

## *INVESTMENT POLICY*

---

### **POLICY**

This Investment Policy for the Santa Margarita Water District (“the District”) establishes procedures that are formulated in compliance with governing provisions of law (California Government Code Sections 53600 et seq.) for a prudent and systemic investment program in support of the District’s overall mission. The District’s General Manager shall annually prepare or cause to be prepared a statement of investment policy and such policy, and any changes thereto, shall be considered by the Board at a public meeting; (CGC 53646(a)).

This Policy covers all funds and investment activities under the direct authority of the District with the exception of deferred compensation assets and any trust funds. The proceeds obtained from the issuance of bonds shall be invested in accordance with the applicable bond documents. If the bond documents are silent as to the investment of the proceeds, the bond proceeds will be invested in the securities permitted by this Policy. Notwithstanding the other provisions of this Policy, the percentage or dollar portfolio limitations listed elsewhere in this Policy do not apply to bond proceeds.

The overall investment program shall be designed and managed with a degree of professionalism worthy of the public’s trust. All persons authorized to make investment decisions on behalf of the District are trustees and therefore fiduciaries subject to the prudent investor standard. The prudent investor standard states that “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.” (CGC 53600.3).

### **OBJECTIVES**

The primary objectives of the District’s investment activities shall be, in order of priority:

1. **Safety.** The safety of principal is the foremost objective of the District’s investment program. The District’s investments shall be undertaken in a manner that shall preserve the District’s capital and mitigate credit risk and interest rate risk. The District will diversify its investments by investing funds among a variety of security types, maturities, and issuers.
2. **Liquidity.** The District’s secondary objective shall be to meet its liquidity needs. The investment portfolio shall maintain sufficient liquidity to enable the District to meet all operating requirements which might be reasonably anticipated.
3. **Yield.** Yield shall become a consideration only after the basic requirements of safety and liquidity have been met. The investment portfolio shall be designed with the objective of attaining a market rate of return throughout budgetary and economic cycles, considering the investment risk, constraints, and the cash flow characteristics of the portfolio.

## **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 of the investment program, or which could impair their ability to make impartial investment decisions.

## **DELEGATION OF AUTHORITY**

Authority of the District's Board to delegate the management of the District's investment program is derived from California Government Code Section 53607 which states: "The authority of the legislative body to invest or to reinvest funds of a local agency, or to sell or exchange securities so purchased, may be delegated for a one-year period by the legislative body to the treasurer of the local agency, who shall thereafter assume full responsibility for those transactions until the delegation of authority is revoked or expires, and shall make a monthly report of those transactions to the legislative body. Subject to review, the legislative body may renew the delegation of authority pursuant to this section each year."

Management responsibility for the investment program is hereby delegated by the Board to the General Manager. The General Manager may delegate the day-to-day operations of investing but not the responsibility for the overall investment program. The General Manager, and/or an identified designee(s) of the General Manager, shall make all investment decisions and transactions in strict accordance with state law and with this Policy.

If authorized by the Board, the General Manager, and/or an identified designee(s) of the General Manager, may utilize an external investment advisor to assist with investment decision-making and trade execution authority. The investment advisor shall be under the supervision of the General Manager and/or an identified designee(s) of the General Manager, and shall follow this Policy and such other written instructions as are provided.

The General Manager, and/or an identified designee(s) of the General Manager, acting in full accordance with the Policy, including all related written procedures and policies and exercising due diligence, shall be relieved of personal responsibility for unexpected and significantly adverse investment outcomes, provided such outcomes are reported in a timely fashion and appropriate action is taken to control further adverse developments.

## **INTERNAL CONTROLS**

The General Manager, and/or an identified designee(s) of the General Manager, shall establish a system of written internal controls to regulate the District's investment activities, including the activities of any subordinate officials acting on behalf of the District. Procedures should include references to individuals authorized to execute transactions or transfers, safekeeping agreements, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking services contracts, as appropriate. As part of the annual financial audit, the District's external auditor will perform a review of investment transactions to verify compliance with policies and procedures.

