I. Policy

It is the policy of the City of Cottonwood to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the City and conforming to all applicable State and City statutes governing the investment of public funds.

II. Scope

This investment policy applies to all financial assets of the City of Cottonwood. These funds are defined in the City of Cottonwood's Comprehensive Annual Financial Report (CAFR) and include:

- General Funds
- Special Revenue Funds
- Debt Service Reserve Funds
- Debt Service Sinking Funds
- Capital Project Funds
- Proprietary Funds
- Fiduciary Funds
- Expendable Trust Funds
- Any new funds created unless specifically exempted by Council

III. Objectives

The primary objectives, in priority order, of the City of Cottonwood’s investment activities shall be:

A. Safety of Principal

The City recognizes its fiduciary responsibility for the stewardship of public funds with which it has been entrusted. Therefore, its foremost investment objective is to ensure safety of principal. Investments of the City shall be undertaken in a manner that seeks to insure the preservation of capital in the overall portfolio. To attain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

B. Liquidity

City of Cottonwood’s investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements, which might be reasonably anticipated.

C. Yield

City of Cottonwood’s investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account City of Cottonwood’s investment risk constraints and the cash flow characteristics of the portfolio.

IV. Standard of Care

A. Prudence

This policy shall apply the "prudent person" standard, as defined in the glossary, in the context of managing the overall portfolio. Investment officials acting in accordance with procedures consistent with this policy and exercising due diligence, shall not be held personally liable for market price changes or the credit risk of a certain investment, provided that any unexpected deviations are reported in a timely manner and that appropriate action is taken to control adverse developments.

B. Ethics and Conflicts of Interest

Investment officials shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Investment officials shall disclose to the City Manager any material personal financial interests in financial institutions that conduct business within this jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the City, particularly with regard to the time of purchases and sales.

C. Delegation of Authority

Authority to manage the investment program is granted to the Administrative Services General Manager, and derived from the Arizona Revised Statues §35-323. Procedures for investing of Trust and Sinking Funds are specified in Arizona Revised Statutes §35-324 and §35-328. Investments in the State Treasurer's Pool investment fund for collective investments of public funds is authorized in Arizona Revised Statutes §35-326. Responsibility for the operation of the investment program is hereby delegated to the Administrative Services General Manager, 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, and resolutions for participation in the State' Treasurer's Local Government Investment Pool – LGIP are included with this. 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 within the City's Financial Operations Guide. The Administrative Services General Manager, with the concurrence of the City Manager, shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

V. Authorized Financial Dealers and Institutions

A. The Administrative Services General Manager shall maintain a list of financial institutions, which are authorized to provide investment services. In addition, a list will be maintained of approved security brokers/dealers selected by credit worthiness who are authorized to provide investment services in the State of Arizona. No public deposit shall be made except in a qualified public depository as established by State laws.

B. Banks and savings and loans shall provide their most recent "Consolidated Report of Condition" (call report) at the request of the City.

C. Securities dealers not affiliated with a bank shall be required to be classified as reporting dealers affiliated with the New York Federal Reserve Bank as primary dealers, or meet certain other criteria as determined by the Administrative Services General Manager.

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the Administrative Services General Manager with the following:

1. Most recent audited annual financial statements,
2. Proof of National Association Security Dealers membership,
3. Proof of State of Arizona registration, and a
4. Completed broker/dealer questionnaire

An annual review of the financial condition and registrations of qualified bidders will be conducted by the Administrative Services General Manager.

A current audited financial statement is required to be on file for each financial institution and broker/dealer with which the City does business.

VI. Safekeeping and Custody

A. Delivery vs. Payment

All trades of marketable securities 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.

B. Safekeeping

All securities shall be held by a third party custodian designated by the Administrative Services General Manager. The third party custodian shall be required to issue a safekeeping receipt to the City listing the specific instrument, rate, maturity and other pertinent information.

Collateralization shall be required on two (2) types of investments:

1. Certificates of deposits
2. Repurchase agreements

In order to anticipate market changes and provide a level of additional security for all funds, the collateralization level will be 102% of market value of principal and accrued interest. Acceptable types of collateral for repurchase agreements shall consist of treasuries and agency notes with a maximum maturity of five (5) years and a collateralization level of 102% of market value of principal and accrued interest.

