

OTAY WATER DISTRICT
BOARD OF DIRECTORS POLICY

Subject	Policy Number	Date Adopted	Date Revised
INVESTMENT POLICY	27	9/15/93	5/7/14

1.0: POLICY

It is the policy of the Otay Water District to invest public funds in a manner which will provide maximum security with the best interest return, while meeting the daily cash flow demands of the entity and conforming to all state statues governing the investment of public funds.

2.0: SCOPE

This investment policy applies to all financial assets of the Otay Water District. The District pools all cash for investment purposes. These funds are accounted for in the District's audited Comprehensive Annual Financial Report (CAFR) and include:

- 2.1) General Fund
- 2.2) Capital Project Funds
 - 2.2.1) Designated Expansion Fund
 - 2.2.2) Restricted Expansion Fund
 - 2.2.3) Designated Betterment Fund
 - 2.2.4) Restricted Betterment Fund
 - 2.2.5) Designated Replacement Fund
 - 2.2.6) Restricted New Water Supply Fund
- 2.3) Other Post Employment Fund (OPEB)
- 2.4) Debt Reserve Fund

Exceptions to the pooling of funds do exist for tax-exempt debt proceeds, debt reserves and deferred compensation funds. Funds received from the sale of general obligation bonds, certificates of participation or other tax-exempt financing vehicles are segregated from pooled investments and the investment of such funds are guided by the legal documents that govern the terms of such debt issuances.

3.0: PRUDENCE

Investments should be made with judgment and care, under current prevailing circumstances, which persons of prudence, discretion and intelligence, exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

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The standard of prudence to be used by investment officials shall be the "Prudent Person" and/or "Prudent Investor" standard (California Government Code 53600.3) and shall be applied in the context of managing an overall portfolio. Investment officers 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 in a timely fashion and appropriate action is taken to control adverse developments.

4.0: OBJECTIVE

As specified in the California Government Code 53600.5, when investing, reinvesting, purchasing, acquiring, exchanging, selling and managing public funds, the primary objectives, in priority order, of the investment activities shall be:

- 4.1) Safety: Safety of principal is the foremost objective of the investment program. Investments of the Otay Water District shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, the District will diversify its investments by investing funds among a variety of securities offering independent returns and financial institutions.

- 4.2) Liquidity: The Otay Water District's investment portfolio will remain sufficiently liquid to enable the District to meet all operating requirements which might be reasonably anticipated.

- 4.3) Return on Investment: The Otay Water District's investment portfolio shall be designed with the objective of attaining a benchmark rate of return throughout budgetary and economic cycles, commensurate with the District's investment risk constraints and the cash flow characteristics of the portfolio.

5.0 DELEGATION OF AUTHORITY

Authority to manage the Otay Water District's investment program is derived from the California Government Code, Sections 53600 through 53692. Management responsibility for the investment program is hereby

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delegated to the Chief Financial Officer (CFO), who shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials and their procedures in the absence of the CFO.

The CFO shall establish written investment policy procedures for the operation of the investment program consistent with this policy. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the CFO.

6.0: ETHICS AND CONFLICTS OF INTEREST

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the General Manager any material financial interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with whom business is conducted on behalf of the District.

7.0: AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS

The Chief Financial Officer shall maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker/dealers who are authorized to provide investment services in the State of California. These may include "primary" dealers or regional dealers that qualify under Securities & Exchange Commission Rule 15C3-1 (Uniform Net Capital Rule). No public deposit shall be made except in a qualified public depository as established by state laws.

All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the District with the following, as appropriate:

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- Audited Financial Statements.
- Proof of National Association of Security Dealers (NASD) certification.
- Proof of state registration.
- Completed broker/dealer questionnaire.
- Certification of having read the District's Investment Policy.
- Evidence of adequate insurance coverage.

An annual review of the financial condition and registrations of qualified bidders will be conducted by the CFO. A current audited financial statement is required to be on file for each financial institution and broker/dealer in which the District invests.

8.0: AUTHORIZED AND SUITABLE INVESTMENTS

From the governing body perspective, special care must be taken to ensure that the list of instruments includes only those allowed by law and those that local investment managers are trained and competent to handle. The District is governed by the California Government Code, Sections 53600 through 53692, to invest in the following types of securities, as further limited herein:

8.01) United States Treasury Bills, Bonds, Notes or those instruments for which the full faith and credit of the United States are pledged for payment of principal and interest. There is no percentage limitation of the portfolio which can be invested in this category, although a five-year maturity limitation is applicable.

