



City Council  
Agenda Memo

**TO:** David A. Vela, Interim City Manager  
**FROM:** Mindy Patterson, Director of Finance  
**SUBJECT:** FY 2014 Financial Workshop

City Council  
Meeting Date: 02/26/15

**GENERAL INFORMATION**

The Comprehensive Annual Financial Report (CAFR) for FY 2014 has been sent for your review. This audit report will be presented at the Council meeting on February 26, 2015. Some sections that you may wish to read are the Transmittal Letter, Management’s Discussion and Analysis, Notes, and Statistical Section.

I will make a presentation of the report and Davis Kinard & Co. will provide their comments regarding the report and audit process.

A presentation of the fund balance recommended expenditures will be made.

**STAFF RECOMMENDATION**

Staff recommends acceptance of the CAFR for year ended September 30, 2014, the Investment Policy, and the fund balance expenditures.

<b>Prepared By:</b>  Name <u>Mindy Patterson</u> Title <u>Director of Finance</u>	Item No. <u>7.4</u>	<b>Disposition by City Council</b> <input type="checkbox"/> Approved <input type="checkbox"/> Denied <input type="checkbox"/> Other        Ord/Res # _____  _____ City Secretary
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# City of Abilene, Texas, Investment Policy

The purpose of this investment policy is to aid the City of Abilene, Texas (“City”) in the administration of its funds and investment of those funds. These funds shall be handled at the highest public trust. The City will invest public funds in a way, which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the City. This policy serves to satisfy local law and the Texas Public Funds Investment Act, Chapter 2256, Texas Government Code (The “Act”).

## I. SCOPE

This investment policy applies to all financial assets and funds held by the City.

- A. Pooling of Funds:** The City commingles its funds into one pooled investment fund for investment purposes for efficiency and maximum investment opportunity with the exception of the proceeds of general obligation and certificate of obligation bond funds which are invested separately. These funds are accounted for in the City’s Comprehensive Annual Financial Report (CAFR) and include:

General Fund	Enterprise Funds
Special Revenue Funds	Internal Service Funds
Debt Service Funds	Trust and Agency Funds
Capital Project Funds	

The bond funds are accounted for in Capital Project Funds and Enterprise Funds.

- B. Income Allocation:** Investment income will be allocated to the various funds based on their respective participation in the pool and in accordance with generally accepted accounting principles.

## II. INVESTMENT STRATEGY / OBJECTIVES STATEMENT

The City of Abilene investment strategy primary objective is 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.

The objectives, in priority order, of investment activities shall be safety, liquidity, and yield:

## **A. 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.

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

- Limiting investments to the safest types of securities
- Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the City will do business
- Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

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

- 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
- Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

## **B. 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 money market mutual funds or local government investment pools, which offer same-day liquidity for short-term funds.

## **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. "Market rate of return" may be defined as the average yield of the current three-month United States Treasury Bill. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core of investments is 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 security with declining credit may be sold early to minimize loss of principal.
- A security swap would improve the quality, yield, or target duration in the portfolio.
- Liquidity needs of the portfolio require that the security be sold.

### III. STANDARDS OF CARE

**A. Prudence:** The standard of prudence 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 responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion 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. It should be noted that in a diversified portfolio occasional measured losses are inevitable and must be considered within the context of the overall portfolio's return.

**B. 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 whom business is conducted on behalf of the City. An employee or investment officer who is related within the second degree of affinity or consanguinity to an individual seeking to sell an investment to the City shall file a statement with the Texas Ethics Commission disclosing this relationship.

**C. Delegation of Authority:** Authority to manage the investment program is granted to the Finance Director and/or Assistant Director of Finance [designated official, hereinafter referred to as investment officer], acting on behalf of the City Council. Responsibility for the operation of the investment program is hereby

delegated to the investment officer, who shall act in accordance with 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 investment officer. The investment officer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

**D. Investment Advisory Committee:** There is hereby created an Investment Advisory Committee (“the Committee”), consisting of, the Director of Finance, and the Assistant Director of Finance.

1. Meetings: The Assistant Director of Finance or any member of the Committee shall have the power to call a meeting of the Committee. Meetings shall be called as necessary to review investment decisions, the investment report, and policies and procedures.
  
2. Responsibilities: It shall be the responsibility of the Committee to:
  - a) Approve the process of selecting authorized dealers, brokers, investment advisors, and safekeeping agents/custodians used by the City.
  
  - b) Immediately notify the Investment Officers in the event any information comes to their attention that may have a material adverse effect upon the portfolio or marketability of any of the investments purchased under the provisions of this policy.
  
  - c) Review the City’s General Portfolio activity and performance for compliance with this policy and recommend any amendments to this policy to the City Council. Also review for actions necessary to bring the City into compliance with the scope of the investment policy of the Act.
  
