

**THE METROPOLITAN WATER DISTRICT OF  
SOUTHERN CALIFORNIA**

**STATEMENT OF INVESTMENT POLICY  
June 14, 2011**

**I INVESTMENT AUTHORITY**

In accordance with Section 53600 et seq. of the Government Code of the state of California, the authority to invest public funds is expressly delegated to the Board of Directors for subsequent re-delegation to the Treasurer. Investments by the Treasurer pursuant to the delegation hereby made by this Statement of Investment Policy are limited to those instruments specified by the Board in Section 5101 of the Metropolitan Water District Administrative Code, and as further defined in this Statement of Investment Policy.

**II STATEMENT OF OBJECTIVES**

Per Section 53600.5 of the California Government Code, the primary objective of the Treasurer shall be to safeguard the principal of the funds under his control when investing public funds. The secondary objective shall be to meet all liquidity requirements and the third objective shall be to achieve a return on the funds under his control.

In order of priority, three fundamental criteria shall be followed in the investment program:

1. Safety of Principal - Investments shall be undertaken in a manner which first seeks to ensure the preservation of principal in the portfolio. Each investment transaction shall be entered into after taking into consideration the quality of the issuer, the underlying security or collateral, and diversification of the portfolio. Cash flow analysis will be conducted and utilized to avoid the need to sell securities prior to maturity and to reduce market risk.
2. Liquidity - In an effort to ensure that Metropolitan's portfolio will be sufficiently liquid to meet current and anticipated operating requirements, a cash flow analysis will be performed on an ongoing basis. Investments shall be made so that the maturity date is compatible with cash flow needs and safety of principal.
3. Return on Investment - Investments shall be undertaken to produce an acceptable rate of return after first considering safety of principal and liquidity and the prudent investor standard.

The Investment Strategy is subordinate to the Statement of Objectives, i.e., implementing the investment strategies listed below is not intended to supersede the objectives of Safety, Liquidity and Return.

Investment Programs - The portfolio is divided into long-term, short-term and bond reserves segments. The long-term segment of the portfolio will be actively managed, and performance measured against the Merrill Lynch, Corporate and Government, 1 to 5 years, A Rated and above index or other index determined by the Finance and Insurance Committee. The duration of the long-term segment will be limited to the duration of the index plus or minus 1.5.

The short-term segment of the portfolio will be managed to meet Metropolitan's cash flow needs. The total return of the short-term segment of the portfolio will be measured against the total return of the Merrill Lynch 3-Month Treasury Bill index, or other index determined by the Finance and Insurance Committee. The duration of the short-term segment is limited to the duration of the index plus or minus 0.2. Also, for purposes of the duration calculation, Local Agency securities that provide Metropolitan the right to redeem the security at par on a daily, weekly, or monthly basis will be considered to have a maturity of no more than 30 days.

The bond reserves segment shall be invested in high quality securities, with the goal of earning a return that minimizes any potential negative arbitrage experienced by each bond reserve fund. The bond reserve funds may be invested in securities issued by a Local Agency (e.g., a California municipality), including securities issued by Metropolitan. Bond reserve funds may also be invested in money market and fixed income investments.

All investment activity shall be consistent with the prudent investor standard.

### **III PRUDENT INVESTOR STANDARD**

As applicable to Metropolitan and its fiduciaries, the prudent investor standard is a standard of conduct whereby any person authorized to make investment decisions on behalf of Metropolitan acts 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 Metropolitan, that a prudent person acting in 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 meet the liquidity needs of Metropolitan.

### **IV PORTFOLIO**

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

#### **1. Maturity Limitations**

- a. The Treasurer is authorized to invest special trust funds in investments with a term to maximum maturity in excess of five years. These funds include, but are not limited, to the following:
  - Water Revenue Bond Reserve Funds
  - Escrow Funds
  - Debt Service Funds
  - Iron Mountain Landfill Closure
  - Postclosure Maintenance Fund
  - Lake Mathews Conservancy
- b. For certain instruments, the term of the investment is limited by market convention or as otherwise prescribed herein.
- c. The Short-Term portfolio may be invested in United States Treasury, Federal Agency and California Local Agency securities (including securities issued by Metropolitan) with stated maturities in excess of five years. All other securities held in the short-term

portfolio are limited to maximum maturities of 5 years or as otherwise specified in Section V, Authorized Securities.

- d. The Long-Term portfolio may be invested in United States Treasury and Federal Agency securities with maturities in excess of five years.