8.02) Local Agency Investment Fund (LAIF), which is a State of California managed investment pool, may be used up to the maximum permitted by State Law (currently \$50 million). The District may also invest bond proceeds in LAIF with the same but independent maximum limitation.

8.03) Bonds, debentures, notes and other evidence of indebtedness issued by any of the following government agency issuers:

- Federal Home Loan Bank (FHLB)

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- Federal Home Loan Mortgage Corporation (FHLMC or "Freddie Mac")
- Federal National Mortgage Association (FNMA or "Fannie Mae")
- Government National Mortgage Association (GNMA or "Ginnie Mae")
- Federal Farm Credit Bank (FFCB)
- Federal Agricultural Mortgage Corporation (FAMCA or "Farmer Mac")

There is no percentage limitation of the portfolio which can be invested in this category, although a five-year maturity limitation is applicable. Government agencies whose implied guarantee has been reduced or eliminated shall require an "A" rating or higher by a nationally recognized statistical rating organization.

8.04) Interest-bearing demand deposit accounts and Certificates of Deposit (CD) will be made only in Federal Deposit Insurance Corporation (FDIC) insured accounts. For deposits in excess of the applicable FDIC insured maximum, approved collateral shall be required in accordance with California Government Code, Section 53652. Investments in CD's are limited to 15 percent of the District's portfolio.

8.05) Commercial paper, which is short-term, unsecured promissory notes of corporate and public entities. Purchases of eligible commercial paper may not exceed 10 percent of the outstanding paper of an issuing corporation, and maximum investment maturity will be restricted to 270 days. Investment is further limited as described in California Government Code, Section 53601(h). Purchases of commercial paper may not exceed 10 percent of the District's portfolio and no more than 10 percent of the outstanding commercial paper of any single issuer.

8.06) Medium-term notes defined as all corporate debt securities with a maximum remaining maturity of five years or less, and that meet the further requirements of California Government Code, Section 53601(k). Investments in medium-term notes are limited to 10 percent of the District's portfolio.

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8.07) Money market mutual funds that invest only in Treasury securities and repurchase agreements collateralized with Treasury securities, and that meet the further requirements of California Government Code, Section 53601(1). Investments in money market mutual funds are limited to 10 percent of the District's portfolio.

8.08) The San Diego County Treasurer's Pooled Money Fund, which is a County managed investment pool, may be used by the Otay Water District to invest excess funds. There is no percentage limitation of the portfolio which can be invested in this category.

8.09) Under the provisions of California Government Code 53601.6, the Otay Water District shall not invest any funds covered by this Investment Policy in inverse floaters, range notes, interest-only strips derived from mortgage pools, or any investment that may result in a zero interest accrual if held to maturity. Also, the borrowing of funds for investment purposes, known as leveraging, is prohibited.

9.0: INVESTMENT POOLS/MUTUAL FUNDS

A thorough investigation of the pool/fund is required prior to investing, and on a continual basis. There shall be a questionnaire developed which will answer the following general questions:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how it 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 audited.
- A description of who may invest in the program, how often, and what size deposits and withdrawals are allowed.
- A schedule for receiving statements and portfolio listings.
- Are reserves, retained earnings, etc., utilized by the pool/fund?
- A fee schedule, and when and how is it assessed.

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- Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

10.0 COLLATERALIZATION

Collateralization will be required on certificates of deposit exceeding the applicable FDIC insured maximum. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be 102% of market value of principal and accrued interest. Collateral will always be held by an independent third party with whom the entity has a current custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the entity and retained. The right of collateral substitution is granted.

11.0: SAFEKEEPING AND CUSTODY

All security transactions entered into by the Otay Water District shall be conducted on a delivery-versus-payment (DVP) basis. Securities will be held by a third party custodian designated by the District and evidenced by safekeeping receipts.

