(4)

CITY OF DANBURY

155 DEER HILL AVENUE

DANBURY, CONNECTICUT 06810

DAVID W. ST. HILAIRE
DIRECTOR OF FINANCE

(203) 797-4652
FAX: (203) 796-1526

MEMORANDUM

TO: Mayor Mark D. Boughton via the City Council

FROM: David W. St. Hilaire, Director of Finance DSH

DATE: April 24, 2012

SUBJECT: Investment Policy Statement

Pursuant to the recommendations of GFOA (Government Finance Officers Association) to follow "Best Practices" for municipal governments, I highly recommend that the City adopt the attached *Statement of Investment Policies and Guidelines for Cash Management.*

Although, the City does have a formally adopted written policy for the Pension Plan investments, it does not have such a written policy for investing of other funds and has historically followed the General Statutes of Connecticut, Chapter 112 Sec. 7-400. As a matter of good financial practices, I strongly support the formal adoption of written policies which provide additional clarity and guidance for the investing of the City's non-pension funds.

Over the last several months, I have worked with Graystone Consulting to draft an Investment Policy for the City's non-pension funds which provide for the following: additional investing guidelines; defines the purpose and overall objectives of the investments; establishing new internal controls/monitoring procedures; and additional oversight. The proposed Investment Policy Statement significantly exceeds the basic requirements of General Statutes of Connecticut, Chapter 112 Sec. 7-400.

The City Council is respectfully requested to consider this policy at its next meeting. Please contact me should you require any additional information.

4

City of Danbury

Statement of Investment Policies and Guidelines for Cash Management

April 2012

Contents

A. Background and Authority

The City of Danbury, Connecticut ("Danbury") operates under Charter and is governed by Mayor and City Council. The Mayor is the chief executive and the City Council is the legislative body and budget-making authority. Chapter 112 Sec.7-400 of the General Statutes of Connecticut grant Danbury the power to invest City funds to the elected City Treasurer, with approval by the budget making authority. The authority and responsibility for the administration of the financial affairs of the City is granted to the Director of Finance per Section 6-6A of the Charter of the City of Danbury ("City Charter").

The Director of Finance shall execute the authority to manage City funds in accordance with allowable arrangements delineated in the General Statutes of Connecticut in addition to the investment guidelines as outlined in this Statement of Investment Policies and Guidelines for Cash Management. Within these parameters, The Director of Finance may engage one or more investment managers, custodians, and other experts in order to manage, monitor, and report upon invested funds.

The "prudent person" standard shall apply to the Director of Finance in the investment of City funds and the execution of these policies. This standard of care applies in the context of managing the overall portfolio. 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. Scope of this Statement of Investment Policies

These policies specify the guidelines that provide for the prudent and productive investment of City funds. City funds covered under these policies include all governmental funds, proprietary funds, and fiduciary funds, including the City's general fund, special revenue funds, capital project funds, and debt service funds. These policies shall apply to City funds in aggregate and allow for the pooling of City funds for purposes of investment. These policies do not apply to current or future Pension, Other Post-Employment Benefits ("OPEB"), Defined Contribution, or other retirement funds, as City retirement funds are managed according to their own distinct policies.

C. Overall Objectives
City funds shall be managed in order to maximize current income while, first, ensuring the preservation and safety of principal, and, second, providing appropriate liquidity to meet expected and unanticipated cash flow requirements. Emphasis is placed on principal protection, return of capital, and maximum safety. Income maximization is a secondary goal as it relates to the safety of invested funds.

D. Investment Guidelines and Objectives

1. Authorized Investments Pursuant to the General Statutes of Connecticut
Investments shall comply with the General Statutes of Connecticut, Chapter 112 Sec.7-400 and allows the following investments:

- Obligations of the United States of America;
- Obligations of the Federal Home Loan Mortgage Corporation;
- Obligations of the Federal National Mortgage Association;
- Obligations of the Government National Mortgage Association;
- Obligations of the Federal Savings and Loan Insurance Corporation;
- Obligations of the United States Postal Service;
- Obligations of any Federal Home Loan Bank;
- Obligations of any Federal Land Bank;
- Obligations of any Federal Intermediate Credit Banks;
- Obligations of the Central Bank for Cooperatives;
- Obligations of the Tennessee Valley Authority;
- Obligations of any other agency of the United States Government;
- Shares or other interests in any custodial arrangement, pool or no-load, open-end management type investment company or investment trust registered or exempt under the Investment Company Act of 1940, 15 USC Section 80a-1 et seq. as from time to time amended, provided :
    - the "pool" is invested in the above with repurchase agreements fully collateralized by the underlying obligations;
    - the "pool" takes delivery of such collateral either directly or through an authorized custodian;

