

INVESTMENT POLICY

1.0 Policy:

This investment policy is intended to outline the guidelines and practices to be used in effectively managing West Basin Municipal Water District (District's) available cash and investment portfolio. District monies not required for immediate cash requirements will be invested in compliance with the California Government Code Section 53600, *et seq.*

2.0 Scope:

This policy applies to the investment of the District fund accounted for in the annual budget. Funds of the District will be invested in compliance with the provisions of, but not necessarily limited to the California Government Code Section 53601 *et seq.* and other applicable statutes. Investments will be in accordance with these policies and written administrative procedures. Investment of bond proceeds shall be subject to the conditions and restrictions of bond documents and are not governed by this policy.

3.0 Prudence:

The Board of Directors and Treasurer adhere to the guidance provided by the "prudent investor rule," California Government Code Section 53600.3, which obligates a fiduciary to ensure that "when investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law."

4.0 Objectives:

In accordance with California Government Code Section 53600.5, and in order of importance, the Treasurer shall adhere to the following three criteria:

- (a) Safety of Principal – Investments shall be undertaken which first seek to ensure the preservation of principal in the portfolio. The Treasurer shall ensure each investment transaction is evaluated or cause to have evaluated each potential investment, seeking both quality in issuer and in underlying security or collateral, and shall diversify the portfolio to reduce exposure to loss. Diversification of the portfolio will be used in order to reduce exposure to principal loss.
- (b) Liquidity – Investments shall be made whose maturity date is compatible with cash flow requirements and which will permit easy and rapid conversion into cash without substantial loss of value.
- (c) Return on Investment – Investments shall be undertaken to produce an acceptable rate of return after first considering safety of principal and liquidity and the prudent investor standard.

5.0 Delegation of Authority:

The authority to invest public funds is expressly delegated to the Board of Directors. The Board re-delegates the investment function to an appointed Treasurer and Deputy Treasurer. The appointed Treasurer may be a board member or staff member and the Deputy Treasurer shall be a District staff member.

The investment of the District's monies is annually delegated by the Board of Directors to an appointed Treasurer and Deputy Treasurer (District Finance staff) who shall thereafter assume full responsibility for those transactions until the delegation is revoked or expires. The appointed Treasurer shall delegate the

day-to-day operations of investing to the Deputy Treasurer, but not the responsibility for the overall investment program. All transactions will be reviewed by the appointed Treasurer on a monthly basis to assure compliance with the Investment Policy. (California Government Code Section 53607.)

6.0 Investment Procedures:

The Treasurer and Deputy Treasurer shall establish written operational procedures pertaining to the investment of District funds. These procedures shall be compliant with the parameters and limits set forth by this investment policy. The procedures should regulate actions regarding: safekeeping, PSA repurchase agreements, wire transfer agreements, banking service contracts, and collateral/depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Treasurer and Deputy Treasurer.

7.0 Ethics and Conflicts of Interest:

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business to the Treasurer and Deputy Treasurer. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the District

8.0 Authorized Financial Dealers and Institutions:

For brokers/dealers of government securities and other investments, the Treasurer shall select only brokers/dealers who are licensed and in good standing with the California Department of Securities, the Securities and Exchange Commission, the National Association of Securities Dealers or other applicable self-regulatory organizations. Before engaging in investment transactions with a broker/dealer, the Treasurer shall obtain a signed verification form that attests the individual has reviewed the District's Investment Policy, and intends to present only those investment recommendations and transactions to the District that is appropriate under the terms and conditions of the Investment Policy.

The Board of Directors may engage the services of one or more external managers to assist in the management of the District's investment portfolio. Such external managers may be granted discretion to purchase and sell investment securities in accordance with this Investment Policy. Such managers must be registered under the Investment Advisers Act of 1940.

9.0 Authorized and Suitable Investments:

The District is governed by the California Government Code, Sections 53600, *et seq.* Within the context of these limitations, the investments listed below are authorized. Those investments not identified in Section 5 are considered to be ineligible. Credit criteria and maximum percentages listed in this section are calculated at the time the security is purchased.

- (a) Time Deposits – The Treasurer may invest in certificates of deposit issued by bank or savings and loans chartered by the United States or California. The maximum term for time deposits or bank certificates of deposit shall be one year. The combined amount invested in time certificates of deposit and negotiable certificates of

deposit shall not exceed 30% of the portfolio. Time certificates of deposit shall meet the conditions in either paragraph (1) or paragraph (2):

- (1) Time certificates of deposit shall meet the requirements for deposit under Government Code Section 53635 et. seq. The Treasurer, for deposits up to \$100,000, may waive collateral requirements if the institution insures its deposits with the Federal Deposit Insurance Corporation (FDIC).
 - (2) Fully insured time certificates of deposit placed through a deposit placement service shall meet the requirements under Government Code Section 53601.8.
- (b) Local Agency Investment Fund (“LAIF”) Deposits – Deposits for the purpose of investment in the Local Agency Investment Fund of the State Treasury may be made up to the maximum amount permitted by State Treasury policy.
- (c) Negotiable Certificates of Deposit – The Treasurer may invest in negotiable certificates of deposit as follows:
- (1) To be eligible, a certificate of deposit must be issued by a nationally, or California-chartered bank, a California savings association or a federal association (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a California licensed branch of a foreign bank. (Government Code Sections 53601(h).)
 - (2) Eligibility for deposits shall be limited to those financial institutions which maintain a rating equivalent to “A” or higher by one of the nationally recognized statistical rating organizations (NRSRO).