12.0: DIVERSIFICATION

The Otay Water District will diversify its investments by security type and institution, with limitations on the total amounts invested in each security type as detailed in Paragraph 8.0, above, so as to reduce overall portfolio risks while attaining benchmark average rate of return. With the exception of U.S. Treasury securities, government agencies, and authorized pools, no more than 50% of the District's total investment portfolio will be invested with a single financial institution.

13.0: MAXIMUM MATURITIES

To the extent possible, the Otay Water District will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the District will not directly invest in securities maturing more than five years from the date of purchase. However, for time deposits with banks or savings and loan

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associations, investment maturities will not exceed two years. Investments in commercial paper will be restricted to 270 days.

14.0: INTERNAL CONTROL

The Chief Financial Officer shall establish an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures.

15.0: PERFORMANCE STANDARDS

The investment portfolio shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow needs.

The Otay Water District's investment strategy is passive. Given this strategy, the basis used by the CFO to determine whether market yields are being achieved shall be the State of California Local Agency Investment Fund (LAIF) as a comparable benchmark.

16.0: REPORTING

The Chief Financial Officer shall provide the Board of Directors monthly investment reports which provide a clear picture of the status of the current investment portfolio. The management report should include comments on the fixed income markets and economic conditions, discussions regarding restrictions on percentage of investment by categories, possible changes in the portfolio structure going forward and thoughts on investment strategies. Schedules in the quarterly report should include the following:

- A listing of individual securities held at the end of the reporting period by authorized investment category.
- Average life and final maturity of all investments listed.
- Coupon, discount or earnings rate.
- Par value, amortized book value, and market value.
- Percentage of the portfolio represented by each investment category.

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17.0: INVESTMENT POLICY ADOPTION

The Otay Water District's investment policy shall be adopted by resolution of the District's Board of Directors. The policy shall be reviewed annually by the Board and any modifications made thereto must be approved by the Board.

18.0: GLOSSARY

See Appendix A.

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APPENDIX A: GLOSSARY

ACTIVE INVESTING: Active investors will purchase investments and continuously monitor their activity, often looking at the price movements of their stocks many times a day, in order to exploit profitable conditions. Typically, active investors are seeking short term profits.

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

BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

BENCHMARK: A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio's investments.

BROKER/DEALER: Any individual or firm in the business of buying and selling securities for itself and others. Broker/dealers must register with the SEC. When acting as a broker, a broker/dealer executes orders on behalf of his/her client. When acting as a dealer, a broker/dealer executes trades for his/her firm's own account. Securities bought for the firm's own account may be sold to clients or other firms, or become a part of the firm's holdings.

CERTIFICATE OF DEPOSIT (CD): A short or medium term, interest bearing, FDIC insured debt instrument offered by banks and savings and loans. Money removed before maturity is subject to a penalty. CDs are a low risk, low return investment, and are also known as "time deposits", because the account holder has agreed to keep the money in the account for a specified amount of time, anywhere from a few months to several years.

COLLATERAL: Securities, evidence of deposit or other property, which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

COMMERCIAL PAPER: An unsecured short-term promissory note, issued by corporations, with maturities ranging from 2 to 270 days.

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COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the Otay Water District. It includes detailed financial information prepared in conformity with generally accepted accounting principles (GAAP). It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed statistical section.

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a set date.

DEALER: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

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

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

DERIVATIVES: (1) Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying index or security, and may include a leveraging factor, or (2) financial contracts based upon notional amounts whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities or commodities).

DISCOUNT: The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, e.g., U.S. Treasury Bills.

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

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

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures deposits in member banks and thrifts, currently up to \$100,000 per deposit.

FEDERAL FARM CREDIT BANK (FFCB): The Federal Farm Credit Bank system supports agricultural loans and issues securities and bonds in financial markets backed by these loans. It has consolidated the financing programs of several related farm credit agencies and corporations.

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

Federal Agricultural Mortgage Corporation (FAMC or Farmer Mac): A stockholder owned, publicly-traded corporation that was established under the Agricultural Credit Act of 1987, which added a new Title VIII to the Farm Credit Act of 1971. Farmer Mac is a government sponsored enterprise, whose mission is to provide a secondary market for agricultural real estate mortgage loans, rural housing mortgage loans, and rural utility cooperative loans. The corporation is authorized to purchase and guarantee securities. Farmer Mac guarantees that all security holders will receive timely payments of principal and interest.

