

# **THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA**

## **STATEMENT OF INVESTMENT POLICY FISCAL YEAR 2024/25**

**June 11, 2024**

### **I. POLICY**

This Statement of Investment Policy (Policy) is intended to outline the guidelines and practices to be used in managing the Metropolitan Water District of Southern California's (District) investment portfolio. District funds not required for immediate cash disbursements will be invested in compliance with the Government Code of the state of California (California Government Code).

### **II. INVESTMENT AUTHORITY**

As authorized by Section 53607 of the California Government Code, authority to invest or reinvest funds of the District is hereby delegated by the Board of Directors to the Treasurer, for a period of one-year, who shall thereafter assume full responsibility for the investment program until the delegation of authority is revoked or expires. Subject to review, the Board of Directors may renew the delegation of authority each year. The Treasurer may delegate the day-to-day investment activities to their designee(s) but not the responsibility for the overall investment program.

The Treasurer may also delegate the day-to-day execution of investments to registered investment managers through written agreements. The investment manager(s), in coordination with the Treasurer, will manage on a daily basis the District's investment portfolio pursuant to the specific and stated investment objectives of the District. The investment manager(s) shall follow this Policy, the specific investment guidelines provided to each investment manager, and such other written instructions provided by the Treasurer or their designee(s). The investment manager(s) may be given discretion to acquire and dispose of assets in their designated account, but the investment manager(s) shall not be permitted to have custodial control over the District's investment portfolio.

### **III. STATEMENT OF OBJECTIVES**

In accordance with California Government Code Section 53600.5, and in order of importance, the Treasurer shall adhere to the following three criteria:

1. **Safety of Principal.** Investments shall be undertaken which first seek to ensure the preservation of principal in the portfolio. The Treasurer shall ensure that each investment transaction is evaluated or cause to have evaluated each potential investment, seeking both quality in issuer and in underlying security or collateral, and shall diversify the portfolio to reduce exposure to loss. Diversification of the portfolio will be used in order to reduce exposure to principal loss.
2. **Liquidity.** Investments shall be made whose maturity date is compatible with cash flow requirements of the District and which will permit easy and rapid conversion into cash without substantial loss 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.

In addition, the monthly report shall also include a statement denoting the ability to meet the District's expenditure requirements for the next six (6) months. The report shall also state compliance of the portfolio to this Policy, or manner in which the portfolio is not in compliance. In the event of non-compliance, staff will prepare a report for the Board that details the compliance issue, provides analysis, and provides a recommendation to bring the portfolio back into compliance with this Policy.

## **IX. PERFORMANCE STANDARDS**

The investment portfolio shall be managed 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 of the District. The District will employ an active management approach that allows for the sale of securities prior to their scheduled maturity dates. Securities may be sold for a variety of reasons, such as to increase yield, lengthen or shorten maturities, to take a profit, or to increase investment quality. In no instance shall a transaction be used for purely speculative purposes. The District recognizes that in a diversified portfolio occasional measured losses are inevitable and must be considered within the context of the overall portfolio's structure and expected investment return, with the proviso that adequate diversification and credit analysis have been implemented.

Because the composition of the portfolio fluctuates, depending on market and credit conditions, various appropriate indices selected by the Treasurer will be used to monitor performance.

## **X. INVESTMENT GUIDELINES AND ELIGIBLE SECURITIES**

The District is governed by the California Government Code, Sections 53600 et seq. Within the context of these limitations, the investments listed below are authorized.

The District is prohibited from investing in any investment authorized by the California Government Code but not explicitly listed in this Policy without the prior approval of the Board of Directors. Some of the limitations on investments set forth below are more stringent than required by the California Government Code and have been included to better manage the credit risks specific to the District's portfolio. Under the provisions of California Government Code Sections 53601.6, the District shall not invest any funds covered by this Investment Policy in inverse floaters, range notes, mortgage-derived, interest-only strips or any investment that may result in a zero interest accrual if held to maturity, except as authorized by Code Section 53601.6.

### **1. US Treasury Obligations**

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.

- Maximum allocation: 100% of the portfolio
- Maximum maturity: Five (5) years, except as otherwise permitted by this Policy
- Credit requirement: N.A.

### **2. Federal Agency Obligations**

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.

