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## **I. INVESTMENT POLICY**

### **A. Purpose**

The purpose of the Union Sanitary District’s (“USD”) Investment Policy is to establish clear guidelines, objectives, policies and understanding for the Board of Directors, USD management, responsible employees, citizens and third parties for the investment of all USD funds. USD funds invested shall provide sufficient cash flow to meet current and expected operating expenses and to fund capital requirements as described in USD’s 10-year Capital Improvement Program and 10-year Financial Plan; and enhance the economic status of USD while protecting its cash. USD shall review this policy as least once annually, and may change its policies as investment objectives change.

### **B. Objectives**

The objectives of this investment policy are, in order of priority:

1. To assure ongoing compliance with all Federal, State and local laws governing the investment of public funds;
2. To ensure safety of invested funds;
3. To maintain sufficient liquidity to meet cash flow needs for all operating requirements which might be reasonably anticipated without requiring a sale of securities;
4. Maintain a diversified investment portfolio to avoid incurring unreasonable risks regarding specific security types or individual financial institutes; and
5. To attain a “market average rate of return” consistent with the primary objectives of safety and liquidity. The expected rate of return on USD’s portfolio is more specifically defined in Section IV.

### **C. Prudence**

1. The Prudent Investor Standard shall be used by investment officials, and shall be applied in the context of managing an overall portfolio. Investment staff acting in accordance with written procedures and the investment policy and

exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported within 30 days and appropriate action is taken to control adverse developments.

2. The Prudent Investor Standard: When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, 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, a trustee is authorized to acquire investments as authorized by law.

#### **D. Ethics and Conflicts of Interest**

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions.

## **II. OPERATIONS AND PROCEDURAL MATTERS**

### **A. Scope**

This investment policy applies to all financial assets and investment activities of USD except USD's Deferred Compensation Plan managed by a third party administrator and invested by individual participants; and USD's retiree medical trust held with CalPERS (the CERBT Trust) and pension assets held with CalPERS since the assets of both plans are managed by CalPERS.

Proceeds of debt issuance shall be invested in accordance with the general investment philosophy of USD as set forth in this policy; however, such proceeds are invested in accordance with permitted investment provisions of their specific bond indentures.

### **B. Delegation of Authority**

1. Authority to manage USD's investment program is derived from the California Government Code Sections 53600 et seq., and USD's Charter.
2. With the approval of the Board of Directors, USD may engage the services of an external investment advisor to assist in the management of USD's investment portfolio in a manner consistent with USD's objectives. Such external investment advisors may be granted discretion to purchase and sell

investment securities in accordance with this Investment Policy. Such discretion will be subject to oversight and other restrictions which are to be described in a written agreement. Such advisor must be registered under the Investment Advisers Act of 1940.

3. In accordance with Government Code Section 53607, the Board of Directors delegates to the General Manager/Treasurer, or his designee, the authority to invest, sell or exchange securities. This delegation of authority must be reviewed, and if still applicable, renewed on an annual basis. The Board shall receive a monthly report of the transactions conducted on its behalf.

### **C. Internal Controls**

The General Manager/Treasurer is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the entity are protected from loss, theft or misuse. The internal control structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

As part of the annual financial audit, USD's external auditor will perform a review of investment transactions to verify compliance with policies and procedures.

### **D. Delivery vs. Payment**

All investment transactions of USD shall be conducted using standard delivery-vs.-payment procedures.

### **E. Safekeeping of Securities**

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 USD shall be held in safekeeping by a third party bank trust department, acting as agent for USD under the terms of a custody agreement executed by the bank and by USD. The only exception to the foregoing shall be depository accounts and securities purchases made with: (i) local government investment pools; (ii) time certificates of deposit, and, (iii) money market mutual funds, since the purchased securities are not deliverable. Evidence of each of these investments will be held by USD.

### **F. Qualifications and Selection of Broker/Dealers**

USD shall purchase investments with security broker/dealers based on their reliability; trustworthiness; and their expertise in public cash management. Brokers/dealers must be registered with the state and provide upon request other

information to determine their creditworthiness and trustworthiness such as proof of Financial Industry Regulatory Authority (FINRA) registration. A list of security brokers/dealers USD is doing business with will be provided to the Board of Directors with the monthly investment report. A copy of the current USD investment policy will be provided to all security broker/dealers doing business with USD. It shall be the policy of USD to purchase securities only from authorized institutions or firms.

