment Act, herein referred to as "PFIA".

B. Scope

This Investment Policy applies to all of the investment activities of PROSPER. These funds are accounted for in the Town's Comprehensive Annual Financial Report (CAFR) and include:

- General Funds
- Debt Service Funds
- Special Revenue Funds
- Capital Project Funds
- Enterprise Funds
- Internal Service Funds
- Economic Development Corporation Funds
- Any new fund created by the Town

The Town of Prosper may consolidate cash balances from multiple 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.

This Policy establishes guidelines for:

1. Who can invest PROSPER funds,

2. How PROSPER funds will be invested, and

3. When and how a periodic review of investments will be made.

In addition to this Policy, bond funds (as defined by the Internal Revenue Service) shall be managed in accordance with their issuing documentation and all applicable State and Federal Law.

All investments made with PROSPER funds prior to the adoption of this Investment Policy shall be held or liquidated as determined to be in the best interest of the financial well being of PROSPER. PROSPER will also monitor changes in the credit ratings of its investments quarterly using a number of resources including rating agencies, broker/dealers or financial publications. PROSPER shall take all prudent measures that are consistent with its investment policy to liquidate an investment that does not have the minimum rating.

C. Review and Amendment

This Policy shall be reviewed annually by the ENTITY's governing body. The ENTITY's governing body shall adopt a written document stating that it has reviewed the Investment Policy.

D. Investment Strategy

In conjunction with the annual Policy review, the ENTITY's governing body shall review the separate written Investment Strategy for each of PROSPER's funds. The Investment Strategy must describe the investment objectives for each particular fund according to the following priorities:

1. Investment suitability,
2. Preservation and safety of principal,
3. Liquidity,
4. Marketability prior to maturity of each investment,
5. Diversification, and
6. Yield.

II. INVESTMENT OBJECTIVES

A. Safety of Principal

The primary objective of all investment activity is the preservation of capital and the safety of principal in the overall portfolio. Each investment transaction shall seek to ensure first that capital losses are avoided, whether they are from securities defaults or erosion of the market value.

B. Maintenance of Adequate Liquidity

The investment portfolio will remain sufficiently liquid to meet the cash flow requirements that might be reasonably anticipated. Liquidity shall be achieved by matching investment maturities with forecasted cash flow requirements; investing in securities with active secondary markets; and maintaining appropriate portfolio diversification.

C. 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. Core investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed.

III. INVESTMENT POLICIES

A. Authorized Investments

Investments described below are authorized by PFIA as eligible securities for PROSPER. In the event an authorized investment loses its required minimum credit rating, all prudent measures will be taken to liquidate said investment. Additionally, PROSPER is not required to liquidate investments that were authorized at the time of purchase in the event that subsequent legislation renders certain securities as no longer authorized for purchase by the Town. PROSPER's funds governed by this Policy may be invested in:

1. **Obligations of Governmental Entities.** Except for the items listed in 1.e. below, the following are authorized investments for obligations of governmental agencies:

   a. Obligations of the United States or its agencies and instrumentalities;

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

   c. Other obligations, the principal and interest on 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 or by the explicit full faith and credit of the United States;

   d. 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;

e. The following ***are not authorized investments*** for PROSPER:

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

2. Obligations whose payments represent the principal stream of cash flow from the underlying mortgage-backed security collateral and bear no interest (Principal Only);

3. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and

4. Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in the market index (Inverse Floater).

   PROSPER expressly prohibits the acceptance for collateralized deposits interest-only and principal-only mortgage backed securities and collateralized mortgage obligations with stated final maturities in excess of ten years or with coupon rates that float inversely to market index movements.

2. Financial Institution Deposits. Certificates of deposit or share certificates provided the certificate is

a. Issued by a depository institution that has its main office or a branch office in Texas that is:

1. Guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or the National Credit Union Share Insurance Fund or its successor; or

2. Secured by obligations that are described by 1. (Obligations of Governmental Entities) above, which are intended to include all direct Federal agency or instrumentality issued mortgage backed securities, but excluding those mortgage-backed securities of the nature described in 1.e. above, that have a market value of not less than the uninsured amount of the deposit; or

3. Secured in any other manner and amount provided by the law for deposits of PROSPER.

b. In addition to the authority to invest funds in certificates of deposit under Subsection "a", an investment in certificates of deposit made in accordance with the following conditions is an authorized investment:

