NUECES COUNTY
HOSPITAL DISTRICT

Memorandum

To: Finance Committee

Copy: Board of Managers

From: Jonny F. Hipp, Administrator

Date: June 3, 2015

Re: Annual Financial Report for Fiscal Year Ended September 30, 2014

The Hospital District was recently informed that the District's Annual Financial Report for Fiscal Year Ended September 30, 2014 ("FY 2014 Report") contained two inadvertent typographical errors; both typos were contained within the Interest Rate Risk section of Note 4 relating to Cash and Investments showing on page 40 of the Report.

The originally-issued FY 2014 Report incorrectly showed, in the third paragraph of the Interest Rate Risk section of page 40, that the current market value of the two Federal Home Loan Bank ("FHLB") callable notes were $300,000,000 each; however, the correct value of each note was $3,000,000.

A copy of pages 39 and 40 of the corrected FY 2014 Report are attached.

Thank you.

Jonny F. Hipp

Note 4 – CASH AND INVESTMENTS – (Continuation)

The District's policy is to report money market investments and short-term participating interest earning investment contracts at amortized cost and to report non-participating interest-earning investment contracts using a cost-based measure. However, U.S. Government Agency Securities are reported at fair value based on quoted market values. All other investments are reported at fair value unless a legal contract exists which guarantees a higher value.

Credit Risk

The primary stated objectives of the District's adopted Investment Policy are the safety of principal, liquidity, diversification and yield. Credit risk within the District's portfolio among the authorized investments approved by the District's adopted Investment Policy is present only in time and demand deposits, repurchase agreements, commercial paper, municipal obligations and money market mutual funds. All investments are rated AAA, or equivalent, by at least one nationally recognized rating agency. Investments are made primarily in obligations of the U.S. Government, its agencies or instrumentalities. State law and the District's adopted Investment Policy require inclusion of a procedure to monitor and act as necessary to changes in credit rating on any investment which requires a rating. State law and the District's adopted Investment Policy also require a procedure to verify continued FDIC insurance weekly.

State law and the District's adopted Investment Policy restrict both time and demand deposits, including certificates of deposit (CD), to those banks doing business in the State of Texas and further requires full insurance and/or collateralization from these depositories (banks and savings banks). Depository certificates of deposit are limited to a stated maturity of three years. Collateral, with a 102% margin, is required and collateral is limited to obligations of the U.S. Government, its agencies or instrumentalities. Independent safekeeping is required outside the pledging bank's holding company with monthly reporting. Securities are priced at market on a daily basis as a contractual responsibility of the bank.

Brokered CD's must be FDIC insured and delivered versus payment to the District's depository. Maximum maturity is one year and FDIC insurance must be verified before purchase. By Policy any change in FDIC status of the banks requires a review to assure FDIC status has not changed and immediate liquidation in the case of a merger or acquisition.

By policy and state law repurchase agreements are limited to those with defined termination dates executed with a Texas bank or a primary dealer (as defined by the Federal Reserve). The agreements require an industry standard, written master repurchase agreement and a minimum 102% margin on collateral as well as delivery versus payment settlement and independent safekeeping. Repurchase agreements may not exceed one year to stated maturity. Reverse repurchase agreements may not exceed 90 days and must be matched with reinvestment maturities.

By policy and state law commercial paper must be rated not less than A1/P1 or equivalent by at least two NRSROs or by one NRSRO if fully secured by an irrevocable letter of credit issued by a bank organized and existing under US law or the law of a state of the US. Commercial paper is restricted to a stated maturity of 90 days or less. The District's adopted Investment Policy restricts investment in money market mutual funds to those rated AAA and registered with the SEC. Each fund must strive to maintain a $1 net asset value.

Local government investment pools in Texas are required to be rated AAA, or equivalent, by at least one nationally recognized rating agency. The Policy further restricts investments to AAA-rated local government investment pools which strive to maintain a $1 net asset value.

As of September 30, 2014 the cash and investments contained:

- FDIC insured or fully collateralized bank deposits representing 1.01% of the total portfolio,
- investment in three local government investment pools representing 78.02% of the total portfolio,
- investment in a AAA-rated money market mutual fund representing 0.41% of the total portfolio, and
- US Government agency securities representing 20.56% of the total portfolio.

Concentration of Credit Risk

The District recognizes over-concentration of assets by market sector or maturity as a risk to the portfolio. The District's adopted Investment Policy establishes diversification as a major objective of the investment program.

As of September 30, 2014, holdings in US Government securities with ratings of AAA represented 20.56% of the total portfolio. Investment in the State Treasurer's local government investment pool, Texpool, represented 69.37% of the total portfolio. Investment in a second local government investment pool, LOGIC, represented .02% of the total portfolio. Investment in a third local government investment pool, TexStar, represented 8.63% of the total portfolio. Holdings in a AAA-rated money market mutual fund represented .41% of the total portfolio. The remaining 1.01 % of the portfolio is invested in FDIC insured or fully collateralized bank deposits.

Interest Rate Risk

In order to limit interest and market rate risk from changes in interest rates, the District's adopted Investment Policy sets a maximum stated maturity date of three years and at least 33% of the District's investments shall be obligations of the U.S. Government. To insure liquidity a minimum of 10% shall be liquid. The maximum weighted average maturity (WAM) of twelve (12) months. At the time any investment is placed, the overall compliance with the Investment Policy is verified. A segmented time distribution analysis of the portfolio is shown above.

As of September 30, 2014, the portfolio contained three holdings in the portfolio with stated maturity dates beyond one year representing 17.13 % of the total portfolio, and the weighted average of the combined portfolio was 180 days.

As of September 30, 2014, the portfolio contained 6 callable notes and one mortgaged backed security. The callable notes are as follows: Federal Home Loan Mortgage Corporation (FHLMC) note with a current market value of $3,000,000, coupon rate of .35%, maturing March 18, 2015; FHLMC note with a current market value of $3,000,000, coupon rate of 1.125%, maturing May 19, 2017; one callable FHLMC note with a current market value of $3,000,000, coupon rate of 1.00%, maturing May 26, 2017; FHLMC note with a current market value of $3,000,000, coupon rate of 1.00%, maturing June 16, 2017; Federal Home Loan Bank (FHLB) note with a current market value of $3,000,000, coupon rate of 1.20%, maturing on August 21, 2017 and one Federal Home Loan Bank (FHLB) note with a current market value of $3,000,000, coupon rate of 1.30% , maturing on September 29, 2017. Additionally, the District had one Government National Mortgage Association (GNMA) pass through with an original par value of $100,000 and a current market value of $178 and a coupon rate of 9%. The GNMA note was purchased October 1, 1986, matures on October 15, 2016: however the final payment is expected as of July 15, 2015.