



City of
Rockville
Get Into It

Statement of Investment Policy

Prepared by the Department of Finance

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I. POLICY

It is the policy of the City of Rockville (“the City”) to invest funds not required for immediate expenditure in a manner that conforms to all State of Maryland statutes governing the investment of public funds. The Investment Officer or an appropriate designee is authorized to invest such funds until the time they will be needed in such investments as are authorized in the guidelines delineated below. This Investment Policy represents the financial boundaries within which its cash and investment management process will operate.

II. SCOPE

This Investment Policy applies to all monies under the oversight of the City of Rockville that are accounted for in the following funds:

- 1) General Fund
- 2) Special Revenue Funds
- 3) Debt Service Funds
- 4) Capital Project Funds
- 5) Enterprise Funds

These funds are accounted for in the City’s Comprehensive Annual Financial Report (CAFR).

Assets held in trust and agency funds are exempt from the provisions of this policy. These assets consist of funds in the pension plan and deferred compensation plans. Pension plan assets are invested in compliance with State statutes and on the basis of direction provided by the City’s Retirement Board, as well as individual employee decisions about defined contribution amounts. Assets held in these plans are held in trust for the participants and are not assets of the City. The City does not have authority over the investments held in these trusts. The funds in the deferred compensation plans are invested in compliance with State statutes and individual employee decisions.

III. PRUDENCE

The standard of performance to be respected by the Investment Officer or designee with respect to investment of City funds shall be the “prudent person” rule which states, “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.” The prudent person rule shall be applied in the context of managing the overall portfolio.

The Investment Officer acting in accordance with written procedures and the investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security’s credit risk or market price changes, provided

deviations are reported in a timely fashion and appropriate action is taken to control adverse developments.

IV. INVESTMENT OBJECTIVES

The City's priorities for the investment and management of public funds are as follows:

- 1) Safety of principal: Investments of the City shall always be undertaken with a view toward ensuring that there will be preservation of the principal.
- 2) Liquidity: The maturity mix of the investment portfolio will be continuously monitored by the Investment Officer with a view toward reasonable estimation of the timing of the City's expenditure needs, so that sufficient liquidity is maintained to meet operating and capital requirements.
- 3) Return on investments: The City's investment program will be formulated with the objective of attaining a favorable rate of return throughout budgetary and economic cycles, taking into account the City's investment risk constraints established elsewhere in this policy.

V. DELEGATION OF AUTHORITY

The Mayor and Council of Rockville recognize that their authority to invest the public funds of the City derives from State Finance and Procurement Article § 6-222 of the Annotated Code of Maryland, as amended. Authority to invest City funds is delegated to the Investment Officer.

The Investment Officer means the Chief Financial Officer or other official of the City of Rockville who is responsible for the investment of public funds. The Investment Officer shall be responsible for all investment transactions undertaken by the City and shall have sole authority to buy and sell securities on behalf of the City. The Investment Officer may utilize qualified outside financial consultants or investment advisory firms to provide the necessary technical expertise, tools, and resources that are required to buy and sell securities. The Investment Officer is a fiduciary subject to the "prudent person" standard.

VI. DELINEATION OF EXPRESS STATE LAW REQUIREMENTS TO WHICH THE CITY HEREBY RESOLVES TO ADHERE

- 1) The City of Rockville will invest only in those types of securities described in State Finance and Procurement Article § 6-222(a) or Local Government Article §§ 17-301 through 17-309 of the Annotated Code of Maryland.
- 2) All investments made by the City will comply with the standards in State Finance and Procurement Article § 6-222(d) of the Annotated Code of Maryland.
- 3) The City is prohibited from borrowing money for the sole purpose of investment.
- 4) The City's Investment Officer is prohibited from investing public funds in a manner inconsistent with this adopted policy.

VII. AUTHORIZED FINANCIAL INSTITUTIONS AND ADVISORS

The Investment Officer shall maintain an approved list of qualified financial institutions that are authorized to provide financial or investment services to the City. Only primary government securities dealers (“primary dealers”) that regularly report to the Federal Reserve Bank of New York shall be included on the approved list.

The Mayor and Council may, at their discretion, accept, review, and approve applications from regional broker/dealers that meet the following criteria:

- 1) have been in business for at least five consecutive years;
- 2) have a net capital position of at least 2% of aggregate debit items as computed under Securities and Exchange Commission Rule 15C3-3;
- 3) are qualified under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule).
- 4) are registered to sell securities in the State of Maryland;
- 5) carry adequate insurance coverage including liability, errors and omissions, and workers’ compensation (if applicable);
- 6) are a member of FINRA.