- Maximum allocation: 100% of the portfolio
- Maximum maturity: Five (5) years, except as otherwise permitted by this Policy
- Credit requirement: N.A.

- Credit requirement: All deposits must be collateralized as required by California Government Code Sections 53630 et seq. The Treasurer may waive collateral for the portion of any deposits that is insured pursuant to federal law.
- Deposits are limited to a state or national bank, savings association or federal association, a state or federal credit union, or a federally insured industrial loan company, located in California.
- Deposits must meet the conditions of California Government Code Sections 53630 et seq.

Pursuant to Government Code 53637, the District is prohibited from investing in deposits of a state or federal credit union if a member of the District's Board of Directors, or any person at the District with investment decision-making authority, serves on the board of directors or committee of the state or federal credit union.

#### **8. Money Market Mutual Funds**

Shares of beneficial interest issued by diversified management companies that are money market funds registered with the SEC.

- Maximum maturity: N/A
- Maximum allocation: Twenty percent (20%) of the portfolio
- Credit requirement: Highest ranking by not less than two NRSROs or must retain an investment advisor that meets specified requirements
- The use of money market funds is limited to Government money market funds that provide daily liquidity and seek to maintain a stable Net Asset Value (NAV)

#### **9. State of California, Local Agency Investment Fund (LAIF)**

LAIF is a pooled investment fund overseen by the State Treasurer, which operates like a money market fund, but is for the exclusive benefit of governmental entities within the state. The maximum investment amount authorized by the Local Agency Investment Fund (LAIF) is set by the California State Treasurer's Office. The LAIF is held in trust in the custody of the State of California Treasurer. The District's right to withdraw its deposited monies from LAIF is not contingent upon the State's failure to adopt a State Budget.

- Maximum limit: The current limit set by LAIF for operating accounts
- Maximum maturity: N/A
- Credit requirement: N/A

#### **10. Municipal Bonds and Notes**

Municipal obligations issued by the State of California, any other of the states in the union, or a local agency within the State of California. This may include bonds, notes, warrants, or other evidences of indebtedness including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by an authorized entity.

- Maximum limit: Thirty percent (30%) of the portfolio; five percent (5%) with any one issuer
- Maximum maturity: Five (5) years
- Credit requirement: A (long-term) or A-1 (short-term) or their equivalents or better by an NRSRO
- Must be issued by State of California, any of the other 49 states, or a California local agency

#### **11. Repurchase Agreement**

A repurchase agreement is a purchase of authorized securities with terms including a written agreement by the seller to repurchase the securities on a future date and price.

investment types at the parent company level. Should an investment percentage be exceeded due to instances such as the fluctuation in overall portfolio size, or market valuation changes, the Treasurer is not required to sell the affected securities. However, no additional investments can be made in that investment type or issuer while it is above the limits established by this Policy.

## **XII. CREDIT RATINGS**

Credit rating requirements for eligible securities in this Policy specify the minimum credit rating category required at the time of purchase without regard to +, -, or 1, 2, 3 modifiers, if any. The security, at the time of purchase, may not be rated below the minimum credit requirement by any of the NRSROs that rate the security.

If a security is downgraded below the minimum rating criteria specified in this Policy, the Treasurer shall determine a course of action to be taken on a case-by-case basis considering such factors as the reason for the downgrade, prognosis for recovery or further rating downgrades, and the market price of the security. The Treasurer shall note in the monthly report any securities which have been downgraded below Policy requirements and the recommended course of action.

## **XIII. MATURITY**

The Treasurer shall maintain a system to monitor and forecast revenues and expenditures so that the District's funds can be invested to the fullest extent possible while providing sufficient liquidity to meet the District's reasonably anticipated cash flow requirements.

The final maturity of any investment in the portfolios shall not exceed five (5) years with certain exceptions:

- The Treasurer is authorized to invest special trust funds in investment with a term to maximum maturity in excess of five years. These funds include, but are not limited to, the Water Revenue Bond Reserve Funds, Escrow Funds, Debt Service Funds, the Iron Mountain Landfill Closure/Post-closure Maintenance Trust Fund, and the Endowment Fund.
- The core portfolio may hold United States Treasury and Federal Agency securities with maturities in excess of five years.

## **XIV. DURATION**

Duration is a measure of a security's price sensitivity to interest rate changes. It indicates the approximate percentage change of a security's value given a 1% change in interest rates. A portfolio's duration is the weighted average of the individual security durations held in the portfolio.

