Part 4 INVESTMENT POLICY

Chapter 1 Investment Rules

Article 1 – Guidelines and Practices

1.1 Investment Authority and Delegation of Authority

This investment policy is intended to outline the guidelines and practices to be used in effectively managing the 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 § 53600 et seq.

The authority to invest public funds is expressly delegated to the Board of Directors, the Board re-delegates the investment function annually to an appointed Treasurer, which will be District staff, who shall thereafter assume full responsibility for those transactions until the delegation is revoked or expires. The appointed Treasurer may 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 regular basis to assure compliance with the Investment Policy. (California Government Code §53607)

It is the District's full intent, at the time of purchase, to hold all investments until maturity in order to ensure the return of all invested principal.

1.2 Statement of Objectives

The District has established the following as a guideline to prudent investment strategy:

A. Legal Investment Authority - temporary idle funds are to be invested in accordance with California Government Code § 53600 et.seq.

B. Safety of Principal - investments shall be undertaken which first seeks 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 principal loss. The District shall seek to preserve principal by mitigating the two types of risk in order of importance:

   a) Credit Risk - defined as the risk of loss due to failure of an issuer of a security. This shall be mitigated by purchasing securities guaranteed by the U.S. Government or high grade securities.

b) Interest Rate Risk - risk that the market value of securities in the portfolio will fall due to changes in general interest rate. This may be mitigated by structuring portfolio to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity, and by investing operating funds primarily in short-term securities.

C. 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.

D. Yield 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.

1.3 Prudent Investor Standard

The Board of Directors and Treasurer adhere to the guidance provided by the “prudent investor rule”, California Government Code (§ 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.”

1.4 Reporting Requirements

In accordance with California Government Code § 53646, 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 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. Finally, the Treasurer’s report shall include a certification regarding the District’s ability to meet the expenditure requirements for the next six months, or provide an explanation as to why sufficient funds shall, or may, not be available.

1.5 Investment Policy Administration

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.

1.6 Internal Control

Internal policies and procedures have been developed to assure that appropriate controls are in place to document and confirm all transactions. An independent analysis by external auditor shall be conducted annually to review internal controls, account activity and compliance with policies and procedures.

Chapter 2 Institutions and Dealers

Article 1 - Authorized Financial Institutions and Securities Dealers

1.1 Brokers and Dealers

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 attest 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 Advisors Act of 1940.

Chapter 3 Investment Portfolio

Article 1 – Security Investments

1.1 Portfolio Limitations

Any reference to the portfolio shall mean the total of the District's cash and securities under management by the Treasurer. The Treasurer may invest in any security authorized for investment under state law, subject to the limitations described herein:

(a) Maturity Limitations - The Treasurer is authorized to invest District funds for terms set forth below. 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 5 years.

(b) 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 Budget and Finance Department for the annual audit. When practicable, the Treasurer shall solicit more than one quotation on each trade.

Eligible securities could be purchased at their original sale or after they have been issued. (California Government Code §53603)

(c) 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.

(d) Safekeeping - All securities purchased should be made on a delivery versus payment (DVP) basis, registered under the name of Central Basin Municipal Water District, and held in safekeeping by a third party bank trust department, acting as agent for the District pursuant to the terms of a custody agreement. The trust department of the District's bank may act as third party custodian, provided that the custodian agreement is separate and apart from the banking agreement.

(e) Prohibited Investments - Under the provisions of the California Government Code §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.

1.2 Authorized Investments

The District is governed by the California Government Code, § 53600 et. seq. Within the context of these limitations, the investments listed below are authorized. Those investments not identified in this section are considered to be ineligible. Credit criteria and maximum percentages listed in this section are calculated at the time the security is purchased.
Where this Policy addresses specific portfolio percentage limitations by category, compliance will be measured as of the date of purchase as stated in the California Government Code §53601: "Where this section specifies a percentage limitation for a particular category of investment, that percentage is applicable only at the date of purchase."

If an investment in the District's portfolio is downgraded by a nationally recognized statistical rating organization (NRSRO) to a level below the credit quality required by this investment policy, the Treasurer will review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio based on its current maturity, the economic outlook for the issuer, and other relevant factors. If a decision is made to hold a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported.

Any investment held at the time prior to a revision of the Policy which does not meet the new policy guidelines may be held until maturity, and the Policy shall not apply to the prior investment currently held. At the time of the investment's maturity or liquidation, such funds shall be reinvested only as provided in the current adopted policy.

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. For purposes of this policy, collateralized time deposits shall be considered investments.

The following criteria will be used in evaluating financial institutions and form of collateral to determine eligibility for deposits:

a) The financial institution must have been in existence for at least five years.

b) 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).

c) The deposit shall not exceed 25 percent of the shareholders' equity of any depository bank. For the purposes of this constraint, shareholders' equity shall be deemed to include capital notes and debentures. (California Government Code § 53638 (a))

d) The deposit shall not exceed 25 percent of the total of the net worth of any depository savings and loan association.

e) The total deposits shall not exceed 25 percent of the eligible financial institution's paid-up capital and surplus. (California Government Code § 53638 (b))

f) To secure such deposits, the financial institution shall maintain in the collateral pool, marketable securities having a market value of at least 10 percent in excess of the total amount deposited. (California Government Code § 53652)

g) The maximum term for time deposits or bank certificate of deposits shall be one year.