1. The funds are invested through:

    (a) a broker that has its main office or a branch office in this state and is selected from a list adopted by the investing entity as required by Section 2256.025; or

    (b) a depository institution that has its main office or a branch office in this state and that is selected by the investing entity;

2. The broker or the depository institution selected by the investing entity under Subdivision (1) arranges for the deposit of the funds in certificates of deposit in one or more federally insured depository institutions, wherever located, for the account of the investing entity;

3. The full amount of the principal and accrued interest of each of the certificates of deposit is insured by the United States or an instrumentality of the United States; and

4. The investing entity appoints the depository institution selected by the investing entity under Subdivision (1), an entity described by Section 2257.041(d), or a clearing broker-dealer registered with the Securities and Exchange Commission and operating pursuant to Securities and Exchange Commission Rule 15c3-3 (17 C.F.R. Section 240.15c3-3) as custodian for the investing entity with respect to the certificates of deposit issued for the account of the investing entity.

3. Mutual Funds. Money market mutual funds regulated by the Securities & Exchange Commission, with a dollar weighted average portfolio maturity of 60 days or less that fully invest dollar-for-dollar all PROSPER funds without sales commission or loads and, whose investment objectives include seeking to maintain a stable net asset value of $1 per share. PROSPER may not invest funds under its control in an amount that exceeds 10% of the total assets of any individual money market mutual fund, excluding bond proceeds and reserves and other funds held for debt service in money market mutual funds;

4. **Local Government Investment Pools.** Eligible investment pools organized and operating in compliance with PFIA that have been authorized by the ENTITY's governing body; and whose investment philosophy and strategy include seeking to maintain a stable net asset value of $1 per share, and are consistent with this Policy and PROSPER's ongoing investment strategy.

PROSPER expressly allows money market mutual funds and eligible investment pools, authorized by the ENTITY's governing body, to invest to the full extent permissible within the Public Funds Investment Act.

5. **Commercial Paper.** Commercial paper is an authorized investment under this policy if the commercial paper:

   a. Has a stated maturity of 270 days or fewer from the date of its issuance; and

   b. Is rated not less than A-1 or P-1 or an equivalent rating by at least:

      1. two nationally recognized credit rating agencies; or

      2. 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.

6. **Repurchase Agreements.**

   a. A fully collateralized repurchase agreement is an authorized investment under PFIA, Subchapter A, if the repurchase agreement:

      1. has a defined termination date;

      2. is secured by a combination of cash and obligations described by PFIA, section 2256.009(a)(1); and

      3. requires the securities being purchased by the Town or cash held by the Town to be pledged to the Town, held in the Town's name, and deposited at the time the investment is made with the Town or with the third-party selected and approved by the Town; and

      4. is placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in this state.

   b. In this section, "repurchase agreement" means a simultaneous agreement to buy, hold for a specific time, and sell back at a future date obligations described by Section 2256.009(a)(1), at market value at the time the funds are disbursed of not less than the principal amount of the funds disbursed. The term includes a direct security repurchase agreement and a reverse Security repurchase agreement.

   c. Notwithstanding any other law, the term of any reverse security repurchase a agreement may not exceed 90 days after the date the reverse security repurchase agreement is delivered.

d. Money received by an entity under the terms of a reverse security repurchase agreement shall be used to acquire additional authorized investments, but the term of the authorized investments acquired must mature not later than the expiration date stated in the reverse security repurchase agreement.

B. Protection of Principal

PROSPER shall seek to control the risk of loss due to failure of a security issuer or grantor. Such risk shall be controlled by investing only in the safest types of securities as defined in the Policy; by collateralization as required by law; and through portfolio diversification by maturity and type.

The purchase of individual securities shall be executed "Delivery versus Payment" (DVP) through PROSPER's Safekeeping Agent. By so doing, PROSPER's funds are not released until PROSPER has received, through the Safekeeping Agent, the securities purchased.

1. Diversification by Investment Type

Diversification by investment type shall be maintained by ensuring an active and efficient secondary market in portfolio investments and by controlling the market and opportunity risks associated with specific investment types.

Bond proceeds may be invested in a single security or investment if PROSPER determines that such an investment is necessary to comply with Federal arbitrage restrictions or to facilitate arbitrage record keeping and calculation.

2. Diversification by Investment Maturity

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. Generally, PROSPER will not directly invest in securities maturing more than five years from the date of purchase.