Under certain circumstances, the Mayor and Council may approve a regional broker/dealer even if they do not meet all six requirements.

All broker/dealers who desire to provide investment services to the City will be provided with a copy of the City’s Investment Policy. Before an institution can provide investment services to the City, it must confirm that it has received and reviewed the Investment Policy and intends to comply with it.

At the request of the Investment Officer, broker/dealers must submit the following information to the City: copies of the firm's latest financial statements or SEC form 10-K; annual or quarterly reports or SEC form 10-Q; proof of Financial Industry Regulatory Authority (FINRA) certification and/or of state registration; and any additional information requested by the Investment Officer necessary in evaluating the qualifications of the institution.

The Investment Officer shall conduct reviews at least every five years of the financial condition and the registrations of all approved broker/dealers in order to determine whether they should remain on the approved list.

The City may choose to work with an external investment advisor in the review and/or selection of broker/dealers or in the purchase of investment instruments. If used, the selection of an investment advisor will be based on a competitive procurement process and will be re-solicited at least every five years.

All investment advisors shall verify that they have received a copy of this Investment Policy, and shall indicate that they have read and understand this policy and all applicable statutes related to City investments.

VIII. AUTHORIZED PUBLIC DEPOSITORIES

The Chief Financial Officer will select and maintain through a competitive process a list of authorized financial institutions to be used as depositories and/or custodians. To be considered for inclusion on this list the financial institution must have::

- 1) at least \$10 billion in total assets;
- 2) a core capital-to-total assets ratio of at least 8 percent, with at least 6 percent in tier 1 capital;
- 3) favorable statistical ratings from a nationally recognized rating service, as determined by the Investment Officer;
- 4) a federal or a state charter; and
- 5) a branch office within Montgomery County.

Under no circumstances shall the City's deposits in a financial institution exceed the total shareholder's equity of that institution.

IX. BOND PROCEEDS

The Investment Officer shall segregate the gross proceeds of tax-exempt bonds from the City's general pool and shall keep the proceeds in separate investment accounts. The proceeds shall be invested pursuant to the instructions in the respective bond indentures of trust. If the bond indenture authorizes investments that conflict with this Investment Policy, then such investments shall be made only with the Mayor and Council's prior approval. All securities shall be held in third-party safekeeping with the bond trustee ("Trustee") where applicable and all deliver-versus-payment (DVP) rules shall apply.

The City is required under the U.S. Tax Reform Act of 1986 to perform annual arbitrage calculations and to rebate excess earnings to the United States Treasury from the investment of the gross proceeds of tax-exempt bonds. The City may contract with qualified outside financial consultants to provide the necessary technical expertise that is required to comply with this law.

X. AUTHORIZED INVESTMENT INSTRUMENTS

The Investment Officer shall use competitive offerings, whenever practical, for all investment transactions. The Investment Officer may exercise discretion in investing City funds among the following instruments within the guidelines provided:

- 1) Any obligation for which the United States has pledged its full faith and credit for the payment of interest and principal;
- 2) Any obligation that a federal agency or a federal instrumentality has issued in accordance with an act of Congress;

- 3) Any Repurchase agreement collateralized in an amount not less than 102% of the principal amount by an obligation of the United States, its agencies or instrumentalities, provided the collateral is held by a custodian other than the seller designated by the City;
- 4) Any Bankers' Acceptances guaranteed by a financial institution with a short-term debt rating in the highest letter and numerical rating by at least one nationally recognized statistical rating organization as designated by either the United States Securities and Exchange Commission or the Treasurer;
- 5) Commercial Paper that has received the highest letter and numerical rating by at least two nationally recognized statistical rating organization as designated by the United States Securities and Exchange Commission, provided that such commercial paper may not exceed 10% of the total investments made by the Investment Officer;
- 6) Any Money Market Mutual Fund that contain only securities of the organizations listed in items 1, 2, and 3 above; are registered with the Securities and Exchange Commission under the Investment Company Act of 1940, 15 U.S.C. § 80a-1 et seq., as amended; are operated in accordance with rule 2A-7 of the Investment Company Act of 1940, 17 C.F.R. § 270.2A-7, as amended; and that has received the highest possible rating from at least one nationally recognized statistical rating organization as designated by the United States Securities and Exchange Commission;
- 7) Any investment portfolio created under the Maryland Local Government Investment Pool that is administered by the Office of the State Treasurer.
- 8) In addition to the investment instruments listed above, the Investment Officer may also deposit unexpended or surplus funds in any federally insured bank or savings and loan institution that is authorized under Section VIII of this Policy, to be invested in one or more certificates of deposit. Each certificate of deposit shall not exceed the applicable Federal Deposit Insurance Corporation maximum insurance coverage limit.

