TOWN OF AMHERST

FINANCIAL MANAGEMENT POLICIES & OBJECTIVES

Finance Committee

OVERVIEW

During the *Planning Amherst Together* project to develop a Master Plan and in other forums, citizens and Town leaders have collectively voiced their aspiration that the Town of Amherst strive to be a community that is a model to others for:

- Honest, transparent, inclusive, professional government;
- The highest standards for public safety services;
- Providing an outstanding education for every student;
- Promotion of lifelong learning;
- Care for our most vulnerable (young, old, disabled, newcomer, etc.);
- Environmental stewardship and leadership;
- Cultural/recreational opportunities;
- Embracing new technology to deliver more and better services and promote connectivity between all members of the community and the wider world;
- Promoting economic and social justice for all of our citizens; and
- Creating and sustaining a vibrant and diverse community and sense of community.

To help reach these goals, it is essential that the Town articulate and disseminate financial management policies and objectives. The Town of Amherst is responsible for carefully accounting for public funds, managing municipal finances wisely, and planning and providing for adequate funding of services desired by the public and required by laws, rules, or regulations, including the provision and maintenance of public facilities and improvements.

The financial management policies and objectives set forth in this document are intended to increase and sustain the financial strength and stability of the Town of Amherst. They reflect a combination of policies and practices either required by state/federal statute or regulation, the Amherst Town Government Act, Town bylaws, industry best practices, and local preferences. Articulation of these policies and objectives is essential to long-term financial planning that sets realistic boundaries on what the Town of Amherst can accomplish and helps direct resources to the highest priorities.

OBJECTIVES

Objectives are broad statements of the financial position the Town seeks to attain. The financial objectives for the Town of Amherst are:

- To provide full value to the residents and business owners of Amherst for each tax dollar by delivering quality services efficiently and on a cost-effective basis;
- To preserve the Town’s quality of life by providing and maintaining adequate financial resources necessary to sustain a sufficient level of municipal services, and to respond to changes in the economy, the priorities of governmental and non-governmental organizations, and other changes that may affect our financial well-being;

- To maintain the Town's strong Aa3 credit rating in order to minimize to taxpayers the cost of borrowing for capital needs of the Town;
- To guide Town decision makers on management and policy decisions which have significant fiscal importance;
- To set forth operating principles that minimize the cost of government and financial risk;
- To employ balanced and fair revenue policies that provide adequate funding for desired programs;
- To maintain appropriate financial capacity for present and future needs;
- To maintain public confidence in the Town's financial management;
- To promote sound financial management by providing accurate and timely information on the Town's financial condition in accordance with generally accepted accounting principles;
- To ensure the legal use of financial resources through an effective system of internal controls.

To achieve these objectives, the Finance Committee adopts the following policies:

A. ACCOUNTING, AUDITING, AND FINANCIAL PLANNING

1. The Town will utilize accounting practices that conform to generally accepted accounting principles as set forth by the Government Accounting Standards Board (GASB). The Town will comply with GASB Statement 34 and continue to track, report, and depreciate capital assets as required. The Town will comply with GASB Statement 45 regarding accounting for Other Post-Employment Benefits (primarily health insurance) to retired employees. <u>ACCOUNTING REQUIREMENT.</u>

2. An annual audit will be performed by an independent public accounting firm. An examination of a community's financial systems, procedures, and data by a certified public accountant (independent auditor), and a report on the fairness of financial statements and on local compliance with statutes and regulations. The audit serves as a valuable management tool for evaluating the fiscal performance of a community. <u>STATE LAW</u>.

3. The Town should enter into multiyear agreements of at least five years in duration when obtaining the services of independent auditors. Such multiyear agreements can take a variety of different forms (e.g., a series of single-year contracts), consistent with applicable legal requirements. Such agreements allow for greater continuity and help to minimize the potential for disruption in connection with the independent audit. Multiyear agreements can also help to reduce audit costs by allowing auditors to recover certain "startup" costs over several years, rather than over a single year.

   The Town should undertake a full-scale competitive process for the selection of independent auditors at the end of the term of each audit contract, consistent with applicable legal requirements. Ideally, auditor independence would be enhanced by a policy requiring that the independent auditor be replaced at the end of the audit contract, as is often the case in the private sector. Unfortunately, the frequent lack of competition among audit firms fully qualified to perform public-sector audits could make a policy of mandatory auditor rotation counterproductive. In such cases, it is recommended that the Town actively seek the participation of all qualified firms, including the current auditors, assuming that the past performance of the current auditors has proven satisfactory. Alternatively, the Town should consider rotating the audit team leader at least once every five years if the same independent audit firm is engaged.

Audit procurement policies are based upon recommended practices promulgated by the Government Finance Officers Association (GFOA).