2. Investment Transactions

- a. Information concerning investment opportunities and market developments will be gained by maintaining contact with the financial community.
- b. Confirmations of all investment transactions will be sent directly to the Controller for audit.
- c. Annually the Treasurer shall transmit a copy of the current Statement of Investment Policy to all approved dealers. Each dealer is required to return a signed statement indicating receipt and understanding of Metropolitan's investment policies.
- d. When practical, the Treasurer shall solicit more than one quotation on each trade. All investment trades will be awarded on a competitive bid basis.
- e. Each day's listing of market indices and quotations shall be recorded and retained by the Treasurer for a period of five years.

3. Sale of Securities

Securities may be sold to provide needed liquidity, to restructure the portfolio to reduce risk or to increase the expected return of the portfolio. In no instance shall a sale of securities be used for speculative purposes.

4. Prohibited Investments

Prohibited investments include inverse floaters, range notes, interest only strips derived from a pool of mortgages (Collateralized Mortgage Obligations), and any security that could result in zero interest accrual if held to maturity. (Zero interest accrual means the security has the potential to realize zero earnings depending upon the structure of the security. Zero coupon bonds and similar investments that start at a level below the face value are legal because their value increases).

5. Portfolio Adjustments

- a. Portfolio percentage limitations for each category of investment are applicable only at the date of purchase. Should an investment percentage of portfolio limitation be exceeded due to an incident such as a fluctuation in portfolio size, the portfolio manager is not required to sell the affected securities.
- b. Should a security held in the portfolio be downgraded below the minimum criteria included in this Statement of Investment Policy, the Treasurer or investment manager shall sell such security in such a manner to minimize losses on the sale of such security. If the security is downgraded to a level that is less than investment grade, the Treasurer or investment manager shall sell such affected security immediately; however, if immediate liquidation of the security is not in the best interests of Metropolitan, the Treasurer or investment manager, in consultation with an ad hoc committee made up of the Chairman

of the Board, the Chairman of the Finance and Insurance Committee and the General Manager, and with the concurrence of the General Counsel, may dispose of the security in an orderly and prudent manner considering the circumstances, under terms and conditions approved by a majority of the members of such ad hoc committee. If the security matures within 60 days of the rating change, the Treasurer or investment manager may choose not to sell the security. The Treasurer shall include a description of any securities that have been downgraded below investment grade and the status of their disposition in his monthly report.

6. Safekeeping

- a. All securities transactions, including collateral for repurchase agreements entered into by Metropolitan shall be conducted on a delivery versus payment (DVP) basis.
- b. Securities will be held by an independent custodian designated by the Treasurer and held in safekeeping pursuant to a safekeeping agreement.
- c. All financial institutions that provide safekeeping services for Metropolitan shall be required to provide reports or safekeeping receipts directly to the Controller to verify securities taken into their possession.

**V AUTHORIZED INVESTMENTS**

Money market securities described in this section must be of prime quality of the highest letter and number rating (A1, P1, F1 or higher) as provided by a nationally recognized statistical rating organization (NRSRO). NRSROs for the purpose of this section are Moody's Investors Service, Standard and Poor's Ratings Services, and Fitch Ratings. Money market securities include Bankers' Acceptances, Commercial Paper, Negotiable Certificates of Deposit, and Time Deposits.

1. U.S. Government and Agencies

- a. Investments in individual U.S. Treasury and Federal Agency securities shall not be subject to any maturity limitations, provided that the duration of the portfolio managed by any manager in which such investments are held does not exceed the applicable limitation described under "STATEMENT OF OBJECTIVES – Investment Strategy" above.
- b. Investments in Treasury or Federal Agency obligations shall not exceed 100 percent of all investments.
- c. United States Treasury securities consist of 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.
- d. Federal Agency securities consist of obligations, participations, or other instruments issued by United States federal agencies or government-sponsored enterprises, including those issued by or fully guaranteed as to principal and interest by federal agencies or United States government-sponsored enterprises.

2. Bankers' Acceptances

Restrictions are as follows:

- a. Investments in prime bankers' acceptances may not exceed 40 percent of the portfolio in effect on the date of purchase of any such investment.
- b. No more than 25 percent of this category of investments may be invested in any one commercial bank's acceptances.
- c. The maximum maturity shall be limited to 180 days.

