VILLAGE OF BALD HEAD ISLAND INVESTMENT POLICY

I. SCOPE

This policy applies to the investment of short-term operating funds. Except for cash in certain restricted and special funds, the Village of Bald Head Island will consolidate cash balances from all funds to maximize investment earnings. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

II. OBJECTIVES

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

1. Safety

Safety of principal is the foremost objective of the investment program. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective will be to mitigate credit risk and interest rate risk.

The Village of Bald Head Island will minimize the risk of loss due to the failure of the security issuer or backer by:

- a. Limiting investments to the safest types of securities:
- b. Pre-qualifying the financial institutions, brokers/dealers, intermediaries, and advisors with which the Village of Bald Head Island will do business; and
- c. Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

The Village of Bald Head Island will minimize the risk that the market value of securities in the portfolio will fall due to changes in general interest rates by:

- a. Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity, and
- b. Investing operating funds primarily in shorter-term securities, money market mutual funds, or similar investment pools.

2. Liquidity

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated

demands. Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets.

3. Yield

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the investment risk constraints and liquidity needs. Return on investment is of least importance compared to the safety and liquidity objectives described above. The core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. Securities shall not be sold prior to maturity with the following exceptions:

- a. A declining credit security could be sold early to minimize loss of principal;
- b. A security swap would improve the quality, yield, or target duration in the portfolio; or
- c. Liquidity needs of the portfolio require that the security be sold.

III. STANDARDS OF CARE

1. Prudence

The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with this investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and the liquidity and the sale of securities are carried out in accordance with the terms of this policy.

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

2. Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the Village of Bald Head Island.

3. Delegation of Authority

Authority to manage the investment program is granted to the Finance Director by North Carolina General Statute 159-30(a). The Finance Director shall carry out established written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures shall include references to: safekeeping, delivery v. payment, investment accounting, wire transfer agreements, collateral/depository agreements, and banking service contracts. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Finance Director. The Finance Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities delegated to Village employees or officials.

IV. SAFEKEEPING AND CUSTODY

1. Authorized Financial Dealer and Institution

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

- a. Audited financial statements;
- b. Proof of National Association of Securities Dealers (NASD) certification;
- c. Proof of state registration;
- d. Certification of having read the Village of Bald Head Island's Investment Policy.

An annual review of the financial condition and registration of qualified bidders will be conducted by the Finance Director.

2. Internal Controls

The Finance Director is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the Village of Bald Head Island 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:

- a. The cost of a control should not exceed the benefits likely to be derived;
- b. The valuation of costs and benefits requires estimates and judgements by management.

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

- a. Control of collusion.
- b. Separation of transaction authority from accounting and record keeping.

- c. Custodial safekeeping.
- d. Avoidance of physical delivery securities.
- e. Written confirmation of telephone transactions for investments and wire transfers.
- f. Development of a wire transfer agreement with the lead bank or third party custodian.

3. Delivery vs. Payment

All trades 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. Securities will be held by a third party custodian as evidenced by safekeeping receipts.

V. SUITABLE AND AUTHORIZED INVESTMENTS

1. Investment Types

Only the following investments will be permitted by this policy although others are authorized by North Carolina General Statute 159-30(c):

- a. Obligations of the United States or obligations fully guaranteed both as to principal and interest by the United States.
- b. Obligations of the Federal Financing Bank, the Federal Farm Credit Bank, the Bank for Cooperatives, the Federal Intermediate Credit Bank, the Federal Land Banks, the Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, Fannie Mae, the Government National Mortgage Association, the Federal Housing Administration, the Farmers Home Administration, the United States Postal Service.
- c. Obligations of the State of North Carolina.
- d. Bonds and notes of any North Carolina local government or public authority, subject to such restrictions as the Secretary of the Local Government Commission may impose.
- e. Deposits at interest or savings certificates of deposit with any bank, savings and loan association or trust company in North Carolina, provided such deposits or certificates of deposit are fully collateralized.
- f. Prime quality commercial paper bearing the highest rating of at least one nationally recognized rating service and not bearing a rating below the highest (A1, P1, F1) by any nationally recognized rating service which rates the particular obligation.
- g. Banker's Acceptances provided the accepting bank or its holding company is either (1) incorporated in the State of North Carolina or (2) has outstanding

publicly held obligations bearing the highest rating of at least one nationally recognized rating service and not bearing a rating below the highest (Aaa or AAA) by any nationally recognized rating service which rates the particular obligations.

h. Participating shares in a mutual fund for local government investment (such as the N.C. Capital Management Trust) which is certified by the N.C. Local Government Commission.