C. Internal Controls

The Administrative Services General Manager shall establish a system of written internal controls, which will be reviewed annually with the independent auditor. This review will provide internal control by assuring compliance with policies and procedures.

VII. Suitable and Authorized Investments

A. Authorized Investments

The City is empowered by statute to invest in the following types of securities. If an investment is not specifically listed in the suitable list, it is prohibited.

1. Fully insured or collateralized certificates of deposit and other evidence of deposit at banks and savings and loan associations.

2. Interest bearing savings accounts in banks and savings and loan institutions doing business in Arizona whose accounts are insured by Federal Deposit Insurance Corporation (FDIC).

3. Repurchase agreements with a maximum maturity of one hundred eighty (180) days, collateralized at no less than one hundred two percent (102%), provided a signed PSA Master Repurchase Agreement is on file with the counterpart bank or broker\dealer.

4. Deposits in the local government investment pool operated by the Treasurer of the State of Arizona.

5. Bonds or other evidences of indebtedness of the United States or any of its agencies or instrumentalities if the obligations are guaranteed as to principal and interest by the United States or by any agency of instrumentality of the United States.

6. Bonds or other evidences of indebtedness of this state or any of its counties, incorporated cities or towns, school districts, or municipal improvement districts which carry as a minimum one of the A ratings of Moody's Investors Service or one of the A ratings of Standard and Poor's Rating Service or their successors.

7. Commercial Paper with an A-1/P-1 rating or higher rating.

8. Mortgage-backed securities.

B. Prohibited Investments

1. Reverse Repurchase Agreements.

2. Futures, Contractual Swaps, Options.

3. Inverse Floaters.

4. Interest Only Securities.

5. Interest Bearing Securities that have the possibility of not accruing current income.

6. Closed end management type companies.

7. Securities whose yield/market value is based on currency, commodity or non-interest indices.

8. Bearer-form securities.

9. Securities lending.

10. Any security product not described in this document until reviewed and approved by the City Council.

C. Investment Pools

A thorough investigation of any investment pool is required prior to investing. There shall be a questionnaire developed which will answer the following general questions:

1. A description of eligible investment securities, and a written statement of investment policy and objectives.

2. A description of interest calculations and how it is distributed, and how gains and losses are treated.

3. A description of how the securities are safekept (including the settlement processes), and how often are the securities priced and the program audited.

4. A description of who may invest in the program, how often, what size deposit and withdrawal.

5. A schedule for receiving statements and portfolio listings.

6. Are reserves, retained earnings, etc. utilized by the pool?

7. A fee schedule, and when and how is it assessed.

8. Is the pool eligible for bond proceeds and/or will it accept such proceeds?

VIII. Diversification and Maturity Limitations

The City will diversify its investment portfolio to minimize the risk of loss resulting from over concentration of assets in a specific maturity, specific issuer, or specific class of securities. Diversification standards by security type and issuer shall not exceed the following:

A.	Fully insured or collateralized CD's	no more than 25%
B.	U.S. Treasuries and securities having principal and interest guaranteed by the U.S. Government or agencies or instrumentalities of the U.S. Government	100%
C.	State, county, school district and other district municipal bonds or debt with an A rating or better	no more than 25%
D.	Repurchase agreements	100%
E.	Local Government Investment Pool	100%

The Administrative Services General Manager shall be required to diversify maturities. To the extent possible, the Administrative Services General Manager will attempt to match investments with anticipated cash flow requirements. Matching maturities with cash flow dates will reduce the need to sell securities prior to maturity, thus reducing market risk. Unless matched to a specific requirement, the Administrative Services General Manager may not invest more than 25% of the portfolio for a period greater than three (3) years. Unless matched to a specific requirement, the Administrative Services General Manager may not invest any portion of the portfolio for a period greater than five (5) years.

IX. Reporting

A. Method

The Administrative Services General Manager shall prepare quarterly reports for the City Manager's, which provide a clear picture of the status of the current investment portfolio. The management reports shall include:

1. Comments on fixed income markets and economic conditions.

2. Discussions regarding restrictions on percentage of investment by category.

3. Possible changes in portfolio structure going forward.

4. Thoughts on investment strategies.

5. Any schedules should include:

- A listing of individual securities held at the end of the reporting period by authorized investment category.
- Weighted average maturity and final maturity of all investments listed.
- Coupon, discount or earnings rate.
- Par Value, Amortized Book Value and Market Value.
- Percentage of the portfolio represented by each investment category.