    - the "pool" is managed to maintain its shares at a constant Net Asset Value or the "pool" is rated within one of the top two risk categories of any nationally recognized rating service;
    - the municipality purchases or redeems shares through the use of a bank.
- Obligations of any state of the United States or any political subdivision, authority or agency thereof as long as they are rated within one of the top two risk categories of any nationally recognized rating service;
- Obligations of any below entity provided it is rated within one of the top three risk categories of any nationally recognized rating service:
    - State of Connecticut;
    - Any regional school district in the state of Connecticut;
    - Any town in the state of Connecticut;
    - Any city in the state of Connecticut;
    - Any borough in the state of Connecticut;
    - Any metropolitan district in the state of Connecticut.

2. Maturities

The City shall attempt to match its investments with anticipated cash flow requirements. Unless an investment is directly matched to a specific cash flow and is therefore exempted from the City's overall funds for purposes of calculating the weighted average life, the City's invested funds shall generally not exceed a weighted average life greater than two and one half (2.5) years. In order to maintain an appropriate investment allocation, the Director of Finance or his delegate shall periodically provide and update external managers with anticipated cash flow requirements, as they are revised.

In order to meet unanticipated cash flow requirements that are not forecasted, a portion of the portfolio may be continuously invested in readily available funds such as local government investment pools, money market funds, or overnight repurchase agreements to ensure that appropriate liquidity is maintained to meet ongoing obligations.

3. Permitted Investments

Funds shall be invested to minimize risk or loss. Flexibility in the investment allocation shall enable investment managers to select investments deemed prudent based on economic outlook, perceived valuation amongst eligible securities, and the City's anticipated cash flow needs, within the permitted investments as outlined in this document.

The following general policies govern permissible securities into which City funds may be invested:

- A portion of City funds shall be invested in overnight instruments or marketable securities available on a daily basis without risk of impairment upon liquidation. This amount that is set aside from City funds invested in other instruments shall be communicated to investment manager(s) by the Director of Finance and/or his or her delegate;
- Over the amount that the Director of Finance projects is needed on an immediate basis, there is no limitation on the percentage of the overall portfolio that may be invested in:
    a. U.S. government and agency obligations and in repurchase agreements fully collateralized by such securities,
    b. Agency backed mortgage obligations including Fannie Mae, Freddie Mac, and Ginnie Mae,
    c. an authorized custodial arrangement, pool, or money market fund, and the General Statutes of Connecticut, or
    d. State of Connecticut Short Term Investment Fund ("STIF");
- Investments in this sub-section must be rated within one of the top three risk categories of any two nationally recognized rating service (Moody's, Standard & Poor's, Fitch);
- If the ratings assigned to a security by Standard & Poor's, Moody's and/or Fitch are not the same, the highest rating of these rating agencies will be used.
- All ratings criteria are to be applied at the time of purchase.
- Securities that are downgraded in quality subsequent to their purchase may be held if it would be advantageous to do so.

This section does not apply to bank accounts used for the temporary deposit of receipts and deposits needed to cover disbursements that are expected to clear over a subsequent seven business days.

4. Investment Objectives

The investment objectives of City funds shall emphasize long-term preservation of purchasing power (preservation of capital after inflation) undertaken in a manner that seeks to safeguard capital preservation on a year-to-year basis. Investment considerations shall emphasize risk management, specifically but not limited to Credit Risk and Interest Rate Risk:

- Credit Risk – Investment managers shall minimize exposure to the risk of loss due to the failure of the security, issuer or backer, by limiting investments to the safest types of securities and diversifying the portfolio so that potential losses on individual securities would be minimized;
- Interest Rate Risk – In order to minimize the risk that the market value of the securities in the portfolio will decline in value due to market interest rate fluctuation, investment managers shall structure the portfolio to meet the cash requirements of ongoing operations, thereby mitigating the need to liquidate securities at a loss prior to maturity. In addition, investments past three years in maturity will be made to coincide as nearly as practicable with the expected use of the funds.

With an emphasis on maximum safety and return of principal, the investment portfolio shall be designed with the objective of attaining the maximum market rate of return throughout budgetary and economic cycles. Considerations for investing City funds shall account for the investment risk profile, constraints, and cash flow characteristics outlined in these policies and/or communicated to investment managers.

