# Model Investment Policy + Guidance

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Vermont law provides that money received by a treasurer on behalf of the town may be invested and reinvested by the treasurer with the approval of the selectboard. 24 V.S.A. § 1571(b). While there are very specific investment requirements in 24 V.S.A. § 2432 that apply to trustees of public funds, there is nothing beyond the broad grant of authority in 24 V.S.A. § 1571(b) applicable to investments made by the treasurer and selectboard.

Given the amounts that could be invested by a town under 24 V.S.A. § 1571(b), it is imperative that the selectboard and treasurer adopt a policy to guide their investment decisions. The primary purpose of a town's investment policy should be to strike a balance between risk and return while following a conservative investment approach that preserves sufficient liquidity to allow the town to meet its cash flow needs. A well written policy will provide the guidelines, parameters, and procedures for investing the municipality's funds.

Consider the following when developing an investment policy:

**Scope.** The policy should identify which funds are subject to the policy. Normally, all funds of the government should be subject to the investment policy, except for trust assets, which are typically handled under a separate trust investment policy, and bond fund investments handled under a separate debt management policy. In addition, certain intergovernmental revenues contain restrictions on income earnings, so the policy would not apply to those funds either.

**Objectives.** The selectboard and treasurer should address the primary objectives of their investment program – safety, liquidity, yield – as well as a discussion of any goals for local investment.

- "Safety" refers to the preservation of capital and the protection of investment principle and should be the foremost objective of the investment policy. Safety risks include credit risk (the risk of loss due to the failure of the security) and

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interest rate risk (the risk that the market value of securities in the portfolio will fall due to changes in market interest rates).

- "Liquidity" refers to the ability of an investment to be converted into cash with minimal loss of principle or interest to insure that the investment portfolio will be able to meet all reasonably anticipated cash flow requirements.

- "Yield" is of less importance than safety or liquidity but is important, nonetheless, as interest earning on an investment is a significant source of additional income for a municipality. A balance must be struck between risk and yield, as lower risk securities generally have a lower yield. Diversification of investments and a routine comparison of the portfolio's performance with market indexes will address concerns over yield.

- Local investment may be an important objective for a municipality if the eligible financial institution demonstrates the intention of using the deposited funds to better the local economy or to invest in community development projects.

**Standard of Care.** The policy should provide a clear delineation of responsibilities for carrying out the investment activities of the municipality. The Government Finance Officers Association (GFOA) recommends using the "prudent person" rule of investment as the standard of care. This rule provides that investments should 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 derived.

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In addition, the policy should include a conflict of interest statement, directing those responsible for investing town funds to refrain from personal business activities that could conflict with the proper execution and management of the investment program.

**Authorized Institutions and Authorized Investments.** Public deposits should only be made in qualified public depositories as established by state law, and the policy should include guidelines as to the information that should be submitted by financial institutions. The municipality should also review the various investments that are permitted under state statutes and determine which investments are appropriate for their size and the type of portfolio they will have.

**Maturity and Diversification Guidelines.** Investment portfolios should be diversified to avoid an over-concentration of assets in any particular maturity, issuer, or class of securities. Maturity guidelines should reflect the cash flows of the municipality and the purposes of the investment. Shorter term investments provide readily available funds to meet expenditure requirements. The policy should limit the amount of funds that may be invested in any one issuer to avoid significant credit risk. Further, the policy should establish guidelines as to the diversification of investments by class of security.

**Collateralization.** Exposure to custodial credit risk – the risk that the municipality may not be able to recover its deposits in the event of the failure of the depository institution – can be minimized by collateralizing all deposits, and by having that collateral held in the name of the municipality with a third party bank or with the bank's trust department.

**Reporting.** The policy should specify the frequency and format of any reporting of the investment portfolio. The reports should be issued frequently enough to give an accurate picture of the funds that are available and should provide enough detail for the users to understand the transactions for the period and the status of the portfolio

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at the end of the period. The policy should also establish benchmarks to determine the performance of the fund. The benchmarks used should be based on similar investment objectives and risk tolerances of comparable municipalities.

For more information on municipal investment policies, please refer to ***Financial Policies: Design and Implementation***, published by the Government Finance Officers Association. A copy of this document can be purchased at www.gfoa.org(opens in a new tab).

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