Consistent with GFOA Recommended Practice on Use of Derivatives by State and Local Governments, extreme caution shall be exercised in the use of derivative instruments.

2. Collateralization

In accordance with North Carolina General Statute 159-31(b) and the GFOA Recommended Practices on the Collateralization of Public Deposits, full collateralization will be required on deposits at interest and savings certificates of deposit. The Village of Bald Head Island shall utilize the pooling method of collateralization and shall use only financial institutions approved by the North Carolina Local Government Commission.

3. Repurchase Agreements

Use of repurchase agreements is prohibited.

VI. INVESTMENT PARAMETERS

1. Diversification

The investments shall be diversified by:

- a. Limiting investments to avoid over-concentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities),
- b. Limiting investment in securities that have higher credit risks,
- c. Investing in securities with varying maturities; i.e. laddering of investments,
- d. Continuously investing a portion of the portfolio in readily available funds such as local government investment pools (NCCMT) or money market funds to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

2. Maximum Maturities

The Village of Bald Head Island's general intent is to make investments and hold until maturity. However, early liquidation may be necessary if cash flow demand warrants an earlier date of sale

The Village of Bald Head Island shall limit the maximum final stated maturities of investments to two (2) years unless specific authority of the Village Council is given to exceed. To the extent possible, the Village of Bald Head Island will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the Village of Bald Head Island will not directly invest in securities maturing more than two (2) years from the date of purchase. The Finance Director shall determine what the appropriate average weighted maturity of the portfolio shall be.

Reserve funds may be invested in securities exceeding the two (2) year maximum if the maturity of such investments is made to coincide as nearly as practicable with the expected use of funds. The ability of investing these types of funds should be disclosed to and approved by the Village Council including appropriate time restrictions, if any apply.

VII. REPORTING

1. Methods

The Village Finance Director shall submit a monthly investment report to the Village Council, Village Manager and Finance Committee. The report shall include a general description of the portfolio in terms of investment securities, maturities, yields and other features. The report will show investment earnings for the month and fiscal year-to-date, including the annualized earned yield percentage for the portfolio.

The Village Finance Director shall also prepare a management summary report at least quarterly that provides a clear picture of the status of the current investment portfolio and transactions made over the last three months. This management summary will be prepared in a manner which will disclose whether investment activities during the reporting period have conformed to the investment policy. The report will be provided to the Village Manager and the Village Council upon request. The report will include the following:

- a. A listing of individual securities held at the end of the reporting period.
- b. Maturity dates.
- c. The percentage of the total portfolio which each type of investment represents.
- d. The market value of the total portfolio as defined by GASB Statement 31 pronouncement.
- e. Average weighted yield to maturity as compared to applicable benchmarks.

2. Performance Standards

The investment portfolio will be managed in accordance with the parameters specified within this policy. The portfolio shall obtain a market average rate of return during a market/economic environment of stable interest rates. Portfolio performance shall be compared to appropriate benchmarks on a regular basis.

3. Market-to-Market

A statement of the market value of the portfolio shall be issued at least semi-annually. This will ensure that the minimal amount of review has been performed on the investment portfolio in terms of value and subsequent price volatility. Review shall be consistent with the GFOA Recommended Practice on Market-to-Market Practices for State and Local Government Investment Portfolios and Investment Pools.

VIII POLICY CONSIDERATIONS

1. Exemption

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

2. Compliance with the Law

This policy shall be deemed amended to conform to the requirements of applicable laws regulating the investment of short-term operating funds and reserve funds by municipalities, as the same may be changed or revised from time to time.

3. Amendment

This policy may be reviewed on an annual basis. Any changes must be recommended by the Finance Director and subsequently formally approved by the Village Council.