XI. DIVERSIFICATION

The City will diversify its portfolio by investment type and issuer. The portfolio shall be diversified to ensure reduction of overall portfolio risk. The portfolio will be limited to the following:

- 1) U.S. Obligations backed by full faith and credit - 100%
- 2) Federal Agency Obligations - 100% total, no more than 35% per Federal Agency issuer
- 3) Repurchase Agreements - 35% total
- 4) Bankers' Acceptance - 35% total
- 5) Commercial Paper (highest rating by at least two NRSROs) - 10% total

- 6) Money Market Mutual Fund (highest rating by at least one NRSRO) - 100%
- 7) Maryland LGIP - 100%

XII. MAXIMUM MATURITIES

The maximum allowable maturity horizon for any purchased security shall be five years from the date of purchase. To the extent possible, the City will attempt to match investment maturities with anticipated cash flow requirements. The Mayor and Council may approve longer maturities for the investment of bond reserve, bond escrow, and other funds if the maturities of such investments are expected to coincide with the expected use of the funds.

XIII. ETHICS AND CONFLICTS OF INTEREST

The Mayor and Council, Investment Officer, and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the City Manager any material financial interests in financial institutions that conduct business with this jurisdiction and they shall further disclose any large personal financial investment positions that could be related to the performance of the City's portfolio.

XIV. INTERNAL CONTROLS

The Chief Financial Officer shall be responsible for establishing a system of internal controls designed to prevent losses of public funds due to fraud, employee error, misrepresentation by third parties, conflict of interests, or imprudent actions by City employees. Accordingly, the Chief Financial Officer shall establish written procedures for the operation of the City's investment program that are consistent with the provisions of this Investment Policy.

Internal controls deemed most important shall include: avoidance of collusion; separation of duties and administrative controls; separating transaction authority from accounting and record keeping; custodial safekeeping; clear delegation of authority; management approval and review of investment transactions; specific limitations regarding securities losses and remedial action; written confirmation of telephone transactions; documentation of investment transactions and strategies; and monitoring of results.

Review of these controls shall be conducted as part of the annual City audit handled by an independent firm of auditors.

XV. COLLATERALIZATION

- 1) Collateral is required on three types of investments: Certificates of deposits, time deposits, and repurchase agreements. In order to mitigate market changes and provide additional level of security, the collateralization level will be at least 102% of market value of principal and accrued interest.

- 2) Collateral will always be held by a third party with whom the City has a current custodial agreement.
- 3) Acceptable collateral is that which is specified under State Finance and Procurement Article § 6-202 of the Annotated Code of Maryland.

XVI. SAFEKEEPING AND CUSTODY

All security transactions, including collateral for repurchase agreement, entered into by the City shall be conducted on a delivery versus payment basis. Securities will be held by a third party custodian approved by the Mayor and Council. All securities held by the custodian shall be in the City of Rockville's name and shall be evidenced by safekeeping receipts. All repurchase agreements will be governed by a Master Repurchase agreement. Broker/dealers shall send a monthly activity statement to the City showing all transactions entered into the period. No City securities or cash will be held by any broker/dealer.

XVII. COMPETITIVE PROCUREMENT

All financial institutions earning fees for assisting the City in choosing or executing investment transactions shall be selected on the basis of a competitive procurement process consistent with the Purchasing Section of the City Code.

XVIII. PERFORMANCE STANDARDS

For short-term and overnight funds invested, the general benchmark to be used by the Investment Officer to determine whether market yields are being achieved shall be the three-month Treasury bill rate. For longer-term, core portfolio, the benchmark to be used by the Investment Officer to compare total return shall be the ICE Bank of America Merrill Lynch 1-5 Year U.S. Treasury Index.

XIX. REPORTING REQUIREMENTS

Cash and Investment reports should be posted quarterly to the City's website for information purposes. This report should include information such as type of investments held, the issuers, maturity dates, par values, and market values of each component of the portfolio. The report should contain certification that all investment transactions have been made in accordance with the Investment Policy and that the City has sufficient liquidity to meet its expenditure obligations for the next six months. The Investment Officer shall maintain a complete record of all investment transactions.

