

City of Prescott, Arizona

INVESTMENT POLICY

I. SCOPE OF POLICY

This investment policy shall govern the investment activities of all funds of the City of Prescott, excluding any specific funds cited hereafter. This policy serves to satisfy the state statute requirement to define and adopt a formal investment policy.

A. FUNDS INCLUDED:

All financial assets of all current funds of the City of Prescott, Arizona, and any new funds created in the future, unless specifically exempted, will be administered in accordance with the objectives and restrictions set forth in this policy. These funds are accounted for in the City's Comprehensive Annual Financial Report.

B. POOLING OF FUNDS:

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

II. PRUDENCE

Investments shall be made with judgement 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 the capital as well as the probable income to be derived. 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 of funds, rather than a consideration as to the prudence of a single investment. 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 to the City Manager and the City Council of the City of Prescott, and appropriate action is taken in accordance with the terms of this policy.

III. OBJECTIVES OF POLICY

The primary objectives in priority order, of investment activities shall be the preservation and safety of principal, liquidity, and yield.

A. SAFETY:

The foremost and primary objective of the City's investment program is the preservation and safety of capital in the overall portfolio. The objectives will be to mitigate credit risk and interest rate risk. To control credit

risk, investments should be limited to the safest types of securities, financial institutions, broker/dealers intermediaries and advisers.

To control interest rate risk, the City will structure the investment portfolio so that securities mature to meet cash requirements for ongoing operations, and monitoring credit rating of portfolio positions to assure compliance with rating requirements imposed by the Public Funds Investment Act.

B. LIQUIDITY:

The City's investment portfolio will remain sufficiently liquid to enable the City to meet operating requirements that might be reasonably anticipated. Liquidity will be achieved by matching investment maturities with forecasted cash flow funding requirements, by investing in securities with active secondary markets and by diversification of maturities and call dates. Furthermore, since all possible cash demands cannot be anticipated, a small portion of the portfolio may also be placed in money market mutual funds or local government investment pools which offer same day liquidity for short term funds.

C. YIELD:

The City's investment portfolio will be designed with the objective of regularly exceeding the average rate of return on three month U.S. Treasury Bills. The investment program will seek to augment returns above this threshold consistent with risk constraints identified herein, cash flow characteristics of the portfolio and prudent investment principles. The care 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:

1. A security swap that would improve the quality, yield or target duration in the portfolio.
2. Liquidity needs of the portfolio require that the security be sold.
3. If market conditions present an opportunity for the City to benefit from the sale.

D. RISK OF LOSS:

All participants in the investment process will seek to act responsibly as custodians of the public trust. Investment officials will avoid any transactions that might impair public confidence in the City's ability to govern effectively. The governing body recognizes that in a diversified portfolio, occasional measured losses due to market volatility are inevitable, and must be considered within the context of the overall portfolio's investment return, provided that adequate diversification has been implemented.

IV. INVESTMENT STRATEGY

The City of Prescott intends to pursue an active vs. passive portfolio management philosophy. Active management means that the financial markets will be monitored by investment officials and investments will be purchased and sold based on the City's parameters for liquidity and based on market conditions. All marketable securities purchased by the City shall have active secondary markets, unless a specific cash outflow is being matched with an investment that will be held to maturity to meet that obligation. Securities may be purchased as a new issue or in the secondary markets. Securities may be sold before they mature if market conditions present an opportunity for the city to benefit from the trade, or if changes in the market warrant the sale of securities to avoid future losses. Securities may be purchased with the intent from the

beginning, to sell them prior to maturity or with the expectation that the security would likely be called prior to maturity under the analyzed market scenario. Market and credit risk shall be minimized by diversification. Diversification by market sector and security types, as well as maturity will be used to protect the city from credit and market risk in order to meet liquidity requirements.

The portfolio will be structured to benefit from anticipated market conditions and to achieve a reasonable return. Relative value between asset groups shall be analyzed and pursued as part of the active investment program within the restrictions set forth by this policy.

