

Union Sanitary District
Policy and Procedure Manual

Effective Date:	Investment Policy	Policy Number 2030
March 2022		Page 1 of 14

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 certain 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 Capital Improvement Program and Financial Plan 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 to maximize the average rate of return consistent with the primary objectives of safety and liquidity.

C. Prudence

The Prudent Investor Standard shall be used by investment officials and shall be applied in the context of managing an overall portfolio. The prudent investor standard states:

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.

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.

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 proceeds of debt issued under an indenture and 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 their 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. United States Treasury notes, bonds, bills, or certificates of indebtedness, or those for which the faith and credit of the United States are pledged for the payment of principal and interest. 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. With the exception of federal agency mortgage-backed securities which are limited to twenty percent (20%) of the total portfolio there is no limitation as to the percentage of the portfolio that may be invested in this category.
3. Bankers' acceptances, otherwise known as bills of exchange or time drafts, that are drawn on and accepted by a commercial bank with a final maturity not exceeding 180 days from the date of trade settlement, rated at least "A-1" or the equivalent by a nationally recognized statistical-rating organization (NRSRO). The aggregate investment in banker's acceptances shall not exceed forty percent (40%) of USD's total portfolio.
4. Federally insured or collateralized time deposits (Non-negotiable certificates of deposit) provided that the certificates of deposit meet the conditions in either paragraph (a) or paragraph (b):
 - a) Certificates of 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 five years.

- b) 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 five years.

The combined amount invested in placement service certificates of deposit and negotiable certificates of deposit shall not exceed twenty percent (20%) of the portfolio.

- 5. Negotiable certificates of deposit (NCD) 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.
- 6. Repurchase agreements with a final termination date not exceeding 90 days from the date of trade settlement collateralized solely by United States Treasury, federal agency, or United States government sponsored enterprises permitted by this Investment Policy. The purchased securities (the "collateral") shall have a minimum market value of one hundred and two percent (102%) of the dollar value of the funds invested. The market value of the collateral securities shall be marked-to-the-market daily and the value shall be adjusted no less frequently than weekly. No substitution of collateral shall be allowed without the prior approval of the General Manager/Treasurer. All collateral securing repurchase agreements must be delivered to USD's custodian bank or handled under a tri-party repurchase agreement. USD or its trustee shall have a perfected first security interest under the Uniform Commercial Code in all securities subject to repurchase agreement.

Approved repurchase agreement counterparties shall have a repurchase agreement counterparty credit rating of at least "A-1" or the equivalent and a long-term credit rating of at least "A" or the equivalent by a NRSRO. Repurchase agreement counterparties shall execute a USD approved master repurchase agreement with USD. No more than ten percent (10%) of USD's total portfolio shall be invested in repurchase agreements.

- 7. Commercial Paper with the highest letter and numerical rating as provided for by a NRSRO. Eligible commercial paper shall have a final maturity not exceeding 270 days from the date of trade settlement. The aggregate investment in commercial paper shall not exceed twenty five percent (25%) of USD's total

portfolio. Furthermore, USD may invest no more than 5% of its total investment assets in the commercial paper and medium-term notes of any single issuer. The entity that issues the commercial paper shall meet all of the following conditions in either paragraph 1 or paragraph 2 below:

(1) The entity meets the following criteria:

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

(2) The entity meets the following criteria:

- 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, overcollateralization, letters of credit, or surety bond; and
- has commercial paper that is rated "A-1" or higher, or the equivalent, by an NRSRO.

8. State of California's Local Agency Investment Fund ("LAIF"), pursuant to California Code Section 16429.1. The maximum limit permitted by the State may be invested in LAIF. -
9. 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 in a rating category of "A" or its equivalent or better by an NRSRO. Purchases may not exceed thirty percent (30%) of invested funds. USD may invest no more than 5% of its total investment assets in the commercial paper and medium-term notes of any single issuer.
10. 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.
- d. Obligations of Other 49 States - 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.

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. USD may invest in this category up to the limit allowed by California Code Section 53601.

11. 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 five hundred million dollars (\$500,000,000); and
- 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.

12. 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 Code Section 53601 subdivisions (a) to (r) inclusive as provided, provided that

- a. The pool’s investment advisor meets the requirements of 53601(p);
- b. The pool seeks to maintain a stable Net Asset Value (“NAV”);

- c. The pool is rated “AAAm” or its equivalent by a NRSRO; and
 - d. 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.
13. A mortgage passthrough security, collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable passthrough certificate, or consumer receivable-backed bond. Securities eligible for investment under this subdivision shall be rated in a rating category of “AA” or its equivalent or better by an NRSRO and have a maximum remaining maturity of five years or less. Purchases may not exceed twenty percent (20%) of invested funds.
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 total portfolio 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, except as provided in the subsequent paragraph.

Notwithstanding the prohibitions stated in the above paragraph, effective January 1, 2021, USD may invest in securities issued by, or backed by, the United States government that could result in zero- or negative-interest accrual if held to maturity, in the event of, and for the duration of, a period of negative market interest rates. USD may hold these instruments until their maturity dates. Securities described in this paragraph shall remain in effect only until January 1, 2026, and as of that date is repealed.

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. With the exception of investments in United States Treasury Obligations, no single investment category shall constitute more than 70% of the District's overall portfolio without prior Board approval. Should United States Treasury Obligations ever exceed 70% of the District's portfolio, the District's General Manager, in consultation with the District's investment advisors, shall report to the Board at the next possible Board meeting advising the Board the reasons for the exceedance and seeking Board input and direction.
2. No more than five percent (5%) 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.
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, return, or yield of the portfolio in response to market conditions or USD's risk preferences.
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.

If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported to USD's Board of Directors. 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.

IV. INVESTMENT PERFORMANCE OBJECTIVES

To maximize the average rate of return consistent with the primary objectives of safety and liquidity. USD staff will establish a performance benchmark for its portfolio consistent with agency needs and will periodically review the benchmark for continued applicability.

V. INVESTMENT GUIDELINES

A. Liquidity

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities to ensure adequate cash reserves to pay current expenses.

If USD uses an investment advisor, USD's General Manager/Treasurer, or designee, 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

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 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. 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 published “next review date” reflected on the current investment policy 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 investment manager/consultant to perform a thorough review of the investment program a minimum of once every four years.

Approved by:	Board of Directors
Author/owner:	Business Services Manager/Chief Financial Officer
Reviewers:	General Manager, Finance and Acquisition Services Coach
Notify Person:	Business Services Manager/Chief Financial Officer
Revision frequency:	Annually
Next Review:	March 2023 (review typically begins 2 months prior to this date)

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.

California Asset Management Program (CAMP). 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

Equivalent Credit Ratings				
Credit Risk	Moody's*	Standard & Poor's*	Fitch IBCA**	Duff & Phelps**
INVESTMENT GRADE				
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
NOT INVESTMENT GRADE				
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.