Investment Policy Guidelines
of the
Vallejo Flood and Wastewater District

Approved by the Board of Trustees on June 8, 2021

Prepared by the Finance Department

Investment Policy Guidelines
Vallejo Flood and Wastewater District

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A. Policy

It is the policy of the Vallejo Sanitation & Flood Control District to invest public funds in a prudent manner which will preserve principal, maintain liquidity to meet the daily cash flow demands of the District and achieve a reasonable rate of return while conforming to all state and local statutes governing the investment of public funds.

B. Scope

This investment policy applies to all moneys (surplus financial assets) and investment activities of the District. These moneys are accounted in the monthly financial reports and the comprehensive annual financial report of District which are under the Treasurer's scope of control unless specifically exempted by statute or resolution. The investment of bond proceeds in the custody of a Trustee shall be governed in accordance with the investment guidelines contained in the bond indenture.

C. Prudence

The standard of prudence to be used by investment officials in the management of District moneys shall be the Prudent Investor Standard as authorized under Section 53600.3 of the California Government Code which shall be applied in the context of managing all aspects of the overall portfolio. Pursuant to California Government Code, all persons authorized to make investment decisions on behalf of the District are trustees and therefore fiduciaries subject to the Prudent Investor Standard:

> "…all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard. 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.".

D. Objective

The objective of this policy is to provide guidance to invest District funds in accordance with California Government Code Section 53600.5 which states that when investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the primary objective of a trustee shall be to safeguard the principal of the funds under its control. The secondary objective shall be to meet liquidity needs of the depositor. The third objective shall be to achieve a return on the funds under its control. Using sound treasury management principles, this policy seeks to achieve, in order of priority:

1. <u>Safety</u>: Safety of principal is the foremost objective of the investment program.

Investments of the District shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio.

2. Liquidity: The District's investment portfolio will maintain sufficient liquidity to enable the District to meet all operating requirements which might be reasonably anticipated.
3. Return on Investments: The District's investment portfolio shall be designed with the objective of attaining a rate of return commensurate with the District's investment risk constraints and the cash flow characteristics of the portfolio.

E. Delegation of Authority

Pursuant to California Government Code Section 53607, management responsibility for the investment program is hereby delegated to the District Treasurer, who shall establish written procedures for the operation of the investment program consistent with this investment policy. This responsibility includes authority to select brokers, establish safekeeping accounts, enter into wire transfer agreements, banking service contracts, and collateral/depository agreements. The Treasurer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials. This delegation shall be for no greater than one year and may be revoked at any time, or, upon review, renewed each year.

The District may engage the services of one or more external investment advisers, who are registered under the Investment Advisers Act of 1940, to assist in the management of the District's investment portfolio in a manner consistent with the District's objectives. External investment advisers may be granted discretion to purchase and sell investment securities in accordance with this investment policy.

The District's overall investment program shall be designed and managed with a degree of professionalism that is worthy of the public trust. The District recognizes that in a diversified portfolio, occasional measured losses may be inevitable and must be considered within the context of the overall portfolio's return and the cash flow requirements of the District.

F. Ethics and Conflicts of Interest

Officers and employees involved in the investment process shall refrain from any personal business activity that could conflict with the proper execution and management of the investment program or which could impair their ability to make impartial investment decisions for the District. Additionally, the Treasurer is required to annually file applicable financial disclosures as required by the Fair Political Practices Commission (FPPC) and/or the District's Conflict of Interest Code.

G. Authorized Financial Dealers and Institutions

The District shall transact business only with banks, associations, and with broker/dealers licensed by the State of California.

In accordance with Section 53601.5, institutions eligible to transact investment business with the District include:

- Primary government dealers as designated by the Federal Reserve Bank and non-primary government dealers.

- Nationally or state-chartered banks.
- The Federal Reserve Bank.
- Direct issuers of securities eligible for purchase.

Investment staff shall investigate dealers who wish to do business with the District to determine if they are adequately capitalized, have pending legal action against the firm or the individual broker and make markets in the securities appropriate to the District's needs.

The District Treasurer shall annually send a copy of the current Investment Policy to all broker/dealers approved to do business with the District. Confirmation of receipt of this policy shall be considered evidence that the dealer understands the District's Investment Policy and intends to sell the District only appropriate investments authorized by this Investment Policy.

Selection of financial institutions and broker/dealers authorized to engage in transactions will be at the sole discretion of the District, except where the District utilizes an external investment adviser in which case the District may rely on the adviser for selection.