V. RESPONSIBILITY AND CONTROL

A. DELEGATION:

Oversight management responsibility for the investment program has been delegated to the Chief Financial Officer, to establish written procedures and controls for the operation of the investment program, consistent with this investment policy. Such procedures shall include explicit delegation of authority to persons responsible for the daily cash management operation, the execution of investment transactions, overall portfolio management and investment reporting.

B. SUBORDINATES:

All persons involved in investment activities shall be referred to as "investment officials". No person shall engage in an investment transaction except as provided under the terms of this policy, the procedures established by the Chief Financial Officer and the explicit authorization by the City Manager to withdraw, transfer, deposit and invest the City's funds. The City Council, by resolution, has authorized the City Manager to appoint these individuals. The Chief Financial Officer shall be responsible for all transactions undertaken, and shall establish a system of controls to regulate the activities of subordinate investment officials.

C. CONFLICTS OF INTEREST:

Investment officials and employees involved in the investment process will refrain from personal business activity that could conflict with proper execution and management of the investment program, or which could impair their ability to make impartial investment decisions. Investment officials and employees shall refrain from undertaking personal investment transactions with the same individual with whom business is being conducted on behalf of the City. THIS POLICY EXPRESSLY INCORPORATES THE PROVISIONS OF TITLE 38, CHAPTER 3, ARTICLE 8, ARIZONA REVISED STATUTES.

D. DISCLOSURE:

Investment officials and employees shall disclose to the City Manager any material financial interest in financial institutions that conduct business with the City of Prescott. Investment officials and employees shall further disclose any material personal investment positions that could be related to the performance of the City's investment portfolio. Investment officials and employees shall subordinate their personal investment transactions to those of this jurisdiction, particularly with regard to the timing of purchases and sales. An investment official who is related within the second degree by affinity or consanguinity to individuals seeking to sell an investment to the city shall file a statement disclosing that relationship.

E. INVESTMENT TRAINING:

Investment officials shall have a finance, accounting or related degree and knowledge of treasury functions. Investment training must take place not less than once in a two year period, and receive no less than ten hours of instruction relating to investment responsibilities from an independent source such as Government Finance Officers Association, Municipal Treasurers Association, American Institute of Certified Public Accountants, Arizona Finance Officers Association, Arizona Society of Public Accounting or other professional organizations. The Chief Financial Officer and all investment officials of the City shall attend at least one training session relating to their cash management and investment responsibilities within 12 months after assuming these duties for the City. Training must include education in investment controls, security risks, strategy risks, market risks, and compliance with state investment statutes.

VI. AUTHORIZED INVESTMENTS

Funds of the City of Prescott, Arizona may be invested in the following investments. Investments not specifically listed below are not authorized:

1. Obligations of the United States or its agencies and instrumentalities;
2. Direct obligations of this state or its agencies;
3. Collateralized Mortgage Obligations and pass-through securities directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States;
4. Other obligations, the principal and interest of which are unconditionally guaranteed or insured by the State of Arizona, the United States or its instrumentalities;
5. Obligations of states, agencies, counties, cities, and other political subdivisions of any state, rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent;
6. Certificates of deposit that are issued by a national bank or savings and loan domiciled in the State of Arizona, and that are guaranteed or insured by the Federal Deposit Insurance Corporation or secured as to principal by obligations described in the preceding clauses or in any other manner and amount provided by law for City deposits;
7. Fully Collateralized Repurchase or Reverse Repurchase Agreements that have a defined termination date and are fully secured by obligations described in the preceding paragraphs, (1) through (5) of this section of the policy;
8. The pooled investment funds established by the state treasurer pursuant to ARS 35-326;
9. Money Market Mutual Funds investing exclusively in obligations authorized by the preceding paragraphs, (1) through (5) of this section of the policy.