XX. ADOPTION OF INVESTMENT POLICY

The Chief Financial Officer shall submit the investment policy to the Mayor and Council at least every five years for their review and adoption. This will allow the Investment Policy to be updated with legislative changes as well as to reflect best practices in municipal finance.

XXI. GLOSSARY OF TERMS

Attached hereto is a glossary defining some technical cash and investment terms to better facilitate an understanding of the Investment Policy.

Glossary of Cash and Investment Management Terms

ACCRUED INTEREST

Interest accumulated on a security since the issue date or the last coupon payment.

ASKED

The price at which securities are offered.

BANKERS'S ACCEPTANCE ("BA")

A draft, bill, or exchange accepted by a bank or a trust company. Both the issuer and the accepting institution guarantee payment of the bill.

BASIS POINT

A unit of measurement used in the valuation of fixed-income securities. One basis point is one hundredth of one percent of yield.

BID

The price offered by a buyer of securities (when you are selling securities, you ask for a bid). See "Offer".

BOOK VALUE

The value at which a security is carried in the financial records of an investor. The Book Value may differ significantly from the security's current value in the market. Book value is acquisition cost less amortization of premium or accretion of discount.

BROKER

A broker brings buyers and sellers together so that he can earn a commission.

CERTIFICATE OF DEPOSIT ("CD")

A time deposit with a specific maturity, as evidenced by a certificate. Large-denomination CDs are typically negotiable.

CERTIFICATE OF DEPOSIT ACCOUNT REGISTRY SERVICE ("CDARS")

A service that offers a deposit instrument that breaks up large deposits and places them across a network of banks and savings institutions around the United States. CDARS allows the City to deposit funds in a single bank, that then invests the funds in several certificates of deposit below the FDIC insurance limits. CDARS deposits are competitively bid among authorized providers.

COLLATERALIZATION

Process by which a borrower pledges securities, property, or other deposits for securing the repayment of a loan and/or security. Also refers to securities pledged by a bank to secure deposits of public monies.

COMMERCIAL PAPER

An unsecured short-term promissory note issued by corporations, with maturities ranging from 2 to 270 days.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (“CAFR”)

The official audited annual financial report for the City of Rockville.

COUPON

(a) The annual rate of interest that a bond’s issuer promises to pay the bondholder on the bond’s face value. (b) A certificate attached to a bond, that evidences interest due on a payment date.

CURRENT MATURITY

Amount of time left to maturity of an obligation. (For example, a one-year bill issued nine months ago has a current maturity of three months.)

DEALER

A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

DELIVERY VERSUS PAYMENT (DVP)

A type of securities transaction in which the purchaser pays for the securities when they are delivered either to the purchaser or the purchaser’s custodian.

DERIVATIVES

(1) Financial instruments that are linked to, or derived from, the movement of one or more underlying indexes or securities, and may include a leveraging factor; or (2) financial contracts based upon a notional amount whose value is derived from an underlying index or security (e.g., interest rates, foreign exchange rates, equities, or commodities).

DISCOUNT

The difference between the acquisition cost of a security and its value at maturity, when quoted at lower than face value. A security that sells below original offering price shortly after sale is also considered to be at a discount.

DISCOUNT SECURITIES

Non-interest bearing money market instruments that are issued a discount and that are redeemed at maturity for full face value (e.g., U.S. Treasury Bills).

DIVERSIFICATION

A process of investing assets among a range of security types by sector, maturity, and rating to eliminate portfolio risk.

FACE VALUE

The principal amount owed on a debt instrument. It is the amount on which interest is computed and represents the amount that the issuer promises to pay at maturity.

FEDERAL AGENCIES

Certain obligations of agencies or instrumentalities of the U.S. Government; may be backed only by the issuing agency or instrumentality and may not be backed by the full faith and credit of the U.S. Government. For example, securities issued by the Federal Home Loan Banks and the Freddie Mac are supported by the credit of the issuer, and not by the United States Government; and securities issued by the Federal Farm Credit System and Fannie Mae are supported by the agency's limited right to borrow money from the U.S. Treasury under certain circumstances.

FEDERAL DEPOSIT INSURANCE CORPORATION ("FDIC")

A federal agency that insures bank deposits, currently up to \$250,000 per deposit.

FEDERAL FUNDS RATE

The Fed Funds Rate is the overnight bank lending rate. This is one of the most influential interest rates in the U.S. economy, since it affects monetary and financial conditions.