## **AUTHORIZED FINANCIAL INSTITUTIONS AND DEALERS**

It shall be the District's policy to purchase securities only from authorized institutions and firms. The General Manager, and/or an identified designee(s) of the General Manager, shall maintain a list of authorized broker/dealers and financial institutions that are approved for investment purposes. If an external investment advisor is authorized to conduct investment transactions on the District's behalf, the investment advisor may use its own list of approved broker/dealers and financial institutions for investment purposes consistent with the District's policies and existing laws.

If an external investment advisor is not utilized, the District shall use at least one authorized broker/dealer to advise the District on investments. For broker/dealers of government securities and other investments, the District shall select only broker/dealers who are licensed and in good standing with the California Department of Securities, the Securities and Exchange Commission, the Financial Industry Regulatory Authority, or other applicable self-regulatory organizations.

Before engaging in investment transactions with a broker/dealer, the General Manager, and/or an identified designee(s) of the General Manager, shall have received from said firm a signed Certification Form. This form shall attest that the individual responsible for the District's account has reviewed the District's Investment Policy and that the firm understands the policy and intends to present investment recommendations and transactions to the District that are appropriate under the terms and conditions of this Investment Policy.

No deposit of public funds shall be made except in a qualified public depository as established by state laws. Full collateralization will be required on all demand deposit accounts.

## **AUTHORIZED AND SUITABLE INVESTMENTS**

The type, quality and percent composition within the portfolio shall be in full compliance with Government Code Section 53601 et seq., as amended by periodic action of the State Legislature. All investment types and the limitations under this policy are listed below in comparison with the current code for both the internal and external investment managers. The percentage limitations and credit requirements listed in this policy shall apply at the time of purchase. In the event a security held by the District is subject to a rating change that brings it below the minimum credit ratings specified in this policy, the General Manager, and/or an identified designee(s) of the General Manager, shall notify the Board of the change.

As approved by the Board of Directors, the District may invest in projects, including the District's infrastructure projects with an identified rate of return and repayment schedule.

| <b>Investment Type</b>                        | <b>INTERNAL MANAGER<br/>CG Code 53601 et seq.</b>  | <b>District Policy Limitation</b>                                      |
|---|--|--|
| <u>State &amp; Local Agencies:</u>            |  |  |
| District's Own Bonds                          | No Limits ("NL"), 5 yr. max  | Not allowed  |
| State Instruments                             | Warrants, Notes or Bonds (NL), 5 yr. max   | 20% of Portfolio, 5 yr. max  |
| Other Local Agencies                          | Warrants, Notes or Bonds within CA only (NL), 5 yr. max  | 20% of Portfolio, 5 yr. max  |
| U.S. Treasuries                               | Notes, Bonds, Bills or certificates of indebtedness (NL), 5 yr. max  | Code   |
| U.S. Agencies                                 | No Limits, 5 yr. max   | 40% of Portfolio   |
| Supranational                                 | 30% of Portfolio, "AA" rated <u>or its equivalent</u> or better by a Nationally Recognized Statistical Ratings Organization (NRSRO), 5 yr. max   | Code   |
| Banker's Acceptances                          | 40% of Portfolio, no more than 30% of portfolio invested with any one commercial bank, 180 day max   | Not allowed  |
| Commercial Paper                              | 40% of Portfolio, "A-1" <u>or its equivalent</u> or better by a NRSRO, U.S. Corporations, the corporation's long-term debt, if any, must be rated "A" <u>or its equivalent</u> or better by a NRSRO and entity has in excess of \$500 million in assets, 270 day max | Not allowed  |
| <u>Certificate of Deposit (CD's)</u>          |  |  |
| Placement Service Deposits                    | 30% of Portfolio, 5 yr. max  | 20% of Portfolio, 5 yr. max  |
| Negotiable CDs                                | 30% of Portfolio, 5 yr. max  | 20% of Portfolio, 5 yr. max  |
| Repurchase Agreement                          | Market value at 102% or greater, 1 yr. max   | Code   |
| Reverse Repurchase Agreement                  | Many restrictions, 92 day max  | Not allowed  |
| Medium Term Notes                             | 30% of Portfolio, "A" rated <u>or its equivalent</u> or better by a NRSRO, 5 yr. max   | Not allowed  |
| Mutual Funds                                  | Invested solely in categories herein   | Not allowed  |
| Money Market Funds                            | 20% of Portfolio, "AAA" rated by at least two NRSRO's or meets advisor requirements per Code.  | 20% of portfolio   |
| Local Government Investment Pools (LGIPs) JPA | Limited to investments in 53601, meets advisor requirements per Code.  | Code   |
| Secured Notes, etc.                           | Depends on Security  | Not allowed  |
| Asset and Mortgage-Backed Securities          | 20% of Portfolio, "AA" rated <u>or its equivalent</u> or better by a NRSRO, 5 yr. max  | Backed by U.S. Govt Instruments Only to 20% of portfolio               |
| Futures                                       | Depends on contract  | Not allowed  |
| Local Agency Investment Fund (LAIF)           | Code 16429.1   | 100% of portfolio or 100% of the current LAIF limit, whichever is less |

