D.C. HOUSING FINANCE AGENCY

INVESTMENT POLICY

MARCH 2018

D.C. Housing Finance Agency

INVESTMENT POLICY

I. PURPOSE AND SCOPE

This policy shall establish guidelines for the efficient management and safeguarding of the District of Columbia Housing Finance Agency (the "Agency") funds in compliance with the requirements of the Government Accounting Standards Board Statement No. 40, as may be amended or succeeded. Its purpose is to outline management responsibilities, set investment parameters, establish strategies to achieve stated objectives, establish internal controls and operational procedures and create performance monitoring procedures.

This investment policy applies to financial assets held by or for the benefit of the Agency and managed by the Agency in its capacity of a fiduciary for its creditors and financiers. This policy does not apply to funds and accounts established under standalone pass-through indentures of trust in connection with the Agency's single family and multifamily bond and other financing programs for which the Agency has no responsibility for making investment decisions.

II. INVESTMENT PHILOSOPHY

The Agency's financial assets will be held in cash and cash equivalents or invested and managed with the intention of obtaining the highest possible total return consistent with Agency liquidity needs and a prudent level of investment risk.

III. STANDARDS OF CARE

A. Prudence

The "prudent person" standard shall be used by investment officials in the management of the overall investment portfolio.

The "prudent person" standard is understood to mean: 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.

B. Ethics and Conflicts of Interest

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, to the extent applicable, members of the Board are prohibited from undertaking personal investment transactions with the individual and or company with whom business is conducted on behalf of the Agency and shall, at least annually disclose to the Board of Directors (the "Board") any financial and or personal relationships with such individual and / or company.

IV. INVESTMENT OBJECTIVES

The Agency's primary objectives of investment activities shall be the safety of principal and liquidity with secondary priority given to investment yield (income), and program asset portfolio growth. The following investment objectives will be applied in the management of the Agency's funds.

1. Safety of principal:

The Agency's investments shall be undertaken in a manner that seeks to ensure the preservation of capital. The objective will be to mitigate credit risk, concentration of credit risk, custodial credit risk and interest rate risk.

a. Credit Risk and Concentration of Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Agency will minimize credit risk, i.e., the risk of capital loss due to deterioration of credit ratings of the security issuer or guarantor by:

- Determining authorized Investments as investments meeting minimum credit rating requirements of the Agency or its indentures.
- Pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisers with which the Agency will do business.
- Diversifying the investment portfolio and investment counterparties so that potential losses on individual securities or investment counterparty portfolios will be minimized.

b. Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank failure, the Agency will not be able to recover its deposits or the value of its collateral securities that are in the possession of a third party collateral agent. The Agency will minimize custodial credit risk by:

- Ensuring that all investments held by trust indentures are kept separate from the assets of the trustee bank and from other trust accounts and are titled in the name of respective indentures.
- Ensuring that all of its demand deposits, certificates of deposit and other cash equivalents are properly collateralized through tri-party collateral agreements with an independent collateral agent, i.e. Federal Reserve Bank and other qualified institutions or that otherwise meet the credit rating requirements of the indentures.

c. *Interest Rate Risk*
Interest rate risk is the risk that the changes in interest rates will adversely affect the fair value of an investment. The Agency will minimize the risk that the market value of securities in any investment portfolio will fall due to changes in market interest rates, by:

- Structuring the investment portfolio so that securities mature to meet its operating cash flow requirements, thereby avoiding the need to sell securities prior to their maturity.
- Keeping a portion of the investment portfolio continuously invested in readily available funds such as money market funds and demand deposits to ensure that appropriate liquidity is maintained to meet ongoing and reasonably expected new obligations.
- Generally avoiding making long-term investments in circumstances where long-term interest rates are reasonably expected to increase.

2. <u>Liquidity of Funds</u>
The Agency's investment strategy will provide sufficient liquidity to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities' cash flows are sufficient to meet ongoing expenses, debt service payments and projected program loan funding obligations.

3. <u>Investment Yield</u>
The Agency's portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the safety of principal and liquidity constraints. In general, securities shall not be sold prior to maturity, with the following exceptions:

- A security with declining credit rating may be sold early to minimize loss of principal.
- A security exchange would improve the quality, yield, or target duration of the portfolio.
- Liquidity needs of the portfolio require that the security be sold.
- The overall portfolio would benefit from the sale of the securities.