  - d) Advise City Investment Staff as to recommendations relative to said portfolio activity/performance.
  
  - e) Inform the City Council of any concerns with the management of the City’s investment portfolio.

**E. Investment Training:** In accordance with the Public Funds Investment Act, Chapter 2256, Texas Government Code, (the “Act”), investment training is required for the Investment Officer(s) of a local government. Training must be received from an independent source approved by the investment committee and must

include educations in investment controls, security risks, strategy risks, market risks, diversification of the investment portfolio, and compliance with the Act. Ten hours of training must be completed within 12 months of taking office or assuming duties. Thereafter, ten hours of training must be completed every two years.

**F. Legal Limitations:** Direct specific investment parameters for the investment of public funds in Texas are found in the Public Funds Investment Act, Chapter 2256, Texas Government Code, (the “Act”). The Interlocal Cooperation Act, Chapter 791, Texas Government Code, authorizes local governments in Texas to participate in an investment pool established thereunder. That statute and the reference to authorize investments in investment pools are the primary authorities for use of investment pools by political subdivisions of the State of Texas.

**G. Internal Controls:** The investment officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the City are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived and (2) the valuation of costs and benefits requires estimates and judgments by management.

Accordingly, the investment officer shall establish a process for an annual independent review by an external auditor to assure compliance with policies and procedures. The internal controls shall address the following points:

- Control of collusion
- Separation of transaction authority from accounting and record keeping
- Custodial safekeeping
- Avoidance of physical delivery securities
- Clear delegation of authority to subordinate staff members
- Written confirmation of transactions for investments and wire transfers
- Development of a wire transfer agreement with the lead bank and third-party custodian

The Investment Advisory Committee shall establish additional controls as warranted.

#### **IV. AUTHORIZED INVESTMENTS**

The City’s investment authority is derived from the Public Funds Investment Act. The investments are to be chosen in a manner, which promotes diversity of market sector and maturity. The choice of high-grade government instruments and high-grade money market instruments is designed to assure the marketability of those investments should liquidity needs arise.

**A. Investment Types** Consistent with the Texas Public Funds Investment Act, Chapter 2256, Texas Government Code, (the “Act”), and the following investments will be permitted by this policy:

- Obligations of the United States Government, its agencies and instrumentalities, and government sponsoring enterprises, which have a liquid market with a readily determinable market value EXCEPT the investments prohibited in section VI PROHIBITED INVESTMENTS
- Certificates of deposit issued by a depository institution that has its main office or a branch office in Texas that is:
  - (a) guaranteed or insured by the Federal Deposit Insurance Corporation, National Credit Union Share Insurance Fund or their successor;
  - (b) secured as described in section VI F.
- Repurchase Agreements fully collateralized and secured by an obligation of the United States, its agencies or its instrumentalities, to include certain mortgage backed securities of the United States. An executed PSA Master Repurchase Agreement must be on file with the City and the counter party bank or primary dealer.
- Money Market Mutual Funds may be invested in a no-load money market mutual fund which is regulated by the Securities and Exchange Commission. This fund must be rated “AAA” or its equivalent by at least one nationally recognized investment rating firm. The money market fund must also maintain a dollar-weighted average stated maturity of 90 days or fewer, and include in its investment objectives the maintenance of a stable net asset value of \$1.00. The City may not own more than 10% of the fund’s total assets.
- Commercial Paper if the paper has a stated maturity of 270 days or less from the date of issuance and is rated not less than A-or P-1 or an equivalent rating by at least: two nationally recognized credit ratings agencies or one nationally recognized credit rating agency and is fully secured by an irrevocable letter of credit issued by a bank organized and existing under the laws of the United States or any state.
- Banker’s Acceptance as defined by the Public Funds Investment Act. The acceptance must have a stated maturity of 270 days or less from the date of issuance, will be in accordance with its terms, liquidated in full at maturity, be eligible for collateral for borrowing from a Federal Reserve Bank and be accepted by a bank organized and existing under the laws of the United States or any state, the short-term obligations of the bank, or of a bank holding company of which the bank is the largest subsidiary, and rated not less than A-1 or P-1 or an equivalent rating by at least on nationally recognized credit rating agency; and
- Local government investment pools, as authorized by the Act.

In the event an investment is downgraded below the required rating all prudent measures will be taken to liquidate that investment in accordance with this policy.