4. A Management Letter, a by-product of an annual audit, shall be provided by the independent public accounting firm no later than March 1 and reviewed by an Audit Committee. The Audit Committee shall be comprised of representatives from the Select Board, School Committee, Library Trustees, and Finance Committee, and a member of the public with appropriate experience and meet with the Finance Director, Comptroller, and the Town's independent auditor to review the independent audit of the Town's financial statements, and further, request that the Audit Committee meet at least annually with the Select Board and report its findings, and how it has discharged its duties and met its responsibilities.

   The charge of the Audit Committee was approved by the Select Board on October 11, 2005.

5. A five-year financial projection shall be prepared annually by the Town Manager and Finance Director/Treasurer, projecting revenues and expenditures for all operating funds. This projection shall be used as a planning tool in developing the following year's operating budget and capital improvements plan. Revenue forecasts for property tax, local receipts and state aid shall be conservative, using generally accepted forecasting techniques and appropriate data. Revenue deficits will be avoided at all costs. To avoid any potential for such a deficit, estimates for local receipts (i.e. inspection fees, investment income, departmental user fees) will generally not exceed 100% of the prior year's actual collections without firm evidence that revenues are achievable.

B. GENERAL FUND

1. All current operating expenditures should be paid for with current operating revenues.

   The purpose of this policy is to maintain a fiscally sound operating position for the Town by promoting Amherst's ability to balance its budget on a current basis, *maintain reserves for emergencies, and have sufficient liquidity to pay bills on time to avoid short-term borrowing costs. The Town will avoid budgetary procedures that balance current expenditures at the expense of meeting future years' expenses, such as delaying expenditures until the next fiscal year, or rolling over short-term debt.*

2. Debt will not be used to fund current operating expenditures.

3. Reserves, including the combined balance of Free Cash and Stabilization Fund, should be maintained at 5 – 15% of general fund operating revenues. The primary objective of the Town's reserve policy is to provide the Town the flexibility to sustain service levels despite the adverse financial impacts of economic downturns and unforeseen and extraordinary expenses.

    a. The Town will endeavor to maintain a certified Free Cash balance equal to at least 5% of general fund operating revenues. Unappropriated Free Cash in excess of the 5% benchmark may be appropriated to the Stabilization Fund in furtherance the objectives outlined in paragraph b) of this policy.

       This goal is a widely accepted measure of good financial standing and a key factor in Amherst's bond rating. The Free Cash balance is an important indicator of whether the Town is living within its means. A declining balance means that the Town is spending more on an annual basis than it is collecting in revenues.

       Free Cash provides a financial cushion against events such as a sudden loss of a revenue source after Annual Town Meeting has approved the operating budget for the next fiscal year, an economic downturn, emergency or other unanticipated expenditures, non-recurring capital expenditures, and uneven cash flow.

    b. The Town will endeavor to maintain a Stabilization Fund large enough to buffer the General Fund from the impact of two to three years of reduced state aid and/or declining local receipts. Appropriations from the Stabilization Fund may be for any lawful purpose (Chapter 40, §5) and may only be made by a two-thirds vote of Town Meeting. Interest earned on Stabilization Fund balances will be retained in the Stabilization Fund. If and when the Town draws monies from the Stabilization Fund, the Town should also present a plan for replenishing the fund.

       During the economic downturn affecting FY 03 through FY 06, the Town lost approximately $5.6 million cumulatively in state aid compared to FY 02 amounts received. State aid was not restored to FY 02 levels until FY 07.

c. Free Cash in excess of the goal reserve amount should be used for non-recurring emergency expenditures, or appropriated to a Stabilization Fund for future capital projects and equipment purchases, or used to provide property tax relief.

This policy, in combination with the other reserves policies, will provide a strategy to avoid creating future operating deficits by over reliance on Free Cash to subsidize the operating budget.

4. One-time revenues will be used for capital improvements, additions to reserves or as legally restricted to a specific purpose.

5. The year-to-year increase of actual revenue from the property tax levy shall generally not exceed 2.5% pursuant to the limitations of Proposition 2 ½. STATE LAW.

    a. Excluding the value gained through new construction (new growth);

    b. Excluding expenditure increases funded outside the tax limit cap.

    The Town's costs to educate children and to deliver Town services are likely to increase at an annual rate that exceeds core inflation rates. Each year these escalating costs are likely to exceed the Town's ability to raise tax revenue within the limits of Proposition 2½. The Town also needs to undertake major capital projects, such as the replacement or renovation of three elementary schools, replacement or renovation of one or more fire stations, and construction of a new DPW facility.

6. Property values shall be re-appraised or re-certified annually. STATE REQUIREMENT.

7. The Collector and Finance Director/Treasurer will carefully and routinely monitor all amounts due the Town. A proactive policy of collection will be followed for all receivables, including property taxes. A target of 98% property tax collection rate by fiscal year end will be achieved.

8. The Town will strive to be informed and aware of all grants and other aid that may be available to us. All potential grants and other aid shall be carefully examined for matching requirements (both dollar and level-of-effort) and restrictive covenants, to ensure that our participation in such grants will be beneficial and cost-effective. When positions are funded with grants, a portion of the grant funding should be allocated to recover the cost of employee benefits if allowed by the granting agency.