4. <u>Program Asset Portfolio Growth</u>
The Agency shall give special consideration to investing its funds with the goal of supporting its core mission-based affordable housing program portfolio growth. This objective shall be secondary to the safety, liquidity and yield objectives stated herein.

5. <u>Asset Allocation</u>
The Agency will maintain and periodically review and revise a target asset allocation. The target asset allocation can change based on market, liquidity, risk and other factors.

V. INVESTMENT COMMITTEE

The Agency shall establish an Investment Committee whose responsibilities are outlined in the appropriate sections of this Policy. The Investment Committee is composed of the Executive Director, Chief Administrative Officer, Chief Financial Officer and one member of the Board of Directors.

VI. INVESTMENT MANAGERS

The Agency may utilize the services of external investment management companies ("Investment Manager") to assist in the investment and management of the Agency's funds. The responsibilities and the investment services to be provided by Investment Managers will be specified in a written agreement. The selection of the Investment Manager will be conducted in accordance with the applicable Agency procurement guidelines and procedures. The Investment Managers will be subject to the terms of their respective written agreements and this Policy.

VII. PERFORMANCE MEASUREMENT

The investment portfolio performance of the Agency will be evaluated quarterly by the Chief Financial Officer and/or Investment Committee by benchmarking its performance to yield levels on investments and cash holdings comparable in their maturity, type of investments and their credit quality.

The Investment Committee will seek to achieve, over specified periods, an average annual total return for the Agency portfolio of financial assets that is in line with the market-based return for a portfolio with comparable liquidity and credit risk characteristics.

Investment risk for Agency-managed financial assets, as measured by the variability of quarterly returns, should not exceed that of a portfolio with comparable liquidity and credit risk characteristics without a corresponding increase in performance.

For a portfolio managed by an Investment Manager, the Office of the Chief Financial Officer will seek a competitive market-based investment performance net of any investment management fees. Over time, each Investment Manager is expected to perform in the upper third of the Investment Managers peer group without a corresponding increase in performance above the peer group.

VIII. AUTHORIZED INVESTMENTS

All individual investment security and portfolio investment decisions are made by the Investment Committee. The Investment Committee may select a pre-qualified Investment Manager to manage a portfolio of investments subject to this Policy. In cases where an investment portfolio is managed by an Investment Manager no single investment may exceed 5% of the market value of an Investment Manager's portfolio at the time of purchase or 10% on an ongoing basis unless reviewed by the Investment Committee and prior written approval is obtained. In cases where the Agency is responsible for making investment decisions under the terms of the indentures of trust, the list of indenture permitted investments may exclude some of the investments authorized by this Policy or contain additional investments as may be allowed by the Agency creditors and financiers. In all cases, investments of funds shall be made in full compliance with applicable federal and local laws. The following investments are authorized by this Policy.

1. Fixed Income Securities. The authorized fixed income securities shall have a liquid market with a readily determinable market value. Generally, fixed income investments must be rated no lower than "A-"/A3 or its equivalent by a nationally recognized rating agency. Purchases of individual securities rated BBB or its equivalent by a nationally recognized rating agency shall be permitted subject to a prior written approval by the Investment Committee. With the exception of U.S. government and agency securities, no more than 10% of the portfolio invested in fixed income securities (at market value) may be invested in any one investor unless reviewed by the Investment Committee and written approval is obtained from the Executive Director of the Agency.

The Agency is permitted to invest in the following fixed income securities:

- Direct obligations of the United States Treasury.
- Obligations of United States federal agencies and instrumentalities, including mortgage-backed securities.
- Corporate bonds and notes including convertible bonds and notes.
- Municipal bonds and notes.
- Certificates of deposit with terms of over one year, not to exceed the current FDIC-insurance limit per issuer unless collateralized at 102% in the same manner as described under the demand deposit section herein.
- Single family and multifamily mortgage loans as part of the Agency's goal of supporting its core mission-based affordable housing program portfolio growth. Investments in such mortgage loans shall be based on the credit analysis and impact on the Agency's issuer credit rating and credit ratings of the respective indentures of trust.

