

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

INVESTMENT POLICY

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TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

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TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

INVESTMENT POLICY

I. POLICY

It is the policy of the Texas Department of Housing and Community Affairs (the “Department”) to invest public funds in a manner that will provide, by priority, the following objectives:

1. Safety of principal;
2. Sufficient liquidity to meet Department cash flow needs;
3. Market rate of return for the risk assumed; and
4. Conformance to all applicable state statutes governing the investment of public funds including the Department’s enabling legislation, Texas Government Code, Chapter 2306, Texas Government Code, Chapter 2263, Ethics and Disclosure Requirements for Outside Financial Advisors and Service Providers, and specifically Texas Government Code, Chapter 2256, the Public Funds Investment Act (the “Act”).

It is further the intent of the Department to set forth in this document how all investments will be administered, providing for an all-inclusive document that will ensure consistency and thoroughness in the presentation of such investments, as they affect the Department’s presentation of its financial statements.

II. SCOPE

This investment policy applies to all investments, including both direct investments and investments that are subject to trust indentures created and supplemented in connection with bonds issued by the Department. All of these investments are accounted for in the Department’s Comprehensive Annual Financial Report and include the General Fund, Special Revenue Fund, Trust and Agency Fund, and Enterprise Fund.

This investment policy does not apply to investments in instruments that constitute hedges, which include but are not limited to, interest rate swaps, caps, floors, futures contracts, forward contracts, etc., that satisfy the eligibility requirements of a “qualified hedge” as defined by Section 1.148-4(h)(2) of the Internal Revenue Code.

The Department has created and adopted a separate Interest Rate Swap Policy for guidance regarding the use and management of such hedges.

III. PRUDENCE

Investments shall be made with judgment and care under prevailing circumstances which persons of prudence, discretion and intelligence would exercise in the management of their own affairs; not for speculation, but for investment, considering the probable safety and liquidity of capital as well as the probable income to be derived.

The standard of prudence to be used by the investment officers named herein shall be the “prudent person” standard and shall be applied in the context of managing an overall portfolio. An investment officer acting in accordance with the investment policy and written procedures 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 appropriate action is taken to control adverse developments.

IV. INVESTMENT PRIORITIES

Investment by the Department will be in accordance with the following priorities in order of importance:

1. Understanding the suitability of the investment to the financial requirements of the Department. Suitability is the first priority in the Department’s investment strategy, and will be evaluated on an overall basis and as a specific component of each of the remaining priorities;
2. Preservation and safety of principal;
3. Liquidity;
4. Marketability of the investment should the need arise to liquidate before maturity;
5. Diversification of the investment portfolio; and
6. Yield (after taking into account the previous five priorities).

Such investment will be in accordance with all federal and state statutes, rules, and regulations.

V. STRATEGIES

The following are the primary strategies for investment activities in order of priority after taking into account the suitability of any investment:

1. Suitability. In accordance with Section 2256.005(d) of the Act, the first priority is the suitability of investment.
2. Preservation and Safety of Principal. Investments of the Department 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. To achieve this objective, diversification is required so that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.
 - A. Credit risk is the risk of loss due to the failure of the security issuer or backer, and may be mitigated by:
 - limiting investments to the safest types of securities;
 - pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisors with whom the Department will do business; and
 - diversifying the investment portfolio to minimize potential losses on individual securities.
 - B. Interest rate risk is the risk that the market value of securities in the portfolio will fall due to changes in general interest rates, and may be mitigated by:

- structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market prior to maturity, and
 - investing operating funds primarily in shorter-term securities.
3. Liquidity. The Department’s investment portfolio shall remain sufficiently liquid to meet all reasonably anticipated cash flow needs. This is accomplished by structuring the portfolio so that securities mature concurrent with estimated or projected cash needs to meet anticipated demands. Since not all cash demands can be fully anticipated or projected with total accuracy, the portfolio should consist largely of securities with active secondary or resale markets, providing a reasonable level of flexibility to deal with unforeseen cash needs.
 4. Marketability. The Department will evaluate investment opportunities based on the marketability of each investment to reduce risk in the event the Department needs to liquidate the investment before maturity. Specifically, the Department will take into consideration the activity level of the secondary market for the investment.
 5. Diversification. The Department will maintain a diversified investment portfolio. Maturities will be staggered to provide cash flows based on anticipated needs. Investment risks will be reduced through diversification among authorized investments.
 6. Yield. The Department’s investment portfolio shall be designed with the objective of attaining a market rate of return through budgetary and economic cycles, taking into account the investment risk constraints and cash flow needs of the Department. Return on investment for short-term operating funds is of less importance than 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. A security experiencing or reasonably seen as being at risk of material decline in credit quality could be sold early to minimize the risk of loss of principal;
 - B. A security swap would improve the quality, yield, or target duration of the overall portfolio without creating other material risks or adverse features; or
 - C. Liquidity needs of the portfolio require that the security be sold and there are no preferable alternatives.