See Appendix A for Investment Type Descriptions of the above.

| <b>Investment Type</b>                   | <b>EXTERNAL MANAGER<br/>CG Code 53601 et seq.</b>   | <b>District Policy Limitation</b>  |
|--|---|--|
| <u>State &amp; Local Agencies:</u>       |   |  |
| District's Own Bonds                     | No Limits ("NL"), 5 yr. max.  | 10% of Portfolio   |
| State Instruments                        | Warrants, Notes or Bonds (NL), 5 yr. max  | 30% of Portfolio   |
| Other Local Agencies                     | Warrants, Notes or Bonds within CA only.<br>(NL), 5 yr. max   | 30% of Portfolio   |
| U.S. Treasuries                          | Notes, Bonds, Bills or certificates of<br>indebtedness (NL), 5 yr. max.   | NL, 10 yr. max.  |
| U.S. Agencies                            | No Limits, 5 yr. max  | NL, 10 yr. max   |
| Supranational                            | 30% of Portfolio, "AA" rated or its<br>equivalent or better by a NRSRO, 5 yr. max   | Code   |
| Banker's Acceptances                     | 40% of Portfolio, 180-day max No more<br>than 30% of portfolio invested with any one<br>commercial bank.  | Code   |
| Commercial Paper                         | 40% of Portfolio, U.S. Corporations with an<br>"A" <u>or its equivalent</u> or better by a NRSRO<br>and entity has in excess of \$500 million in<br>assets, 270 day max | Code   |
| <u>Certificate of Deposit (CD's)</u>     |   |  |
| Placement Service Deposits               | 30% of Portfolio, 5 yr. max   | Not allowed  |
| Negotiable CDs                           | 30% of Portfolio, 5 yr. max   | 30% of Portfolio, 5 yr. max  |
| Repurchase Agreement                     | Market value at 102% or greater, 1 yr. max  | Not allowed  |
| Reverse Repurchase Agreement             | Many restrictions, 92 day max   | Not allowed  |
| Medium Term Notes                        | 30% of Portfolio, "A" rated <u>or its<br/>equivalent</u> or better by a NRSRO, 5 yr. max  | Code   |
| Mutual Funds                             | Invested solely in categories herein  | Not allowed  |
| Money Market Funds                       | 20% of Portfolio, "AAA" rated by at least<br>two NRSRO's or meets advisor<br>requirements per Code.   | Money Market Fund Allowed as<br>Sweep Vehicle in District's<br>Custody Account |
| LGIP JPA                                 | Limited to investments in 53601, meets<br>advisor requirements per Code.  | Not allowed  |
| Secured Notes, etc.                      | Depends on Security   | Not allowed  |
| Asset- and Mortgage-Backed<br>Securities | 20% of Portfolio, "AA" rated <u>or its<br/>equivalent</u> or better by a NRSRO, 5 yr. max   | Code   |
| Futures                                  | Depends on contract   | Not allowed  |
| Local Agency Investment Fund<br>(LAIF)   | Code 16429.1  | Not allowed  |

See Appendix A for Investment Type Descriptions of the above.

## **SAFEKEEPING AND CUSTODY**

All deliverable security transactions entered into by the District shall be conducted on a delivery-versus-payment (DVP) basis. To protect against potential losses by collapse of individual securities dealers, and to enhance access to securities, interest payments and maturity proceeds, all securities owned by the District shall be held in safekeeping by a third-party bank trust department, acting as agent for the District under the terms of a custody agreement executed by the bank and by the District. The only exception to the foregoing shall be depository accounts and securities purchases made with: (i) State of California Local Agency Investment Fund (LAIF) and government investment pools and, (ii) money market funds, since the purchased investments are not deliverable. Evidence of each these investments will be held by the District.