Public deposits will be made only in qualified public depositories as established by State law. Deposits will be insured by the Federal Deposit Insurance Corporation, or, to the extent the amount exceeds the insured maximum, will be collateralized in accordance with State law.

Selection of broker/dealers used by an external investment adviser retained by the District will be at the sole discretion of the adviser. Where possible, transactions with broker/dealers shall be selected on a competitive basis and their bid or offering prices shall be recorded. If there is no other readily available competitive offering, best efforts will be made to document quotations for comparable or alternative securities. When purchasing original issue instrumentality securities, no competitive offerings will be required as all dealers in the selling group offer those securities at the same original issue price.

H. Use of External Professional Investment Manager

The District may employ the services of a professional investment manager to assist in the management of the District's investment portfolio. Such manager may be granted the discretion to purchase and sell investment securities in accordance with this Investment Policy. A professional investment manager shall only be retained by written agreement with the District, and approved by the Board of Trustees, and must contractually agree to conform to the District's Investment Policy and all provisions of governing law and collateralization and other requirements contained herein.

I. Authorized Investments

The District's investments are governed by California Government Code, Sections 53600 et seq. Within the investments permitted by the Code, the District seeks to further restrict eligible investments to the guidelines listed below. In the event a discrepancy is found between this policy and the Code, the more restrictive parameters will take precedence. Percentage holding limits and credit quality minimums listed in this section apply at the time the security is purchased.

Any investment currently held at the time the policy is adopted which does not meet the new policy guidelines can be held until maturity, and shall be exempt from the current policy. At the time of the investment's maturity or liquidation, such funds shall be reinvested only as provided in the current policy.

An appropriate risk level shall be maintained by primarily purchasing securities that are of high quality, liquid, and marketable. The portfolio shall be diversified by security type and institution to avoid incurring unreasonable and avoidable risks regarding specific security types or individual issuers.

MUNICIPAL SECURITIES include obligations of the District, the State of California and any local agency within the State of California, provided that the securities are rated in a rating category of "A" or its equivalent or better by at least one nationally recognized statistical rating organization ("NRSRO"). No more than 5% of the portfolio may be invested in any single issuer. No more than 30% of the portfolio may be in Municipal Securities. The maximum maturity does not exceed five (5) years.

MUNICIPAL SECURITIES (REGISTERED TREASURY NOTES OR BONDS) of any of the other 49 states in addition to California, 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 any of the other 49 states, in addition to California. The securities are rated in a rating category of "A" or its equivalent or better by at least one "NRSRO". No more than 5% of the portfolio may be invested in any single issuer. No more than 30% of the portfolio may be in Municipal Securities. The maximum maturity does not exceed five (5) years.

U.S. TREASURIES and other government obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest. There are no limits on the dollar amount or percentage that the District may invest in U.S. Treasuries, provided that the maximum maturity is five (5) years.

FEDERAL AGENCIES 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. There are no limits on the dollar amount or percentage that the District may invest in Federal Agency or Government-Sponsored Enterprises (GSEs), provided that no more than 25% of the portfolio may be invested in any single Agency/GSE issuer. The maximum maturity does not exceed five (5) years. The maximum percent of federal agency callable securities in the portfolio will be 20%.

BANKERS' ACCEPTANCES: As provided in Government Code Section 53601 (g), up to 40% of the District's moneys may be invested in Bankers Acceptances (that are eligible for purchase by the Federal Reserve System), although no more than 5% of the moneys may be invested in Bankers Acceptances of any one commercial bank. Additionally, the maturity period of any Bankers Acceptance shall not exceed 180 days. Eligible bankers' acceptances must be issued by institutions which have short-term debt obligations rated "A-1" or its equivalent or better by at least one NRSRO; or long-term debt obligations which are rated in a rating category of "A" or its equivalent or better by at least one NRSRO.

COMMERCIAL PAPER: As authorized in Government Code Section 53601 (h), up to 25% of the District's moneys may be invested in "prime" commercial paper of quality of the highest ranking or of the highest letter and number rating provided by a NRSRO. The issuing corporation must meet all of the following conditions in either paragraph (1) or paragraph (2):

(1) The entity meets the following criteria:

a. Is organized and operating in the United States as a general corporation.
b. Has total assets in excess of five hundred million dollars ($500,000,000).
c. Has debt other than commercial paper, if any, that is rated "A" or its equivalent or higher by an NRSRO.