Maturity guidelines by fund type are discussed in Section IV, Investment Strategy.

3. Ensuring Liquidity

Liquidity shall be achieved by anticipating cash flow requirements, by investing in securities with active secondary markets and by investing in eligible money market mutual funds and local government investment pools.

A security may be liquidated to meet unanticipated cash requirements, to redeploy cash into other investments expected to outperform current holdings, or otherwise to adjust the portfolio.

4. Depository Agreements

Consistent with the requirements of State Law, PROSPER requires all bank deposits to be federally insured or collateralized with eligible securities. Financial institutions serving as PROSPER's Depositories will be required to sign a Depository Agreement with PROSPER and PROSPER's safekeeping agent. The safekeeping portion of the Agreement shall define PROSPER'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:

- The Agreement must be in writing;
- The Agreement has to be executed by the Depository and PROSPER contemporaneously with the acquisition of the asset;
- The Agreement must be approved by the Board of Directors or the designated committee of the Depository and a copy of the meeting minutes must be delivered to PROSPER;
- The Agreement must be part of the Depository's "official record" continuously since its execution.

a. Allowable Collateral

Eligible securities for collateralization of PROSPER deposits are defined by Chapter 2257, Texas Government Code, the Public Funds Collateral Act, as amended and meet the constraints of this Section III. A. 2.

b. Collateral Levels

The market value of pledged collateral must at all times be equal to or greater than 102% of the principal and accrued interest for PROSPER balances, less the applicable level of FDIC insurance.

c. Monitoring Collateral Adequacy

PROSPER shall require monthly reports of pledged securities marked to market using quotes by a recognized market pricing service quoted on the valuation date from all financial institutions with which PROSPER has collateralized deposits. The Investment Officers will monitor adequacy of collateralization levels to verify market values and total collateral positions.

d. Additional Collateral

If the collateral pledged for a deposit falls below adequate levels, as defined above in Section 4.b. , the institution holding the deposit will be notified by the Investment Officers and will be required to pledge additional securities no later than the end of the next succeeding business day.

e. Security Substitution

Collateralized deposits often require substitution of securities. Any financial institution requesting substitution must contact an Investment Officer for approval and settlement. The substituted security's value will be calculated and substitution approved if the substitution maintains a pledged value equal to or greater than the required security level. An Investment Officer must provide written notification of the decision to the bank or the safekeeping agent holding the security prior to any security release. Substitution is allowable for all transactions, but should be limited, if possible, to minimize potential administrative problems and transfer expense. The Investment Officers may limit substitution and assess appropriate fees if substitution becomes excessive or abusive.

5. Safekeeping

a. Safekeeping Agreement

PROSPER shall contract with a bank or banks for the safekeeping of securities either owned by PROSPER as a part of its investment portfolio or as a part of its depository agreements.

b. Safekeeping of Deposit Collateral

All collateral securing bank deposits must be held by a third-party custodian bank eligible under the Public Funds Collateral Act, and acceptable to and under contract with PROSPER, or by a Federal Reserve Bank.

C. Investment Advisers and Securities Dealers

Investment Advisers shall adhere to the spirit, philosophy and specific terms of this Policy and shall invest within the same "Standard of Care" as defined in Section E. 3. below. Securities Dealers shall avoid recommending or suggesting transactions outside that "Standard of Care."

1. **Selection of Investment Advisers**

   The selection of Investment Advisers will be performed by the Investment Officers. The Investment Officers will establish criteria to evaluate Investment Advisers including:

   a. Adherence to PROSPER's policies and strategies,

   b. Investment performance and transaction pricing within accepted risk constraints,

   c. Responsiveness to PROSPER's request for services, information and open communication,

   d. Understanding of the inherent fiduciary responsibility of investing public funds, and

   e. Similarity in philosophy and strategy with PROSPER's objectives.

   Selected Investment Advisers must be registered under the Investment Advisers Act of 1940 or with the State Securities Board. A contract with an Investment Adviser may not be for a term longer than two years and any contract, renewal or extension must be approved by Town Council.