The City Manager and Administrative Services General Manager shall be responsible for making recommendations to the City Council of changes in the investment policy and in establishing performance benchmarks based upon City of Cottonwood's portfolio composition and current investment strategy.

The Administrative Services General Manager shall include a market report on investment activity and returns in City of Cottonwood's Comprehensive Annual Financial Report - CAFR.

B. Performance Standards

The City of Cottonwood's cash management portfolio shall be designed with the objective of regularly meeting or exceeding a selected performance benchmark, which could be the average return on three-month U.S. Treasury bills, the state investment pool, a money market mutual fund or the average rate of Federal funds. These indices are considered benchmarks for lower risk investment transactions and therefore comprise a minimum standard for the portfolio's rate of return.

X. Investment Policy Adoption

City of Cottonwood's Investment Policy shall be adopted by the City Council. The policy shall be reviewed on an annual basis by the City Manager and significant modifications thereto must be approved by the City Council.

XI. Glossary

A glossary of financial terms referenced herein follows.

GLOSSARY

AGENCIES: Federal agency securities and/or Government-sponsored enterprises.

ASKED: The price at which securities are offered.

BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

BENCHMARK: A comparative base for measuring the performance of risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

BID: The price offered for securities.

BROKER: A broker brings buyers and sellers together for a commission paid by the initiator of the transaction or by both sides; he does not position. In the money market, brokers are active to markets in which banks buy and sell money and in inter-dealer markets.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property, which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits or public monies.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the City. It includes five (5) combined statements and basic financial statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed statistical section.

CITY: The City of Cottonwood, Arizona

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date.

DEALER: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

DEBENTURE: A bond secured only by the general credit of the issuer.

DELIVERY VERSUS PAYMENT: There are two (2) methods of delivery of securities: delivery versus payment and delivery versus receipt (also called free). Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

DISCOUNT: The difference between the cost price of a security and its value at maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g. U.S. Treasury Bills.

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent return.

FEDERAL CREDIT AGENCIES: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g., S&L's, small-business firms, students, farmers, farm cooperatives, and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to $100,000 per deposit.

FEDERAL FUNDS RATE: The rate of interest at which Federal funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks) that lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district bank.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven (7) members of the Federal Reserve Board and five (5) of the twelve (12) Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven (7) member Board of Governors in Washington, D.C., twelve (12) regional banks and about 5,700 commercial banks that are members of the system.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae): Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA, or FmHA mortgages. The term "passthroughs" is often used to describe Ginnie Maes.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL GOVERNMENT INVESTMENT POOL (LGIP): The aggregate of all funds from political subdivisions that are placed in the custody of the state treasurer for investment and reinvestment.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase--reverse repurchase agreements that establish each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date upon which the principal or stated value of an investment becomes due and payable.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

OFFER: The price asked by a seller of securities.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the Federal Open Market Committee in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers that submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC) registered securities broker-dealers, banks, and a few unregulated firms.

PRUDENT PERSON RULE: An investment standard. 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 expected income to be derived. The care skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than it maximum liability and which has been approved by the public deposit protection commission to hold public deposits.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.

REPURCHASE AGREEMENT: A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use repurchase agreements extensively to finance their positions.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types of descriptions are held in the bank's vaults for protection.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES & EXCHANGE COMMISSION: Agency created by congress to protect investors in securities transactions by administering securities legislation.

STATE: State of Arizona

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations that have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

TREASURY BILL: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three (3) months, or one (1) year.

TREASURY BOND: Long-term U.S. Treasury securities having initial maturities of more than ten (10) years.

TREASURY NOTES: Intermediate term coupon bearing U.S. Treasury securities having initial maturities of from one (1) to ten (10) years.

YIELD: The rate of annual income return on an investment, expressed as a percentage.

(a) **Income yield** is obtained by dividing the current dollar income by the current market price for the security.

(b) **Net yield or yield to maturity** is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.