5. Monitoring

With the exception of City funds that are maintained in "cash" instruments and are not otherwise invested in the portfolio, investment funds shall be monitored in relation to the performance of the Merrill Lynch 1-3 US Year Treasury Index ("Policy Index"). The Merrill Lynch 1-3 US Year Treasury Index is an unmanaged index that tracks the performance of the direct sovereign debt of the U.S. Government having a maturity of at least one year and less than three years. The Director of Finance shall receive statements of account balances from third party custodians and/or depository institutions monthly and investment performance summaries from a third party, aside from investment managers, no less than on a quarterly basis. As City funds are on deposit and/or held in physical custody with one or more third party custodians, in order to affirm the appropriateness and safety of the City's funds, monitoring shall include periodic review of depository institutions and third party custodians.

The Mayor may appoint a committee to serve in an advisory role to the Director of Finance. Independent from the management of the funds, the City may engage the services of an investment consultant to serve in an oversight capacity, including but not limited to production of investment performance reports, investment manager reviews, and other advisory services as requested by the Director of Finance.

E. Safekeeping and Custody

All City funds shall be properly designated as an asset of the City and held in safekeeping by a third party custodial bank. Any physical delivery securities shall be held by the third party custodial bank and all Depository Trust Company (DTC) eligible securities shall be held in the third party custodian's account with the DTC.

Except for cash in certain restricted and special accounts, City funds may be pooled into a single fund in order to maximize investment earnings and minimize costs commensurate with efficient financial management. Investment income shall be allocated to the various funds based upon their respective participation and accounted by the third party custodian no less than on a monthly basis. This process may utilize sub-accounting and/or unitization processes in order to maximize efficiency and meet the reporting requirements of the Director of Finance.

F. Internal Controls

The Director of Finance shall incorporate additional internal controls into the cash management process and document them in writing. The internal control procedures will be reviewed as part of the City's audit process with independent auditors. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, misrepresentation by third parties, imprudent actions by employees and officers of the City, and to ensure adherence to these policies.

G. Investment Policy Adoption and Review

The City of Danbury's Investment Policy has been adopted by resolution of the City Council on _<<DATE>>_.

The Policy shall be reviewed periodically, at least once every two years from the date of adoption. Modifications made at that time or when necessitated by statutory revision

4-7

must be approved by the appropriate action of the City Council. Modifications to appendices may be made by the Director of Finance without City Council approval.

Glossary of Select Terms

Agency Securities – the securities issued by U.S. Government agencies, such as the Federal Home Loan Bank, and others.

Benchmark – a standard unit used as the basis of comparison identified with sufficient detail so that investments may be compared as being above, below, or comparable to a performance metric.

Certificates of Deposit (CDs) – a debt instrument issued by banks usually paying interest periodically and/or upon maturity.

Custodian – an organization, usually a financial institution, that provides services of holding and reporting upon a customer's securities held in safekeeping.

Delivery versus Payment (DVP) – a settlement procedure where payment for a securities purchase is applied to the transfer of those securities into the customer's account. The same procedure applies for a securities sale whereby sold securities are transferred to the purchaser in exchange for payment which settles into the customer's account.

Diversification – dividing investment funds among a variety of securities to mitigate risk or loss and/or volatility of the overall investment results.

Federal Deposit Insurance Corporation (FDIC) – a federal agency that insures bank deposits from losses incurred when a bank cannot meet its debt obligations.

Liquidity – a description of the convertibility of a security into cash. A highly liquid investment may be readily converted into cash without impairment whereas less liquid security may require greater concession either in time or price received if the investor chooses to sell prior to maturity.

Maturity Date – the date on which the principal amount of a bond or other debt obligation becomes payable or due.

Money Market Fund – an open-ended mutual fund that invests in short term, highly liquid securities and pays investors a rate of interest while attempting to maintain a net asset value that does not fluctuate.

Rate of Return – the amount of income or gain or loss received from an investment expressed as a percentage.

Repurchase Agreement (Repos) – an agreement to purchase securities from an entity for a specified amount of cash and to resell the securities to the entity at an agreed upon price and time. Repos are widely used as a money market instrument.

Safekeeping – a procedure where securities are held by a third party acting as custodian.

Total Return – interest income plus investment gains (or losses) on an investment and/or on the overall investment portfolio.

Weighted Average Life - also called average life or weighted average maturity. The measure is used to provide the average time to return a dollar of principal. It is calculated by multiplying each portion of principal received by the time at which it is received, and then summing and dividing by the total amount of principal.

Yield – the rate of annual income on an investment expressed as a percentage.

Definitions provided in the glossary section are included for informational purposes. The content found herein is provided on an "as is" basis, with no guaranty or warrantee as to its completeness.