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CITY OF MT. PLEASANT

INVESTMENT POLICY

Dated: May 26, 1998

SCOPE

This investment policy has been prepared by the Finance Division staff of the City of Mt. Pleasant as a guideline for investing short-term operating funds, legally required reserve funds and construction proceeds of the City. This policy does not apply to the investment of Police and Fire Pension funds or bond proceeds.

This investment policy shall be in accordance with Public Act 196 of 1997, the state statute governing investment of public funds.

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INVESTMENT OBJECTIVES

The primary objectives, in priority order, of investment activities shall be:

1. Safety

Safeguarding the City's investment 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. Investment transactions will be made in a manner that doesn't result in a loss of public funds.

2. Liquidity

The investment portfolio shall remain sufficiently liquid to meet all reasonably anticipated operating requirements. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands. Also, since all possible cash demands cannot be anticipated, the investment portfolio should consist only of investments that have active secondary or resale markets. The portfolio shall not have any securities that are from narrow or restricted markets. The City under no circumstances should ever purchase a security that cannot be resold quickly and easily in a broadly traded market.

3. Yield

The investment portfolio shall be designed to maximize the rate of return on the City's investments. The core of investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed.

STANDARDS OF CARE

Prudence

The City requires that it's Finance Division staff utilize the "prudent person" standard in managing the City's investments. Employees of the Finance Division staff acting in accordance with written procedures and this investment policy and exercising due diligence shall be relieved of personal liability for investment performance, 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.

STANDARDS OF CARE (Continued)

<u>Ethics and Conflicts of Interest</u>

City 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. City employees involved in the investment process shall disclose any material interests in a financial institution 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. City employees involved in the investment process shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the City.

It shall be a breach of ethical standards for any person or business involved in a City of Mt. Pleasant investments to offer, give or agree to give any employee of the City any gratuity. Any employee who fails to report any offer or receipt of such a gratuity may be subject to disciplinary action. Diminimus gratuities may be accepted.

<u>Delegation of Authority</u>

In accordance with the City Charter, the authority to manage the investment program is granted to the City Treasurer or the Deputy City Treasurer. The City Treasurer is further authorized to execute the agreements and documents as required, in connection with the daily management responsibility of the City's investment program. The Finance Director shall oversee the responsibility of the City Treasurer and establish the appropriate internal control procedures regarding investments.

SAFEKEEPING AND CUSTODY

<u>Authorized Financial Dealers and Institutions</u>

A list will be maintained of financial institutions authorized by the Treasurer to provide investment and depository services. In addition, a list will also be maintained of approved security broker/dealers selected by creditworthiness.

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

- audited financial statements
- proof of National Association of Securities Dealers (NASD) certification
- proof of state registration
- certification of having read the City's investment policy and willingness to abide by it

SAFEKEEPING AND CUSTODY (Continued)

Authorized Financial Dealers and Institutions (Continued)

Financial Institutions must qualify as public depositories according to Public Act 105, section 5 or 6.

An annual review of the financial condition and registration of qualified bidders will be conducted by the City Treasurer. Bidders who have not consistently submitted competitive bids maybe dropped from the qualified bidders' list at the discretion of the City Treasurer.

Safekeeping

The City shall use third party safekeeping wherever possible. In no case shall purchases be held in the broker's safekeeping unit.

The City will execute a third party custodial agreement with it's bank or financial institution. Such agreement may include letters of authority from the City, details as to responsibilities of each party, methods of notification of security purchases, sales, delivery, procedures related to wire transfers, safekeeping and transaction costs, procedures in case of wire failure or other unforeseen mishaps and a description of the liability of each party.

Delivery vs. Payment

All investment purchases where applicable will be executed by delivery vs. payment (DVP). This ensures that securities are deposited in the eligible financial institution prior to the release of funds.

Written Confirmation

All telephone transaction should be verified by written communications and approved by the appropriate person. Written communications may be via fax if on letterhead and if the safekeeping institution has a list of authorized signatures.

SUITABLE AND AUTHORIZED INVESTMENTS

Investment Types

The City shall invest in only those investment types provided for in Public Act 196 of 1997 (Appendix A). Investments in mutual funds shall be restricted to securities whose intention is to maintain a net asset value of $1.00 per share. The City shall not invest in derivatives.

Registration

The City shall invest only in registered securities or funds.

