

CITY OF NEWTON

FINANCIAL AUDIT ADVISORY COMMITTEE

INVESTMENT POLICIES AD HOC SUB-COMMITTEE REPORT

WEDNESDAY, SEPTEMBER 12, 2012

Present: Howard Merkowitz (Chair), School Committee Member Matt Hills, Alderman Ruthanne Fuller, Alderman Lenny Gentile, Jim Reardon (Treasurer), David Wilkinson (Comptroller), Maureen Lemieux (Chief Financial Officer)

The Sub-committee reviewed the attached memo on the City's investment policy provided by Treasurer Jim Reardon. The memo lists four areas of the investment policy that the sub-committee may want to consider revising or updating. The first area is related to the possibility of amending the current policy's requirement that a bank have a continual Veribanc rating of "green." Some of the banks that the City does business with provide critical services to the City and immediate termination of any one of those relationships if the rating turned "yellow" would create a significant operational problem for the City. The Treasurer suggested that the policy be amended to allow the City to continue a relationship with a bank under a yellow designation with restrictions, such as implementing a time limit for "yellow" status and basing decisions related to the bank by considering the safety of the capital to be invested as stated in the prudent man rule.

There was conversation regarding whether there should be language included in the City's investment policy regarding local banks. The City of Nashua's Financial Policies include a section called Investing in Local Institutions. It states that the City encourages investment in local institutions but not at the sacrifice of safety or liquidity. The policy includes additional language stating that the City of Nashua is willing to give up some yield because they are supporting economic development of the City by using local banks; however, they will not give up more yield than 80 basis points and that they will use this section infrequently.

The City of Newton uses local banks to invest. The range of investment is between \$60,000 up to \$21 million with one bank. The average investment in local banks is \$10 million. There was some skepticism that local banks fill a role that otherwise would not be filled by regional banks. It was pointed out that some of the City's local banks contribute a substantial amount of money to the community and the City may want to consider investing additional funds in those banks but not at the expense of yield on investment.

Mr. Reardon emphasized that the City currently invests large amounts of money in local banks but he must consider the overall health of the bank before investing funds. If the City were to encourage investing in local banks, the policy would need to contain a definition of a local bank. The Treasurer added that it seems futile to put in a yield limit related to investment in local banks as the limits change, which would result in constant changes to the policy as the rates fluctuate. It is important that the City hold local banks to the same investment standards as other banks. Mr. Reardon does not see a need for language pertaining to investment in local

banks in the investment policy. Most other cities and towns do not have that kind of policy as it is done as a matter of routine. Including language on local bank investments would provide protection for the Treasurer. If local bank language is included, it should be a general statement that encourages investment in local banks that contribute to the community and should not include any language related to loss of yield. There should be flexibility in the investment policy and it may not make sense to codify where to invest City funds. Ald. Fuller offered to work with the Chief Financial Officer and Treasurer to come up with draft language related to local banks for review at the next sub-committee meeting.

The Sub-committee moved on to a discussion regarding whether to continue to limit the amount of the City's funds placed in a single banking institution. If so, what is the right percentage or percentage range? The current limit is 15% of the bank's capital and surplus and no more than 25% of the Treasurer's cash balance. Mr. Reardon felt that the 15% limit is appropriate for the City of Newton. The Sub-committee would like a better understanding of the rationale used for determining the percentages. The Sub-committee would like further information on the 15% limit and plan to seek advice from people with investment expertise before continuing the discussion.

There was discussion regarding the possibility of establishing an investment advisory committee composed of citizens with expertise in investment to help with all investment decisions including the investment limits. The City may want to consider getting advice from experts without the establishment of a formal committee. It is important to keep in mind that the Comptroller asked the City's external auditor for a recommendation on the optimum number of City bank accounts. The external auditor responded that the City should maintain the minimum number of accounts necessary to comply with legal and contractual requirements, but a sufficient number to effectively diversify the City's deposits. The concern for minimizing the number of accounts is principally related to the fact that the Treasurer must reconcile each account monthly and each additional account that the City maintains places an additional burden on the treasurer. On one hand, it may be helpful to minimize the number of accounts but on the other hand, the City wants to diversify its accounts for the sake of safety and liquidity.

