

FINANCIAL POLICY GUIDELINES

For

DAYTON, VIRGINIA

Adopted:

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FINANCIAL POLICY GUIDELINES

Dayton, Virginia

March 2019

GUIDELINES AND OBJECTIVES

These financial policies are a statement of the guidelines and goals that guide the financial management practices for the Town of Dayton (“Town”). A financial policy that is adopted, adhered to, and regularly reviewed is recognized as the cornerstone of sound fiscal management.

Effective fiscal policy:

- Contributes significantly to the Town's ability to insulate itself from recessions and other fiscal crises,
- Promotes long-term financial stability by establishing clear and consistent guidelines,
- Directs attention to the overall fiscal condition of the Town,
- Links long-term financial planning with day to day cash operations,
- Provides Town Council (“Council”) and citizens a framework for measuring the financial operations of the Town’s government services against established fiscal parameters and guidelines, and
- Creates financial transparency for citizens, taxpayers and other stakeholders.

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ACCOUNTING, AUDITING AND FINANCIAL REPORTING

1. The Town will establish and maintain a high standard of accounting practices.
2. The accounting system will provide procedures to ensure that records are maintained consistent with generally accepted accounting principles (GAAP) established by the Governmental Accounting Standards Board.
3. Regular monthly and annual financial reports are prepared to present a summary of financial activity by source and function, and by major fund types.
4. An independent public accounting firm will perform an annual audit in accordance with GAAP for all funds received or expended by the Town or any committee or department, thereof.

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OPERATING BUDGET

1. The Town Superintendent shall develop and submit to Council an annual budget. As part of this process, the Superintendent shall analyze and report on the Town's ability to meet the strategic initiatives established by Council. The Superintendent and Treasurer shall meet with the Finance Committee of Council at least ten working days in advance of the presentation to Council to review and prepare a recommendation for Council. The budget is to be presented to Council no later than April 30 each year. The budget hearing is to be scheduled to allow Council to consider approval of the budget no later than the June Council meeting each year.
2. The Town will pay for current expenditures with current revenues. The Town will avoid budgetary actions that balance current expenditures at the cost of meeting future years' expenses. Examples of such actions include postponing necessary capital maintenance expenditures to fund expenses for optional activities and using accrued future years' revenues to meet current year expenditures.
3. The budget will provide funding at the rate established by the Virginia Retirement System (VRS) for the retirement benefits provided by the Town, and the Town will reserve funds in the operating account to fund the liability of the self-funded short-term disability insurance program.
4. The Treasurer will prepare monthly financial reports comparing actual revenue and expenditures to budget and to the prior year actual for review by management. Quarterly reports will be reviewed by the Finance Committee with the Treasurer and Town Superintendent.
5. The Town will use one-time or other special revenues to finance one-time expenditures, special projects, or to build reserve accounts established by Council.

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REVENUES

1. The Town will work to maintain a diverse, stable revenue system to mitigate the adverse impact to operations from short-term fluctuations in any one revenue source.
2. The Town will use objective, analytical measures to prepare annual revenue projections.
3. The Town, through its Treasurer, will pursue an aggressive policy to collect delinquent taxes and fees due to the Town.
4. The Town will, as a part of its annual budget preparation process, reconcile the full cost of activities supported by user fees to determine the adequacy of the fees to cover costs.
5. The Town will periodically review fees and user charges for the water & sewer operation to maintain fees at a level to cover both the direct and indirect cost of the service. Indirect costs include annual depreciation and amortization of capital assets.
6. The Town will set fees for other user activities, such as Town events and other similar activities, and for the use of Town-owned facilities at a level based upon the services provided and the objectives of Council.
7. The Town will routinely identify and evaluate intergovernmental grant opportunities. In considering approval of such grants, Council should assess the merits of the program as if it were funded with local tax dollars. Likewise, local tax dollars are not intended to be used to offset the loss of grant funding without the Council first reviewing the merits of the program and the incremental impact of continuing the program on the operations budget.