SUITABLE AND AUTHORIZED INVESTMENTS (Continued)

Investment Ratings

The City shall only invest with financial institutions maintaining at least five of the standard investment ratings for banks (Appendix B). The City shall only invest in bankers acceptances and commercial paper rated in the two highest categories by not less than two of the four major rating agencies. (Appendix C)

INVESTMENT PROCEDURES

Competitive Bids

All investments shall be purchased by competitive bid. Bids will be obtained from at least three bidders on the current bid list. The City Treasurer is responsible for maintaining the integrity of the bid process.

Cash Forecasting

A cash forecast shall be prepared, from time to time, using expected revenue sources and items of expenditure to project cash requirements over the fiscal year. The forecast shall be updated, as appropriate, to identify probable investable balances that will be available. The Treasurer shall strive to keep at least eighty (80) percent of the City's idle cash invested at all times.

Pooling of Investments

Except for cash in certain legally restricted and special accounts, the City Treasurer may pool cash of various funds to maximize interest earnings.

Sale Prior to Maturity

Securities shall not be sold prior to maturity with the following exceptions:

1. a credit rated security that is downgraded below the two highest rating categories by any of the four major rating agencies, shall be liquidated immediately

2. a declining credit rated security could be sold early to minimize loss of principal

3. a security swap would improve the quality, yield, or target duration in the portfolio

4. liquidity needs of the portfolio require that the security be sold

INVESTMENT PROCEDURES (Continued)

Portfolio Review

It shall be the responsibility of the Treasurer to stay current with market changes and trends. The Treasurer shall be knowledgeable about rating downgrades and have access to specific financial data about the City's investment portfolio.

Diversification

The investment portfolio shall be sufficiently diversified to minimize the risk of loss resulting from over concentration of investments in a specific maturity, a specific issuer, a class of instruments and a dealer through whom investments are bought or sold.

Maximum Maturities

The Treasurer shall not purchase securities with maturity dates greater than five years unless specific authority is given by the City Commission. To the extent possible, the City will attempt to match its investment with anticipated cash flow requirements.

INVESTMENT PERFORMANCE AND REPORTING

Reporting

The City Treasurer shall prepare an investment report quarterly. This report must include a summary of the status of the investment portfolio and a list of transactions made during the quarter. The report will be prepared in a manner which will allow the City Commission to ascertain whether investment activities during the reporting period have conformed to the investment policy. This report should be provided to the City Manager and the City Commission. This report shall include the following:

1. a listing of individual securities held at the end of the reporting period and their current market value

2. average weighted yield to maturity of portfolio as compared to an applicable benchmark, as determined by the Finance Director

3. a listing of investments by maturity date

4. the percentage each investment type represents to the total portfolio

5. Other information as deemed appropriate by the Treasurer or requested by the City Commission.

APPENDIX A

AUTHORIZED INVESTMENTS PER PUBLIC ACT 196 OF 1997

Section 1. (1) The governing body by resolution may authorize its investment officer to invest the funds of that public corporation in 1 or more of the following:

(a) Bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.

(b) Certificates of deposit, savings accounts, deposit accounts, or depository receipts of a financial institution.

(c) Commercial paper rated at the time of purchase within the 2 highest classifications established by not less than 2 standard rating services and that matures not more than 270 days after the date of purchase.

(d) Repurchase agreements consisting of instrument listed in subdivision (a).

(e) Bankers' acceptances of United States banks.

(f) Obligations of this state or any of its political subdivisions that at the time of purchase are rated as investment grade by not less than 1 standard rating service.

(g) Mutual funds registered under the investment company act of 1940, title I of chapter 686, 54 Stat. 789, 15 U.S.C. 80a-1 to 80a-3 and 80a-4 to 80a-64, with authority to purchase only investment vehicles that are legal for direct investment by a public corporation. However, a mutual fund is not disqualified as a permissible investment solely by reason of either of the following:

(i) The purchase of securities on a when-issued or delayed delivery basis.

(ii) The ability to lend portfolio securities as long as the mutual fund receives collateral at all times equal to at least 100% of the value of the securities loaned.

(iii) The limited ability to borrow and pledge a like portion of the portfolio's assets for temporary or emergency purposes.

(h) Obligations described in (a) through (g) if purchased through an interlocal agreement under the urban cooperations act of 1967, 1967 (Ex Sess) PA 7, MCL 124.501 to 124.512

(i) Investment pools organized under the surplus funds investment pool act, 1982 PA 367, MCL 129.111 to 129.118

APPENDIX B

Financial Institution Ratings

A bank must comply with standard #1 and meet at least five of the standards numbered 2-7.