2. **Selection of Authorized Securities Dealers**

   The ENTITY's governing body or its Investment Officers acting as the ENTITY's Investment Committee shall, at least annually, review, revise, and adopt a list of qualified broker/dealers and financial institutions that are authorized to engage in investment transactions with the ENTITY.

   a. Eligibility

   Authorized firms may include primary dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (Uniform Net Capital Rule), and qualified depositories.

   b. Documentation Requirements

   Brokers/dealers and financial institutions requesting to become qualified to transact investment business with PROSPER shall be required to provide:

   1. a completed Broker/Dealer Questionnaire that provides information regarding creditworthiness, experience and reputation; and

2. a Certification stating the firm has received, reviewed, understood and agrees to comply with PROSPER's investment policy. This Certification also acknowledges that the business organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between PROSPER and the organization that are not authorized by PROSPER's investment policy, except to the extent that this authorization is dependent on an analysis of the makeup of PROSPER's entire portfolio or requires an interpretation of subjective investment standards.

PROSPER shall not enter into an investment transaction with a business organization prior to receiving the written instruments described above.

c. Competitive Bids

It is the policy of PROSPER to require competitive bidding for all individual security purchases and sales except for:

1. transactions with money market mutual funds and local government investment pools; and

2. treasury and agency securities purchased at issue through an approved broker/dealer or financial institution.

D. Responsibility and Control

1. Authority to Invest

The Finance Director and the Accounting Manager are the "Investment Officers" of the Town of Prosper. The PEDC Treasurer and the Accounting Manager are the "Investment Officers" of the PEDC. The Investment Officers are authorized to deposit, withdraw, invest, transfer, execute documentation, and otherwise manage PROSPER's funds according to this Policy. The Investment Officers may authorize one or more Investment Officers to deposit, withdraw or transfer funds out of or into an investment pool or money market mutual fund in order to meet daily operating needs of PROSPER.

2. Prudent Investment Management

The designated Investment Officers shall perform their duties in accordance with the adopted Investment Policy and internal procedures. In determining whether an Investment Officer has exercised prudence with respect to an investment decision, the investment of all funds over which the Investment Officer had responsibility, rather than the prudence of a single investment shall be considered.

Investment Officers acting in good faith and in accordance with these policies and procedures shall be relieved of personal liability.

3. Standard of Care

The standard of care used by PROSPER shall be that as defined in PFIA, Section 2256.006. It states:

"Investments shall be made with judgment and care, under circumstances then prevailing, 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."

4. Standards of Ethics

The designated Investment Officers shall act as custodians of the public trust avoiding any transactions which might involve a conflict of interest, the appearance of a conflict of interest, or any activity which might otherwise discourage public confidence. Investment Officers shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Additionally, all Investment Officers shall file with the Texas Ethics Commission and the ENTITY's governing body a statement disclosing any personal business relationship with a business organization seeking to sell investments to PROSPER or any relationship within the second degree by affinity or consanguinity to an individual seeking to sell investments to PROSPER. For purposes of this subsection, an Investment Officer has a personal business relationship with business organization if:

a. 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;

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

c. 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.

5. Establishment of Internal Controls

PROSPER's Investment Officers will maintain a system of internal controls over the investment activities of PROSPER.

6. Reporting

Investment performance will be monitored and evaluated by the Investment Officers. The Investment Officers will provide a quarterly comprehensive report signed by all Investment Officers to the ENTITY's governing body. This investment report shall:

a. Describe in detail the investment position of PROSPER,

b. Contain a summary statement, prepared in compliance with generally accepted accounting principles, of each pooled fund group that states the:

1. beginning market value of the reporting period;
2. ending market value for the period;
3. fully accrued interest for the reporting period

c. State the book value and market value of each separately invested asset at the end of the reporting period by the type of asset and fund type invested;

d. State the maturity date of each separately invested asset that has a maturity date;

e. State the account or fund or pooled group fund in the state agency or local government for which each individual investment was acquired; and

f. State the compliance of the investment portfolio with PROSPER's Investment Policy, strategy, and PFIA.

In defining market value, sources independent of the investment provider will determine valuations and consideration will be given to GASB Statement No. 31.

PROSPER, in conjunction with its annual financial audit, shall perform a compliance audit of the management controls on investments and adherence to PROSPER's Investment Policy. If PROSPER invests in other than money market mutual funds, investment pools or accounts offered by its depository bank in the form of certificates of deposits, or money market accounts or similar accounts, the reports prepared by the Investment Officers shall be formally reviewed at least annually by an independent auditor, and the result of the review shall be reported to the ENTITY's governing body by that auditor.

