

CITY OF SOUTH PADRE ISLAND

And

SOUTH PADRE ECONOMIC DEVELOPMENT

CORPORATION

INVESTMENT POLICY

Adopted
July 1, 2020

INTRODUCTION

The purpose of this document is to set forth specific investment policy and strategy guidelines for the City of South Padre Island (the "City") and the South Padre Island Economic Development Corporation (the "EDC") to achieve the goals of safety, liquidity, public trust, and yield for all investment activity. The City Council of the City and Board of Directors of the EDC shall review its investment strategies and policy not less than annually. This Policy serves to satisfy the statutory requirement (specifically the Public Funds Investment Act, Government Code chapter 2256, (the "PFIA")) to define, adopt and review a formal investment strategy and policy.

Throughout this Investment Policy, the City and EDC shall be collectively referred to as "SOUTH PADRE."

INVESTMENT POLICY

I. SCOPE

This Investment Policy applies to all financial assets of SOUTH PADRE. The funds are accounted for in SOUTH PADRE's Comprehensive Annual Financial Report (CAFR) and include (but are not limited to):

- General Fund
- Special Revenue Funds
- Debt Service Funds
- Capital Projects Funds
- Economic Development Funds

II. OBJECTIVES

SOUTH PADRE shall manage and invest its cash with the objectives (listed in order of priority): Safety, Liquidity, Public Trust, and Yield. The safety of the principal invested always remains the primary objective. All investments

shall be designed and managed in a manner responsive to the public trust and consistent with State and Local law.

SOUTH PADRE shall utilize cash management procedures which include 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 to ensure maximum cash availability and interest earnings on short-term investment of idle cash.

Safety

The primary objective of SOUTH PADRE's investment activity is the preservation of capital 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 investment portfolio shall be structured such that SOUTH PADRE is able to meet all obligations in a timely manner. This shall be achieved by matching investment maturities with forecasted cash flow requirements, maintaining adequate levels of highly liquid investments and by investing in securities with active secondary markets.

Public Trust

In addition to achieving the stated objectives, all participants in SOUTH PADRE's investment process shall seek to act responsibly as custodians of the public trust. Investment Officers shall avoid any transaction which might impair public confidence in SOUTH PADRE's ability to govern effectively.

Yield

The investment 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. To determine portfolio performance, this Policy establishes “weighted average yield to maturity” as the standard calculation.

INVESTMENT STRATEGY

SOUTH PADRE maintains portfolios which utilize four specific investment strategy considerations designed to address the unique characteristics of the fund groups represented in the portfolios:

- A. Investment strategies for operating fund 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 investments that will complement each other in a ladder or barbell maturity structure with a maximum maturity of two years. The dollar weighted average maturity of 365 days or less will be calculated using the stated final maturity date of each investment. Funds shall be managed and invested with the objectives (listed in order of priority): Safety, Liquidity, Public Trust, and Yield.

- B. Investment strategies 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. Investments purchased shall not have a stated final maturity date which exceeds the next unfunded debt service payment date. Funds shall be managed and invested with the objectives (listed in order of priority): Safety, Liquidity, Public Trust, and Yield.

- 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 investments with a low degree of volatility. Investments 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 with a maximum maturity of five years. Funds shall be managed and invested with the

objectives (listed in order of priority): Safety, Liquidity, Public Trust, and Yield.

- 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 cash equivalent investments to allow for flexibility and unanticipated project outlays. The stated final maturity dates of investments held should not exceed the estimated project completion date. Funds shall be managed and invested with the objectives (listed in order of priority): Safety, Liquidity, Public Trust, and Yield.

- E. Investment strategies for Economic Development Funds will consider that these fund balances are designated for economic development projects and will be scheduled by the South Padre Economic Development Corporation. In addition to considerations addressed in the balance of this Investment Policy, the maximum weighted average maturity of Economic Development Funds shall not exceed two years. The maximum maturity of an individual investment shall not exceed three years. To ensure adequate liquidity for unanticipated cash needs, a portion of the fund balances shall be invested in financial institution deposits, constant dollar investment pools, or money market mutual funds. Any term-specific investments shall be matched with anticipated cash requirements. Funds shall be managed and invested with the objectives (listed in order of priority): Safety, Liquidity, Public Trust, and Yield.

III. RESPONSIBILITY AND CONTROL

Delegation of Authority and Training

The City Manager and Chief Financial Officer are designated as Investment Officers of SOUTH PADRE. The City Manager shall approve all strategic investment programs prior to implementation. The City's Chief Financial Officer is responsible for day-to-day cash management activities, including, but not limited to, transfers between the City's Primary Depository and

authorized local government investment pools. The City's Chief Financial Officer shall establish procedures for the operation of the cash management and investment programs, consistent with this Investment Policy.