VI. DELEGATION OF AUTHORITY

The Board establishes the investment policy and objectives, obtains expert advice and assistance with respect to its actions as is necessary to exercise its responsibilities prudently, and monitors the actions of staff and advisors to ensure compliance with its policy. It is the Board’s intention that this policy be carried out by those persons who are qualified and competent in their area of expertise.

Authority to manage the Department’s investment program is granted under the provisions of Texas Government Code, Section 2306.052(b) (4) and (5) to the Director of the Department, (“Executive Director”). Responsibility for the operation of the investment program is hereby delegated to the Acting Director and the Director of Bond Finance and Chief Investment Officer acting in those capacities (collectively the “Investment Officer”) who shall carry out established written procedures and internal controls for the operation of the investment program consistent with this investment policy. The

Investment Officer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials. Procedures should include reference to safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking service contracts. Such procedures may include explicit delegation of authority to persons responsible for investment transactions. 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.

VII. ETHICS AND CONFLICTS OF INTEREST

1. Department employees and Board members must comply with all applicable laws, and should specifically be aware of the following statutes:
 - A. Texas Government Code, Section 825.211, *Certain Interests in Loans, Investments or Contracts Prohibited*;
 - B. Texas Government Code, Section 572.051, *Standards of Conduct for Public Servants*;
 - C. Texas Government Code, Sections 553.001-003, *Disclosure by Public Servants of Interest in Property Being Acquired by Government*;
 - D. Texas Government Code, Section 552.352, *Distribution of Confidential Information*;
 - E. Texas Government Code, Section 572.054, *Representation by Former Officer or Employee of Regulatory Agency Restricted*;
 - F. Texas Penal Code, Chapter 36, *Bribery, Corrupt Influence and Gifts to Public Servants*; and
 - G. Texas Penal Code, Chapter 39, *Abuse of Office, Official Misconduct*.

The omission of any applicable statute from this list does not excuse violation of its provisions.

2. Department employees and Board members must be honest in the exercise of their duties and must not take actions which will discredit the Department.
3. Department employees and Board members should be loyal to the interest of the Department to the extent that such loyalty is not in conflict with other duties which legally have priority, and should avoid personal, employment or business relationships that create conflicts of interest.
 - A. 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.
 - B. Officers and employees shall disclose to the Executive Director 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 Department's investment portfolio.
 - C. Officers and employees shall refrain from undertaking personal investment transactions with the same individuals with whom business is conducted on behalf of the Department.
 - D. Department employees and Board members may not use their relationship with the Department to seek or obtain personal gain beyond agreed compensation and/or any properly

authorized expense reimbursement. This should not be interpreted to forbid the use of the Department as a reference or the communication to others of the fact that a relationship with the Department exists, provided that no misrepresentation is involved.

E. Department employees and Board members who have a personal business relationship with a business organization offering to engage in an investment transaction with the Department shall file a statement disclosing that personal business interest. An individual who is related within the second degree by affinity or consanguinity to an individual seeking to sell an investment to the Department shall file a statement disclosing that relationship. A statement required under this section must be filed with the Texas Ethics Commission and the Department's Board. For purposes of this policy, an individual has a personal business relationship with a business organization if:

- the individual owns 10 percent or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;
- funds received by the Investment Officer from the business organization exceed 10 percent of the individual's gross income from the previous year; or
- the individual has acquired from the business organization during the previous year investments with a book value of \$2,500 or more for the personal account of the individual.

VIII. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS

The Department (in conjunction with the State Comptroller) will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker/dealers selected by credit worthiness; these may include "primary" dealers or regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule). No public deposit shall be made except in a qualified public depository as established by state law.