(2) The entity meets the following criteria:

a. Is organized within the United States as a special purpose corporation, trust, or limited liability company.
b. Has program-wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or a bond.
c. Has commercial paper that is rated "A-1" or higher, or the equivalent, by an NRSRO.

The District shall not purchase more than 10% of the outstanding commercial paper of any one issuer. No more than 5% of the portfolio may be invested in a single commercial paper issuer. Maturities may not exceed 270 days.

NEGOTIABLE CERTIFICATES OF DEPOSIT OR BONDS (NCD): As authorized in Government Code Section 53601 (i), up to 30% of District's moneys may be invested in negotiable certificates of deposit issued by a nationally or state-chartered bank, or a savings or federal association, a state or federal credit union, or by a federally-licensed or state-licensed branch of a foreign bank. The maturity period for this investment vehicle may not exceed five years unless approved by the Board of Trustees. The amount of the NCD insured up to the FDIC limit does not require any credit ratings. Any amount above the FDIC insured limit must be issued by institutions which have short-term debt obligations rated "A-1" or its equivalent or better by at least one NRSRO; or long-term obligations rated in a rating category of "A" or its equivalent or better by at least one NRSRO. No more than 5% of the portfolio may be invested in any single issuer.

MEDIUM-TERM CORPORATE NOTES: As authorized in Government Code Section 53601 (k), up to 30% of District's moneys may be invested in medium term corporate notes. Maturities may not exceed five years. The issuing corporation must be organized and operating within the U.S. or be a depository institution licensed by the United States or any state and operating within the United States, and must be rated in a rating category of "A" or its equivalent or better by an NRSRO. No more than 5% of the portfolio may be invested in any single issuer.

MUTUAL FUNDS and MONEY MARKET MUTUAL FUNDS. Mutual Funds are referred to in California Government Code Section 53601(l), as "shares of beneficial interest issued by diversified management companies." Mutual Funds and Money Market Mutual Funds that are registered with the Securities and Exchange Commission under the Investment Company Act of 1940 are authorized investments for funds subject to the following provisions:

(1) **Mutual Funds** that invest in the securities and obligations as authorized under California Government Code Section 53601(a) to (k) and (m) to (q) inclusive and that meet either of the following criteria:
   a. Attained the highest ranking or the highest letter and numerical rating provided by not less than two (2) NRSROs; or
   b. Have retained an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by California Government Code Section 53601 and with assets under management in excess of $500 million.
   c. No more than 10% of the total portfolio may be invested in Mutual Funds.

(2) **Money Market Mutual Funds** registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and issued by diversified management companies and meet either of the following criteria:
   a. Have attained the highest ranking or the highest letter and numerical rating provided by not less than two (2) NRSROs; or
   b. Have retained 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 with assets under management in excess of $500 million.
   c. No more than 20% of the total portfolio may be invested in Money Market Mutual Funds.

All Money Market Mutual Funds must be compliant with Rule 2a-7 of the Investment Company Act of 1940.

- No more than 20% of the total portfolio may be invested in these securities.

TIME CERTIFICATES OF DEPOSIT: As authorized in Government Code Section 53630 and following, the District may invest moneys in non-negotiable, fixed-term Certificates of Deposit collateralized in accordance with the Government Code requirements. In order to secure such deposits, an institution shall maintain in the collateral pool securities having a market value of at least 10% in excess of the total amount deposited (50% in excess of the total amount of deposits secured by promissory notes secured by first mortgages and first trust deeds). The District is permitted to waive the first $250,000 of collateral security for such deposits if the institution is insured pursuant to federal law. There are no special portfolio limits on the amount or maturity for this investment vehicle. Time Certificates of Deposit may be purchased from banks, associations, federally insured credit unions, and federally insured industrial loan companies which meet the requirements set forth in the Government Code.

COLLATERALIZED BANK DEPOSITS. District's deposits with financial institutions will be collateralized with pledged securities per California Government Code, Section 53651. There are no limits on the dollar amount or percentage that the District may invest in collateralized bank deposits.

REPURCHASE AGREEMENTS collateralized with securities authorized under California Government Code, maintained at a level of at least 102% of the market value of the Repurchase Agreement. There are no limits on the dollar amount or percentage that the District may invest, provided that securities used as collateral for Repurchase Agreements will be delivered to an acceptable third party custodian. Repurchase Agreements are subject to a Master Repurchase Agreement between the District and the provider of the repurchase agreement. The Master Repurchase Agreement will be substantially in the form developed by the Securities Industry and Financial Markets Association (SIFMA). The maximum maturity does not exceed one (1) year.