To ensure qualified and capable investment management, each Investment Officer shall attend at least one training session, from an independent training source, and accumulating at least 10 hours of instruction relating to the Officer's responsibility under the PFIA within 12 months after assuming duties. Thereafter, each Investment Officer shall additionally attend at least one training session, from an independent training source, and accumulating at least 8 hours of instruction relating to the Officer's responsibility under the PFIA not less than once in a two-year period that begins on the first day of the City's fiscal year and consists of the two consecutive fiscal years after that date.

The approved independent sources of training are: Government Finance Officers Association of Texas, Government Treasurers' Organization of Texas, Government Finance Officers Association, University of North Texas, Texas City Managers Association, and the Texas Municipal League.

Internal Controls

The City's Chief Financial Officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of SOUTH PADRE 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 City's Chief Financial Officer shall establish a process for annual independent review by an external auditor in conjunction with the annual audit 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. Avoidance of physical delivery securities.
- E. Clear delegation of authority to subordinate staff members.
- F. Written confirmation for telephone (voice) transactions for investments and wire transfers.

Prudence

The standard of prudence to be applied to the Investment Officers shall be the "prudent person" rule, which states: "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." 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 SOUTH PADRE's control, over which the Officer had responsibility rather than a consideration as to the prudence of a single investment.
- B. Whether the investment decision was consistent with the written Investment Policy of SOUTH PADRE.

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 to the City Manager and/or the Council and that appropriate action is taken to control adverse developments.

Ethics and Conflicts of Interest

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

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

Quarterly Reporting

The Investment Officers shall submit a signed quarterly investment report, crafted in compliance with the PFIA, to the City Manager and each respective governing body, that summarizes current market conditions, economic developments and anticipated investment conditions. The report shall summarize investment strategies employed in the most recent quarter, and describe the portfolio in terms of investment instruments, maturities, risk characteristics, and shall explain the total investment return for the quarter.

At the end of the fiscal year, the Investment Officers shall include information incorporating the full year's investment portfolio activity and performance.

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 SOUTH PADRE to ascertain whether investment activities during the reporting period have conformed to the Investment Policy. The report will include the following:

- A. A listing of individual investments held at the end of the reporting period by maturity date.
- B. Unrealized gains or losses resulting from appreciation or depreciation by listing the beginning and ending book and market value of investments for the period.
- C. Average weighted yield to maturity of portfolio on entity investments as compared to applicable benchmarks.
- D. Listing of investments held by fund.
- E. The percentage of the total portfolio which each type of investment represents.
- F. Statement of compliance of SOUTH PADRE's investment portfolio with State Law and the Investment Strategy and Policy approved by the governing bodies.

Active Portfolio Management

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

SOUTH PADRE is not required to liquidate investments that were authorized investments at the time of purchase but no longer meet one or more requirements of this Policy.

Not less than quarterly, the Investment Officer will obtain the current credit rating for each held investment from a reliable source to ensure that the investment has maintained the required minimum rating. An investment that requires a minimum rating does not qualify as an authorized investment during the period the investment does not have the minimum rating. SOUTH PADRE shall take all prudent measures that are consistent with this Investment Policy to liquidate an investment that does not have the minimum rating.

Investments

Assets of SOUTH PADRE may be invested in the following instruments.

1. Authorized

- A. Obligations of the United States of America, its agencies and instrumentalities, including the Federal Home Loan Banks.
- B. Direct obligations of the State of Texas and agencies thereof.
- C. Other obligations, the principal of and interest on which are unconditionally guaranteed by the State of Texas or United States of America 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 the States, agencies thereof, Counties, Cities, and other political subdivisions of any state having been rated as investment quality by a nationally recognized investment rating firm and having received a rating of not less than "A" or its equivalent.

- E. Certificates of deposit and other evidences of deposit at a financial institution that, a) has its main office or a branch office in Texas and is guaranteed or insured by the Federal Deposit Insurance Corporation or its successor, b) is secured by obligations described in Section V. SAFEKEEPING AND CUSTODY and in a manner and amount provided by law for deposits of SOUTH PADRE, or c) is executed through a depository institution or an approved broker that has its main office or a branch office in Texas that meets the requirements of the PFIA.

- F. Fully collateralized direct repurchase agreements with a defined termination date secured by cash or obligations of the United States or its agencies and instrumentalities pledged with a third party, selected by the City's Chief Financial Officer, other than an agency for the pledger. Repurchase agreements must be purchased through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in Texas.

- G. Texas local government investment pools that seek to maintain a stable dollar asset value, would be described as "government" portfolios, are specifically authorized by the governing bodies of the City of South Padre Island and the South Padre Economic Development Corporation, and comply with the requirements of State law.

- H. Investment pools that provide fixed maturity, fixed yield investments, are specifically authorized by the governing bodies of the City of South Padre Island and the South Padre Economic Development Corporation and comply with the requirements of State law.

- I. SEC registered, no load, government money market mutual funds that comply with the requirements of State law.

2. Not Authorized

SOUTH PADRE'S authorized investment options are more restrictive than those allowed by State law. State law specially prohibits investment in the following investment securities.