## **V. PROHIBITED INVESTMENTS**

The City of Abilene will not invest in any of the following investment instruments which are strictly prohibited:

- 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; and
- D.** Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

## **VI. POLICY GUIDELINES**

### **A. Investment Administration**

The City's Investment Program is divided into three portfolios: 1) Core; 2) Emergency/Liquidity; and 3) Discretionary

- 1) **CORE PORTFOLIO:** The core portfolio is specifically managed to achieve the first three objectives of safety, liquidity, and legality. This portfolio consists of instruments that have a stated maturity date covering a twelve (12) to eighteen (18) month period. The instruments are timed to meet payrolls, bond payments, accounts payable, and capital project schedules. Typical investments may include Treasury Bills, Treasury Notes, and other short-term obligations of agencies or instrumentalities of the United States. Derivatives are not purchased for core portfolio purposes.
- 2) **EMERGENCY/LIQUIDITY PORTFOLIO:** The emergency/liquidity portfolio is managed to not only achieve the objectives of the core portfolio but also to achieve better yields and flexibility. This portfolio consists of instruments with a stated maturity date that is not required to cover operations but is available for liquidity purposes, if necessary, or to take advantage of changes in the market. In addition, Local Government Investment Pools are maintained to provide immediate access to funds should conditions warrant. Derivatives are not purchased for emergency/liquidity purposes.



3) **DISCRETIONARY PORTFOLIO:** The discretionary portfolio is managed to achieve all of the objectives while allowing somewhat more flexibility including longer maturities. This portfolio is utilized to enhance the overall yield of the investment program by allowing flexibility in the type of instruments purchased from monies not needed in the immediate futures. Derivatives are allowed in this portfolio as allowed by the Act only after careful analysis. Any derivative within six (6) months of expected maturity is moved to the core portfolio for maturity balancing purposes only. Should market conditions extend the expected maturity beyond the six months, the investment is returned to the discretionary portfolio. *For the purpose of this Investment Policy, the definition of derivatives include instruments which have embedded features that alter their character or income stream or allow holders to hedge or speculate on a market or spreads between markets that are external to the issuer, or not correlated on a one-to-one basis to the associated index or market.*

**B. Diversification** The investments shall be diversified by:

- o limiting investments to avoid over concentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities),
- o limiting investment in securities that have higher credit risks,
- o investing in securities with varying maturities, and
- o continuously investing a portion of the portfolio in readily available funds.

Specific portfolio composition guidelines will be guided by the following general parameters:

<b><i>US Government Securities, Agencies and Instrumentalities</i></b>
The portfolio may be comprised of 100% direct government obligations. However, at all times at least twenty five percent (25%) of the portfolio will be invested in US governmental securities unless market conditions warrant otherwise.
<b><i>Local Government Investment Pools</i></b>
The portfolio may be comprised of 100% local government investment pools. The need for liquidity directs a high use of local government investment pools.
<b><i>Repurchase Agreements</i></b>
Fifty percent (50%) of the portfolio may be invested in direct repurchase agreements.
<b><i>Certificates of Deposit</i></b>
A maximum of fifty percent (50%) of the portfolio may be invested in fully collateralized certificates of deposit.
<b><i>Money Market Mutual Funds</i></b>
A maximum of fifteen percent (15%) of the portfolio may be invested in approved money market funds.

<b>Commercial Paper</b>
A maximum of fifteen percent (15%) of the portfolio may be invested in commercial paper.

**C. Maximum Maturities** To the extent possible, the City shall attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than five (5) years from the date of purchase or in accordance with state and local statutes and ordinances. The City shall adopt weighted average maturity limitations (which often range from 90 days to 3 years), consistent with the investment objectives.

Reserve funds and other funds with longer-term investment horizons may be invested in securities exceeding five (5) years if the maturities of such investments are made to coincide as nearly as practicable with the expected use of funds.

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

Specific portfolio maturity limitation guidelines will be guided by the following general parameters:

<b>US Government Securities, Agencies and Instrumentalities</b>
The maximum stated maturity on any US obligation, agency or instrumentality in the City's portfolio shall be limited to two (2) years in the core and emergency portfolio and not to exceed ten (10) years as stated by the Act in the discretionary portfolio.
<b>Repurchase Agreements</b>
The maximum maturity on direct repurchase agreements shall not exceed ninety (90) days.
<b>Certificates of Deposit</b>
The maximum maturity on certificates of deposit is one year.
<b>Money Market Mutual Funds</b>
Money market funds will have a weighted average maturity of ninety (90) days.
<b>Commercial Paper</b>
The maximum maturity on commercial paper shall not exceed one hundred eighty (180) days.

**D. Competitive Bidding:** It is the policy of the City to obtain competitive bidding on all security purchases with the exception of local government investment pools which are deemed to be made at prevailing market rates. The securities will be purchased or sold after a minimum of two (2) documented competitive bids/offers are obtained to verify that the City is paying or receiving fair market value/price for the investment. For those situations where it may be impractical or unreasonable to receive two bids for a transaction due to a rapidly changing market environment or to secondary market availability, documentation of a competitive market survey of comparable securities or an explanation of the specific circumstance must be noted.