For transactions initiated through an external investment advisor, the investment advisor may use their own list of approved broker/dealers and financial institutions, which it will maintain and review periodically.

### **III. PERMITTED INVESTMENT AND PORTFOLIO RISK MANAGEMENT**

#### **A. Authorized Investments**

All investments shall be made in accordance with Sections 53600 et seq. of the Government Code of California and as described within this Investment Policy. Within the investments permitted by the Government Code, USD seeks to further restrict eligible investment to the investments listed below. In the event an apparent discrepancy is found between this Investment Policy and the Government Code, the more restrictive parameters will take precedence. Percentage holding limits listed in this section apply at the time the security is purchased.

1. U.S. Treasury securities not exceeding five (5) years to final maturity. There is no limitation as to the percentage of the portfolio that may be invested in this category.
2. 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, provided that there shall be no maximum allowable investment in such securities. Purchases of Federal Agency mortgage-backed securities issued by or fully guaranteed as to principal and interest by government agencies are limited to a maximum of 20 % of the portfolio.
3. Eligible Banker's acceptances, highest letter and numerical short term debt ratings by a National Recognized Standard Rating Organization (NRSRO) and an A1 or P1 or equivalent rating, if any, of other debt, shall have a maximum duration of one hundred eighty (180) days. The aggregate investment in banker's acceptances shall not exceed forty percent (40%) of USD's total portfolio, and no more than five percent (5%) of the District's total portfolio shall be invested in banker's acceptances of any one bank.

4. Bank Deposits. FDIC insured or fully collateralized demand deposit accounts, savings accounts, market rate accounts, time certificates of deposits (“TCDs”) and other types of bank deposits in financial institutions located in California. Bank deposits shall meet the requirements for deposit under Government Code Section 53630 et. seq. To be eligible to receive USD deposits, the financial institution must have received a minimum overall satisfactory rating for meeting the credit needs of California Communities in its most recent evaluation, as provided in Government Code Section 53635.2. Deposits are required to be collateralized as specified under Government Code Section 53630 et. seq. The General Manager/Treasurer, at his or her discretion, may waive the collateralization requirements for any portion that is covered by federal deposit insurance. USD shall have a signed agreement with all depositories receiving USD deposits per Government Code Section 53649. The maturity of time deposits may not exceed 5 years. There is no limit on the percentage of the portfolio that may be invested in bank deposits. However, a maximum of 20 percent of the portfolio may be invested in time deposits.
5. Certificates of deposit placed through a deposit placement service shall meet the requirements under Government Code Section 53601.8. The full amount of the principal and the interest that may be accrued during the maximum term of each certificate of deposit shall at all times be insured by federal deposit insurance. The maximum term for placement service certificates of deposit shall be 5 years. The combined amount invested in placement service certificates of deposit and negotiable certificates of deposit shall not exceed 30% of the portfolio.
6. Negotiable certificates of deposit (NCDs issued by a nationally or state-chartered bank, a savings association or a federal association (as defined by Section 5102 by the Financial Code), a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank. Purchases of NCDs shall not exceed thirty percent (30%) of the total portfolio and will have a maturity date not to exceed five (5) years.
7. Repurchase agreements, provided that:
  - a. The maximum maturity of repurchase agreements shall be 90 days;
  - b. No more than 10% of the portfolio shall be invested in repurchase agreements;
  - c. Repurchase agreements shall be fully secured by deliverable U.S. Treasury and Federal Agency obligations as described under Sections III (A1-2) of this policy (without limit to maturity) having a market value at all times of at least one hundred two percent (102%) of the

amount of the contract. If additional collateral is required then that collateral must be delivered within one business day (if a collateral deficiency is not corrected within this time frame, the collateral securities will be liquidated);