ASSET-BACKED, MORTGAGE-BACKED, MORTGAGE PASS-THROUGH SECURITIES, AND COLLATERALIZED MORTGAGE OBLIGATIONS FROM ISSUERS NOT ISSUED BY THE U.S. GOVERNMENT AND ITS FEDERAL AGENCIES, provided that the securities are rated in a rating category of "AA" or its equivalent or better by a NRSRO. No more than 20% of the total portfolio may be invested in these securities. No more than 5% of the portfolio may be invested in any single Asset-Backed or Commercial Mortgage security issuer. The maximum legal final maturity does not exceed five (5) years.

SUPRANATIONALS, provided that issues are US 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. The securities must be rated in a rating category of "AA" or its equivalent or better by a NRSRO. No more than 30% of the total portfolio may be invested in these securities. No more than 10% of the portfolio may be invested in any single issuer. The maximum maturity does not exceed five (5) years.

Local Agency Investment Fund (LAIF): As authorized by Government Code Section 16429.1, the District may invest in the Local Agency Investment Fund, a pooled investment money market fund established by the State of California and managed by the California State Treasurer's Office. The District is a current participant in this fund.

J. Prohibited Investments

The District shall not invest any moneys, pursuant to Government Code 53601.6 or pursuant to Article 2 (commencing with Section 53630), in inverse floaters, range notes, mortgage-derived, or interest-only strips that are derived from a pool of mortgages. In addition, the District shall not invest in any security that could result in zero interest accrual if held to maturity, except that, under a provision of state law sunsetting on January 1, 2026, securities backed by the U.S. Government that could result in a zero- or negative-interest accrual if held to maturity are permitted. Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited. Purchasing or selling securities on margin is prohibited. The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited. The purchase of foreign currency denominated securities is prohibited.

K. Social Responsibility

Investment of funds should be guided by the following socially responsible investment goals when investing in corporate securities and depository institutions. Investments should be made in compliance with these goals to the extent that such investments achieve substantially equivalent safety, liquidity and yield compared to investments permitted by California state law.

The District shall seek opportunities for investing in companies that have a positive impact on the environment and fair workplace practices. Investments are encouraged in entities that support equality of rights, regardless of sex, race, religion, age, disability or sexual orientation. No investment is to be made in a company that receives more than 51 percent of its gross revenues from the production or manufacture of fossil fuels, weapons manufacturing, cigarettes, alcohol or gaming products

L. Investment Pools

The Treasurer shall have a thorough understanding of the operational areas listed below for each pool and/or fund prior to investing, and on a continual basis.

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how interest 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 is audited.
- A description of who may invest in the program, how often, and the permissible size of deposit and withdrawal.
- A schedule for receiving statements and portfolio listings.
- Whether reserves, retained earnings, etc. are utilized by the pool/fund.
- A fee schedule, and when and how it is assessed.
- Whether the pool/fund is eligible for bond proceeds and/or whether it will accept such proceeds.

M. Collateral Requirements

Collateral is required for investments in certificates of deposit. In order to reduce market risk, the collateral level will be at least 102% of market value of principal and accrued interest.

The only securities acceptable as collateral shall be direct obligations which are fully guaranteed as to principal and interest by the United States Government or any agency or government sponsored enterprise of the United States.

Collateral must be held in the District’s name by an independent third party with whom the District has a current custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the District.

N. Safekeeping and Custody

To protect against fraud or embezzlement or losses caused by collapse of an individual securities dealer, all securities owned by the District shall be held in safekeeping by a third party custodian, acting as agent for the District under the terms of a custody agreement executed by the Treasurer. All security transactions will settle delivery vs. payment (DVP) through the District’s safekeeping agent. Securities purchased from brokers/dealers shall be held in third party safekeeping by the trust department of the District’s main bank, or by another third party trustee designated by the Treasurer.

Securities held in custody for the District shall be independently audited annually to verify investment holdings.

O. Delivery

The purchase of an eligible security shall require delivery of the securities to the District, including those purchased for the District by financial advisors, consultants, or managers using the District's moneys, by book entry, physical delivery, or by third party custodial agreement. The transfer of securities to the counter party bank's customer book entry account may be used for book entry delivery. A counter party bank's trust department or separate safekeeping department may be used for the physical delivery of the security if it is held in the District's name.