9. Fees and user charges should be reviewed annually in relation to the costs of providing the service.

As state and federal assistance has declined and/or been eliminated, the Town's local non-property tax revenue base has provided more funding for local services. In order to continue to provide these services without an additional burden on the property tax, these fees should be reviewed to cover, where appropriate, any cost increase or decrease associated with delivering that program or service.

10. Each year and whenever appropriate, existing revenues will be re-examined and possible new sources of revenues will be explored to ensure that the Town is maximizing its revenue potential.

    Examples include the updated Strategic Partnership Agreement between the Town and the University of Massachusetts increasing the University's payments in lieu of taxes (PILOT) to the Town for fire and emergency medical services, pursuit of legislative authority to adopt local option taxes on meals and lodging, and the closing of telecommunications property tax loopholes.

C. CAPITAL PLANNING

1. Section 5.2 of the Amherst Town Government Act states that "the town manager, with the advice of a joint capital planning committee comprised of representatives from the select board, finance committee, school committee and library trustees, shall develop a capital improvement program to be presented to the select board, finance committee, school committee and library trustees in time to be included in the finance committee report to the next annual town meeting." <u>STATE LAW</u>.

2. On or before January 16 of each year, the Town Manager, after consulting with the School Superintendent and the Library Director, will submit a capital program to the Joint Capital Planning Committee. The proposed program will detail each capital project, the estimated cost, description and funding source.

3. The Joint Capital Planning Committee will update and readopt annually a five-year capital improvement plan, including the upcoming annual capital improvement budget and a four-year projection of capital needs and expenditures which details the estimated cost, description and anticipated funding sources for capital projects.

4. The first year of the five-year capital improvement plan will be the basis of a formal fiscal year appropriation request during the annual budget process.

5. Policies adopted by the Joint Capital Planning Committee (last revised December 8, 2005) are listed below. These policies shall be reviewed by the Joint Capital Planning Committee annually.

    a. Definition of a capital project: a capital improvement is a tangible asset or project with an estimated useful life of five (5) years or more, and a cost of

$5,000 or more. Among the items properly classified as capital improvements are:

1. New public buildings, or additions to existing buildings, including land acquisition costs and equipment needed to furnish the new building or addition for the first time;

2. Major alterations, renovations, or improvements to existing buildings that extend the useful life of the existing buildings by at least ten (10) years;

3. Land acquisition and / or improvement, unrelated to a public building, but necessary for conservation or park and recreation purposes;

4. Major equipment acquisition, replacement or refurbishment, including but not limited to vehicles, furnishings, and information technology systems' hardware and software or other items that combined in purpose together make it a Capital Project;

5. New construction or major improvements to Town's physical infrastructure, including streets, sidewalks, storm water drains, the water distribution system, and the sanitary sewer system. Infrastructure improvements must extend the useful life of the infrastructure by at least ten (10) years to be appropriately classified as a capital improvement;

6. A feasibility study, engineering design services, or consultant services which are ancillary to a future capital improvement project.

b. Guidelines for prioritizing capital projects (not necessarily in priority order):

   1. Imminent threat to health and safety of citizens, employees or property (e.g. police cruisers and radios, self- contained breathing apparatus for firefighters);

   2. Maintenance and improvement of capital assets (e.g. major repairs of buildings, replacement of vehicles and equipment, park and play area renovations);

   3. Requirement of state or federal law (e.g. asbestos cleanup program mandated by federal law in 1986, removal of gas tanks, etc);

4. Improvement of the infrastructure (e.g. streets and sidewalks, water and sewer programs);

5. Improvement/maintenance of productivity (e.g. equipment replacement, computer hardware / software);

6. Improvement of an overburdened situation (e.g. Town Hall renovations, cemetery expansion program);

7. Newly identified need (e.g. recreation fields);

8. Priority assigned by Department (Very High, High, Medium, Low); and

9. Consistency with and in furtherance of long-term planning objectives of the Town (e.g. Climate Action Plan, Historic Preservation Plan, etc.).

6. The capital program will be funded by a combination of property taxes, enterprise and other special purpose funds of the Town, and grant funds from the federal and state governments.

   An example of a Special Purpose fund is the Ambulance Fund. Grant funding examples include state Chapter 90 grants for road repair/reconstruction and equipment, public safety equipment grants, state grants for economic development infrastructure and parks improvements and federal Community Development Block Grants (CDBG).

7. The annual budget should include a Capital Program that includes debt service obligations and cash-funded capital projects funded from current revenues equal to at least 10% of the estimated property tax levy. This does not include capital projects funded via debt exclusions (debt excluded from Proposition 2 ½ limits). If in any year funds for the capital program recommended to Town Meeting are below the target allocation of 10% of the estimated property tax levy, a plan will also be presented to replenish funding of the capital program to 10% within a reasonable timeframe.