- d. Securities used as collateral for repurchase agreements, shall be free and clear of any lien and be held by USD's custodian bank or an independent third-party custodian acting solely as agent for the USD, provided such third party is not the seller under the repurchase agreement;
  - e. The repurchase agreements are the subject of a master repurchase agreement or a specific written repurchase agreement between USD and the provider of the repurchase agreement; and
  - f. The counterparty meets the following criteria:
    - (i) The counterparty must be a primary government securities dealer who reports daily to the Federal Reserve Bank of New York, or a bank, savings and loan association, or diversified securities broker-dealer having \$5 billion in assets and \$500 million in capital and subject to regulation of capital standards by any state or federal regulatory agency;
    - (ii) Has a long-term credit rating of at least 'AA' or the equivalent from a NRSRO;
    - (iii) Has been in operation for at least 5 years; and
    - (iv) Is reputable among market participants.
8. Commercial Paper with the highest letter and numerical short term debt ratings by a NRSRO and A1 or P1 or equivalent rating with a corporation organized and operating in the United States and has assets in excess of five hundred million dollars (\$500,000,000). No more than twenty-five percent (25%) of the portfolio shall be invested in commercial paper and no more than five percent (5%) of USD's total portfolio shall be invested in the commercial paper of any one issuer. Maximum maturity shall not exceed two hundred seventy (270) days
9. State of California's Local Agency Investment Fund ("LAIF"), pursuant to California Code Section 16429.1. A maximum of seventy percent (70%) of USD's funds or the limit permitted by the State may be invested in LAIF, whichever is less;

10. Corporate medium-term notes, 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. Notes eligible for investment under this subdivision shall be rated A or better by a NRSRO. Purchases may not exceed thirty percent (30%) of invested funds and five percent (5%) of the total portfolio of any one issuer's securities.
11. Municipal Obligations. USD may purchase municipal obligations in the following categories.
  - a. USD Bonds – Bonds issued by USD, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by USD or by a department, board, agency, or authority of USD.
  - b. California State Obligations – Registered state warrants or treasury notes or bonds of the State of California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the State or by a department, board, agency, or authority of the State.
  - c. Local Agency Bonds – Bonds, notes, warrants, or other evidences of indebtedness of any local agency within the State of California, 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.

With the exception of obligations issued by USD, purchases of municipal obligations are limited to securities rated at least in the "A" (long-term) or "A-1" (short-term), or their equivalents, by a NRSRO. Obligations shall have a maximum maturity of five years. A maximum of thirty percent (30%) of the portfolio may be invested in this category. The amount invested with any one issuer shall not exceed ten percent (10%) of the portfolio.

12. Money market mutual funds, provided that such funds
  - a. Are registered with the Securities and Exchange Commission and are rated "AAAm" or its equivalent by not less than two NRSROs; or have retained an investment adviser 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;

- b. The purchase price of shares shall not exceed twenty percent (20%) of USD's portfolio; and
  - c. If USD has funds invested in a money market fund, a copy of fund's information statement shall be maintained on file for due diligence. In addition, the General Manager/Treasurer should review the fund's summary holdings on a quarterly basis.
13. Shares of beneficial interest issued by a joint powers authority organized pursuant to Section 6509.7 that invests in the securities and obligations authorized in subdivisions (a) to (o) as provided, provided that
- a. A maximum of fifty percent (50%) of USD's funds may be invested in the shares of any one investment pool;
  - b. The pool's investment advisor meets the requirements of 53601(p);
  - c. The pool seeks to maintain a stable Net Asset Value ("NAV");
  - d. The pool is rated "AAAm" or its equivalent by a NRSRO; and
  - e. If USD has funds invested in a pool, a copy of pool's information statement shall be maintained on file for due diligence. In addition, the General Manager/Treasurer should review the pool's summary holdings on a quarterly basis.
14. United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or the Inter-American Development Bank, with a maximum remaining maturity of five years or less, and eligible for purchase and sale within the United States. Investments under this subdivision shall be rated "AA" or better by an NRSRO and shall not exceed thirty percent (30%) of the agency's moneys that may be invested pursuant to this section.

#### **B. Prohibited Investment Vehicles and Practices**

- 1. State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to, mutual funds.
- 2. In accordance with Government Code Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.

3. In accordance with Government Code Section 53601.6, investment in any security that could result in a zero interest accrual if held to maturity is prohibited.
4. Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.
5. Purchasing or selling securities on margin is prohibited.
6. The use of reverse repurchase agreements, securities lending or any other form of borrowing or leverage is prohibited.
7. USD is not permitted to deposit funds into any state or federal credit union, if a member of the Board of Directors, or any person with investment decision making authority also serves on the board of directors, or any committee appointed by the board of directors, or the credit committee or supervisory committee, of the state or federal credit union.