P. Risk Management and Diversification

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. The District will mitigate credit risk by adopting the following strategies:

- The diversification requirements included in the "Authorized Investments" section of this policy are designed to mitigate credit risk in the portfolio.
- No more than 5% of the total portfolio may be deposited with or invested in securities issued by any single issuer with the exception of US Treasuries, Federal Agencies, LAIF, mutual funds, money market funds, or supranational securities, or unless otherwise specified in this policy.
- The District may elect to sell a security prior to its maturity and record a capital gain or loss in order to manage the quality, liquidity or yield of the portfolio in response to market conditions or District's risk preferences.
- If the credit ratings of any security owned by the District are downgraded to a level below the quality required by this investment policy, it will be the District's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio.
    - If a security is downgraded, the Treasurer will use discretion in determining whether to sell or hold the security based on its current maturity, the economic outlook for the issuer, and other relevant factors.
    - If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported monthly to the District Board.

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 District recognizes that, over time, longer-term portfolios have the potential to achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The District will 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 District further recognizes that certain types of securities, including variable rate securities, securities with principal paydowns prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The Agency, therefore, adopts the following strategies to control and mitigate its exposure to market risk:

- The District will maintain a minimum of six months of budgeted operating expenditures in short term investments to provide sufficient liquidity for expected disbursements.
- The maximum stated final maturity of individual securities in the portfolio will be five (5) years, except as otherwise stated in this policy.
- The duration of the portfolio will generally be approximately equal to the duration (typically, plus or minus 20%) of a Market Benchmark, an index selected by the District based on the District's investment objectives, constraints and risk tolerances.

Q. Maximum Maturity

The District will attempt to match its investments with anticipated cash flow requirements whenever possible. Pursuant to California Government Code Section 53601, the District will not invest in any security with a final maturity of more than five years from the date of purchase, unless the Board of Trustees has granted express authority to make that investment at least three months before the investment is made.

R. Internal Control

Separation of functions between the receipt and transfer of funds is designed to provide an ongoing internal review to prevent the potential for converting assets or concealing transactions. Existing procedures require all wire transfers to be approved by the Finance Director/Treasurer or District Manager. Proper documentation obtained from confirmation and cash disbursement wire transfers is required for each investment transaction. Timely bank reconciliation is conducted to ensure proper handling of all transactions. The investment portfolio and all related transactions are reviewed and balanced to appropriate general ledger accounts by the Finance Department on a monthly basis. All employees involved in the investment of District moneys must be properly bonded. District shall receive confirmations from the financial institutions. All investment confirmations received from financial institutions shall be reviewed for accuracy and filed. The District investment accounting software package shall meet all legal reporting requirements. An independent confirmation by an external auditor shall be conducted annually to review internal control, account activity and compliance with policies and procedures.

S. Other Guidelines

1. **Pooled Cash**: Cash for all District enterprise funds are consolidated into one general bank account and one payroll account (except bond proceeds, retirement portfolios, and deferred compensation moneys) and invested on a pooled concept basis.
2. **Liquidity**: Liquidity refers to the ability to convert investment holdings to cash immediately with minimal loss of principal or accrued interest. This quality is important when the need for unexpected moneys suddenly occurs. The secondary duty of the Treasurer is to ensure that the liquidity needs of the District are met.
3. **Selling Securities Prior to Maturity**: It is the District's intent, at the time of purchase, to

hold all investments until maturity. However, investments may be sold prior to maturity for cash flow purposes or to take advantage of principal appreciation. Generally, losses are acceptable on a sale before maturity if the earnings from the reinvested proceeds will exceed the income that would have been generated by the old investment considering any capital loss or foregone interest on the original investment.

4. **Time Deposit Placement**: Time deposits (insured and collateralized certificates of deposit) are not placed with banks, credit unions and/or associations unless an office is maintained in the State of California.
5. **TCD Evaluation**: Time Certificates of Deposit (TCD) are evaluated in terms of FDIC coverage. For deposits in excess of the insured maximum of $250,000 approved levels of collateral at full market value are required, as prescribed in the California Government Code.
6. **Security Marketability**: The marketability (salability) of a security is considered at the time of purchase, as the security may have to be sold prior to maturity in order to meet unanticipated cash demands.
7. **Cash Flow Requirements Used to Establish Maturity**: Projected cash flow requirements and the overall weighted average maturity of the District's investment portfolio are the primary factors to be used in determining investment maturity terms.