- (3) The amount invested shall be subject to the capital limitations of Government Code Section 53638.
 - (4) The combined amount invested in time certificates of deposit and negotiable certificates of deposit shall not exceed 30% of the total portfolio.
 - (5) The maximum maturity shall be limited to one (1) year.
- (d) Bankers' Acceptances – The Treasurer may invest in bankers' acceptances as follows:
- (1) Investment in a prime banker's acceptance shall not exceed 15% of the portfolio in effect immediately after any such investment is made.
 - (2) Eligibility shall be limited to those securities issued by domestic or foreign banks, which are eligible for purchase by the Federal Reserve System, the short-term paper of which is rated in the highest category by one or more of the NRSRO.
 - (3) No more than 15% of this category of investments may be invested in any one commercial bank's acceptances.
 - (4) The maximum maturity shall be limited to 180 days. (Government Code Sections 53601(f).)
- (e) Commercial Paper – The Treasurer may invest in commercial paper as follows:
- (1) Only commercial paper of prime quality of the highest ranking or of the highest letter and numerical rating as provided for by a NRSRO. (Government Code Sections 53601(g).)
 - (2) Eligible paper is further limited to issuing corporations that are organized and operating within the United States as a general corporation and having total assets in excess of \$500,000,000.

- (3) Eligible issuer's debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.
 - (4) Investments in commercial paper shall not exceed 25% of the portfolio.
 - (5) No more than 10% of the outstanding commercial paper of an issuing corporation may be purchased.
 - (6) The term shall not exceed 270 days.
- (f) United States Treasuries.
- The Treasurer may invest in United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the full faith and credit of the United States are pledged for the payment of principal and interest. (Government Code 53601 (b)).
- (g) Federal Agencies.
- The Treasurer may invest in Federal agency or United States government-sponsored enterprise obligations, participations, or other instruments, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises. (Government Code 53601 (e)).
- (1) Additionally the Treasurer may invest in FDIC-guaranteed corporate debt issued under the Temporary Liquidity Guarantee Program (TLGP) and backed by the full faith and credit of the United States Government with a maximum final maturity of five years or for the length of the TLGP guarantee.
- (h) Money Market Funds.
- The Treasurer may invest in shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission under the

Investment Company Act of 1940 (Government Code Section 53601(k).)

The following criteria will be used in evaluating companies:

- (1) Attain the highest ranking letter and numerical rating provided by not less than two nationally recognized rating services; or
- (2) Have an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five (5) years' experience managing money market mutual funds and with assets under management in excess of \$500,000,000.
- (3) The maximum purchase price of shares shall not exceed 20% of the portfolio.

(i) California Municipal Obligations

- (1) Bonds issued by the local agency, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency or by a department, board, agency, or authority of the local agency.
- (2) Bonds, notes, warrants, or other evidences of indebtedness of any local agency within this state, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.

- (3) For obligations without a fixed rate of interest, these obligations must have an unconditional demand feature, guarantee or put within the maximum maturity limitations
- (4) Eligibility shall be limited to those obligations that maintain a rating of Aa3/AA- for the long term and P1/A-1 for the short-term, if any, by the Nationally Recognized Statistical Rating Organizations (NRSRO)
- (5) Any bonds, notes, warrants, or other evidences of indebtedness of the District:
 - (i) District obligations that maintain short-term ratings will be tendered to the trustee for cancellation no later than the 5th anniversary of their purchase.

10.0 Prohibited Investments:

Under the provisions of California Government Code Sections 53601.6 and 53631.5, the District shall not invest any funds covered by this Investment Policy in inverse floaters, range notes, mortgage-derived, interest-only strips or any investment that may result in a zero interest accrual if held to maturity.

11.0 Investment Pools/Mutual Funds Due Diligence:

A thorough investigation of any investment pool or mutual fund is required prior to investing, and on a continual basis. The Treasurer or a staff member delegated by the Treasurer will complete a standard questionnaire that addresses the following issues to determine the safety and appropriateness of a prospective investment pool or mutual fund:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how it is distributed, and how gains and losses are treated.
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.
- A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings.
- A description of how reserves, retained earnings, etc. are utilized by the pool or fund
- A fee schedule, and when and how is it assessed.

12.0 Collateralization:

Collateralization is required on Certificates of Deposit as per California Government Code section 53601. The collateralization level for certificates of deposit is 100% of market value of principal and accrued interest.

The entity chooses to limit collateral to the following: U.S. Treasuries and Federal Agency Obligations. Collateral will always be held by an independent third party with whom the entity has a current custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the entity and retained. The right of collateral substitution is granted.

13.0 Safekeeping and Custody:

All securities purchased may be delivered versus payment (“DVP”) basis, and held in safekeeping pursuant to a safekeeping agreement.