FEDERAL RESERVE SYSTEM

The Federal Reserve, or simply known as "the Fed," is the central banking system of the United States that was created by Congress in 1913. The Fed manages the nation's money supply through monetary policy. The Fed is composed of presidentially appointed Board of Governors, the Federal Open Market Committee (FOMC), twelve regional Federal Reserve Banks located in major cities throughout the nation, numerous privately owned U.S. member banks, and various advisory councils.

LIQUIDITY

A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value.

LOCAL GOVERNMENT INVESTMENT POOL (LGIP)

An investment by local governments in which their money is pooled as a method for managing local funds.

MARKET VALUE

The current market price of a security.

MARK-TO-MARKET

The process whereby the book value or collateral value of a security is adjusted to reflect its current market value.

MASTER REPURCHASE AGREEMENT

A written contract covering all future transactions between the parties to repurchase-reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer (lender) to liquidate the underlying securities in the event of default by the seller (borrower).

MATURITY

The date upon which the principal or stated value of an investment becomes due and payable.

MONEY MARKET

The market in which short-term debt instruments (e.g., bills, commercial paper, banker's acceptances) are issued and traded.

OFFER

The price asked by a seller of securities (when you are buying securities, you ask for an offer). See "Asked" and "Bid".

PAR VALUE

The face value or principal value of a bond.

PORTFOLIO

A collection of securities held by an investor.

PRIMARY DEALER

A pre-approved bank, broker/dealer, or other financial institution that buys U.S. Treasury securities (T-bills, T-notes, and T-bonds) directly from the Federal government, with the intention of reselling them to others, thus acting as a market maker of government securities. These dealers must meet certain liquidity and quality requirements. In 2016, there were 23 registered primary dealers.

PRINCIPAL

The face value or par value of a debt instrument, or the amount of capital invested in a given security.

PRUDENT PERSON RULE

The standard of performance to be respected by the Investment Officer or designee with respect to investment of funds. 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.

QUALIFIED PUBLIC DEPOSITORIES

A financial institution that: (1) does not claim exemption from the payment of any sales, compensating use, or ad valorem taxes under the laws of this state; (2) has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability; and (3) has been approved by the Public Deposit Protection Commission to hold public deposits.

RATE OF RETURN

The yield obtainable on a security based on its purchase price or its current market price.

RATING

The designation used by investor services to rate the quality of a security's creditworthiness.

REPURCHASE AGREEMENT ("RP" OR "REPO")

An agreement of one party to purchase securities at a specified price to a second party and a simultaneous agreement of the first party to repurchase the securities at a specified price or at a specified later date.

SAFEKEEPING

A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in bank vaults for protection.

SECURITIES AND EXCHANGE COMMISSION (SEC)

Agency of the U.S. federal government that is primary responsibility for enforcing the federal securities laws; proposing securities rules; and regulating the securities industry, the nation's stock and options exchanges, and other activities and organizations, including the electronic securities markets.

STRUCTURED NOTES

Notes that have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) in their debt structure. The market performance of structured notes is affected by fluctuating interest rates; the volatility of imbedded options; and shifts in the yield curve.

TIER 1 CAPITAL

A measure of the capital adequacy of a bank and refers to core capital that includes equity capital: shares, unavailable balance sheet reserves, and shareholders retained earnings, accrued over the life of the bank. This measure is considered a measure of the financial strength of a bank because it is composed of core capital which represents the amount of capital that allows a bank to absorb losses without affecting interests of depositors.

TREASURY BILLS

A non-interest bearing discount security that is issued by the U.S. Treasury to finance the national debt. Most T-bills are issued to mature in three months, six months, or one year.

TREASURY BONDS

Long-term, coupon-bearing U.S. Treasury securities that are issued as direct obligations of the U.S. Government, with initial maturities of more than 10 years.

TREASURY NOTES

Medium-term, coupon-bearing U.S. Treasury securities that are issued as direct obligations of the U.S. Government, with initial maturities of two to 10 years.

UNDERWRITER

A dealer who purchases a new issue of municipal securities for resale.

WEIGHTED AVERAGE MATURITY (WAM)

The average maturity of all the securities that comprise a portfolio.

YIELD

The current rate of return on an investment security generally expressed as a percentage of the security's current price.

YIELD CURVE

A graphic representation that shows the relationship at a given point in time between yields and maturity for bonds that are identical in every way except maturity.