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DEBT

1. The Town will adopt a balanced approach to capital funding using current-year revenues, capital reserves and debt financing.
2. The Town will use long-term borrowing only for capital improvement projects and will take every option available to prevent the use of short-term borrowing to fund current operations.
3. The Town will match the repayment schedule (debt service) for bonds with a period not to exceed the expected useful life of the project.
4. The Town may evaluate the use of special assessment bonds, revenue bonds, or other similar financing tools, rather than general obligation bonds, when the benefit from a project is readily assignable to a specific area or function,
5. From time to time, the Town may engage the services of an independent financial advisor to assist Council in its evaluation.

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RESERVE ACCOUNTS

1. Council establishes an emergency reserve to offset costs related to unforeseen emergencies, including unanticipated expenditures of a nonrecurring nature, or to meet unexpected small increases in service delivery costs. This reserve shall be maintained at not less than one percent (1%) of current year's budgeted General Fund and Water & Sewer Fund expenditures. No funds may be expended from this reserve without the express approval of Council and the appropriation of the funds.
2. The total unassigned fund balance in the General and Water & Sewer Funds at the close of each fiscal year shall equal \$2,400,000 or 6-months General Fund operating expenditures and funding to meet the annual HRRSA obligation of the Town in the most recently completed year, whichever is greater.
3. Council may, from time-to-time, to meet a critical need caused as the result of a declared emergency or other significant catastrophic event, authorize the use of a portion of the unassigned fund balance reserve which results in reducing the unassigned fund balance below the level established in the previous paragraph. In such circumstances, the Town Superintendent shall, within two (2) months of approval by Council to use the funds, prepare a plan to restore the unassigned fund balance reserve to the required level in no more than thirty-six (36) months.
4. In recognition of the incremental costs of capital improvements and their future maintenance and replacement costs, Council may establish a capital improvement designated reserve. The level of transfer to the reserve will be determined annually as part of the Town's annual budget process.
5. The Town will maintain self-insurance reserves at such level as established by reasonable judgment based upon funding techniques utilized and historical loss information.

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INVESTMENT POLICY

1. The purpose of this statement is to establish guidelines for the safeguarding and efficient management of Town funds, and for the purchase and sale of investment instruments. The goal is to minimize risk and to ensure the availability of cash to meet the Town's expenditures, while generating revenue from the use of funds, which might otherwise remain idle.
2. All investments shall comply with the Code of Virginia Sections §2.2-4400 et seq. and §2.2-4500 et seq. (the Virginia Security for Public Deposits Act and the Virginia Investments Act).
3. The cash management and investment activities of the Town is to be conducted in a manner which is consistent with prevailing prudent business practices, and other public organizations of similar size and financial resources.
4. The primary objectives of the Town's investment activities, in priority order, are: safety, liquidity, and yield.
 - **Safety of Principal-** Safety of principal is the foremost objective of the investment of public funds. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio.
 - **Maintenance of Liquidity-** The investment portfolio will remain sufficiently liquid to enable the Treasurer to meet the operating needs of the Town, which might be reasonably anticipated.
 - **Maximizing Return-** The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles. This objective shall consider constraints as to acceptable risk and the characteristics of the Town's cash flow.

5. Investment Committee

Council shall establish an Investment Committee comprised of the Town Superintendent, the Treasurer, and the members of Council's Finance Committee. The Treasurer is designated as the investment officer, whose responsibility is to manage the funds within the parameters set by the Investment Committee. The Committee, with approval of Council, may select an Investment Manager(s) to manage the day-to-day operations of the investment portfolio and place actual purchase/sell orders with brokers. The Committee shall meet at least semi-annually with the Town's Investment Manager(s) to review performance and provide recommendations to Council on revisions to the investment policy.

6. Prudence Standards

The standard of prudence applied by Investment Managers in Town transactions shall be the “Prudent Investor” rule; which states “investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercised 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 investor rule shall be applied in the context of managing the overall portfolio.

When investments are made in accordance with Title 2.2, chapter 45, neither the Treasurer, the Town Superintendent, nor any other Town official shall be liable for any loss therefrom in the absence of negligence, malfeasance, misfeasance, or nonfeasance on his part or on the part of his assistants or employees. Further, the Treasurer, the Town Superintendent, or other Town official shall not be held liable for any loss of public money deposited as provided by Title 2.2, chapter 44 or Title 58.1, chapter 31, article 2, due to the default, failure or insolvency of a depository.