### **C. Mitigating Credit Risk in the Portfolio**

Credit risk is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt. USD shall mitigate credit risk by adopting the following strategies:

1. The diversification requirements included in Section III (A) are designed to mitigate credit risk in the portfolio;
2. No more than 10% of the total portfolio may be invested in securities of any single issuer, other than LAIF, local government investment pools, all U.S. Government, its agencies and instrumentalities. In regards to commercial paper and medium-term notes no more than five percent (5%) of the total two combined shall be with the same issuing company; and
3. USD may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or USD's risk preferences; and
4. If securities owned by USD are downgraded by a NRSRO to a level below the quality required by this Investment Policy, it shall be USD's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio. Please see Appendix A for credit ratings.

- a. If a security is downgraded two rating categories below the level required by USD (A, depending on the rating Agency), the security shall be sold immediately.
- b. If a security is downgraded one rating category below the level required by this policy, USD will use discretion in determining whether to sell or hold the security based on its current maturity, the loss in value, the economic outlook for the issuer, and other relevant factors.
- c. 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 USD's Board of Directors.

#### **IV. INVESTMENT PERFORMANCE OBJECTIVES**

A 12-month rolling average of the 1-year U.S. Treasury yield may serve as a reasonable benchmark for the total current portfolio.

#### **V. INVESTMENT GUIDELINES**

##### **A. Liquidity**

1. A minimum of ten percent (10%) of USD's funds shall be invested in liquid investments such as LAIF or CAMP to ensure adequate cash reserves to pay current expenses. Any changes to investments or new investments approved by the state shall require an amendment to the policy approval by the Board.
2. If USD uses an investment advisor, USD's General Manager/Treasurer shall communicate periodically with the investment adviser in order to keep the adviser informed as to USD's specific short-term liquidity requirements.

##### **B. Maximum Maturities**

1. To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities. USD will not invest in securities maturing more than five (5) years from the date of trade settlement, unless the Board of Directors has by resolution granted authority to make such an investment at least three months prior to the date of investment.

## **VI. REPORTING, DISCLOSURE AND PROGRAM EVALUATION**

### **A. Monthly Reports**

Monthly investment reports shall be submitted by USD finance staff to USD's Board of Directors and the General Manager. These reports shall disclose, at a minimum, the following information about the risk characteristics of USD's portfolio:

1. As asset listing showing par value, cost and accurate and complete market value of each security, type of investment, issuer name, credit quality, coupon rate and yield to maturity at cost;
2. A one or two-page summary report which shows:
  - a. Weighted average maturity of the portfolio;
  - b. Maturity distribution of the portfolio;
  - c. Average monthly yield to maturity at cost for the portfolio for the prior twelve months compared to the Benchmark Index returns for the same periods;
  - d. A list of portfolio transactions;
3. A statement of compliance with the investment policy, including a schedule of any transactions or holdings which do not comply with this policy or with the California Government Code, if any, including a justification for their presence in the portfolio and a timetable for resolution; and
4. A statement that USD has adequate funds to meet its cash flow requirements for the next six months.
5. A list of broker/dealers the District is currently using.

### **B. Annual Reports**

1. The investment policy shall be reviewed at least two months before the current investment policy expires and adopted before the current investment policy expires to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.
2. The investment program shall be included in the scope of USD's annual audit.

### C. Periodic Investment Program Review

USD shall retain the services of an expert consultant to perform a thorough review of the investment program a minimum of once every four years.

This revision supersedes the versions listed below, which are no longer effective.

<b>Title</b>	<b>Policy #</b>	<b>Effective Date</b>
Investment Policy	2030	11/27/95
Investment Policy	2030	10/11/11
Investment Policy	2030	9/24/12
Investment Policy	2030	9/22/14
Investment Policy	2030	1/1/15

Approved by: Board of Directors  
 Author/owner: Business Services Manager/Chief Financial Officer  
 Reviewers: General Manager, Senior Accountant and Principal Financial Analyst  
 Notify Person: Business Services Manager/Chief Financial Officer  
 Revision frequency: Annually  
 Next Review: 11/1/16 (two months before the effective policy expires)

## GLOSSARY OF INVESTMENT TERMS

**Asset-backed security.** A security supported by assets such as automobile loans or other consumer receivables which are placed with a trustee for the benefit of the owners of the security.