T. Strategy

Strategy refers to the ability to manage the District's financial resources in the most advantageous manner.

1. **Economic Forecasts**: The Treasurer obtains economic forecasts periodically from investment professionals to assist with the formulation of an investment strategy for the District.

2. **Developing the Investment Plan**: The Treasurer should anticipate changes in interest rates, inflation, monetary and/or fiscal policy, and other economic indicators and evaluate their impact on the District's portfolio.

U. Performance Standards

The investment portfolio shall be designed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the District's risk constraints, the cash flow characteristics of the portfolio, and state and local laws, ordinances or resolutions that restrict investments.

The Treasurer shall monitor and evaluate the portfolio's performance relative to the chosen market benchmark(s), which will be included in the Treasurer's monthly report. The Treasurer shall select an appropriate, readily available index to use as a market benchmark.

V. Reporting

Monthly Report

Monthly transaction reports will be submitted by the Treasurer to the Board of Trustees in accordance with California Government Code Section 53607.

Annual Policy Approval

The Treasurer shall submit the investment policy annually to the Board, disclose the sources of market value information, confirm compliance with the guidelines or explain the differences, and affirm the agency's ability to meet its obligations over the next six months.

W. Investment Policy Adoption

The District's investment policy guidelines shall be adopted by resolution as modifications are required due to changing economic conditions and legislative changes affecting public agency investment practices.

GLOSSARY OF INVESTMENT TERMS

AGENCIES. Shorthand market terminology for any obligation issued by *a government-sponsored entity (GSE),* or a *federally related institution*. Most obligations of GSEs are not guaranteed by the full faith and credit of the US government. Examples are:

- **FFCB.** The Federal Farm Credit Bank System provides credit and liquidity in the agricultural industry. FFCB issues discount notes and bonds.
- **FHLB.** The Federal Home Loan Bank provides credit and liquidity in the housing market. FHLB issues discount notes and bonds.
- **FHLMC.** Like FHLB, the Federal Home Loan Mortgage Corporation provides credit and liquidity in the housing market. FHLMC, also called "FreddieMac" issues discount notes, bonds and mortgage pass-through securities.
- **FNMA.** Like FHLB and FreddieMac, the Federal National Mortgage Association was established to provide credit and liquidity in the housing market. FNMA, also known as "FannieMae," issues discount notes, bonds and mortgage pass-through securities.
- **GNMA.** The Government National Mortgage Association, known as "GinnieMae," issues mortgage pass-through securities, which are guaranteed by the full faith and credit of the US Government.
- **PEFCO.** The Private Export Funding Corporation assists exporters. Obligations of PEFCO are not guaranteed by the full faith and credit of the US government.
- **TVA.** The Tennessee Valley Authority provides flood control and power and promotes development in portions of the Tennessee, Ohio, and Mississippi River valleys. TVA currently issues discount notes and bonds.

ASSET BACKED SECURITIES. Securities supported by pools of installment loans or leases or by pools of revolving lines of credit.

AVERAGE LIFE. In mortgage-related investments, including CMOs, the average time to expected receipt of principal payments, weighted by the amount of principal expected.

BANKER'S ACCEPTANCE. A money market instrument created to facilitate international trade transactions. It is highly liquid and safe because the risk of the trade transaction is transferred to the bank which "accepts" the obligation to pay the investor.

BENCHMARK. A comparison security or portfolio. A performance benchmark is a partial market index, which reflects the mix of securities allowed under a specific investment policy.

BROKER. A broker brings buyers and sellers together for a transaction for which the broker receives a commission. A broker does not sell securities from his own position.

CALLABLE. A callable security gives the issuer the option to call it from the investor prior to its maturity. The main cause of a call is a decline in interest rates. If interest rates decline, the issuer will likely call its current securities and reissue them at a lower rate of interest.

CERTIFICATE OF DEPOSIT (CD). A time deposit with a specific maturity evidenced by a certificate.

CERTIFICATE OF DEPOSIT ACCOUNT REGISTRY SYSTEM (CDARS). A private placement service that allows local agencies to purchase more than $250,000 in CDs from a single financial institution (must be a participating institution of CDARS) while still maintaining FDIC insurance coverage. CDARS is currently the only entity providing this service. CDARS facilitates the trading of deposits between the California institution and other participating institutions in amounts that are less than $250,000 each, so that FDIC coverage is maintained.