7. Authorized Investments

Town funds may be invested in the following securities in compliance with the Code of Virginia. Council, upon recommendation of the Investment Committee may impose additional requirements and restrictions to ensure that the Town’s primary goals are met. Permitted Investments include:

- a. **U.S. Treasury Obligations.** Bills, notes and any other obligation or security issued by or backed by the full faith and credit of the United States Treasury, as described by Code of Virginia §2.2-4501.
- b. **Federal Agency Obligations.** Bonds, notes and other obligations of the United States, and securities issued by any federal government agency or instrumentality or government sponsored enterprise as described by Code of Virginia §2.2-4501.
- c. **Municipal Obligations.** Bonds, notes and other general obligations of a state or municipal government and its agencies, authorities, and political subdivisions upon which there is no default and otherwise meets the requirements of Code of Virginia §2.2-4501.
- d. **Negotiable Certificates of Deposit and Bank Deposit Notes.** Negotiable certificates of deposit and negotiable bank deposit notes of domestic banks and domestic offices of foreign banks and otherwise meeting the requirements of Code of Virginia §2.2-4509.
- e. **Money Market Mutual Funds (Open-Ended Investment Funds).** Shares in open-end, no-load investment funds provided such funds are registered under the Securities Act (section 13.1-501 et seq.) or the Federal Investment Act of 1940. The mutual fund must comply with the diversification, quality and maturity requirements of Rule 2(a)-7, or any successor rule, of the United States Securities and Exchange Commission, provided the investments by such funds are restricted to investments otherwise permitted by the Code of Virginia for political subdivisions as described in Code of Virginia §2.2-4500 et seq.
- f. **Pools.** Pooled investment programs provided that the underlying investments by such funds are restricted to investments otherwise permitted by the Code of Virginia for political sub-divisions, as described by Code of Virginia §2.2-4513.1, §2.2-4600 et seq.,

and §2.2-4700 et seq. The Town can invest in two different types of Pools:

1. Principal Stability Pools that operate in compliance with the Government Accounting Standards Board's Statement 79 ("GASB 79"), which maintain a weighted average maturity of less than 60 days and whose primary objective is to maintain a stable net asset value; and
 2. Short-Term Bond Pools that may have a longer average maturity than principal stability pools and a fluctuating net asset value. Short-Term Bond Pools are designed to generate a higher rate of return than Principal Stability Pools.
- g. **Bank Deposits and Non-Negotiable Certificates of Deposit.** Demand deposits, time deposits, and other deposits that comply with all aspects of the Virginia Security for Public Deposits Act, sections §2.2-4400 et seq., and with Code of Virginia §2.2-4518.

8. Investment Parameters

Mitigating Credit Risk in the Portfolio

Credit risk is the risk that a security or a portfolio will lose some or all its value due to a real or perceived change in the ability of the issuer to repay its debt. It is the policy of the Town to diversify its investment portfolios to minimize risk of loss resulting from the over-concentration of assets in a specific maturity, issuer, or class of securities.

Mitigating Market Risk in the Portfolio

Market risk is the risk that the portfolio value will fluctuate due to changes in the general level of interest rates. The Town recognizes that, over time, longer-term/core portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The Town desires to mitigate market risk by providing adequate liquidity for short-term cash needs, and by making longer-term investments only with funds that are not needed for current cash flow purposes. The Town further recognizes that certain types of securities, including variable rate securities, securities with principal pay downs prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments.

Maturity scheduling shall be laddered according to anticipated need. Investment maturities for operating funds shall be scheduled to coincide with projected cash flow needs, considering large routine expenditures as well as cash flow from anticipated revenue. Investment of capital project funds are to be timed to meet project needs and contractor payments.

Maximum Maturity

Maintaining adequate liquidity to meet the Town's cash flow needs is essential. Accordingly, to the extent possible, the Investment Portfolio shall be structured to ensure sufficient cash is available to meet anticipated liquidity needs. The selection of investment maturities shall be consistent with the cash requirements of the Town to minimize the forced sale of securities prior to maturity.

Investments are limited to a maximum maturity of five (5) years from the transaction settlement date (except for Agency Mortgage-Backed Securities (“MBS”) which must have a weighted average life (“WAL”) of no more than five (5) years). To manage the volatility of the Investment Portfolio, the Investment Committee shall determine an appropriate duration or weighted average maturity (“WAM”) target for each component of the Investment Portfolio. At no time shall the duration or WAM of any component of the Investment Portfolio exceed three (3) years.