   For FY 08, only 7.2% of the tax levy was allocated to the capital program. The Capital Plan was founded on the premise that an allocation of 10% of the levy along with the other resources has proved to be enough, or almost enough, to keep up with renovation and maintenance of existing buildings, and also equipment replacement, but not enough to cover significant new projects.

   Much of the Town government's wealth is invested in our capital plant i.e. buildings, fields, infrastructure, equipment, and vehicles. Long-term debt is an appropriate source of funding for certain types of projects while current revenues *should be used for those assets with a short useful life. This goal will provide for a source of funding that does not compete with the operating budget, but increases or decreases in relation to growth in the tax levy and growth in the community.*

8. The Town will emphasize preventive maintenance as a cost-effective approach to infrastructure maintenance. Exhausted capital goods will be replaced as necessary.

9. The annual operating cost of a proposed capital project, as well as debt service costs, will be identified before any long-term bonded capital project is recommended.

   Capital projects may increase future expenses, decrease future expenses, or may be cost-neutral. The funding of capital projects may fall within available revenues (taxes or fees) or new revenue sources (debt or capital exclusions). It is important to project the impact that the proposed capital project has on the operating budget so that operating budget funding sources could also be identified or new funding sources recommended.

D. DEBT MANAGEMENT

1. The requirements for debt financing shall be an expenditure of at least $25,000 and a useful life in excess of five (5) years for only those projects not able to be financed from current revenues,.

2. Long-term debt will be issued only for objects or purposes authorized by state law.

   Debt is an effective way to finance capital improvements or to even out short-term revenue flows. For certain capital projects with a long useful life, debt financing is an equitable financing strategy that allows current and future beneficiaries of a capital investment to share in the cost of that improvement. Unlike most personal or private debt, towns have access to capital at very competitive tax exempt rates.

   Properly managed debt helps to preserve the Town's credit rating, provides flexibility in current and future operating budgets, and provides the Town with long-term assets that maintain or improve our quality of life.

3. The term of long-term debt generally shall not exceed the expected useful life of the capital asset being financed. Long-term debt should not be incurred without a clear identification of its financing sources. State law strictly regulates both the purposes for which cities and towns can borrow and the time periods for which these borrowings can occur. Borrowing purposes and maximum loan durations are set out in Chapter 44 §§7 & 8. STATE LAW.

Chapter 44 enunciates numerous limitations and procedures that govern local debt issues. One of these limitations places a ceiling on the maximum amount of debt a town may have authorized at any one time. Chapter 44 §10 sets this limit at 5% of the equalized valuation (EQV) for towns. The statute permits municipalities to exceed these limits only with the approval of the Emergency Finance Board (EFB), established under the provisions of Chapter 10 §47. With EFB approval, the Town's borrowing limit may be increased by an additional 5%. As of June 30, 2006, the Town's debt service equaled only 0.12% of EQV.

4. General Fund debt service, exclusive of debt funded from dedicated revenues raised via voter-approved debt exclusions, will not exceed 10% of General Fund revenues.

   The credit rating agencies, such as Moody's Investor Services, consider debt service exceeding 20% of net operating revenues as a potential problem. Dramatic increases in debt service also indicate potential problems unless revenue sources increase to keep pace with these additions to fixed costs. The 10% benchmark provides a policy to apply to new projects and the growth of revenues to finance such projects. As of June 30, 2006, the Town's debt service equaled 3.9% of net operating revenues.

5. The Town will attempt to maintain a long-term debt schedule so that at least 50% of outstanding principal will be paid within 10 years.

   Debt service costs include annual principal and interest payments. Debt service costs are also a significant portion of fixed costs. A reasonable maturity schedule not only reduces interest costs, but recognizes that capital needs will continue to be identified and recommended. Credit rating bureaus review these maturity schedules and future capital needs.

E. ENTERPRISE FUNDS

1. The Town shall establish and maintain enterprise funds pursuant to Chapter 44 §53 to ensure annual operation and maintenance needs are met and services are financed in an equitable manner. <u>STATE LAW</u>.

   The Town currently administers the following enterprise funds: Water, Sewer, Solid Waste, and Transportation.

2. The term of debt for enterprise funds shall not exceed the useful life of the asset and in no case shall the term exceed 30 years, or other such limits pursuant to Massachusetts General Laws.

3. Rates for enterprise funds shall be designed to generate sufficient revenues to support the full cost (direct and indirect) of operations and debt, and to ensure

appropriate levels of working capital. Fees should be reviewed annually in relation to the cost of providing the service.

Each enterprise fund should be reviewed annually to project revenues and expenditures for the next fiscal year, estimates of the current year, and projections for future years. Estimates of capital projects and debt service should be included in order to project the impact on rates and user fees. Any costs not supported by user revenues or betterments would place a requirement on the General Fund for financial support.

4. Water and sewer main replacements, treatment facilities, pump stations, transportation, and other infrastructure should be scheduled so as to avoid major increases in water and sewer rates and other user fees.