The Department will use as its authorized list of broker/dealers and financial institutions any broker/dealer or financial institution that is authorized to do business with the State Comptroller. With respect to investments provided in connection with the issuance of bonds, the above requirements will be deemed met if the investment provider has the minimum credit ratings required by rating agencies and is acceptable to the bond insurer/credit enhancer, if applicable, and if the investment meets the requirements of the applicable bond trust indenture. A broker, engaged solely to secure a qualified investment referred to in this paragraph on behalf of the Department, and who will not be providing an investment instrument, shall not be subject to the above requirements and may only be engaged if approved by the Board.

IX. ETHICS AND DISCLOSURE REQUIREMENTS FOR OUTSIDE FINANCIAL ADVISORS AND SERVICE PROVIDERS

During the 78th Legislature, Regular Session, the Texas Legislature passed *Chapter 2263, Ethics And Disclosure Requirements For Outside Financial Advisors And Service Providers* ("Chapter 2263"). Chapter 2263, under Senate Bill 1059, requires certain actions by governing boards of state entities involved in the management and investment of state funds and adds disclosure requirements for outside financial advisors and service providers. Chapter 2263 became effective September 1, 2003. Each state governmental entity required to adopt rules under Chapter 2263, Government Code, as added by this Act, must have adopted its initial rules in time for the rules to take effect not later than January 1, 2004.

Applicability. Chapter 2263 applies in connection with the management or investment of any state funds managed or invested:

1. under the Texas Constitution or other law, including Chapter 404, State Treasury Operations of Comptroller, and Chapter 2256, Public Funds Investment; and
2. by or for:
 - A. a public retirement system as defined by Section 802.001 that provides service retirement, disability retirement, or death benefits for officers or employees of the state;
 - B. an institution of higher education as defined by Section 61.003, Education Code; or
 - C. another entity that is part of state government and that manages or invests state funds or for which state funds are managed or invested.

Chapter 2263 applies in connection with the management or investment of state funds without regard to whether the funds are held in the state treasury.

Chapter 2263 does not apply to or in connection with a state governmental entity that does not manage or invest state funds and for which state funds are managed or invested only by the comptroller.

Definition. With respect to this Chapter 2263, "financial advisor or service provider" includes a person or business entity who acts as a financial advisor, financial consultant, money or investment manager, or broker.

Construction With Other Law. To the extent of a conflict between Chapter 2263 and another law, the law that imposes a stricter ethics or disclosure requirement controls.

Ethics Requirements For Outside Financial Advisors Or Service Providers. The governing body of a state governmental entity by rule shall adopt standards of conduct applicable to financial advisors or service providers who are not employees of the state governmental entity, who provide financial services to the state governmental entity or advise the state governmental entity or a member of the governing body of the state governmental entity in connection with the management or investment of state funds, and who:

1. may reasonably be expected to receive, directly or indirectly, more than \$10,000 in compensation from the entity during a fiscal year; or
2. render important investment or funds management advice to the entity or a member of the governing body of the entity, as determined by the governing body.

A contract under which a financial advisor or service provider renders financial services or advice to a state governmental entity or other person as described immediately above, in regard to compensation or duties, is voidable by the state governmental entity if the financial advisor or service provider violates a standard of conduct adopted under this section.

In addition to the disclosures required by Chapter 2263 and described below, the Department will rely upon financial advisors and service providers' submission of an Acknowledgement of Receipt of Investment Policy and Certificate of Compliance with the Public Funds Investment Act forms to evidence compliance with the Department's code of conduct and procedures as related to investments.

Disclosure Requirements For Outside Financial Advisor Or Service Provider. A financial advisor or service provider described by Section 2263.004 shall disclose in writing to the administrative head of the applicable state governmental entity and to the state auditor:

1. any relationship the financial advisor or service provider has with any party to a transaction with the state governmental entity, other than a relationship necessary to the investment or funds management services that the financial advisor or service provider performs for the state governmental entity, if a reasonable person could expect the relationship to diminish the financial advisor's or service provider's independence of judgment in the performance of the person's responsibilities to the state governmental entity; and
2. all direct or indirect pecuniary interests the financial advisor or service provider has in any party to a transaction with the state governmental entity, if the transaction is connected with any financial advice or service the financial advisor or service provider provides to the state governmental entity or to a member of the governing body in connection with the management or investment of state funds.

The financial advisor or service provider shall disclose a relationship described by the immediately preceding subsections (1) or (2) without regard to whether the relationship is a direct, indirect, personal, private, commercial, or business relationship.