7. Training

In order to insure the quality and capability of PROSPER's investment personnel making investment decisions, PROSPER shall provide periodic training in investments for the investment personnel through courses and seminars offered by GFOA, GFOAT, GTOT, TML, NCTCOG, ICMA, TSCPA, AICPA, or any independent source or institute of higher learning approved by the Finance Director.

a. The Investment Officers shall:

1. attend at least 10 hours of training relating to the Investment Officers' responsibilities within 12 months after taking office or assuming duties; and

2. attend an investment training session not less than once in a two-year period that begins on the first day of the Town's fiscal year and consists of the two consecutive fiscal years after that date and receive not less than 10 hours of instruction relating to investment responsibilities under this subchapter from an independent source approved by the governing body of the local government or a designated investment committee advising the investment officer as provided for in the investment policy of the local government.

b. Training under this section must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio and compliance with PFIA.

IV. INVESTMENT STRATEGY

In order to minimize risk of loss due to interest rate fluctuations, investment maturities will not exceed the anticipated cash flow requirements of the fund. Investment guidelines by fund-type are as follows:

A. Operating Funds

1. Suitability – Any investment eligible in the Investment Policy is suitable for the Operating Funds.

2. Safety of Principal – All investments shall be of high quality securities with no perceived default risk.

3. Liquidity – The Operating Fund requires the greatest short-term liquidity of any of the fund types. Short term investment pools and money market mutual funds provide daily liquidity and may be utilized as a competitive yield alternative to fixed maturity investments. The weighted average days to maturity for the operating fund portfolio shall be less than 365 days, and the maximum allowable maturity shall be five years.

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

5. Diversification – Investment maturities shall be staggered throughout the budget cycle to provide cash flow based on the anticipated operating needs of PROSPER. Market cycle risks will be reduced by diversifying the appropriate maturity structure out no longer than five years.

6. Yield – Attaining a competitive market yield for comparable security-types and portfolio restrictions is the desired objective. The yield of an equally weighted, rolling portfolio of Treasury securities with an average maturity roughly equivalent to that of the portfolio shall be the minimum yield objective.

B. Construction and Capital Improvement Funds

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

2. Safety of Principal – All investments shall be of high quality securities with no perceived default risk. By managing Construction and Capital Improvement Fund's portfolio to exceed the anticipated expenditure schedule, the market risk of the overall portfolio will be minimized.

3. Liquidity – PROSPER funds used for construction and capital improvement programs have reasonably predictable draw down schedules. The investment maturity of construction and capital improvement funds shall generally be limited to the anticipated cash flow requirement or the "temporary period," as defined by Federal Tax Law. During the temporary period, which is generally three years for capital projects, bond proceeds may be invested at an unrestricted yield. After the expiration of the temporary period, bond proceeds subject to yield restriction shall be invested considering the anticipated cash flow requirements of the funds and market conditions to achieve compliance with the applicable regulations. The stated final maturity dates of investments held should not exceed the estimated project completion date; the maximum maturity for all construction or capital improvement funds shall be five years.

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

5. Diversification – Investment maturities shall be staggered throughout the budget cycle to provide cash flow based on the anticipated needs of the construction and capital improvement funds of PROSPER.

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

C. Debt Service Funds

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

2. Safety of Principal – All investments shall be of high quality securities with no perceived default risk. By managing Debt Service Fund's portfolio to not exceed the debt service payment schedule the market risk of the overall portfolio will be minimized.

3. Liquidity – Debt Service have predictable payment schedules. Debt Service Funds shall be invested to ensure adequate funding for each consecutive debt service payment. The Investment Officers shall invest in such a manner as not to exceed an "unfunded" debt service date with the maturity of any investment. An 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. The weighted average days to maturity for the debt service fund portfolio shall be less than 365 days and the maximum allowable maturity shall be two years.

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

Appendix “A”

Glossary of Cash Management Terms

Accretion – Common investment accounting entry in which the book value of securities purchased at a discount are gradually written up to the par value. The process has the effect of recording the discount as income over time.

Accrued Interest – Interest earned, but not yet paid, on a bond.

Agency – See Federal Agency.

Amortization – Common investment accounting entry in which the book value of securities purchased at a premium are gradually written down to the par value. The process has the effect of recording the premium as a reduction to income over time.

Arbitrage – Dealing simultaneously in the same product in two markets to take advantage of temporary price distortions at minimal risk

Basis Point – A unit of measurement used in the valuation of fixed-income securities equal to 1/100 of 1 percent of yield; e.g., “1/4” of 1 percent is equal to 25 basis points.