   The water and sewer funds are established as self-supporting on a cash basis. Revenues are planned to cover operating budgets, indirect and overhead costs, and debt service payments. Depreciation is not funded; therefore, a carefully designed replacement plan is necessary to ensure a rate structure adequate to pay all costs including proposed new long-term debt.

F. COMMUNITY PRESERVATION ACT

1. The Community Preservation Act (CPA) was adopted by Amherst voters in April 2001, which established a local fund based on a 1% tax surcharge on property valuations above $100,000 *"for the acquisition, creation and preservation of open space; for the acquisition, preservation, rehabilitation and restoration of historic resources; for the acquisition, creation and preservation of land for recreational use; for the creation, preservation and support of community housing; and for the rehabilitation or restoration of open space, land for recreational use and community housing that is acquired or created."* The tax surcharge was increased to 1.5% (from 1%) by Amherst voters via a referendum in April 2006. The law also established a State Trust Fund, from which annual allocations are made to towns that have accepted the Act, partially or fully matching local appropriations. To date, local allocations have been matched 100% by the state and have allowed for a wide range of projects to be undertaken. <u>STATE LAW</u>.

2. The Community Preservation Act Committee (CPAC) is charged with assessing the needs of the Town in those areas identified by the Act, and recommending relevant expenditures to Town Meeting. By state law, CPA funds are to be spent <u>only</u> on community housing, historic preservation, open space, and recreation. A minimum of 10% of the available funds (from the surcharge and the state match) must be set aside each year (although not necessarily spent) for each of three categories of community housing, historical preservation, and open space. Recreation is the fourth recipient, or beneficiary, but is not mandated to receive the minimum 10%. <u>STATE LAW</u>.

3. Pursuant to a Town Bylaw adopted in April 2001 by Town Meeting, "There shall be a community preservation committee, pursuant to and with the authority granted under Section 5, as now or hereafter amended, of Chapter 44B of the Massachusetts General Laws consisting of nine members. In accordance with Section 5(a) its membership shall include one member of the conservation commission as designated by the commission, one member of the historical commission as designated by the commission, one member of the planning board as designated by the board, one member of the leisure services and supplemental education commission as designated by the commission, and one member of the Amherst Housing Authority as designated by the authority, and four representatives of other town boards or committees or citizens at-large as designated by the Select Board. The Select Board shall make all appointments to the committee. The committee shall also consult with and coordinate its recommendations with the Joint Capital Planning Committee."

G. REVOLVING FUNDS

1. The Town may establish one or more revolving funds pursuant to state law, which allows the Town to raise revenues from a specific service and use those revenues without appropriation by town meeting to support the service. Most municipal and school revolving funds do not require annual town meeting reauthorization. <u>STATE LAW.</u>

   A revolving fund receives its income from selling goods and services to users or participants in a program, and expends monies to cover the costs of such goods or the expenses of providing the particular program or service. The intent is for such activities to break even financially, and the revolving fund is a mechanism that allows for fluctuations in levels of activity. Revolving funds are commonly used for park and recreation programs, school athletic programs, community, adult education and continuing education programs, and school lunch programs.

   The Town currently administers the following revolving funds: LSSE Recreation, LSSE Adult Education, Arts Lottery, School Lunch, Pre School, After School, SPED Bill Backs, SPED Circuit Breaker, and School Facility Rental.

2. Unless specified elsewhere in statute like those listed above, all other departmental revolving funds shall be authorized under Chapter 44 §53E½ of the Massachusetts General Laws. Each fund must be reauthorized each year at annual town meeting and a limit on the total amount that may be spent from each fund must be established at that time. The aggregate of all revolving funds may not exceed ten percent of the amount raised by taxation by the city or town in the most recent fiscal year, and no more than one percent of the amount raised by taxation may be administered by a single fund. <u>STATE LAW.</u>

H. INVESTMENT POLICY

Statement of Purpose: This Investment Policy is intended to provide a clear understanding regarding the objectives, goals, risk tolerance and guidelines established by the Town of Amherst.

Section I: Investment of General Funds, Special Revenue Funds, and Enterprise Funds

A. Scope

This section of the investment policy applies only to short term operating funds such as general funds, special revenue funds, enterprise funds, and capital project funds. Section two will deal with trust funds, bond proceeds, and any other funds with special circumstances such as stabilization funds. A separate Hampshire County Retirement Board is responsible for the investment of the pension funds. Funds held for the Town's self-insuring health trust and worker's compensation insurance are also held separately and subject uniquely to Massachusetts General Law, Chapter 32B Section 3A and Chapter 40 Section 13A, respectively.

B. Objectives

Massachusetts General Laws, Chapter 44, section 55B requires the municipal treasurer to invest all public funds except those required to be kept liquid for purposes of immediate distribution. Modern banking systems enable the public treasurer to maintain even these funds in interest bearing form until the date a disbursement order clears through the banking system.