A financial advisor or service provider described by Section 2263.004 shall file annually a statement with the administrative head of the applicable state governmental entity and with the state auditor. The statement must disclose each relationship and pecuniary interest described by Subsection (a) or, if no relationship or pecuniary interest described by that subsection existed during the disclosure period, the statement must affirmatively state that fact.

The annual statement must be filed not later than April 15 on a form prescribed by the governmental entity, other than the state auditor, receiving the form. The statement must cover the reporting period of the previous calendar year. The state auditor shall develop and recommend a uniform form that other governmental entities receiving the form may prescribe. The Department's disclosure form is provided as Attachment "D".

The financial advisor or service provider shall promptly file a new or amended statement with the administrative head of the applicable state governmental entity and with the state auditor whenever there is new information to report related to the immediately preceding subsections (1) or (2).

Public Information. Chapter 552, Government Code, controls the extent to which information contained in a statement filed under this chapter is subject to required public disclosure or is excepted from required public disclosure.

Anti-Boycott Verification. Financial advisors and service providers are required to comply with the requirements of Chapter 2270 of the Texas Government Code. Compliance includes a representation by each financial advisor or service provider that their firm (including any wholly owned subsidiary, majority-owned subsidiary, parent company, or affiliate) (i) does not boycott Israel and (ii) will not boycott Israel during the term for which they provide services to the Department.

Iran, Sudan and Foreign Terrorist Organizations. Financial advisors and service providers are required to comply with the requirements of Chapter 2252 of the Texas Government Code. Compliance includes a representation by each financial advisor or service provider that their firm (including any wholly owned

subsidiary, majority-owned subsidiary, parent company, or affiliate) is not an entity listed by the Texas Comptroller of Public Accounts under Sections 2252.153 or 2270.0201 of the Texas Government Code.

Exemption from Disclosure of Interested Parties. Financial advisors and service providers are required to comply with the requirements of Chapter 2252 of the Texas Government Code. Financial advisors and service providers that make a representation that their firm (including any wholly owned subsidiary, majority-owned subsidiary, parent company, or affiliate) is a publicly traded business entity are exempt from Section 2252.908 of the Texas Government Code.

X. AUTHORIZED AND SUITABLE INVESTMENTS

Trust Indenture Funds for which the Department has control of the investment decisions, all of which are held by Treasury Safekeeping for the benefit of bondholders, will be subject to the authorized investments set-forth in the applicable Indenture of Trust and any applicable supplemental indenture(s).

General, Special Revenue and Trust and Agency Funds, all of which are on deposit with the State Treasury (specifically excluding Enterprise Funds), are invested by the Treasury pursuant to Texas Government Code, Section 404.024 and Article 5221(f), Subsection 13A(d) as amended relating to Manufactured Housing.

Enterprise Fund

1. Subject to a resolution authorizing issuance of its bonds, the Department is empowered by Texas Government Code, Section 2306.173 to invest its money in bonds, obligations or other securities: or place its money in demand or time deposits, whether or not evidenced by certificates of deposit. A guaranteed investment contract is an authorized investment for bond proceeds. All bond proceeds and revenues subject to the pledge of an Indenture shall be invested in accordance with the applicable law and the provisions of the applicable indenture including “Investment Securities” as listed in such Indenture and so defined.
2. All other enterprise funds shall be invested pursuant to state law. The following are permitted investments for those funds pursuant to the Act:
 - A. Obligations of, or guaranteed by governmental entities:
 - Obligations of the United States or its agencies and instrumentalities.
 - Direct obligations of this state or its agencies and instrumentalities.
 - Collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, that have a market value of not less than the principal amount of the certificates and which has a maturity that does not exceed 10 years.
 - Other obligations the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of this state or the United States or their respective agencies and instrumentalities.
 - 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.

B. A Certificate of Deposit is an authorized investment under this policy if the certificate of deposit is issued by a depository institution that has its main office or a branch office in this state and is:

- guaranteed or insured by the Federal Deposit Insurance Department (FDIC) or its successor;
- secured by obligations that are described in subsection 2A above, including mortgage backed securities directly issued by a federal agency or instrumentality that have a market value of not less than the principal amount of the certificates and secured by collateral as described in Section XII of this policy; and
- secured in any other manner and amount provided by law for deposits of the Department.