Another area in Mr. Reardon's memo relates to consideration of the relationship between collateralization and rating status and determining what constitutes acceptable collateral. There is no language to address collateralization in the current Investment Policies. The Sub-committee members decided to discuss collateralization at the next meeting.

Respectfully submitted

Howard Merkowitz, Chairman

Investment Policy

Authority

Massachusetts General Laws, Chapter 44, Section 55B requires that the Treasurer invest all public funds except those required to be kept uninvested for purposes of immediate distribution. Invested funds are to be placed at the highest possible rate reasonably available, taking account of safety, liquidity, and yield. (MGL Ch. 740, Acts of 1985).

Legal Investment

Massachusetts General Laws, Chapter 44, Section 55 sets forth the types of investments that are legal for municipal Treasurers. They are:

- Certificates of Deposits of a maturity of no more than one year.
- Savings and Money Market Accounts.
- U.S. Treasury securities with a maturity of one year or less.
- Investment in a pooled fund operated under the authority of the State Treasurer.
- Repurchase Agreements backed by US Govt. securities, term of no more than 90 days.

Investment Goals

The Treasurer pursuant to the following goals will manage the City's investment activities:

Safety - Safety of principal is the foremost goal of the City of Newton's Investment Policy. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

Liquidity - The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements that might be reasonably anticipated.

Return on Investment - The City's investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, taking into account the City's investment risk constraints and the cash flow characteristics of the portfolio.

In order to achieve these goals, the Treasurer shall:

1. Continue to analyze the cash flow of all funds on a regular basis to ensure maximum cash availability.
2. Continue to pool cash from several different funds for investment purposes, in order to obtain the best possible return on all cash investments.
3. Continue to analyze market conditions and investment securities on a daily basis to determine the maximum yield to be obtained.
4. Invest in quality issues and will comply with State statutes regarding investment-requirements.

5. Organize and maintain banking relationships designed to ensure investment of all funds available in disbursement accounts.
6. Continue to invest at least 97% of its idle cash on a continuous basis.
7. Utilize bank certificates of deposit with U.S. Treasury securities for maturity periods that provide a favorable rate differential compared to the State Treasurer's pooled investment based upon the Treasurer's judgment as to projected future interest rates.
8. Utilize the State Treasurer's pooled investment fund during those periods when, in the Treasurer's judgment, liquidity is necessary, or it is advantageous to do so in order to accumulate cash for later investments in periods when interest rates are forecasted to rise.
9. Utilize repurchase agreements only on a limited basis when no other more favorable options are possible and then only for duration of no more than three days and only with a principal Boston Bank which is rated no lower than Veribanc green.
10. Avoid the necessity to redeem a term deposit prior to maturity, with attendant interest forfeiture or penalty in order to meet cash flow needs.
11. Utilize wire transfer of funds whenever the interest benefit exceeds the transaction costs associated with the wire.
12. Utilize a bank rating service in judging the safety and/or risk of an investment.

Risk Limits

The following limits shall be utilized:

- State Treasurer's Pooled Fund No Limit
- U.S. Treasury Securities No Limit
- Bank Certificates of Deposit:

Minimum Investment Limit

Not to exceed 15% of capital and surplus as of most recent Veribanc report

Bank rating Veribanc green.

In addition to the above limits, no single banking institution shall hold in excess of 25% of the Treasurer's cash balance (cash and investments) at any time.

Statutory References

The Treasurer shall at all times be cognizant of and comply with provisions of the following sections of Massachusetts General Laws:

- Chapter 44, Section 55 - Deposit of Public Funds
- Chapter 44, Section 53F - Compensatory Balance
- Chapter 44, Section 55B - Requirement to Invest.