2. Cash. The Policy permits the following cash and cash equivalents as authorized holdings:

- Demand deposits at commercial banks, subject to the minimum collateralization requirement of 102% measured by market value of the qualifying collateral securities with ongoing mark-to-market and undervalue cure provisions. The collateral shall be held by a designated collateral agent, i.e. the Federal Reserve Bank or other qualified third party under tri-party agreements.
- Deposits at any one commercial bank may not be more than 3% of that bank's total deposit base.
- Uncollateralized demand deposits funded with specific financing program receipts permitting such holdings.
- Money market mutual funds regulated by the Securities and Exchange Commission subject to further provisions of this policy.
- Commercial paper of prime quality with a stated maturity of 270 days or less from date of issuance, rated in the highest tier (e.g., A-1, P-1, F-1, or their equivalent) by a nationally recognized rating agency.
- Bankers' acceptances which have a stated maturity of 180 days or less from the date of issuance, and have the highest letter and numerical ratings as provided for by at least one nationally recognized rating agency, and are drawn on and accepted by commercial banks and which are eligible for purchase by the Federal Reserve Bank.

- Certificates of deposit with terms of one year or less, not to exceed the current FDIC-insurance limit per issuer unless collateralized at 102% in the same manner as described under the demand deposits herein;
- U.S. government and agency bills.

3. Investment Agreements. The policy permits the following investment agreements:
   - Repurchase agreements whose underlying purchased securities consist of the aforementioned instruments;
   - Investment agreements with any financial institution or other entity either (i) with debt rated at least comparable to the Agency general obligation issuer credit rating or the respective indenture credit rating or (ii) if an investment agreement maintains only a short-term rating, a rating not less than F-1/P1 or the comparable rating by a nationally recognized rating agency, unless counterparty ratings lower than the indenture ratings are permitted in a specific indenture and do not affect the ratings on the bonds or violate minimum rating requirements imposed by the creditors.

4. Mutual Funds, Unit Investment Trusts, and Pooled Investment Vehicles. Authorized investments include shares in open-end or closed-end management investment trusts or investment companies registered under the Investment Company Act of 1940 as amended. Shares of unit investment trusts are also permitted. However, shares for which there is a sales charge in the form of a front-end, contingent deferred (back-end), or level load may not be purchased unless specifically authorized in writing by the Executive Director, nor may the investment manager/consultant receive 12(b)(1) fees or any other commissions from the distributor of the fund.

Permitted investments include commingled investment funds such as common trust funds managed by bank trust departments.

Any pooled investment vehicles must invest in investment grade companies as reflected by such factors as ratings, capitalization, financial strength, quality of earnings, competitive position, and executive management.

Sector funds may be employed consistent with the limitation on exposure to any single industry.

Passively managed (i.e., index) funds may be employed.

Mutual funds must have at least a five-year record of performance and at least a three-star rating from Morning Star. Exceptions to this provision must be reviewed by the Investment Committee and approved in writing by the Executive Director.

5. Real Estate. Authorized real estate investments are Real Estate Investment Trusts (REITs), partnerships that invest in real property managed by third-party real estate professionals, and direct investments in real property. Direct investments in property development and management may be made in keeping with the Agency's core mission. Such investments will be made upon authorization of the Agency's Investment Committee, and must be appraised at purchase and periodically thereafter by a qualified third-party appraiser.

6. Equity Investments. Equity investments must be readily marketable and may not include illiquid securities. No more than 25% of the amount of the portfolio invested in equities (at market value) may be invested in any one industry (as defined by Standard & Poor's), and no more than 15% of the amount of the portfolio invested in equities (at market value) may be invested in any one company unless reviewed by the Investment Committee and written approval is obtained from the Executive Director of the Agency. No more than 20% of the international component of the portfolio (at market value) may be invested in a single foreign country.

The policy permits the following equity investments:

- Common stocks;
- Preferred stocks;
- American Depository Receipts (ADRs) listed on the New York Stock Exchange, American Stock Exchange, NASDAQ, and foreign exchanges;

7. Investments Resulting from Agency Program Hedging Activities. As the Agency employs financial hedging mechanisms to mitigate interest rate risks ("hedges") in its core affordable housing financing activities, portions of such hedges may periodically become ineffective and result in the Agency carrying such hedges as investments. The value of the hedges shall be determined by a qualified third party. This policy will permit such investments as long as the hedges were originally approved by the Investment Committee and have not been purchased as direct investments.