The average duration of the investment portfolio will not deviate by more than +/- 25% of the average duration of the performance benchmark.

Debt service reserve funds associated with revenue bond issues may be invested in securities exceeding five (5) years, if the maturity of such investment is made to coincide as nearly as practical with the expected use of funds.

Diversification Parameters

The following diversification parameters have been established and will be reviewed annually by the Investment Committee with the Investment Manager. The Committee may choose to implement limitations that are more restrictive than these parameters if it deems it prudent to do so. The diversification parameters will be applied across the Town’s investments. The investment portfolios shall be diversified by security type and institution. The maximum percentage of the portfolio permitted in each eligible security is as follows:

Permitted Investment	Sector Limit	Issuer Limit³	Ratings Requirement^{1,2}	Max Maturity⁴
U.S. Treasury Obligations	100%	100%	N/A	
Federal Agency Obligations	100%	35%	AA or equivalent by at least two NRSROs, one of which will be either Moody’s or S&P	5 Years
Negotiable Certificates of Deposit and Bank Deposit Notes	100%	10% ³	A-1 (S&P) & P-1 (Moody’s) if maturity of one year or less; AA (S&P) and Aa (Moody’s) if greater than one year to five year maturity	1 to 5 Years
Money Market Mutual Funds	100%	50%	AAAm or equivalent by at least two of the following: Moody’s, S&P, Fitch, or	N/A
Principle Stability Pools	100%	100%	AAAm or equivalent by an NRSRO	N/A
Short-term Bond Pools	100%	100%	AAf or equivalent by an NRSRO	3 Years
Bank Deposits and Non-Negotiable Certificates of Deposit	100%	100%	Collateralized in accordance with the Virginia Security for Public Deposits Act	N/A

1. *Ratings by Nationally Recognized Statistical Rating Organizations (NRSRO) as designated by the SEC*
2. *At time of purchase*
3. *Negotiable certificates of deposit limited to \$250,000 per institution for FDIC coverage.*
4. *From transaction settlement date*

When investing in a Pool, the Town shall limit its investment to no more than ten (10) percent of the total assets of the Pool.

9. Investment of Bond Proceeds

The Town intends to comply with all applicable sections of the Internal Revenue Code as it related to Arbitrage Rebate and the investment of bond proceeds. All investment records will be maintained to ensure compliance with all regulations. All bond proceeds will be invested in accordance with applicable bond resolutions.

10. Collateralization of Bank Deposits

All bank deposits of the Town should be considered Public Deposits as defined by Code of Virginia Security for Public Deposits Act (Section 2.2-4400 et seq.) and all deposits must be made with Qualified Public Depositories.

11. Engagement of Investment Managers

The Town may contract with one or more qualified firms to provide investment management services. All investment management firms who desire to provide investment services for the Town will be provided with a current copy of the Investment Policy. Before an organization can provide investment services for the Town, it must confirm in writing that it has received and reviewed the Investment Policy.

Only firms meeting the following requirements will be eligible to serve as investment manager for the Town:

- a. Registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940;
- b. Must provide the Town an annual updated copy of Form ADV, Part II;
- c. Must be registered to conduct business in the Commonwealth of Virginia; and
- d. Must have proven experience in providing investment management services under Code of Virginia §2.2-4500 et seq.

Any firm engaged by the Town to provide investment services shall:

- a. Maintain a list of approved security brokers/dealers selected by creditworthiness who are authorized to provide investment services in the Commonwealth of Virginia;
- b. Provide monthly reports of transactions and holdings to the Treasurer;
- c. Provide semi-annual performance reports that display investment performance in comparison to appropriate investment benchmarks, and which show that the manager has performed due diligence when purchasing securities to ensure competitive pricing is used to obtain the security; and
- d. Not collect any soft dollar fees from any broker/dealer or other financial firm in relation to services provided to the Town.

12. Safekeeping and Custody

All investment securities purchased by the Town or held as collateral on deposits or investments shall be held by the Town or by a third-party custodial agent that may not otherwise be counterparty to the investment transaction.