3. Negotiable Certificates of Deposit

Restrictions are as follows:

- a. Investments in negotiable certificates of deposit may not exceed 30 percent of the total portfolio in effect on the date of purchase of any such investment.
- b. The total investment in an eligible financial institution shall not exceed 25 percent of the total portfolio available for investment in this investment category.
- c. To be eligible, a negotiable certificate of deposit must be issued by a nationally or state-chartered bank, a state or federal savings and loan association or savings bank, or by a state-licensed branch of a foreign bank.
- d. The investment shall not exceed the shareholders' equity of any depository bank. For the purpose of this constraint, shareholders' equity shall be deemed to include capital notes and debentures.
- e. The investment shall not exceed the total of the net worth of any depository savings and loan association, except that investments up to a total of \$500,000 may be made to a savings and loan association without regard to the net worth of that depository, if such investments are insured or secured as required by law.
- f. The maximum maturity shall be limited to two years.

4. Commercial Paper

Restrictions are as follows:

- a. Investments in commercial paper shall not exceed 25 percent of the portfolio in effect on the date of purchase of any such investment.
- b. Each investment shall not exceed 270 days maturity.
- c. No more than 10 percent of the outstanding commercial paper of an issuing corporation may be purchased.

In addition, the entity that issues the commercial paper shall meet the following conditions in Option 1 or Option 2:

Option 1:

Is organized and operating in the United States as a general corporation and has total assets in excess of \$500 million.

Has debt other than commercial paper, if any, that is rated "A" or higher by a nationally recognized rating agency.

Option 2:

Is organized within the United States as a special purpose corporation, trust or limited liability company.

Has program-wide credit enhancements including, but not limited to, over-collateralization, letters of credit or surety bond.

Has commercial paper that is rated "A-1" or higher by a nationally recognized rating agency.

5. Repurchase Agreements

A repurchase agreement is a purchase of authorized securities (other than commercial paper) with terms including a written agreement by the seller to repurchase the securities on a later specified date for a specified amount. Restrictions are as follows:

- a. The percentage limit for investment in repurchase agreements shall be 50 percent of the total portfolio.
- b. Purchases of repurchase agreements will be limited to a maximum maturity of one year.
- c. Repurchase agreements shall be made only with primary dealers in government securities or financial institutions with a Moody's Investors Service, Inc., or equivalent, rating of A or better.
- d. Such investments shall provide for purchased securities with a market value at least 102 percent of the amount of the invested funds. Value shall be adjusted not less than quarterly.
- e. Purchased securities are limited to Treasury bills, bonds and notes, or other investments that are direct obligations of or fully guaranteed as to principal and interest by the United States or any agency thereof; negotiable certificates of deposit; and bankers' acceptances eligible for acceptance under Federal Reserve rules. Zero coupon and stripped coupon instruments are not acceptable.
- f. Such investments shall provide for transfer of ownership and possession of the purchased securities either to Metropolitan directly or to a custodian depository institution which shall take record title and shall establish and maintain a sub-account in its financial records for the securities in Metropolitan's name, and such custodian shall not be the dealer from which the securities were purchased.
- g. Each repurchase agreement shall provide a contractual right to liquidation of the purchased securities upon the bankruptcy, insolvency or other default of the counterparty.
- h. Purchased securities shall have maturities within 60 months of the date of investment.

6. Reverse Repurchase Agreements

A reverse repurchase agreement is a sale by the Treasurer of securities in the portfolio with terms including a written agreement to repurchase the securities on or before a specified date for a specified amount.

- a. Subject to the approval of the Board of Directors, the Treasurer may enter into a reverse repurchase agreement provided that the proceeds are invested solely to supplement the income normally received from the securities involved in the agreement. These agreements shall only be performed with primary dealers of the Federal Reserve Bank of New York.
- b. Investments in reverse repurchase agreements are limited to 20 percent of the base value of the portfolio. For the purpose of this constraint, base value of the portfolio shall be the total of Metropolitan's cash and securities under management by the Treasurer, excluding any amounts obtained through selling securities by reverse purchase agreements, securities lending agreements, or similar borrowing methods.
- c. The investment purchased with the proceeds of a reverse repurchase agreement must match or closely approximate the maturity of the reverse repurchase agreement(s).
- d. Purchases of securities with proceeds from reverse repurchase agreements may not be subject to a reverse repurchase agreement.
- e. Reverse repurchase agreements will be limited to a maximum maturity of 92 days.
- f. Securities used to make reverse repurchase agreements must be paid for and held for a minimum of 30 days prior to the transaction.