The state law further requires that invested funds are to be placed at the highest possible rate of interest reasonably available, taking account of safety, liquidity and yield. Therefore, these guidelines are intended to further these objectives.

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 through the mitigation of credit risk and interest rate risk. These risks shall be mitigated by the diversification and prudent selection of investment instruments and choice of depository. In addition, these risks are mitigated by depositing funds in financial institutions that are insured by federal and state insurance programs, by obtaining collateralization agreements for deposits, and by depositing funds only in institutions that receive strong scores from a bank safety rating service to which the Town subscribes. Credit risk is the risk of loss due to the failure of the security issuer or backer. Interest rate risk is the risk that the market value of the security will fall due to changes in general interest rates. Interest rate risk is limited by the provision of Massachusetts General Law restricting investment term to one year or less.

Liquidity is the next most important objective. The overall investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. Since all possible cash demands cannot be anticipated, the treasurer shall carry out investment activities in a manner that provides for meeting unusual cash demands without the liquidation of investments that could result in forfeiture of accrued interest earnings or loss of principal.

Yield is the third, and last, objective. Investments shall be undertaken so as to achieve a fair market average rate of return, taking into account safety and liquidity constraints as well as all legal requirements.

Where possible, and when in accordance with the Town's priorities of safety, liquidity and yield, funds may be invested for the betterment of the local economy or that of local entities within the State. Such local consideration may be based on the location of the institution or the institution's participation in community projects and programs.

C. Investment Instruments

The Treasurer may invest in the following instruments, as defined in MGL Chapter 44, section 55. Sequence in the list is according to risk level, with the state of Massachusetts pooled funds considered to have the least risk. A direct inverse relationship to yield is not implied intentionally and does not hold.

1. The Massachusetts Municipal Depository Trust (MMDT), an investment pool for state, local, county and other independent governmental authorities, is under the auspices of the State Treasurer. Unlimited amounts. It invests in Bankers Acceptances, Commercial Paper of high quality, Bank Certificates of Deposit, Repurchase agreements (Repos), and U. S. Treasury Obligations. It has Federal Deposit Insurance Corporation (F.D.I.C.) pass-through insurance on the Certificates of Deposit (C.D.s) and takes delivery on the Repos and Treasuries. Under Government Accounting Standards Board Regulation (GASB III), it is not a collateralized product.

2. U. S. Treasuries that will be held to maturity: Unlimited amounts (Up to one year maturity from date of purchase.)

3. U.S. Agency obligations that will be held to maturity. Unlimited amounts (Up to one year maturity from date of purchase.)

4. Bank accounts or Certificates of Deposit, which are fully collateralized through a third party agreement. : Unlimited amounts. (Up to one year) Public investments in Massachusetts are not protected through provisions in State law. Therefore, they are largely uncollateralized. Many banking institutions are willing to put up collateral, albeit at a cost to the entity of a lower interest rate. The Treasurer negotiates for the highest rates possible, consistent with safety principles.

5. Bank accounts and CDs fully insured by F.D.I.C. up to $250,000 and in some cases also Depository Insurance Fund of Massachusetts (D.I.F.M) up to $5,000,000 in a single institution as all bank accounts and CDs in one institution are considered in the aggregate to receive F.D.I.C. and D.I.F.M. insurance coverage. These limits are defined by the insurance thresholds. (Up to one year)

6. Unsecured bank deposits are any kind of deposits such as other checking, savings, money market, or Certificates of Deposit accounts at Banks that do not fit the above categories. These investments are subject to the following limitations: These investments will be limited to no more than 2% of an institution's assets and no more than 10% of a municipality's cash on hand. Their credit worthiness will be tracked by Veribanc, Sheshunoff, or other bank credit worthiness reporting systems. They will be diversified by maturity, financial institution and type (typically CDs or interest bearing money market accounts). These accounts will be reviewed frequently.

D. Diversification

Diversification should be interpreted in three ways: maturity date diversity to minimize interest rate risk and to match planned liquidity, instrument type diversity for planned liquidity, and issuer diversity to minimize credit risk and custodial credit risk. With the exception of U.S. Treasury obligations or investments fully collateralized by U.S. Treasuries or agencies, and State pools (MMDT), no more than 25% of the Town's investments shall be invested in a single financial institution.

E. Authorization

The Treasurer has authority to invest municipal funds, subject to the statutes of the Commonwealth cited above.

F. Ethics

The Town Treasurer (and any Assistant Treasurers) shall refrain from any personal activity that may conflict with the proper execution of the investment program or which could impair or appear to impair ability to make impartial investment decisions. Said individuals shall disclose to the Finance Director any material financial interest in financial institutions that do business with the town. They shall also disclose any large personal financial investment positions or loans that could be related to the performance of the town's investments.