VII. INVESTMENT REPORTS

The Chief Financial Officer shall submit quarterly an investment report, including a management summary that provides an analysis of the status of the current investment portfolio with a comparison to the average three-month US Treasury Bill.

VIII. PORTFOLIO AND INVESTMENT ASSET PARAMETERS

A. BIDDING PROCESS FOR INVESTMENTS:

Investment officials for the City may accept bids for certificates of deposit and for all marketable securities either orally, in writing, electronically, or in any combination of these methods. The investment official will strive to receive two to three price quotes on marketable securities being sold, but may allow one broker/dealer to sell at a predetermined price under certain market conditions. Investments purchased shall be shopped competitively between approved financial institution and broker/dealers. Security swaps are allowed as long as maturity extensions, credit quality changes, and profits or losses taken are within the other guidelines set forth in this policy.

B. MAXIMUM MATURITIES:

The City of Prescott will manage its investments to meet anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than ten years from the date of purchase. The City shall adopt weighted average maturity limitations consistent with the investment objectives.

C. MAXIMUM DOLLAR-WEIGHTED AVERAGE MATURITY:

Under most market conditions, the composite portfolio will be managed to achieve a two year dollar-weighted average maturity. However, under certain market conditions, investment officials may need to shorten or lengthen the average life or duration of the portfolio to protect the city. The maximum-dollar weighted average maturity based on the stated final maturity, authorized by this investment policy for the composite portfolio of the City shall be four years.

D. PRICING:

Market price for investments acquired for the City's Investment Portfolio shall be priced using independent pricing sources and market value monitor at least annually.

IX. SELECTION OF DEPOSITORY, FINANCIAL INSTITUTIONS AND BROKER/DEALERS

A. BIDDING PROCESS:

Depositories shall be selected through the City's banking services procurement process, which shall include a formal request for proposal (RFP) issued at least every five years, with a typical contract being for two (2) years with an option to extend the contract for three (3) additional one (1) year terms. In selecting depositories, the credit worthiness of institutions shall be considered, and the Chief Financial Officer shall conduct a comprehensive review of the prospective depositories credit characteristics and financial history. No public deposit shall be made except in a qualified public depository as established by state depository laws. The depository bank bid will not include bids for investment rates on certificates of deposit. Certificate of deposit rates will be shopped competitively between qualified financial institutions in accordance with the manner in which all other types of investment assets are purchased.

B. INSURABILITY:

Banks and Savings and Loan Associations seeking to establish eligibility for the City's competitive certificate of deposit purchase program, shall submit financial statements, evidence of federal insurance and other information as required by the investment officials of the City of Prescott.

C. AUTHORIZED DEPOSITORY, FINANCIAL INSTITUTIONS AND BROKER/DEALERS:

The Chief Financial Officer will maintain a list of financial institutions authorized to provide investment services. All financial institutions, broker/dealers or bank/dealers who desire to become a qualified bidders for investment transactions, must supply the Chief Financial Officer with the following:

1. Audited financial statements.
2. Proof of National Association of Security Dealers certification where applicable.
3. Proof of state registration where applicable.
4. Completed broker/dealer questionnaire.
5. Certification of having read the City of Prescott's investment policy

A current audited financial statement is required to be kept on file for each financial institution and broker/dealer which the City of Prescott uses.

X. COLLATERALIZATION OF CITY'S DEPOSITS

A. INSURANCE OR COLLATERAL PLEDGED:

Collateralization shall be required on depository bank deposits, certificates of deposit, and repurchase (and reverse) agreements in accordance with the "Public Funds Collateral Act" and depository laws (see Appendix B). In order to anticipate market changes and provide a level of security for all funds, the collateralization level will not be less than 102% of market value of principal and accrued interest, less an amount of \$100,000, which represents insurance by the FDIC or FSLIC on certain types of bank deposits. Evidence of the pledged collateral shall be documented by a safekeeping agreement or a master repurchase agreement with the collateral pledged clearly listed in the agreement and safekeeping confirmations. The master repurchase agreement must be executed and in place prior to the investment of funds. Collateral shall be monitored daily to ensure that the market value of the securities pledged equals or exceeds the related deposit or investment balance.