COLLATERAL. Securities or cash pledged by a borrower to secure repayment of a loan or repurchase agreement. Also, securities pledged by a financial institution to secure deposits of public monies.

COLLATERALIZED BANK DEPOSIT. A bank deposit that is collateralized at least 100% (principal plus interest to maturity). The deposit is collateralized using assets set aside by the issuer such as Treasury securities or other qualified collateral to secure the deposit in excess of the limit covered by the Federal Deposit Insurance Corporation.

COLLATERALIZED MORTGAGE OBLIGATIONS (CMO). Classes of bonds that redistribute the cash flows of mortgage securities (and whole loans) to create securities that have different levels of prepayment risk, as compared to the underlying mortgage securities.

COLLATERALIZED TIME DEPOSIT. Time deposits that are collateralized at least 100% (principal plus interest to maturity). These instruments are collateralized using assets set aside by the issuer such as Treasury securities or other qualified collateral to secure the deposit in excess of the limit covered by the Federal Deposit Insurance Corporation.

COMMERCIAL PAPER. The short-term unsecured debt of corporations.

COUPON. The rate of return at which interest is paid on a bond.

CREDIT RISK. The risk that principal and/or interest on an investment will not be paid in a timely manner due to changes in the condition of the issuer.

DEALER. A dealer acts as a principal in security transactions, selling securities from and buying securities for his own position.

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

DELIVERY VS. PAYMENT (DVP). A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser's agent.

DERIVATIVE. Any security that has principal and/or interest payments which are subject to uncertainty (but not for reasons of default or credit risk) as to timing and/or amount, or any security which represents a component of another security which has been separated from other components ("Stripped" coupons and principal). A derivative is also defined as a financial instrument the value of which is totally or partially derived from the value of another instrument, interest rate, or index.

DISCOUNT. The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as T-bills and banker's acceptances, are known as discount securities. They sell at a discount from par and return the par value to the investor at maturity without additional interest. Other securities, which have fixed coupons, trade at a discount when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

DIVERSIFICATION. Dividing investment funds among a variety of investments to avoid excessive exposure to any one source of risk.

DURATION. The weighted average time to maturity of a bond where the weights are the present values of the future cash flows. Duration measures the price sensitivity of a security to changes interest rates.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC). The Federal Deposit Insurance Corporation (FDIC) is an independent federal agency insuring deposits in U.S. banks and thrifts in the event of bank failures. The FDIC was created in 1933 to maintain public confidence and encourage stability in the financial system through the promotion of sound banking practices.

FEDERALLY INSURED TIME DEPOSIT. A time deposit is an interest-bearing bank deposit account that has a specified date of maturity, such as a certificate of deposit (CD). These deposits are limited to funds insured in accordance with FDIC insurance deposit limits.

LEVERAGE. Borrowing funds in order to invest in securities that have the potential to pay earnings at a rate higher than the cost of borrowing.

LIQUIDITY. The speed and ease with which an asset can be converted to cash.

LOCAL AGENCY INVESTMENT FUND (LAIF). A voluntary investment fund open to government entities and certain non-profit organizations in California that is managed by the State Treasurer's Office.

LOCAL GOVERNMENT INVESTMENT POOL. Investment pools that range from the State Treasurer's Office Local Agency Investment Fund (LAIF) to county pools, to Joint Powers Authorities (JPAs). These funds are not subject to the same SEC rules applicable to money market mutual funds.

Make Whole Call. A type of call provision on a bond that allows the issuer to pay off the remaining debt early. Unlike a call option, with a make whole call provision, the issuer makes a lump sum payment that equals the net present value (NPV) of future coupon payments that will not be paid because of the call. With this type of call, an investor is compensated, or "made whole."

Margin. The difference between the market value of a security and the loan a broker makes using that security as collateral.

Market Risk. The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates.

Market Value. The price at which a security can be traded.

Maturity. The final date upon which the principal of a security becomes due and payable.

Medium Term Notes. Unsecured, investment-grade senior debt securities of major corporations which are sold in relatively small amounts on either a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

Modified Duration. The percent change in price for a 100-basis point change in yields. Modified duration is the best single measure of a portfolio's or security's exposure to market risk.

Money Market. The market in which short-term debt instruments (T-bills, discount notes, commercial paper, and banker's acceptances) are issued and traded.