7. Time Deposits

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

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

- a. The financial institution must have been in existence for at least five years.
- b. Credit requirements may be waived for the maximum deposit amount that is insured by the Federal Deposit Insurance Corporation.
- c. The deposit shall not exceed the shareholders' equity of any depository bank. For the purposes of this constraint, shareholders' equity shall be deemed to include capital notes and debentures.
- d. The deposit shall not exceed the total of the net worth of any depository savings and loan association, except that deposits not exceeding a total of five hundred thousand dollars (\$500,000) may be made to a savings and loan association without regard to the net worth of that depository, if such deposits are insured or secured as required by law.
- e. The total deposits shall not exceed the shareholders' equity of any depository bank.
- f. In order to secure such deposits, the financial institution shall maintain in the collateral pool, securities having a market value of at least 10 percent in excess of the total amount deposited.
- g. Promissory notes secured by real estate mortgages or deeds of trust may not be accepted as collateral.



11. Shares of Beneficial Interest

The Treasurer may invest in shares of beneficial interest issued by eligible diversified management companies that (1) invest in authorized securities such as United States Treasury notes, bonds, bills; registered state warrants or treasury notes and bonds for the State of California, obligations of local agencies; commercial paper; negotiable certificates of deposit; repurchase agreements or reverse repurchase agreements and medium term notes or (2) are money market funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940. These companies must meet the following criteria:

- a. Attain the highest ranking of the highest letter and numerical rating provided by not less than two nationally recognized statistical rating agencies.
- b. Retain an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in authorized securities and obligations listed above.
- c. Assets under management shall be in excess of \$500 million.
- d. The purchase price of the shares of beneficial interest purchased shall not include any commission that the companies may charge and shall not exceed 20 percent of the Portfolio. However, no more than 10 percent of the Portfolio may be invested in shares of beneficial interest of any one mutual fund described above.

12. Investment Contracts

Funds held by a trustee or fiscal agent and pledged to the payment or security of bonds may be invested in accordance with the statutory provisions governing the issuance of those bonds or other forms of debt. These funds may also be invested in accordance with the ordinance, resolution, indenture or agreement executed by Metropolitan. Other forms of debt include, but are not limited to, the following: (a) obligations under a lease, and (b) an installment sale or other agreements. Eligible investments would consist of the following:

Guaranteed Investment Contracts  
Forward Delivery Agreements collateralized with U.S. Treasury or Agency Securities  
Other investment contracts collateralized with U.S. Treasury or Agency Securities

These investments may be purchased with maturities in excess of five years as noted in Section IV 1. of this policy.

13. California Local Agency Securities

- a. Investments in California local agency securities, including securities issued by Metropolitan, shall not be subject to any maturity limitations, provided that the duration of the portfolio managed does not exceed the applicable limit described under "STATEMENT OF OBJECTIVES – Investment Strategy."
- b. California local agency securities with a maturity in excess of five years must have a credit rating of at least AA (may be insured) and an underlying credit rating of A or better by a nationally recognized rating service
- c. The purchase of California local agency securities may not exceed 30 percent of the portfolio.

- d. The total investment in California local agency securities of an issuer shall not exceed 25 percent of the total portfolio available for investment in local agency securities. Investments in Metropolitan’s tendered bonds may exceed the 25 percent limitation by issuer.
- e. The maximum limit of 30 percent specified in c. of this section is waived to the extent that such investments are for the purpose of purchasing Metropolitan’s tendered bonds as a temporary investment. In other words, the investment portfolio may consist of Metropolitan-issued debt in amounts greater than 30 percent, but only Metropolitan securities.

**VI REPORTING**

In accordance with Administrative Code Section 5114, the Treasurer shall submit a monthly report to the Board Executive Secretary of the Board of Directors via the General Manager indicating the types of investment by fund and date of maturity, and shall provide the current market value of all securities, rates of interest, and expected yield to maturity. The Treasurer shall also submit a monthly summary report to the Board of Directors via the General Manager showing investment activity, including yield and earnings, and the status of cash by depository.

**VII MONITORING SAFETY AND LIQUIDITY OF DISTRICT FUNDS**

The Treasurer shall monitor or cause to be monitored the extent to which financial institutions with which Metropolitan maintains deposits or investments are consistent with Metropolitan’s policies regarding business activities within countries that may jeopardize the safety and liquidity of Metropolitan funds or violate other Metropolitan policies. Such matters shall be reported to the Finance and Insurance Committee as part of the Treasurer’s monthly report.

**VIII ADMINISTRATION**

The Treasurer may, at any time, establish more restrictive requirements for the securities approved for investment as deemed appropriate in this Statement of Investment Policy. These restrictions may include, but are not limited to, higher credit ratings, lower percentage limits by security type or issuer, shorter maturities and additional collateral for repurchase agreements.