- A. Obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal.
- B. Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest.
- C. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years.
- D. Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

3. Holding Period

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

4. Risk and Diversification

SOUTH PADRE 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 PFIA, 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 dollar weighted average maturity of operating fund investments to one year, and avoidance of over-concentration of assets in specific instruments.

C. All investment funds shall be placed directly with qualified investment providers as authorized by this Investment Policy and the PFIA.

IV. SELECTION OF QUALIFYING INSTITUTIONS

All local government investment pool providers must submit an Investment Policy Certification to acknowledge that they have received a copy of the City's current Investment Policy, in compliance with the PFIA.

Primary Depository

In compliance with State legislation, a Primary Depository shall be selected through SOUTH PADRE's banking services procurement process, which shall include a formal request for application (RFA). In selecting a Primary Depository, the credit worthiness of institutions shall be considered, and the City's Chief Financial Officer shall conduct a review of prospective depository's credit characteristics and financial history.

Broker/Dealers

For broker/dealers of investment securities, SOUTH PADRE may select any dealers reporting to the Market Reports Division of the Federal Reserve Board of New York, also known as the "Primary Government Security Dealers." Other non-primary firms may be utilized if analysis reveals that such firms are adequately financed to conduct public business. Any broker/dealer must have been authorized by the City Council to execute transactions with SOUTH PADRE prior to any such transaction (Appendix A.).

V. SAFEKEEPING AND CUSTODY

Insurance and Collateral

All financial institution deposits shall be insured or collateralized in compliance with applicable State law. SOUTH PADRE reserves the right, in its sole discretion, to accept or reject any form of insurance or

collateralization pledged towards deposits. Financial institutions serving as SOUTH PADRE depositories will be required to sign a depository agreement with SOUTH PADRE. The collateralized deposit portion of the agreement shall define SOUTH PADRE'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 SOUTH PADRE contemporaneously with the acquisition of the asset;
- The agreement must be approved by the Board of Directors or authorized Committee of the depository and a copy of the meeting minutes must be delivered to SOUTH PADRE; and
- The Agreement must be part of the depository's "official record" continuously since its execution.

Insurance, Pledged Collateral or Purchased Securities - With the exception of deposits secured with irrevocable letters of credit at 100% of the principal and anticipated accrued interest amount, all deposits of SOUTH PADRE funds with eligible depositories shall be secured by pledged collateral with a market value equal to or greater than 102% of the principal and anticipated accrued interest, less any amount insured by the FDIC. Repurchase agreements shall be documented by a specific agreement noting the "purchased securities" in each agreement. Collateral pledged and purchased securities shall be held at an independent safekeeping agent approved by SOUTH PADRE and reports of said securities reviewed at least monthly to assure the market value equals or exceeds the related SOUTH PADRE investment.

Evidence of the pledged collateral shall be maintained by the City's Chief Financial Officer or a third-party financial institution.

Custodial Agreement

Collateral pledged to secure deposits of SOUTH PADRE shall be held by a safekeeping institution in accordance with a custodial agreement which clearly defines the procedural steps for gaining access to the collateral should SOUTH PADRE determine that SOUTH PADRE's funds are in jeopardy. The custodial institution, or Custodian, shall be the Federal Reserve Bank or an institution not affiliated with the firm pledging the collateral. A custodial receipt shall be issued to SOUTH PADRE listing the specific investment, CUSIP, rate, maturity, and other pertinent information.

Collateral Defined

SOUTH PADRE shall accept only the following as collateral:

- A. FDIC insurance coverage.
- B. A bond, certificate of indebtedness, debenture or letter of credit of the United States or its agencies and instrumentalities, or other evidence of indebtedness of the United States that is guaranteed as to principal and interest by the United States or its agencies and instrumentalities.
- C. Obligations, the principal and interest on which, are conditionally guaranteed or insured by the State of Texas.
- D. A bond of a county, city or other political subdivision of the State of Texas having been rated no less than "A" or its equivalent by a nationally recognized rating agency, with a remaining maturity of ten (10) years or less.
- E. A letter of credit issued to SOUTH PADRE by the Federal Home Loan Bank.

Subject to Audit

All collateral shall be subject to inspection and audit by the City's Chief Financial Officer or SOUTH PADRE's independent auditors.

Delivery vs. Payment

Investment securities shall be purchased using the 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 safekeeping agent. The security shall be held in an account in the name of SOUTH PADRE or held on behalf of SOUTH PADRE. The safekeeping agent's records shall assure the notation of SOUTH PADRE's ownership of or explicit claim on the securities. The original copy of all safekeeping receipts shall be delivered to SOUTH PADRE.

VI. INVESTMENT POLICY ADOPTION

SOUTH PADRE Investment Policy shall be annually reviewed and adopted by action of each respective governing body.

Appendix A.

Authorized Broker/Dealers

Duncan Williams, Inc.
Multi-Bank Securities
Oppenheimer & Company, Inc
Raymond James
Rice Financial
Wells Fargo Securities