## **MAXIMUM MATURITIES**

The General Manager, and/or an identified designee(s) of the General Manager, shall maintain a system to monitor and forecast revenues and expenditures to identify funds for investment. Maturities of investments will be selected to provide necessary liquidity, manage interest rate risk, and optimize earnings. Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio should be continuously invested in readily available funds.

The maximum maturity of individual investments shall not exceed the limits set forth in the Authorized and Suitable Investments section. If the section does not specify a maturity limit, no investment shall have a remaining maturity in excess of five years from the date of purchase unless the District has granted its express authority to make that investment either specifically or as a part of an investment program no less than three months prior to the investment.

A maximum of 20% of the portfolio to be invested in securities (those without a Policy stated maturity limit) with maturities between five to ten years.

The Policy authorizes investing bond reserve funds beyond five years if authorized by the applicable bond documents.

## **REPORTING AND REVIEW**

The General Manager, and/or an identified designee(s) of the General Manager, shall maintain a complete record of all investments and transactions and shall submit a monthly list of investment transactions to the District as set by Government Code Section 53607. The General Manager, and/or an identified designee(s) of the General Manager, shall submit a quarterly investment report to the Finance and Administration Committee of the Board of Directors within 30 days following the end of the quarter covered by the report as stated by California Government Code Section 53646(b)(1). This report will include all elements as prescribed by Government Code Section 53646(b), including the type of investments, the issuers, maturity dates, and par values and dollar amounts invested on all securities. The report will also include investments and moneys held by the District and a description of any of the District's funds or investments that are under the management of contracted parties, such as an investment advisor. For all securities held by the District and under management of an outside party other than a local agency or the State of California Local Agency Investment Fund (LAIF), the report shall also include a current market value as of the date of the report and the source of the portfolio market valuation. The report shall also include a certification that: (1) all investment actions executed since the last report have been made in full compliance with this Investment Policy; and (2) the District can meet its anticipated expenditure obligations for the next six months.

This Policy shall be reviewed by the General Manager, and/or an identified designee(s) of the General Manager, on an annual basis. Any modifications must be approved by the District's Board of Directors.

## Appendix A Investment Type Descriptions

**The appendix is for general information only. Please see the body of the Policy for the District's investment requirements.**

**State and Local Agencies.** Registered treasury notes or bonds of this or any of the other 49 United States, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of this state or any of the other 49 United States.

Bonds, notes, warrants, or other evidence of indebtedness of any local agency within this state (including the District), 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.

**United States Treasury Issues.** United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

**U.S. Agencies (Federal Agency Obligations).** 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.

**Supranational.** Supranational organizations are international financial institutions that are generally established by agreements among nations, with member nations contributing capital and participating in management. Supranational bonds finance economic and infrastructure development and support environmental protection, poverty reduction, and renewable energy around the globe. The Government Code allows local agencies to purchase the United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank.

**Bankers' Acceptances.** Bankers' acceptances otherwise known as bills of exchange or time drafts that are drawn on and accepted by a commercial bank. Purchases of bankers' acceptances may not exceed 180 days maturity. Eligible bankers' acceptances are restricted to issuing financial institutions with short-term debt rating of at least "A-1," or its equivalent, by a NRSRO.

**Commercial Paper.** Commercial paper rated the highest ranking or of the highest letter and number rating as provided for by a NRSRO. The entity that issues the commercial paper shall meet all of the conditions in either paragraph (1) or paragraph (2):

(1) The corporation shall be organized and operating within the United States, shall have total assets in excess of five hundred million dollars (\$500,000,000), and shall issue debt, other than commercial paper, if any, that is rated in a rating category of "A" or its equivalent, or higher by a NRSRO.

(2) The corporation shall be organized within the United States as a special purpose corporation, trust, or limited liability company, have program wide credit enhancements, including, but not limited to, over collateralization, letters of credit, or surety bond; have commercial paper that is rated at least "A-1," or equivalent, by a NRSRO.