In addition to the authority to invest funds in certificates of deposit noted above, an investment in certificates of deposit made in accordance with the following conditions is an authorized investment under this policy:

- the funds are invested by an investing entity through a depository institution that has its main office or a branch office in this state and that is selected by the investing entity;
- the depository institution guaranteed or insured by the Federal Deposit Insurance Department (FDIC) or its successor as selected by the investing entity arranges for the deposit of the funds in certificates of deposit in one or more federally insured depository institutions, wherever located, for the account of the investing entity;
- the full amount of the principal and accrued interest of each of the certificates of deposit is insured by the United States or an instrumentality of the United States;
- the depository institution guaranteed or insured by the Federal Deposit Insurance Department (FDIC) or its successor as selected by the investing entity acts as custodian for the investing entity with respect to the certificates of deposit issued for the account of the investing entity; and
- at the same time that the funds are deposited and the certificates of deposit are issued for the account of the investing entity, the depository institution guaranteed or insured by the Federal Deposit Insurance Department (FDIC) or its successor as selected by the investing entity receives an amount of deposits from customers of other federally insured depository institutions, wherever located, that is equal to or greater than the amount of the funds invested by the investing entity through the depository institution guaranteed or insured by the Federal Deposit Insurance Department (FDIC) or its successor.

C. A “repurchase agreement” is a simultaneous agreement to buy, hold for a specified time, and sell back at a future date, obligations of the United States or its agencies and instrumentalities at a market value at the time the funds are disbursed of not less than the principal amount of the funds disbursed. The term includes a direct security repurchase agreement and a reverse security repurchase agreement. The Department will comply with the Policy Statements and Recommended Practices for Repurchase Agreements as outlined in Attachment B. A fully collateralized repurchase agreement is an authorized investment under this policy if the repurchase agreement:

- has a defined termination date;
- is secured by collateral described in Section XV of this policy;
- requires the securities being purchased by the Department to be pledged to the Department, held in the Department’s name, and deposited at the time the investment is made with the Department or with a third party selected and approved by the Department;

- is placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in this state; and
 - in the case of a reverse repurchase agreement, notwithstanding any other law other than the Act, the term of any such reverse security repurchase agreement may not exceed 90 days after the date the reverse security repurchase agreement is delivered. In addition, money received by the Department under the terms of a reverse security repurchase agreement may be used to acquire additional authorized investments, but the term of the authorized investments acquired must mature not later than the expiration date stated in the reverse security repurchase agreement.
- D. Commercial Paper is an authorized investment under this policy if the commercial paper:
- has a stated maturity of 270 days or fewer from the date of its issuance; and
 - is rated not less than A-1 or P-1 or an equivalent rating by at least two nationally-recognized credit rating agencies, or one nationally-recognized credit rating agency and is fully secured, and by an irrevocable letter of credit issued by a bank organized and existing under the laws of the United States or any state.
3. The following are not authorized investments pursuant to the Act:
- 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.

XI. DIVERSIFICATION

The Department will diversify its investments by security type and institution. The amount of required diversification will be determined based upon:

1. The maturity date of the investment – longer maturity dates will require more diversification; and
2. The rating of the underlying investment – lower rated investments will require a greater degree of diversification.

XII. PERFORMANCE STANDARDS

The investment portfolio shall be designed and managed with the objective of preserving principal and obtaining a rate of return throughout budgetary and economic cycles commensurate with the investment risk constraints and the cash flow needs. The basis used to determine whether market yields are being achieved shall be the three-month U.S. Treasury bill.

XIII. EFFECT OF LOSS OF REQUIRED RATING

An investment that requires a minimum rating under this subchapter does not qualify as an authorized investment during the period the investment does not meet or exceed the minimum rating. The Department shall take all prudent measures that are consistent with its investment policy to liquidate an investment that does not meet or exceed the minimum rating. Still further, the Investment Officer is required to review monthly all investments subject to this policy to ensure that there have been no rating changes which would render such investment in violation of this policy.

XIV. MAXIMUM MATURITIES

To the extent possible, the Department will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the Department will not directly invest in securities maturing more than five years from the date of purchase. The Department will periodically determine what the appropriate average weighted maturity of the portfolio should be based on anticipated cash flow requirements.

General funds dedicated to the support of single family programs may be invested in securities exceeding five years if the maturities of such investments are made to coincide as nearly as practicable with the expected use of funds.