Benchmark – Index used to compare risk and performance to a managed portfolio.

Bid – The indicated price at which a buyer is willing to purchase a security or commodity.

Book Value – The original acquisition cost of an investment plus or minus the accrued amortization or accretion.

Broker – A financial firm that brings securities buyers and sellers together in return for a fee. The term “broker” is often used interchangeably with “dealer” to refer to a seller of investment securities.

Callable Bond – A bond issue in which all or part of its outstanding principal amount may be redeemed before maturity by the issuer under specified conditions.

Cash Settlement – A transaction which calls for delivery and payment of securities on the same day that the transaction is initiated.

Collateralization – Process by which a borrower pledges securities, property, or other deposits for the purpose of securing the repayment of a loan and/or security.

Collateralized Mortgage Obligation (CMO) – A derivative mortgage-backed security (MBS) created from pools of home mortgage loans. A single MBS is divided into multiple classes, each class containing unique risk profile and security characteristics. A number of CMO classes are expressly prohibited by Texas State law.

Commercial Paper – An unsecured short-term promissory note issued by corporations, with maturities ranging from 1 to 270 days. Commercial paper must carry a minimum rating of A1/P1 in order to be eligible under the Texas Public Funds Investment Act.

Constant Maturity Treasury (CMT) – A calculated average released by the Federal Reserve of all Treasury yields along a specific maturity point. This calculation is frequently used as a benchmark for conservative government portfolios.

Coupon Rate – The annual rate of interest received by an investor from the issuer of certain types of fixed-income securities. Also known as the “interest rate.”

Credit Risk – The risk to an investor that an issuer will default in the payment of interest and/or principal on a security.

Derivative – Financial instruments whose value is derived from the movement of an underlying index or security.

Dealer – A dealer, as opposed to a broker, sets as a principal in all securities transactions, buying and selling for their own account. Often times, the terms “broker” and “dealer” are used interchangeably to refer to a seller of investments securities.

Delivery Versus Payment (DVP) – A type of securities transaction in which the purchaser pays for securities at the time of delivery either to the purchaser or his/her custodian.

Derivative Security – Financial instrument created from, or whose value depends upon, one or more underlying assets or indices of asset values.

Discount – The amount by which the par value of a security exceeds the price paid for the security.

Diversification – A process of investing assets among a range of security types by sector, maturity, and quality rating.

Dollar Weighted Average Maturity (WAM) – The average maturity of all the securities that comprise a portfolio weighted by the dollar value of each security.

Fair Market Rate – A documented and verifiable rate of interest which approximates the average rate which could have been earned on similar investments at the time of the transaction.

Federal Agency – A debt instrument that carries a rating of AAA because it is government sponsored.

Federal Deposit Insurance Corporation (FDIC) – A federal agency that insures bank deposits, currently up to $250,000 per account. Public deposits that exceed this amount must be properly collateralized with investment securities or insured through a surety bond.

Financial Industry Regulatory Authority (FINRA) - the successor to the **National Association of Securities Dealers, Inc. (NASD)**. FINRA is a private corporation that focuses on regulatory oversight of all securities firms that do business with the public; professional training, testing and licensing of registered persons; arbitration and mediation; market regulation by contract for the New York Stock Exchange, the NASDAQ Stock Market, Inc., the American Stock Exchange LLC, and the International Securities Exchange.

Interest Rate – See “Coupon Rate.”

Internal Controls – An internal control structure designed to ensure that the assets of the entity are protected from loss, theft, or misuse. The internal control structure is designed to provide reasonable assurance that these objectives are met.

Interlocal Cooperation Act – Law permitting joint participation by local governments providing one or more government functions within the State. This law [Section 891.001 et seq. of the Texas Government Code (the “Act”)] has allowed for the creation of investment pools in Texas.

Investment Advisers Act of 1940 – Law which requires all Investment Advisers to be registered with the SEC in order to protect the public from fraud.

Investment Policy – A concise and clear statement of the objectives and parameters formulated by an investor or investment manager for a portfolio of investment securities. The Texas Public Funds Investment Act requires that public entities have a written and approved investment policy.

Investment Pool – An entity created under the Interlocal Cooperation Act to invest public funds jointly on behalf of the entities that participate in the pool.