All securities in the Investment Portfolio will be held in the name of the Town and will be free and clear of any lien. Further, all investment transactions will be conducted on a delivery-vs-payment basis. The custodial agent shall issue a safekeeping receipt to the Town listing the specific instrument, rate, maturity, and other pertinent information. On a monthly basis, the custodial agent will provide reports that list all securities held for the Town, the book value of holdings, and the market value as of month-end.

The officials and representatives of the custodial agent responsible for, or in any manner involved with, the safekeeping and custody process of the Town shall be bonded in such a manner as to protect the Town from losses from malfeasance and misfeasance.

Original copies of non-negotiable certificates of deposit and confirming copies of all other investment transactions must be delivered to the Town or its custodial agent.

13. Reporting

The Investment Committee will review an investment report on at least a semi-annual basis provided by external investment managers. This report will provide an analysis of the current investment portfolio and the individual transactions executed over the last period. This report will allow the Committee to ascertain whether investment activities during the reporting period have conformed to the Investment Policy.

The report will include, at a minimum, the following:

- a. An asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer, and interest rate
- b. Average maturity of the portfolio and effective duration of the portfolio
- c. Maturity distribution of the portfolio
- d. Average portfolio credit quality
- e. Distribution by type of investment
- f. Performance relative to established benchmarks

Financial statement presentation of investments, accrual of interest, and amortization of premiums and accretion of discounts shall be according to generally accepted accounting principles as applied to municipalities. Those principals shall be as determined by the Virginia Auditor of Public Accounts, the AICPA, and its designated units, the Financial Accounting Standards Board and the Governmental Accounting Standards Board.

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CAPITAL IMPROVEMENT BUDGET

1. The Town shall develop a five-year plan for capital improvements, and the Council should review and update the plan annually.
2. The Town shall include as part of its annual budget process an annual capital budget based on the five-year capital improvement plan. In evaluating capital projects Council should consider projections used to develop the capital budget such as expected changes in population, real estate development, economic activity, and other factors.
3. Intergovernmental grants and loans should be used to finance capital improvements consistent with the capital improvement plan and Town priorities. Council should consider any grant requirements prior to applying for or accepting such grant or loan. The Town Superintendent should review operating and maintenance costs for such improvements and ensure that such costs are included in operating budget forecasts.
4. Council shall take all prudent steps to maintain its assets at a level adequate to protect the Town's capital investment, and to minimize future maintenance and replacement costs.
5. Council shall review estimated costs and potential funding sources for each capital project prior to approval. Included in this review should be the anticipated impact to operational budgets.
6. The Town Superintendent shall analyze and present to the Council financing alternatives with a project recommendation.

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WATER AND SEWER FUND

1. Council's goal is to establish a sound financial budget policy to protect the Town from changes in the economic environment. The Town receives over 80% of its water and sewer revenue from one large industrial consumer.
2. To protect the Town from an unplanned event causing a decrease in the revenue provided from the large user, the Town establishes the following fund reserve policies:
 - a. Working Capital of the Water & Sewer Fund shall be sufficient to meet the reserve requirements established in these policy guidelines. Working Capital is defined as current assets less current liabilities. Operating expenses includes depreciation expense.
 - b. The Town establishes a minimum of 4% of the budgeted water/sewer revenue as a cash reserve; provided however, the Town may use the cash to fund a capital project if the minimum cash reserve balance listed early in these policy guidelines is established.
 - c. Monthly water and sewer usage fees should be reviewed annually and adjusted by Council to ensure that operating revenue at a minimum offsets operating expense (including depreciation). Revenue collected from connection fees shall be used to fund capital projects, debt service or cash reserves.
3. Council may from time to time decide to borrow from the reserves below the minimum threshold to fund a special/critical project. If this action is taken, the Town Superintendent shall recommend a plan to restore the reserves to the minimum balance, set forth above, within the following three fiscal years.

FINANCIAL POLICY GUIDELINES
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ADOPTION AND ANNUAL REVIEW

1. The Town's fiscal policies were adopted by resolution of Council on _____, 2019. After release of the Town's annual financial report, the Finance Committee should review these policies with the Town Superintendent and Treasurer for compliance.
2. These fiscal policies shall remain in effect until such time as they are amended or repealed by the Town Council.