8. Alternative Assets. Authorized alternative asset investments are private equity funds, buy-out funds, and hedge funds. The employment of alternative assets investments is expected to provide significant opportunity for portfolio stabilization and shall be subject to prior approval by the Investment Committee. No more than 3% of the total market value of the portfolio may be invested with any single fund manager in the alternative asset class. A qualified third party must value alternative assets at least quarterly.

IX. PROHIBITED TRANSACTIONS

Investments not authorized in Section VIII above are prohibited without review of the Investment Committee and written approval of the Executive Director. Prohibited transactions include, but are not limited to: direct margin transactions, direct foreign currency transactions, direct commodities transactions, and foreign fixed income transactions, investments in derivatives outside of providing the Agency's program hedge.

Prohibited investments include gold, collectibles, commodities, options, short selling, and margin transactions. In addition, specific investments are prohibited in companies whose primary business is in firearms, tobacco, gambling, adult entertainment and any company that has a negative impact on the mission of the agency. Best efforts will be made to invest in only socially responsible companies with continual review by the Investment Committee.

X. CONTROL PROCEDURES OVER INVESTMENT MANAGERS

A. <u>Duties and Responsibilities of Investment Manager</u>. An Investment Manager retained by the Agency will:

1. Invest the Agency's money only in financial institutions regulated or insured by a federal or District Agency.

2. Invest the Agency's financial assets, utilizing the care, skill, prudence, and diligence, under the circumstances then prevailing, that experienced professionals acting in a like capacity and fully familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

3. Acknowledge and agree in writing to its fiduciary responsibility to comply fully with this Policy and any subsequent modifications.

4. Recommend appropriate portfolio investment strategy, asset allocation, and investment vehicles, which are in the best interest of the Agency, optimizing both short-term and long-term investment yield objectives.

5. Manage the Agency's financial assets under its care, custody, and/or control in accordance with the objectives and guidelines set forth in this Policy and any written agreement between the Investment Manager and the Agency.

6. Promptly inform the Agency's Investment Committee in writing regarding all significant and/or material matters and changes pertaining to the investment of Agency's financial assets, including, but not limited to:

    - Investment strategy;
    - Portfolio structure;
    - Ownership;
    - Organizational structure;
    - Financial condition;
    - Professional staff;
    - Legal and/or regulatory proceedings and actions;
    - Recommended changes to this Policy.

7. Promptly vote all proxies and related actions in a manner consistent with the long-term interests of the Agency's Fund and this Investment Policy guideline. Each investment manager/consultant will provide an annual report of proxy votes and related actions to the Investment Committee and will comply with all associated legal and regulatory obligations.

8. Provide the Investment Committee, for assets under its care, with monthly statements of activity and portfolio holdings, and quarterly investment performance reports showing investment returns on a total return basis.

Returns for each asset class shall be compared against a specific benchmark and peer group. The investment manager should be available to meet with the Investment Committee members on request, to make presentations, and provide additional reports upon request.

9. Meet (preferably in person), at least annually, with the Investment Committee to review the performance of assets under management, including actions taken by the Investment Manager to achieve its performance objectives and to recommend adjustments to the managed portfolio holdings or this Policy.

B. Brokerage Policy. All transactions effected for the portfolio will be "subject to best price and execution." The Investment Manager will keep records of brokerage used to effect soft dollar transactions and will be able to provide periodic reports on soft dollar transactions to the Agency's Chief Financial Officer.

C. Monitoring of Investment Manager. In accordance with Section VII, the Office of the Chief Financial Officer will evaluate Investment Manager performance on a regular basis to assess progress toward the attainment of the investment portfolio performance objectives.

At least yearly, the Office of the Chief Financial Officer will review: a) the Investment Manager's adherence to the Investment Policy; b) any material changes in the Investment Manager's organization, investment philosophy, or personnel; and c) the Investment Manager's performance versus benchmarks and peer groups.