Money Market Mutual Fund. A mutual fund that invests exclusively in short-term securities. Examples of investments in money market funds are certificates of deposit and U.S. Treasury securities. Money market funds attempt to keep their net asset values at $1 per share.

Mortgage Pass-Through Securities. A securitized participation in the interest and principal cash flows from a specified pool of mortgages. Principal and interest payments made on the mortgages are passed through to the holder of the security.

Municipal Securities. Securities issued by state and local agencies to finance capital and operating expenses.

Mutual Fund. An entity which pools the funds of investors and invests those funds in a set of securities which is specifically defined in the fund's prospectus. Mutual funds can be invested in various types of domestic and/or international stocks, bonds, and money market instruments, as set forth in the individual fund's prospectus. For most large, institutional investors, the costs associated with investing in mutual funds are higher than the investor can obtain through an individually managed portfolio.

Nationally Recognized Statistical Rating Organization (NRSRO).
A credit rating agency that the Securities and Exchange Commission in the United States uses for regulatory purposes. Credit rating agencies provide assessments of an investment's risk. The issuers of investments, especially debt securities, pay credit rating agencies to provide them with ratings. The three most prominent NRSROs are Fitch, S&P, and Moody's.

Negotiable Certificate of Deposit (CD). A short-term debt instrument that pays interest and is issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. Negotiable CDs are traded in a secondary market.

Primary Dealer. A financial institution (1) that is a trading counterparty with the Federal Reserve in its execution of market operations to carry out U.S. monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the U.S. Government securities market.

Prudent Person (Prudent Investor) Rule. A standard of responsibility which applies to fiduciaries. In California, the rule is stated as "Investments shall be managed with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of like character and with like aims to accomplish similar purposes."

REPURCHASE AGREEMENT. Short-term purchases of securities with a simultaneous agreement to sell the securities back at a higher price. From the seller's point of view, the same transaction is a reverse repurchase agreement.

SAFEKEEPING. A service to bank customers whereby securities are held by the bank in the customer's name.

SECURITIES AND EXCHANGE COMMISSION (SEC). The U.S. Securities and Exchange Commission (SEC) is an independent federal government agency responsible for protecting investors, maintaining fair and orderly functioning of securities markets and facilitating capital formation. It was created by Congress in 1934 as the first federal regulator of securities markets. The SEC promotes full public disclosure, protects investors against fraudulent and manipulative practices in the market, and monitors corporate takeover actions in the United States.

SECURITIES AND EXCHANGE COMMISSION SEC) RULE 15C3-1. An SEC rule setting capital requirements for brokers and dealers. Under Rule 15c3-1, a broker or dealer must have sufficient liquidity in order to cover the most pressing obligations. This is defined as having a certain amount of liquidity as a percentage of the broker/dealer's total obligations. If the percentage falls below a certain point, the broker or dealer may not be allowed to take on new clients and may have restrictions placed on dealings with current client.

STRUCTURED NOTE. A complex, fixed income instrument, which pays interest, based on a formula tied to other interest rates, commodities or indices. Examples include inverse floating rate notes which have coupons that increase when other interest rates are falling, and which fall when other interest rates are rising, and "dual index floaters," which pay interest based on the relationship between two other interest rates - for example, the yield on the ten-year Treasury note minus the Libor rate. Issuers of such notes lock in a reduced cost of borrowing by purchasing interest rate swap agreements.

SUPRANATIONAL. A Supranational is a multi-national organization whereby member states transcend national boundaries or interests to share in the decision making to promote economic development in the member countries.

TOTAL RATE OF RETURN. A measure of a portfolio's performance over time. It is the internal rate of return, which equates the beginning value of the portfolio with the ending value; it includes interest earnings, realized and unrealized gains, and losses in the portfolio.

U.S. TREASURY OBLIGATIONS. Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are considered to have no credit risk and are the benchmark for interest rates on all other securities in the US and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

TREASURY BILLS. All securities issued with initial maturities of one year or less are issued as discounted instruments and are called Treasury bills. The Treasury currently issues three- and six-month T-bills at regular weekly auctions. It also issues "cash management" bills as needed to smooth out cash flows.

TREASURY NOTES. All securities issued with initial maturities of two to ten years are called Treasury notes and pay interest semi-annually.

TREASURY BONDS. All securities issued with initial maturities greater than ten years are called Treasury bonds. Like Treasury notes, they pay interest semi-annually.

YIELD TO MATURITY. The annualized internal rate of return on an investment which equates the expected cash flows from the investment to its cost.