1. A current annual report on the bank or 10-K on the holding company must be on file.

2. The bank's return on average assets must be in the top 60% of its peer group.

3. The bank's loan charge-offs must be less than 3/10 of 1% of its loans.

4. The bank's loan loss reserves must exceed 150% of its net charge-offs.

5. The bank's capital adequacy as a percentage of total assets must be greater than 6.6%.

6. The bank's dividend payout ratio must be 50% or less.

7. The bank must be in a positive income bracket.

APPENDIX C

Commercial Paper Ratings

Four major rating agencies available to review the financial information on all recognized commercial paper issuers and assign rating are as follows:

1. Duff & Phelps, Inc.
   D-1 High credit quality
   D-2 Good credit quality
   D-3 Satisfactory investment grade credit quality

2. Fitch Investors Service, Inc.
   F-1 Highest grade
   F-2 Very good grade
   F-3 Good grade
   F-4 Poor grade

3. Moody's Investors Service, Inc.
   Prime-1
   Prime-2
   Prime-3
   "Not rated"

4. Standard & Poor's Corporation
   A Highest - further refined by the use of number 1,2,3 to denote relative strength within this highest classification.
   B Medium
   C Speculation
   D Probably soon be in default

APPENDIX D

Glossary of Investment Types

U.S. Treasury Bills - obligations of the United States Government sold at a discount or premium from par with specific maturity dates up to a maximum maturity of one year. The minimum denomination is $10,000 and interest discount is calculated using actual number of days on a 360 day year.

U.S. Treasury Notes - obligations of the United States Government bearing interest payable at six month intervals until maturity. Notes are sold at a discount or premium from par. Maturities are from one to ten years. Denominations are in $1,000 multiples.

U.S. Treasury Bond - similar to notes except original maturities are ten years and longer.

U.S. Treasury Strips - U.S. Treasury notes and bonds that have been stripped of their coupon interest payments. The strips are sold at a discount from par.

U.S. Government Agency Obligations - include securities that are fully guaranteed by the United States Government: Export-Import Bank of the U.S., Farmers Home Administration, Government National Mortgage Association (GNMA), General Services Administration, Small Business Administration, U.S. Maritime Administration, Washington Metropolitan Area Transit Authority. Securities consist of short-term notes, debentures and participation certificates. Several of these securities may have markets that are very thinly traded.

Certificate of Deposit - receipt for funds deposited in a financial institution for a specified period at a specified rate of interest. A negotiable receipt may be in bearer or registered form and can be traded on the secondary market. A non-negotiable receipt is always registered and has no secondary market. Denominations can be any agreed amount, however, the interest rate paid is regulated by Federal Regulations. Interest normally is calculated using actual number of days on a 360 day year.

Savings Account - depository evidenced by a passbook or monthly statement. Entries are made for each deposit and withdrawal and interest is paid in accordance with the policy with the financial institution. It is often used to accumulate small amounts of funds until a larger, higher yielding investment can be made.

APPENDIX D

Glossary of Investment Types

Bankers' Acceptance - negotiable time draft or bill of exchange drawn on and accepted by a commercial bank. Acceptance of the draft irrevocably obligates the bank to pay the bearer the face amount of the draft at maturity. Bankers' acceptances are usually created to finance the import and export of goods, the shipment of goods within the United States and the storage of readily marketable staple commodities. Bankers' acceptances are sold at a discount from par similar to U.S. Treasury bills, and since acceptance is tied to a specific loan transaction, the amount and maturity of the acceptance are fixed.

Commercial Paper - unsecured promissory notes of finance companies, industrial corporations, utilities and bank holding companies. Interest is discounted from par and calculated using actual number of days on a 360 day year. The notes are in bearer form maturing from one to 270 days selected by the purchaser, and denomination generally start at $100,000 with some exceptions. There is a secondary market for commercial paper and an investor may sell a note prior to maturity.

Repurchase Agreement- not a security but a contractual arrangement between a financial institution or dealer and an investor. The agreement normally can run for one to thirty days, but may run longer. The investor puts up his funds for a certain number of days at a stated yield. In return the investor takes title to a given block of securities as collateral. At maturity the securities are returned and the fund repaid plus interest. Usual amounts are $500,000 or more, but some repurchase agreements can be smaller. Interest is calculated the same as certificates of deposit.