**Banker's acceptance.** A high quality, short term money market instrument used to finance international trade. There has never been an instance of a failure to pay a banker's acceptance in full at its maturity date.

**Benchmark.** A segment of the securities market with characteristics similar to the subject portfolio. It is used to compare portfolio performance to the performance of the appropriate segment of the market.

**Callable Security.** Callable securities are those which contain an option allowing the issuer to retire the security prior to its final maturity date. If the level of interest rates falls sufficiently, the issuer of the bond will exercise the option and call the bond away from the investor. The issuer can save money by issuing new bonds at lower rates. Types of callable bonds can range from "one-time" to "quarterly" to "continuous" calls.

**CAMP (California Asset Management Program).** A pooled investment vehicle and Joint Powers Authority for local agencies in California which manages the California Asset Management Trust.

**Commercial paper.** Short term, negotiable unsecured promissory notes of corporations.

**Delivery vs. payment.** A securities industry procedure in which payment for a security is not released until the security is delivered to the customer's bank custodial account.

**Inverse floaters.** A security with an interest rate which changes periodically in the opposite direction to the change in the general level of interest rates.

**Investment Official.** An individual who is authorized to make investment decisions and execute investments of funds on behalf of USD.

**Leverage.** An investment practice in which the investor borrows money in order to increase the amount invested.

**Local Agency Investment Fund (LAIF).** A pooled investment vehicle for local agencies in California sponsored by the State of California and administered by the State Treasurer.

**Market cycle.** A market cycle is defined as a period of time which includes a minimum of two consecutive quarters of falling interest rates followed by a minimum of two consecutive quarters of rising interest rates.

**Money market mutual fund.** A mutual fund which invests in short term money market instruments only, and which has as an investment objective.

**Nationally Recognized Statistical Rating Organization (NRSRO).** A credit rating agency which issues credit ratings that the US Securities and Exchange Commission (SEC) permits other financial firms to use for certain regulatory purposes. Commonly used NRSROs are Moody's Investor Service, Standard & Poor's, and Fitch Ratings.

**Negotiable certificate of deposit.** A large denomination certificate of deposit which can be sold in the open market prior to maturity.

**Range notes.** Fixed income securities which pay interest only under certain conditions which are defined in the bond's indenture.

**Repurchase agreement.** An investment transaction wherein an investor agrees to purchase securities at an agreed upon price, and simultaneously agrees to sell the securities back to the counterparty on an agreed upon future date at an agreed upon price.

**Time certificate of deposit.** A non-negotiable certificate of deposit which cannot be sold prior to maturity.

**Total rate of return.** Annual return on an investment including appreciation and dividends or interest. For bonds held to maturity, total return is yield to maturity.

**Weighted Average Maturity.** The weighted average of the remaining terms of the underlying securities, using the current balance of each security as the weighting factor.

## Appendix A – Credit Ratings for Corporate Notes

<b>Equivalent Credit Ratings</b>				
Credit Risk	Moody's*	Standard & Poor's*	Fitch IBCA**	Duff & Phelps**
<b>INVESTMENT GRADE</b>				
Highest quality	Aaa	AAA	AAA	AAA
High quality (very strong)	Aa	AA	AA	AA
Upper medium grade (strong)	A	A	A	A
Medium grade	Baa	BBB	BBB	BBB
<b>NOT INVESTMENT GRADE</b>				
Lower medium grade (somewhat speculative)	Ba	BB	BB	BB
Low grade (speculative)	B	B	B	B
Poor quality (may default)	Caa	CCC	CCC	CCC
Most speculative	Ca	CC	CC	CC
No interest being paid or bankruptcy petition filed	C	C	C	C
In default	C	D	D	D

Source: The Bond Market Association

\* The ratings from Aa to Ca by Moody's may be modified by the addition of a 1, 2 or 3 to show relative standing within the category.

\*\*The ratings from AA to CC by Standard & Poor's, Fitch IBCA and Duff & Phelps may be modified by the addition of a plus or minus sign to show relative standing within the category.