G. Relationship with Financial Institutions

Financial institutions should be selected first and foremost with regard to safety. Amherst will subscribe to and use one of the recognized bank rating services. The Treasurer shall adhere to best business practices in selecting banking and broker services for the Town, including seeking requests for proposals, invitations to bid, and multiple quotes as required by MGL Chapter 30B., The Treasurer shall pursue the Town’s objective of minimizing costs while maximizing earnings, consistent with the considerations of safety, liquidity and yield. The Treasurer may use compensating balance agreements, as provided by MGL Chapter 44, Section 53F to procure banking services with reduced or no fees.

H. Reporting Requirements

The Treasurer shall meet all reporting requirements of the Massachusetts Department of Revenue, prudent reconciliations, internal controls, and external audit. This includes:

- A list of the individual accounts and individual securities held at the end of the reporting period.
- A list of the short-term investment portfolio by security type and maturity to ensure compliance with the diversification and maturity guidelines established in the "Diversification" section of this Investment Policy.
- A summary of the income earned on a monthly basis and year to date basis.
- The lists should demonstrate the degree of compliance with the tenets set forth in the Investment Policy.

Section II: Investment of Bond Proceeds, Trust Funds and Stabilization

A. Scope

This section of the policy applies to funds that could be invested long term, i.e., trust funds and stabilization funds, and proceeds from bonds issued by the Town.

B. Bond Proceeds

Funds resulting from the sale of notes or bonds by the Town of Amherst reside within the care of the Treasurer until spent in accordance with the authorizing article. Examples of reasons for which the Town issues notes include revenue anticipation and bond anticipation. Bonds, longer in term than notes, are typically issued for capital projects such as construction, major repair to town property or land acquisition.

The Treasurer will generally co-mingle bond proceeds with other operating funds within bank accounts and investments, unless unique duration of a project or rate disadvantages are expected. These funds are subject to arbitrage regulation, due to the Town's tax exempt status, which creates requirements for reporting of spending, spending schedules, and interest earnings (Appendix 1).

Although the range of options for investment of bond proceeds is wider than the options for general funds, the Treasurer will invest and monitor bond proceeds with the same priorities for safety, liquidity, and yield as described in Section I, using the same types of investment devices and terms. This conservative approach allows for liquidity in the event of errors in projected spending schedule of the project.

C. Trust Funds

Long term investment of trust funds is defined in MGL Chapter 44, Section 54, which adds those investment devices on the Legal List to the devices available to Treasurers in Section I. State law also provides for the use of a combined investment fund as described in Chapter 29, section 38A. These funds may be invested through a broker or advisor, consistent with the overruling principles of safety, liquidity, and yield as described in

Section I for short term operating funds. Each trust fund must be accounted for separately. The Legal List of Investments is available at the website: http://www.mass.gov/ocabr/business/banking-services/banking-legal-resources/laws-and-regs/list-of-legal-investments.html.

D. Stabilization Funds

The Stabilization Fund shall not exceed ten per cent of the equalized valuation of the Town, and any interest shall be added to and become a part of the fund, MGL Chapter 40, Section 5B. Like trust funds, the Treasurer may invest the Stabilization Fund in all devices described in section I, as well as those on the Legal List of Investments. Again, management through a broker or advisor is allowed when consistent with the overruling priorities of safety, liquidity, and yield.

E. Other Post Employment Benefits Trust Funds

The Town has accepted the provisions of MGL chapter 32B, Section 20 that allows the Town to establish an Other Post Employment Benefits (OPEB) Liability Trust Fund. OPEB funds will be managed in accordance with the “prudent person” rule, which allows a wider range of investment instruments, in accordance with the overarching principles of safety, liquidity, and yield. Interest shall be added to and become a part of the fund.

F. Health Claims Trust Funds

The authority to collect and invest funds in a Health Claims Trust Fund is provided by MGL Chapter 32B, Section 3A. The Treasurer shall be the custodian and may use banks, savings banks, federal savings and loans we well as securities available on the Legal List to invest funds not needed for the immediate needs of the Trust, in accordance with the overarching principles of safety, liquidity and yield. Interest shall be added to and become a part of the fund.

G. Broker Qualifications

Brokers working on behalf of the Town should be recognized, reputable dealers. The Treasurer shall require any brokerage houses and broker/dealers, wishing to do business with the municipality, to supply the following information to the Treasurer (custodial credit risk):

- Audited financial statements.
- Proof of National Association of Security Dealers certification.
- A statement that the dealer has read the municipality's investment policy and will comply with it.
- Proof of credit worthiness (minimum standards: at least five years in operation and a minimum capital of 10 million dollars).
- Proof of adequate insurance coverage.

Appendix 1: Arbitrage Regulations and Bond Proceeds Spending Schedules

Arbitrage Regulations

Tax free debt may be issued by cities, towns, and districts, which means that they are able to borrow at rates well below market rates. At the same time, the federal government has issued regulations to prevent them from issuing debt with the goal of investing the borrowed funds at a higher rate of interest than that at which the money was borrowed, or committing arbitrage. If the federal regulations are not followed, there are fines and penalties, but even worse, the tax free status of the debt could be jeopardized. Bond proceeds shall be used within certain prescribed time frames. Expenditures of and interest earned on borrowed funds will be recorded and monitored using an approved tracking system to prevent arbitrage, and to answer such questions as they arise.