Liquidity – A liquid investment is one that can be easily and quickly converted to cash without substantial loss of value. Investment pools and money market funds, which allow for same day withdrawal of cash, are considered extremely liquid.

Local Government Investment Pool (LGIP) – An investment by local governments in which their money is pooled as a method for managing local funds.

Market Risk - The risk that the value of a security will rise or decline as a result of changes in market conditions.

Market Value – A security’s par amount multiplied by its market price.

Master Repurchase Agreement – A written contract covering all future transactions between the two parties to a repurchase agreement.

Maturity – The date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder. See "Weighted Average Maturity."

Money Market Mutual Fund – Mutual funds that invest solely in money market instruments (short term debt instruments, such as Treasury bills, commercial paper, bankers' acceptance, repos and federal funds).

Mortgage-Backed Security (MBS) – Security backed by pools of home loan mortgages.

Net Asset Value (NAV) – The value of a mutual fund or investment pool at the end of the business day. NAV is calculated by adding the market value of all securities in a fund or pool, deducting expenses, and dividing by the number of shares in the fund or pool.

Offer – An indicated price at which market participants are willing to sell a security. Also referred to as the "Ask Price."

Par – Face value or principal value of a bond, typically $1,000 per bond. A security's par value is multiplied by its coupon rate to determine coupon payment amount.

Premium – The amount by which the price paid for a security exceeds the security's par value.

Primary Government Securities Dealer (Primary Dealer) – One of 20 (as of 02/2011) large government securities dealers who are required to submit daily reports of market activity and monthly financial statements to the New York Federal Reserve Bank. Primary Dealers are required to continually "make a market" in Treasury securities, buying or selling when asked, thereby creating a liquid secondary market for US debt obligations.

Principal – The face value or par value of a debt instrument. Also may refer to the amount of capital invested in a given security.

Prudent Investor Rule – Refers to an investment principle in the Public Funds Investment Act outlining the fiduciary responsibilities of Investment Officers.

Regular Way Delivery – Securities settlement that calls for delivery and payment on the third business day following the trade date (T + 3); payment on a T + 1 basis is currently under consideration. Mutual funds are settled on a same day basis; government securities are settled on the next business day.

Repurchase Agreement (repo or RP) – An agreement of one party to sell securities at a specified price to a second party and a simultaneous agreement of the first party to repurchase the securities at a specified price or at a specified later date.

Reverse Repurchase Agreement (Reverse Repo) – An agreement of one party to purchase securities at a specified price from a second party and a simultaneous agreement by the first party to resell the securities at a specified price to the second party on demand or at a specified date.

Safekeeping – Holding of assets (e.g., securities) by a financial institution.

Total Return – The sum of all investment income plus changes in the capital value of the portfolio. For mutual funds, return on an investment is composed of share price appreciation plus any realized dividends or capital gains. This is calculated by taking the following components during a certain time period: (Price Appreciation) + (Dividends Paid) + (Capital Gains) = (Total Return).

Treasury Bills – Short term U.S. government non-interest bearing debt securities with maturities of no longer than one year and issued with a minimum purchase of $100. Bills pay interest only at maturity. The interest is equal to the face value minus the purchase price. Auctions of four week, 13 week and 26 week bills are every week, while auctions of 52 week bills are done every four weeks. The yields on these bills are monitored closely in the money markets for signs of interest rate trends.

Treasury Notes – Intermediate U.S. government debt securities with maturities of one to 10 years and issued with a minimum purchase of $100. Treasury notes, or T-notes, are issued in terms of 2, 3, 5, 7, and 10 years, and pay interest every six months until they mature.

Uniform Net Capital Rule – SEC Rule 15C3-1 outlining capital requirements for brokers/dealers.

Volatility – A degree of fluctuation in the price and valuation of securities.

Yield – The current rate of return on an investment security generally expressed as a percentage of the security's face value.

Yield-to-Call (YTC) – The rate of return an investor earns from a bond assuming the bond is redeemed (called) prior to its nominal maturity date.

Yield Curve – A graphic representation that depicts the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity. A normal yield curve may be alternatively referred to as a positive yield curve.

Yield-to-Maturity – The rate of return yielded by a debt security held to maturity when both interest payments and the investor's potential capital gain or loss are included in the calculation of return.

Zero-coupon Securities – Security that is issued at a discount and makes no periodic interest payments. The rate of return consist of a gradual accretion of the principal of the security and is payable at par upon maturity.