B. COLLATERAL DEFINED:

The City of Prescott shall accept only the following insurance and securities as collateral for cash deposits, certificates of deposit, and repurchase agreements:

1. FDIC insurance coverage.
2. Obligations of the United States of America, its agencies and instrumentalities, including agency and instrumentality issued mortgage backed collateral.
3. Other obligations, the principal of and interest on which are unconditionally guaranteed or insured by the State of Arizona, the United States of America or its agencies and instrumentalities.
4. Obligations of states, agencies thereof, 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 no less than A or its equivalent.

C. COLLATERAL SAFEKEEPING AGREEMENT:

The City shall not accept, as depository collateral, any security that is not specifically allowed to be held as a direct investment by the City's portfolio, and that the maximum maturity of the collateral securities may not be greater than five years. An independent third party with whom the City has a current custodial agreement will always hold collateral. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the City. The safekeeping agreement must clearly define the responsibility of the safekeeping bank. The safekeeping institution shall be the Federal Reserve Bank or an institution not affiliated with the financial institution or broker/dealer that is pledging the collateral. The safekeeping agreement shall include the authorized signatories of the City and the firm pledging collateral.

D. AUDIT OF PLEDGED COLLATERAL:

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

XI. SAFEKEEPING AND CUSTODY OF INVESTMENT ASSETS

All security transactions, including collateral for repurchase (reverse) agreements, entered into by the City shall be conducted using the delivery vs. payment (DVP) basis. That is, funds shall not be wired or paid until verification has been made that the safekeeping bank received the correct security. The safekeeping, or custody, bank is responsible for matching instructions from the City's investment officials on an investment settlement, with what is wired from the broker/dealer, prior to releasing the City's designated funds for a given purchase. The security shall be held in the name of the City, or held on behalf of the City in a bank nominee name. A third party custodian designated by the Chief Financial Office and evidenced by safekeeping receipts will hold securities. The safekeeping bank's records shall assure the notation of the City's ownership of, or explicit claim on, the securities. The original copy of all safekeeping receipts shall be delivered to the City. A safekeeping agreement that clearly defines the responsibilities of the safekeeping bank must be in place.

City of Prescott, Arizona Broker/Dealer Questionnaire

1. Name of Firm:
2. Local Address: National Address:
3. Telephone:
4. PRIMARY REPRESENTATIVE/MANAGER/PARTNER-IN-CHARGE: Secondary
representative/manager/partner-in-charge
5. Are you a Primary Dealer in U.S. Government Securities?
6. What is the date of your firm's fiscal year end?
7. Attached certified documentation of your capital adequacy and financial solvency. In addition, an audited financial statement must be provided within 120 days of your fiscal year-end.
8. Is your firm owned by a holding company? If so, what is its name and net capitalization?
9. Identify all personnel who will be trading with or quoting securities to our employees (attach current resumes of all persons listed).
10. Please identify your most directly comparable clients in our geographical area.
11. Have any of your public-sector clients ever sustained or claimed a loss on a securities transaction, or loss of principal arising from a misunderstanding or misrepresentation of the risk characteristics of a recommended instrument purchased through your firm?
12. Has your firm ever been subject to a regulatory or state or federal agency investigation for alleged improper, fraudulent, disreputable or unfair activities related to the sale of government securities or money market instruments? If yes, please explain.
13. Please provide your wiring and delivery instructions.
14. Which instruments are offered regularly by your local desk?
15. Which of the above does your firm specialize in marketing?
16. What precautions are taken by your firm to protect the interest of the public when dealing with government agencies as investors?
17. Do you participate in the SIPC Insurance program? If not, please explain.