**E. Authorized Financial Dealers and Institutions:** A list will be maintained of financial institutions authorized to provide investment services. In addition, a list also will be maintained of approved security broker/dealers selected. These may include "primary" dealers or regional dealers that are licensed and in good standing with the Texas Department of Securities, the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA) or other applicable self-regulatory organization. Every dealer with whom the City transacts business with will be provided a copy of the Investment Policy to assure that they are familiar with the goals and objectives of the investment program. The broker/dealer will be required to return a signed copy of the Certification form (Exhibit A) certifying that the policy has been received and reviewed.

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

- Audited financial statements
- Proof of Financial Industry Regulatory Authority certification
- Proof of state registration
- Completed broker/dealer questionnaire
- Certification of having read and understood and agreeing to comply with the City of Abilene's investment policy

**F. Collateralization and Safekeeping:**

- 1) Securities will be held by a third party custodian designated by the City and evidenced by safekeeping receipts.
  
- 2) All uninsured demand, time deposits, and repurchase agreements will be fully collateralized with pledged securities or by letters of credit for both principal and accrued interest in accordance with Texas Government Code Chapter 2257, Collateral for Public Funds.
  - a) The pledged securities will be held by a third party banking institution as approved by the City or at the Federal Reserve Bank.
  - b) The City will accept as collateral any security that is directly allowed to be held in the City's portfolio as authorized

under Section IV. In addition, obligations of states, agencies, counties, cities, and other political subdivisions of Texas rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent will be accepted.

- c) Substitution or release of collateral is allowed with prior approval by the investment officer.
- d) The value of the pledged investment securities shall be the market value as determined by a nationally recognized rating agency.

**G. Delivery vs. Payment** All trades where applicable will be executed by delivery vs. payment (DVP) to ensure that securities are deposited in an eligible financial institution prior to the release of funds. A third-party custodian as evidenced by safekeeping receipts will hold securities.

## VII. REPORTING

**A. Methods** The investment officer shall prepare an investment report providing basic information regarding the City's investments. Reports shall be filed monthly, quarterly, and annually with the City Secretary's Office to be available to the City Council and citizens for review 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 which 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 investment officer and the legislative body. The report will include the following:

- o Listing of individual securities held at the end of the reporting period.
- o Realized and unrealized gains or losses resulting from appreciation or depreciation by listing the cost and market value of securities over one-year duration that are not intended to be held until maturity (in accordance with Governmental Accounting Standards Board (GASB) requirements).
- o Average weighted yield to maturity of portfolio on investments as compared to applicable benchmarks.
- o Listing of investment by maturity date.
- o Percentage of the total portfolio that each type of investment represents.

**B. 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 shall be established against which portfolio performance shall be compared on a regular basis.

**C. 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 quarterly. This will ensure that review of the investment portfolio, in terms of value and price volatility, has been performed. The market price shall be obtained from a nationally recognized rating agency that has been approved by the investment committee.

## **VIII. POLICY CONSIDERATIONS**

**A. Exemption** Any investment currently held that does not meet the guidelines of this policy shall be exempted from the requirements of this policy. At maturity or liquidation, such monies shall be reinvested only as provided by this policy.

**B. Amendments** This policy shall be reviewed on an annual basis. Any changes must be approved by the investment officer and any other appropriate authority, as well as the individual(s) charged with maintaining internal controls.

## **IX. INVESTMENT POLICY ADOPTION**

The investment policy of the City of Abilene shall be adopted by the City Council. This policy shall be reviewed on an annual basis.

Adopted by the City Council on February 27, 2014.

**MEMORANDUM**

February 17, 2015

**TO:** Honorable Mayor and Members of the City Council

**FROM:** Mindy Patterson, Director of Finance

**SUBJECT:** FY 2014 General Fund and Water Utility Fund

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The Comprehensive Annual Financial Report (CAFR) for FY 2014 will be presented at the Council meeting on February 26, 2014. Some sections that you may wish to read are the Transmittal Letter (Page I-3), Management's Discussion and Analysis (Page 3), Notes (Page 29), and Statistical Section (Page 116).

***General Fund –***

During FY 2014, the General Fund's budget basis fund balance will increase by approximately \$2.8 million. This is a result of a few revenue sources exceeding our estimates and expenditure savings. These revenue sources were property tax (\$512,104), sales tax (\$383,733), and licenses and permits (\$295,403).

On the expenditure side, personnel costs were below budget (\$494,719), supplies (\$66,148), maintenance (\$45,059), and other services and charges (\$301,672).

***Water Utility Fund –***

The water utility system experienced an approximate \$6.9 million gain in FY 2014 as compared to \$2.4 million gain in FY 2013. Revenues increased by \$3.6 million over FY 2013, and expenses were down by an approximate \$.3 million.

Should you have any questions, please contact me.

MP:ls  
MEMO18

cc: David A. Vela, Interim City Manager