FEDERAL HOME LOAN BANK (FHLB): Government sponsored wholesale banks (currently 12 regional banks), which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies.

FEDERAL HOME LOAN MORTGAGE CORPORATION (FHLMC or Freddie Mac): A stockholder owned, publicly traded company chartered by the United States federal government in 1970 to purchase mortgages and related securities, and then issue securities and bonds in financial markets backed by those mortgages in secondary markets. Freddie Mac, like its

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competitor Fannie Mae, is regulated by the United States Department of Housing and Urban Development (HUD).

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

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

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae): A government owned agency which buys mortgages from lending institutions, securitizes them, and then sells them to investors. Because the payments to investors are guaranteed by the full faith and credit of the U.S. Government, they return slightly less interest than other mortgage-backed securities.

INTEREST-ONLY STRIPS: A mortgage backed instrument where the investor receives only the interest, no principal, from a pool of mortgages. Issues are highly interest rate sensitive, and cash flows vary between interest periods. Also, the maturity date may occur earlier than that stated if all loans within the pool are pre-paid. High prepayments on underlying mortgages can return less to the holder than the dollar amount invested.

INVERSE FLOATER: A bond or note that does not earn a fixed rate of interest. Rather, the interest rate is tied to a specific interest rate index identified in the bond/note structure. The interest rate earned by the bond/note will move in the opposite direction of the index. An inverse floater increases the market rate risk and modified duration of the investment.

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LEVERAGE: Investing with borrowed money with the expectation that the interest earned on the investment will exceed the interest paid on the borrowed money.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL AGENCY INVESTMENT FUND (LAIF): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase/reverse repurchase agreements that establish each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller borrower.

MATURITY: The date upon which the principal or stated value of an investment becomes due and payable.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

MUTUAL FUNDS: An open-ended fund operated by an investment company which raises money from shareholders and invests in a group of assets, in accordance with a stated set of objectives. Mutual funds raise money by selling shares of the fund to the public. Mutual funds then take the money they receive from the sale of their shares (along with any money made from previous investments) and use it to purchase various investment vehicles, such as stocks, bonds, and money market instruments.

MONEY MARKET MUTUAL FUNDS: An open-end mutual fund which invests only in money markets. These funds invest in short term (one day to one

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year) debt obligations such as Treasury bills, certificates of deposit, and commercial paper.

NATIONAL ASSOCIATION OF SECURITIES DEALERS (NASD): A self-regulatory organization of the securities industry responsible for the operation and regulation of the NASDAQ stock market and over-the-counter markets. Its regulatory mandate includes authority over firms that distribute mutual fund shares as well as other securities.

PASSIVE INVESTING: An investment strategy involving limited ongoing buying and selling actions. Passive investors will purchase investments with the intention of long term appreciation and limited maintenance, and typically don't actively attempt to profit from short term price fluctuations. Also known as a buy-and-hold strategy.

PRIMARY DEALER: A designation given by the Federal Reserve System to commercial banks or broker/dealers who meet specific criteria, including capital requirements and participation in Treasury auctions. These dealers submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission registered securities broker/dealers, banks, and a few unregulated firms.

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

PUBLIC SECURITIES ASSOCIATION (PSA): A trade organization of dealers, brokers, and bankers who underwrite and trade securities offerings.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

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RANGE NOTE: An investment whose coupon payment varies and is dependent on whether the current benchmark falls within a pre-determined range.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond the current income return.

REGIONAL DEALER: A securities broker/dealer, registered with the Securities & Exchange Commission (SEC), who meets all of the licensing requirements for buying and selling securities.

REPURCHASE AGREEMENT (RP OR REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money that is increasing bank reserves.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

SECONDARY MARKET: A market made for the purchase and sale of outstanding securities issues following their initial distribution.

SECURITIES & EXCHANGE COMMISSION: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

SEC RULE 15C3-1: See Uniform Net Capital Rule.

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, FAMCA, etc.), and Corporations, which have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

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TREASURY BILLS: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

TREASURY BONDS: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

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

YIELD: The rate of annual income return on an investment, expressed as a percentage. (a) INCOME YIELD is obtained by dividing the current dollar income by the current market price for the security. (b) NET YIELD or YIELD TO MATURITY is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.