D. Review for Underperformance. Pursuant to Section VII, the Office of the Chief Financial Officer will conduct a review of an investment manager/consultant if the manager/consultant:

1. Performs in the bottom quartile of its peer group over a semiannual or annual period.

2. Consistently generates a negative alpha.

3. Fails to provide reports on a timely basis or to respond to requests for information.

E. Replacement for Underperformance. The Investment Committee may replace an Investment Manager if the Investment Manager:

1. Performs in the bottom quartile of its peer group for three consecutive quarters.

2. Consistently performs below the upper third of its peer group over rolling three-year periods.

3. Generates a negative alpha for three and/or five-year time periods.
4. Repeatedly fails to provide reports on a timely basis or to respond to requests for information.

F. Review for Reasons Other than Underperformance. The Agency will conduct a review of an Investment Manager if the Investment Manager experiences or exhibits:

1. Significant turnover in professional staff.

2. Significant loss of business.

3. Significant new business.

4. Style drift.

5. A change in ownership.

6. Significant legal action initiated by a client or regulatory agency.

G. Replacement for Reasons Other than Underperformance. The Investment Committee has the discretion to replace an Investment Manager at any time and for any reason if it is in the best interest of the Agency.

XI. ADMINISTRATIVE EXPENSES

The administrative expenses of the portfolio, including expenses reasonably related to the operations, will be paid solely from the earnings on the financial assets and, in the case of an Investment Manager, shall be subject to availability of positive earnings generated on the managed portfolio.

XII. MUTUAL FUNDS

Notwithstanding anything contained in this Policy to the contrary, the Agency's financial assets invested in mutual funds will be invested and managed in accordance with the investment fees, expenses, policies, procedures, and guidelines set forth in the prospectuses for such mutual funds.

XIII. AMENDMENTS AND EXCEPTIONS

The Office of the Chief Financial Officer of the Agency will review this Policy at least annually and will recommend changes for review and adoption by the Investment Committee. The Executive Director may at its discretion waive any of the provisions contained herein, as determined in the best interests of the Agency.

IN WITNESS WHEREOF, the Executive Director has authorized this Policy on this 13th day of February, 2018.

By: ______________________________

Title: Executive Director

Approved and adopted by the Board on March 8, 2018.

Appendix

GLOSSARY

Benchmarks - Standards against which the performance of a security, mutual fund or investment manager can be measured. Generally, broad market and market-segment stock and bond indexes are used for this purpose.

Financial assets - The entries on a balance sheet showing all properties, both tangible and intangible, and claims against others that may be applied to cover the liabilities of a person or business. Assets can include cash, stock, inventories, property rights, and goodwill.

Mutual Funds - A security that gives small investors access to a well-diversified portfolio of equities, bonds and other securities. Each shareholder participates in the gain or loss of the fund. Shares are issued and can be redeemed as needed.

Negative Alpha - A measure of underperformance on a risk-adjusted basis.
Alpha takes the volatility (price risk) of a mutual fund and compares its risk-adjusted performance to a benchmark index. When a fund returns less than the return of the benchmark index, the difference in the returns is negative alpha.

Peer groups - Contemporaries of the same status- Managers of similar style and process.

Pooled Investment Vehicles - Funds which pool together the money from hundreds of investors into a fund, which in turn invests in the stock market. These vehicles spread the risk of investing around. Some examples are hedge funds, venture capital funds, private equity funds, listed close-end funds, and mutual funds.

Proxies - A formal power of attorney document that may be signed by a shareholder to authorize another shareholder, a representative of the shareholder or the company's management, to vote on behalf of the shareholder at the annual meeting. Proxy documents are meant to provide shareholders with the information necessary to make informed votes on issues important to the company's performance.

Quartile - A statistical term describing a division of observations into four defined intervals based upon the values of the data and how they compare to the entire set of observations. Each quartile contains 25% of the total observations.

Soft dollar transactions - A means of paying brokerage firms for their services through commission revenue, as opposed to through normal payments (hard-dollar fees).

Unit Investment Trusts - A registered trust in which a fixed portfolio of income-producing securities are purchased and held to maturity. Commonly used with municipal bonds, investors receive an undivided interest of the portfolio's principal as well as income proportionate to the amount they invested. Each unit typically costs $1,000 and is sold to investors by brokers. UITs can be resold in the secondary market.

12(b)(1) Fees - Annual charges which investors pay to mutual funds. These fees are used to pay for the marketing and distribution costs of the fund.