In addition, funds may be invested in any investments that are being sold from a bond indenture or are the result of the operation of the Department's single family program so long as:

1. such investment furthers the goals of that program;
2. the Investment Officer receives Board approval prior to undertaking such investment.

XV. COLLATERALIZATION

Collateralization will be required on certificates of deposit, repurchase and reverse repurchase agreements, and savings and demand deposits if not insured by FDIC. In order to anticipate market changes and provide a level of security for all funds, the collateralization level should be at least 101% of the market value of principal and accrued interest for repurchase and reverse repurchase agreements. Collateralization of 100% will be required for overnight repurchase agreements and bank deposits in excess of FDIC insurance.

The following obligations may be used as collateral under this policy:

1. obligations of the United States or its agencies and instrumentalities;
2. direct obligations of this state or its agencies and instrumentalities;
3. collateralized mortgage obligations 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 or backed by the full faith and credit of this state or the United States or their respective agencies and instrumentalities; and
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.

Collateral will always be held by an independent third party with whom the Department has a current custodial agreement. A clearly marked evidence of ownership or a safekeeping receipt must be supplied to the Department and retained. The right of collateral substitution is granted subject to prior approval by the Investment Officer.

XVI. SAFEKEEPING AND CUSTODY

All security transactions, including collateral for repurchase agreements, entered into by the Department 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. Securities will be held by a third-party custodian as evidenced by safekeeping receipts.

XVII. INTERNAL CONTROL

The Investment Officer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the entity 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.

Once every two years, the Department, in conjunction with its annual financial audit, shall have external/internal auditors perform a compliance audit of management controls on investments and adherence to the Department's established investment policies. The internal controls shall address the following points:

1. Control of collusion. Collusion is a situation where two or more employees are working in conjunction to defraud their employer.
2. Separation of transaction authority from accounting and record keeping. By separating the person who authorizes or performs the transaction from the person who records or otherwise accounts for the transaction, a separation of duties is achieved.
3. Custodial safekeeping. Securities purchased from any bank or dealer including appropriate collateral as defined by state law shall be placed with an independent third party for custodial safekeeping.
4. Avoidance of physical delivery securities. Book entry securities are much easier to transfer and account for since actual delivery of a document never takes place. Delivered securities must be properly safeguarded against loss or destruction. The potential for fraud and loss increases with physically delivered securities.
5. Clear delegation of authority to subordinate staff members. Subordinate staff members must have a clear understanding of their authority and responsibilities to avoid improper actions. Clear delegation of authority also preserves the internal control structure that is contingent on the various staff positions and their respective responsibilities.
6. Written confirmation or telephone transactions for investments and wire transfers. Due to the potential for error and improprieties arising from telephone transactions, all telephone

transactions must be supported by written communications and approved by the appropriate person, as defined by investment internal control procedures. Written communications may be via fax if on letterhead and the safekeeping institution has a list of authorized signatures.

7. Development of a wire transfer agreement with the lead bank or third party custodian. This agreement should outline the various controls, security provisions, and delineate responsibilities of each party making and receiving wire transfers.

The Department's external/internal auditors shall report the results of the audit performed under this section to the Office of the State Auditor not later than January 1 of each even-numbered year. The Office of the State Auditor compiles the results of reports received under this subsection and reports those results to the legislative audit committee once every two years.

XVIII. REPORTING

1. **Methods.** Not less than quarterly, the Investment Officer shall prepare and submit to the Executive Director and the Board of the Department a written report of investment transactions for all funds covered by this policy for the preceding reporting period; including a summary that provides a clear picture of the status of the current investment portfolio and transactions made over the previous reporting period. This report will be prepared in a manner which will allow the Department and the Board to ascertain whether investment activities during the reporting period have conformed to the investment policy. While not required under the Act, this report will provide information regarding investments held under bond trust indentures as well as investments covered under the Act. The report must:
 - A. describe in detail the investment position of the Department on the date of the report;
 - B. be prepared jointly by each Investment Officer of the Department;
 - C. be signed by each Investment Officer of the Department;
 - D. contain a summary statement, prepared in compliance with generally accepted accounting principles for each fund that states the:
 - book value and market value of each separately invested asset at the beginning and end of the reporting period; and
 - fully accrued interest for the reporting period;
 - E. state the maturity date of each separately invested asset that has a maturity date;
 - F. state the fund in the Department for which each individual investment was acquired; and
 - G. state the compliance of the investment portfolio of the Department as it relates to the investment strategy expressed in the Department's investment policy and relevant provisions of the policy.