## **Appendix A (Continued)**

### **Investment Type Descriptions**

**Placement Service Deposit.** Deposits placed through a deposit placement service shall meet the requirements under Government Code Section 53601.8. A maximum of 20 percent of the portfolio may be invested in this category under the District's Policy. The full amount of the principal and the interest that may be accrued during the maximum term of each deposit will at all times be insured by federal deposit insurance.

**Negotiable Certificates of Deposit.** Negotiable certificates of deposit (NCDs) issued by a nationally or state-chartered bank, a savings association or a federal association, a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank. Purchases are limited to institutions which have long-term debt rated at least in the "A" category, or its equivalent, by a NRSRO; and/or have short-term debt rated at least "A-1," or its equivalent, by a NRSRO. NCDs may not exceed 5 years in maturity. A maximum of 20 percent of the portfolio may be invested in this category under the District's Policy. The amount invested in NCDs with any one financial institution in combination with any other securities from that financial institution shall not exceed 10 percent of the portfolio.

**Repurchase Agreements.** Repurchase agreements are to be used as short-term investments not to exceed one year. The following collateral restrictions will be observed: Only U.S. Treasury securities or Federal Agency securities will be acceptable collateral. All securities underlying repurchase agreements must be delivered to the District's custodian bank or be handled under a properly executed tri-party repurchase agreement. The total market value of all collateral for each repurchase agreement must equal or exceed 102% of the total dollar value of the money invested by the District for the term of the investment.

**Medium-Term Notes.** Medium-term notes are defined as all corporate and depository institution debt securities with a maximum remaining maturity of five years or less, issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Purchases are limited to securities rated in a rating category of "A" or its equivalent, or better, by a NRSRO.

**Money Market Funds.** Shares of beneficial interest issued by diversified management companies that are money market funds registered with the Securities and Exchange Commission that invest solely in U.S. Treasuries and Federal Agency obligations and repurchase agreements relating to such obligations.

The company must meet either of the following criteria: (A) Attained the highest ranking or the highest letter and numerical rating provided by not less than two NRSROs. (B) Retained an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years of experience managing money market mutual funds with assets under management in excess of five hundred million dollars (\$500,000,000). A maximum of 20 percent of the portfolio may be invested in this category.

If the District has funds invested in a money market fund, a copy of the fund's information statement shall be maintained on file. In addition, the Treasurer should review the fund's summary holdings on a quarterly basis.

**Mutual Funds.** Shares of beneficial interest issued by diversified management companies that invest solely in securities and obligations authorized by this policy. The company must meet either of the following criteria: (A) Attained the highest ranking or the highest letter and numerical rating provided by not less than two NRSROs. (B) Retained an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years of experience managing money market mutual funds with assets under management in excess of five hundred million dollars (\$500,000,000).



## **Appendix A (Continued)**

### **Investment Type Descriptions**

**Local Government Investment Pools (LGIP JPA).** Shares of beneficial interest issued by a joint powers authority organized pursuant to Government Code Section 6509.7. To be eligible for purchase, the pool must meet the requirements of California Government Code Section 53601(p), the pool must seek to maintain a stable Net Asset Value (“NAV”), and the pool must be rated at least “AAAm,” or its equivalent, by a NRSRO.

**Mortgage- and Asset-Backed Securities.** Any mortgage pass-through security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable pass-through certificate, or consumer receivable-backed bond. Securities eligible for investment under this subdivision shall be rated in a rating category of “AA,” or its equivalent, or better, by a NRSRO and have a maximum remaining maturity of five years or less. Purchase of securities authorized by this subdivision shall not exceed 20 percent of the District’s portfolio.

**State of California Local Agency Investment Fund (LAIF).** LAIF is a voluntary program created by California statute in 1977 as an investment alternative for California local governments and special districts. This program offers opportunity to participate in a major portfolio which invests using the investment expertise of the State Treasurer’s Office. The fund is highly liquid and safe. “Moneys placed with the Treasurer for deposit in the LAIF ...shall not be subject to either of the following: (a) transfer of loan pursuant to Sections 16310, 16312, or 16313, or (b) impoundment or seizure by any state official or state agency (CGC 16429.3). Further, “The right of a city, county ...special district ...to withdraw its deposited moneys from the LAIF, upon demand, may not be altered, impaired, denied in any way, by state official or state agency based upon the state’s failure to adopt a State Budget by July 1 of each new fiscal year” (CGC 16429.4).