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:

(a) Investment in negotiable certificates of deposit shall not exceed 30 percent of the total portfolio in effect immediately after any such investment is made.

(b) To be eligible, a certificate of deposit must be issued by a nationally or state-chartered bank, a savings association or a federal association (as defined by California Financial Code § 5102), a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank. (California Government Code § 53601 (i))

(c) All deposits may only be made in institutions that enable the deposit in addition to accrued interest to be fully FDIC insured.

(d) The investment shall not exceed 25 percent of the shareholders' equity of any depository bank. For the purposes of this constraint, shareholders' equity shall be deemed to include capital notes and debentures. (California Government Code § 53638(a))

(e) The investment shall not exceed 25 percent of the total net worth of any depository savings and loan association.

(f) The total investment in an eligible financial institution shall not exceed 25 percent of the total portfolio available for investment in this investment category.

(g) The maximum maturity shall be limited to five years.

D. Bankers' Acceptances

The Treasurer may invest in bankers' acceptances as follows:

(a) Investment in prime bankers' acceptance shall not exceed 15 percent of the portfolio in effect immediately after any such investment is made.

(b) Eligibility shall be limited to those bankers acceptances' 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.

(c) No more than 15 percent of this category of investments may be invested in any one commercial bank's acceptances. (California Government Code § 53601(g)

(d) The maximum maturity shall be limited to 180 days. (California Government Code § 53601 (g))

E. Commercial Paper

The Treasurer may invest in commercial paper as follows:

(a) Only commercial paper of prime quality of the highest ranking or of the highest letter and numerical rating as provided for by NRSRO. (California Government Code § 53601 (h))

(b) 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.

(c) Eligible issuer's debt other than commercial paper, if any, that is rated "A" or higher by a NRSRO.

(d) Investments in commercial paper shall not exceed 25 percent of the portfolio.

(e) No more than 10 percent of the outstanding commercial paper of an issuing corporation may be purchased.

(f) The term shall not exceed 270 days.

F. U.S. 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. (California Government Code §53601 (b))

G. Federal Agencies or United States government-sponsored enterprise obligations

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. (California Government Code §53601 (f))

Includes obligations issued by the Federal Home Loan Banks, the Government National Mortgage Association, the Farm Credit System, the Federal Home Loan Mortgage Association, the Federal National Mortgage Association, or obligations or other instruments of or issued by a federal agency or a United States Government sponsored enterprise.

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. (California Government Code § 53601(l))

The following criteria will be used in evaluating funds:

a) Attain the highest ranking letter and numerical rating provided by not less than two NRSRO; or

b) Have an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years experience managing money market mutual funds and with assets under management in excess of $500,000,000.

c) The maximum purchase price of shares shall not exceed 20% of the portfolio.

I. Medium-Term Notes

The Treasurer may invest in medium-term notes issued by U.S. Corporations with “A” ratings or higher. The term shall not exceed five years and shall not exceed 10% of the portfolio.

J. Municipal Bonds

The Treasurer may invest in municipal bonds with “A” ratings or higher by Standard and Poors and A2 by Moody’s. The term shall not exceed five years and shall not exceed 20% of the portfolio.

K. Los Angeles County Pooled Investment Fund

Deposits for the purpose of investment in the Los Angeles County Pooled Investment Fund administered by the Los Angeles County Treasurer may be made up to the maximum amount permitted by the Treasurer’s policy.

1.3 Market Yield (Benchmark)

The Treasurer shall determine whether market yields are being achieved using one of the following basis:

- Local Agency Investment Fund (LAIF)
- Los Angeles County Pooled Investment Fund (LACPIF)
- 3-month, 6-month, and 1-year Treasury Bills

1.4 Bond Funds

Investment of bond proceeds shall be subject to the conditions and restrictions of bond documents and are not governed by this policy.

1.5 Trust Funds

Investment of District pension trust funds are governed by the provisions of California Government Code § 53215 through 53224.

Investment of District post-employment health benefit trust funds are governed by the provisions of California Government Code § 53620-53622.

1.6 Glossary Of Terms

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

ASKED: The price at which securities are offered.

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.

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

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.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report of the (entity). It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

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. Delivery versus payment is delivery of securities with an exchange of money 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.)

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent returns.

DURATION: A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices.

FEDERAL CREDIT AGENCIES: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g., S&L's, small business firms, students, farmers, farm cooperatives, and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to $250,000 per entity.

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.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks), which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

FEDERAL NATIONAL MORTGAGE ASSOCIATION (FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC): Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae): Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FHA mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

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.

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

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

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.

PRUDENT PERSON RULE: An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state—the so-called legal list. In other states the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

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.

SEC RULE 15(C)3-1: See Uniform Net Capital Rule.

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.

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.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

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.