The reports prepared by the Investment Officer under this policy shall be formally reviewed at least annually by an independent auditor, and the result of the review shall be reported to the Board by that auditor.

2. **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. Portfolio performance will be compared to appropriate benchmarks on a regular basis.

3. Marking to Market. A statement of the market value of the portfolio shall be issued at least quarterly. The Investment Officer will obtain market values from recognized published sources or from other qualified professionals as necessary. This will ensure that a review has been performed on the investment portfolio in terms of value and subsequent price volatility.

XIX. AUTHORIZED LIST OF BROKER/DEALERS AND FINANCIAL INSTITUTIONS

Not less than annually, the Investment Officer shall prepare and submit to the Executive Director and the Board of the Department a written report outlining the list of authorized broker/dealers and financial institutions maintained by the State Comptroller. The current list is provided in Attachment E.

XX. INVESTMENT POLICY ADOPTION

The Department's investment policy shall be adopted by resolution of the Board.

1. Exemptions. 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.
2. Amendment. The policy shall be reviewed at least annually by the Board and any amendments made thereto must be approved by the Board. The Board shall adopt by written resolution a statement that it has reviewed the investment policies and strategies.

XXI. ACKNOWLEDGMENT OF RECEIPT OF INVESTMENT POLICY

A written copy of the investment policy shall be presented to any person offering to engage in an investment transaction related to Department funds. The qualified representative of the business organization shall execute a written instrument in a form acceptable to the Department and the business organization, substantially to the effect that the offering business organization has:

1. received and reviewed the investment policy of the Department; and
2. acknowledged that the business organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the Department and the business organization that are not authorized by the Department's investment policy, except to the extent that this authorization is dependent on an analysis of the makeup of the Department's entire portfolio or requires an interpretation of subjective investment standards.

The Investment Officer of the Department may not buy any securities from a person who has not delivered to the Department an instrument complying with this investment policy. (See sample documents in Attachment "C".)

XXII. TRAINING

Each member of the Department's Board and the Investment Officer who are in office on September 1, 1996 or who assume such duties after September 1, 1996, shall attend at least one training session relating to the person's responsibilities under this chapter within six months after taking office or assuming duties.

Training under this section is provided by the Texas Higher Education Coordinating Board and must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with this policy. The Investment Officer shall attend a training session not less than once in a two-year period and may receive training from any independent source approved by the Department's Board. The Investment Officer shall prepare a report on the training and deliver the report to the Board not later than the 180th day after the last day of each regular session of the legislature.

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

Attachment A

STRATEGY

SECTION 1

All of the Department's funds as listed below are program / operational in nature, excluding the bond funds which are listed separately in Section 2 below. The following funds are held in the State Treasury and the Department earns interest on those balances at the then applicable rate.

- General Fund
- Trust Funds
- Agency Funds
- Proprietary Funds (excluding Revenue Bond Funds)

SECTION 2

The Department's Revenue Bond Funds, including bond proceeds, are invested in various investments as stipulated by the controlling bond indenture. Certain investments, controlled by indentures prior to the latest revised Public Funds Investment Act, are properly grandfathered from its provisions. Typical investments include: guaranteed investment contracts; agency mortgage-backed securities resulting from the program's loan origination; in some cases, long-term Treasury notes; and bonds used as reserves with maturities that coincide with certain long-term bond maturities.