14.0 Diversification:

The District's investments shall be diversified by:

- Limiting investments to avoid over concentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities).
- Limiting investment in securities that have higher credit risks.
- Investing in securities with varying maturities.
- Continuously investing a portion of the portfolio in readily available funds such as money market funds to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

15.0 Maximum Maturities:

To the extent possible, the District will attempt to match its investments with anticipated cash flow requirements. For certain instruments, the term of the investment is limited by market convention or as otherwise prescribed herein. No investments may be acquired that exceed five (5) years.

16.0 Investment Transactions:

Information concerning investment opportunities and market developments will be gained by maintaining contact with the financial community. Confirmations of all investment transactions will be maintained by the Finance Department for the annual audit. When practical, the Treasurer shall solicit more than one quotation on each trade

17.0 Exchange of Securities:

An exchange of securities is a shift of assets from one instrument to another and may be done for a variety of reasons, such as to increase yield, lengthen or shorten maturities, to take a profit, or to increase investment quality. In no instance shall an exchange be used for speculative purposes. Any such exchange shall be simultaneous (same day execution of sale and purchase), and

shall require the approval of the Treasurer.

18.0 Internal Control:

The Treasurer shall establish an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures. The Treasurer may, at any time, further restrict the securities approved for investment as deemed appropriate.

19.0 Performance Standards:

The District's portfolio is managed with the objective of obtaining a market rate of return, commensurate with identified risk constraints and cash flow characteristics. Because the composition of the portfolio fluctuates, depending on market and credit conditions, various appropriate indices selected by the Treasurer will be used to monitor performance.

20.0 Reporting:

In accordance with Government Code Section 53607, the Treasurer shall submit a monthly report to the Executive Secretary of the Board of Directors via the General Manager indicating the types of investment by fund, institution, date of maturity, and amount of deposit, and shall provide the current market value of all securities with a maturity of more than twelve (12) months, rates of interest, and expected yield to maturity.

The Treasurer shall also submit a monthly summary report to the Board of Directors via the General Manager showing investment activity and the status of cash by depository.

21.0 Investment Policy Adoption:

The Treasurer may, at any time, further restrict the securities approved for investment as deemed appropriate. This policy shall be reviewed at least annually by the Board of Directors.

Additionally, the Treasurer shall annually send a copy of the current Investment Policy to all approved dealers. Each dealer is required to return a signed statement indicating receipt and understanding of the District's investment policies.

Appendix A: Glossary

AGENCIES: Federal agency securities and/or Government-sponsored enterprises.

BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

BENCHMARK: A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

BROKER: A broker brings buyers and sellers together for a commission.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a Certificate. Large-denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property, which a borrower pledges to secure repayment of a loan. 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.

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 evidencing interest due on a payment date.

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

DEBENTURE: A bond secured only by the general credit of the issuer.

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

DERIVATIVES: (1) Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying index or security, and may include a leveraging factor, or (2) financial contracts based upon notional amounts whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities or commodities).

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

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

FAIR VALUE: The amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to \$100,000 per deposit.

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

GOVERNMENT SECURITIES: An obligation of the U.S. government, backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market. See "Treasury Bills, Notes, and Bonds."

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL GOVERNMENT INVESTMENT POOL (LGIP): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold.

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 (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

MUTUAL FUND: An investment company that pools money and can invest in a variety of securities, including fixed-income securities and money market instruments. Mutual funds are regulated by the Investment Company Act of 1940 and must abide by the following Securities and Exchange Commission (SEC) disclosure guidelines:

1. Report standardized performance calculations.
2. Disseminate timely and accurate information regarding the fund's holdings, performance, management and general investment policy.
3. Have the fund's investment policies and activities supervised by a board of trustees, which are independent of the adviser, administrator or other vendor of the fund.
4. Maintain the daily liquidity of the fund's shares.
5. Value their portfolios on a daily basis.
6. Have all individuals who sells SEC-registered products licensed with a self-regulating organization (SRO) such as the National Association of Securities Dealers (NASD).
7. Have an investment policy governed by a prospectus which is updated and filed by the SEC annually.

NATIONAL ASSOCIATION OF SECURITIES DEALERS (NASD): A self-regulatory organization (SRO) of brokers and dealers in the over-the-counter securities business. Its regulatory mandate includes authority over firms that distribute mutual fund shares as well as other securities.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which 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. This may be the amortized yield to maturity on a bond the current income return.

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

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES & EXCHANGE COMMISSION: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations, which have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

SWAP: Trading one asset for another.

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

TREASURY BONDS: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

WEIGHTED AVERAGE MATURITY (WAM): The average maturity of all the securities that comprise a portfolio. According to SEC rule 2a-7, the WAM for SEC registered money market mutual funds may not exceed 90 days and no one security may have a maturity that exceeds 397 days.

YIELD: The rate of annual income return on an investment, expressed as a percentage. (a) **INCOME YIELD** is obtained by dividing the current dollar income by the current market price for the security. (b) **NET YIELD** or **YIELD TO MATURITY** is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