Following, find the general rules and time frames for spending borrowed funds in order to avoid having to pay a rebate to the Federal government on investment income earned on the borrowed funds. All funds must be used according to the following schedules or sooner:

1. CONSTRUCTION DEBT

First six months: 10%
First year: 45%
Eighteen months: 75%
Two years: 100%

2. CAPITAL EXPENDITURES DEBT OTHER THAN CONSTRUCTION PROJECTS

First six months: 15%
First year: 60%
Eighteen months: 100%

3. ALL OTHER MUNICIPAL PURPOSE DEBT

   First six months: 100%

Appendix 2: Glossary

Accrued Interest:
The accumulated interest due on a bond as of the last interest payment made by the issuer.

Agency:
A debt security issued by a federal or federally sponsored agency. Federal agencies are backed by the full faith and credit of the U.S. Government. Federally sponsored agencies (FSAs) are backed by each particular agency with a market perception that there is an implicit government guarantee.

Arbitrage:
As applied to municipal debt, the investment of tax-exempt bonds or note proceeds in higher yielding, taxable securities. Section 103 of the Internal Revenue Service (IRS)

Code restricts this practice and requires (beyond certain limits) that earnings be rebated (paid) to the IRS.

Certificate of Deposit (CD):
A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs are typically negotiable as to maturity and yield.

Collateralization:
Value of securities pledged to a specific amount or investment as supplemental security to the credit of the issuer or the broker. Collateral can be of a specific nature and priced at par or market value.

Compensating balances:
A bank provides particular services in return for the municipality's maintaining a specified, minimum balance in a noninterest bearing account.

Consolidate:
A process by which cash, or any other item, is combined while maintaining the identity of each item. Consolidating several bank accounts into one account is always accomplished by a continuation of separate book balances for each fund on the government unit's ledger. Consolidation is a legal and efficient way to gain economies of scale in cash management. Also referred to as "pooling of funds".

Credit Risk:
The risk to an investor that an issuer will default in the payment of interest and/or principal on a security.

Custodial Credit Risk:
The risk that the Town's deposits may not be returned to it in full value in the event of bank failure. In the case of investments, it is the risk that the counterparty (e.g. broker-dealer) to a transaction may not be able to recover full value of the investment in the event of failure of another party.

Interest Rate Risk:
The risk that the market value of securities in the portfolio will fall due to changes in general interest rates.

Investment Pools:
In most states there are provisions for the creation and operation of a government investment pool. The purpose of the Pool is to allow political subdivisions to pool investable funds in order to achieve a potentially higher yield.

Liquidity:
Ease with which a financial instrument can be converted to cash quickly with minimal loss of principal.

Prudent Person Investment Rule:
This is a general principle of investing and managing described in detail in MGL Chapter 203C, sections 1-3, allowing the custodian or trustee to use "reasonable care, skill and caution" when considering terms of investments, diversification to form an investment strategy appropriate to the Trust. The custodian is charged to consider general economic and situational factors in combination with the safety, liquidity and yield needs of the fund. The custodian is charged to manage the fund "solely in the interests of the beneficiaries". The rule gives explicit consideration to evaluation of the custodian's decisions in the context of information available at the time the decision was made.

Repurchase Agreement:
A repurchase agreement (repos) is the sale by a bank or dealer of a government security with the simultaneous agreement to repurchase the security on a later date. Repos are commonly used by public entities to secure money market rates of interest.

Special Revenue Funds:
All segregated fund balances required to be in interest bearing accounts.

Stabilization Fund:
MGL, C. 40, sec. 5B. Cities, Towns and districts may appropriate in any year an amount not exceeding ten (10) percent of the amount raised in the preceding fiscal year by taxation. The aggregate amount in the fund at any time shall not exceed ten (10) percent of the equalized valuation of the city or town. Any interest shall be added to and become part of the fund; The Treasurer shall be the custodian of the fund. The stabilization fund may be appropriated in a town, at annual town meeting by a two-thirds vote or at a special town meeting by a two-thirds vote. Said fund may be appropriated for any lawful purpose.

Town Trust Funds:
Gifts and donations accepted by the Select Board of Amherst given to the Town through trust or in perpetuity agreements.

U.S. Government Agency Securities:
A variety of securities issued by several U.S. agencies. Some are issued on a discount basis and some are issued with coupons. Several have the full faith and credit guarantee of the U.S. government, although others do not.

U.S. Government Treasury Securities:
A non-interest bearing security issued by the U.S. Treasury to finance the national debt. Bills are issued in three-month, six-month, and one-year maturities. Notes are issued in 2, 3, 5, 10 or 30 year maturities.

Yield:
The rate of annual income returned on an investment, expressed as a percentage.