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

Attachment B

POLICY STATEMENTS AND RECOMMENDED PRACTICE

Repurchase Agreements

1. Repurchase agreements (“repos”) are the sale by a bank or dealer of government securities with the simultaneous agreement to repurchase the securities on a later date. Repos are commonly used by public entities to secure money market rates of interest.
2. The Department affirms that repurchase agreements are an integral part of its investment program.
3. The Department and its designated Investment Officer should exercise special caution in selecting parties with whom they will conduct repurchase transactions, and be able to identify the parties acting as principals to the transaction.
4. Proper collateralization practices are necessary to protect the public funds invested in repurchase agreements. Risk is significantly reduced by delivery of underlying securities through physical delivery or safekeeping with the purchaser’s custodian. Over-collateralization, commonly called haircut, or marking-to-market practices should be mandatory procedures.
5. To protect public funds the Department should work with securities dealers, banks, and their respective associations to promote improved repurchase agreement procedures through master repurchase agreements that protect purchasers’ interests, universal standards for delivery procedures, and written risk disclosures.
6. Master repurchase agreements should generally be used subject to appropriate legal and technical review. If the prototype agreement developed by the Public Securities Association is used, appropriate supplemental provisions regarding delivery, substitution, margin maintenance, margin amounts, seller representations and governing law should be included.
7. Despite contractual agreements to the contrary, receivers, bankruptcy courts and federal agencies have interfered with the liquidation of repurchase agreement collateral. Therefore, the Department should encourage Congress to eliminate statutory and regulatory obstacles to perfected security interests and liquidation of repurchase collateral in the event of default.

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

Attachment C

ACKNOWLEDGMENT OF RECEIPT OF INVESTMENT POLICY

- 1. I am a qualified representative of _____ (the “Business Organization”).
- 2. The Business Organization proposes to engage in an investment transaction (the “Investments”) with the Texas Department of Housing and Community Affairs (the “Department”).
- 3. I acknowledge that I have received and reviewed the Department’s investment policy.
- 4. I acknowledge that the Business Organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the business organization and the Department that are not authorized by the Department’s investment policy.
- 5. The Business Organization makes no representation regarding authorization of the Investments to the extent such authorization is dependent on an analysis of the Department’s entire portfolio and which requires an interpretation of subjective investment standards.

Dated this _____ day of _____, _____.

Name: _____

Title: _____

Business Organization: _____

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

Attachment D

Annual Disclosure Statement for Financial Advisors and Service Providers

2) Do you or does your business entity have any direct or indirect pecuniary interests in any party to a transaction with the state governmental entity if the transaction is connected with any financial advice or service that you or your business entity provides to the state governmental entity or to a member of the governing body in connection with the management or investment of state funds?

Yes _____ No _____

If yes, please explain in detail. (Attach additional sheets as needed.)

PART 3: SIGNATURE AND DATE

I hereby attest that all information provided above is complete and accurate. I acknowledge my or my firm's responsibility to submit promptly a new or amended disclosure statement to the parties listed in step 4 of the instructions if any of the above information changes.

Signature _____ Date _____

TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

Attachment E



COMPTROLLER OF PUBLIC ACCOUNTS
Revised FY19 Broker Dealer List
March 2019

Amherst Pierpont Securities LLC
Barclays Capital Inc.
Blaylock Van LLC
BMO Capital Markets Corp.
BNP Paribas Securities Corp.
BNY Mellon Capital Markets, LLC
BOK Financial Services
Brean Capital
Cantor Fitzgerald & Co.*
Capital Institutional Services, Inc.
CIBC World Markets Corp.*
Citigroup Global Markets Inc.
Credit Agricole Securities (USA)
**Daiwa Capital Markets America,
Inc.***
FTN Financial Securities Corp.
Goldman Sachs & Co.
Guggenheim Partners
HSBC Securities (USA), Inc.
Jefferies, LLC
J.P. Morgan Securities LLC
Loop Capital Markets, LLC*
Merrill Lynch Pierce Fenner & Smith
Mesirow Financial Inc.
Mischler Financial Group, Inc.
Mitsubishi UFJ Securities (USA)
Mizuho Securities USA Inc.

Morgan Stanley Smith Barney LLC
Multi-Bank Securities, Inc.
Mutual Securities, Inc.*
NatWest Securities (formerly RBS)
Nomura Securities International Inc.
Oppenheimer & Co. Inc.
Piper Jaffray & Co.
Ramirez & Company
Raymond James & Associates Inc.
RBC Capital Markets, LLC
Rice Securities, LLC
Robert W. Baird & Co., Inc.
Scotia Capital (USA) Inc.
S.G. Americas Securities LLC
Signature Securities Group Corp.
**SMBC Nikko Securities America,
Inc.***
Stifel, Nicolaus & Company Inc.
SunTrust Robinson Humphrey Inc.
T.D. Securities (USA) LLC
UBS Securities LLC
Vining Sparks IGB, LP
Virtu Americas LLC
Wells Fargo Securities, LLC
Williams Capital Group, LP*
ZB, NA, Investment Division

***Added, Mid-Year Review 2019**