The investment portfolio is divided into liquidity, core, and endowment fund portfolios. The Policy's duration limits only apply to the liquidity and core portfolios. The duration of the liquidity portfolio is limited to the duration of the benchmark index plus or minus 0.5 years. The duration of the core portfolio will be limited to the duration of the benchmark index plus or minus 1.5 years. The appropriate benchmark indices will be set by the Treasurer and reported to the Board in the Monthly Treasurer's Report.

## **XV. ADMINISTRATION**

The Treasurer may, at any time, establish more restrictive requirements for securities approved for investment as deemed appropriate in this 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 requirements for collateralized investments.

## SUMMARY TABLE OF INVESTMENT GUIDELINES AND ELIGIBLE SECURITIES

The following table is intended to be a summary of the Policy's requirements in Section X of this Policy. If there is a discrepancy between Section X and this table, the requirements listed in Section X take precedence.

Authorized Investments	Maximum % Holdings	Purchase Restrictions	Maximum Maturity	Credit Quality
US Treasury Obligations	100%	N/A	5 Years <sup>1</sup>	N/A
Federal Agency Obligations	100%	N/A	5 Years <sup>1</sup>	N/A
Bankers' Acceptance	40%	5% per issuer <sup>2</sup>	180 days	"A-1" or its equivalent or higher by an NRSRO.
Commercial Paper	40%	5% per issuer <sup>2</sup>	270 days	Highest ranking or of the highest letter and number rating as provided for by an NRSRO.
Medium Term Corporate Notes	30%	5% per issuer <sup>2</sup> . US licensed and operating corporations	5 years	"A" or its equivalent or higher by an NRSRO.
Negotiable CD	30%	5% per issuer <sup>2</sup> , National or state chartered bank, S&L, or branch of foreign bank	5 years	"A-1" (short-term) or "A" (long-term) or their equivalents or higher by an NRSRO.
Bank Deposit	30%	See California Government Code Section 53637	5 Years	Collateralized/FDIC Insured in accordance with California Government Code
Money Market Mutual Funds	20%	Gov't MMF. Stable NAV	Daily Liquidity	Highest ranking by two NRSROs or advisor requirements
Local Agency Investment Fund ("LAIF")	LAIIF limit for operating accounts	Subject to California Government Code Section 16429.1 limitations	N/A	N/A
Municipal Bonds and Notes	30%	5% per issuer <sup>2</sup> . State of California or California agencies or other 49 states	5 Years <sup>1</sup>	"A" or its equivalent or higher by an NRSRO.

## GLOSSARY

The glossary is provided for general information only. It is not to be considered a part of the Policy for determining Policy requirements or terms.

**AGENCIES:** Federal agency securities and/or Government-sponsored enterprises (GSEs), also known as U.S. Government instrumentalities. Securities issued by Government National Mortgage Association (GNMA) are considered true agency securities, backed by the full faith and credit of the U.S. Government. GSEs are financial intermediaries established by the federal government to fund loans to certain groups of borrowers, for example homeowners, farmers and students and are privately owned corporations with a public purpose. The most common GSEs are Federal Farm Credit System Banks, Federal Home Loan Banks, Federal Home Loan Mortgage Association, and Federal National Mortgage Association.

**ASSET BACKED:** Securities whose income payments and hence value is derived from and collateralized (or “backed”) by a specified pool of underlying assets which are receivables. Pooling the assets into financial instruments allows them to be sold to general investors, a process called securitization, and allows the risk of investing in the underlying assets to be diversified because each security will represent a fraction of the total value of the diverse pool of underlying assets. The pools of underlying assets can comprise common payments credit cards, auto loans, mortgage loans, and other types of assets. Interest and principal is paid to investors from borrowers who are paying down their debt.

**BANKERS’ ACCEPTANCE (BA):** A draft or bill of exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer. This money market instrument is used to finance international trade.

**BASIS POINT:** One-hundredth of one percent (i.e., 0.01%).

**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 investment.

**BOND:** A financial obligation for which the issuers promises to pay the bondholder a specified stream of future cash flows, including periodic interest payments and a principal repayment.

**BOOK VALUE:** The value at which a debt security is shown on the holder’s balance sheet. Book value is acquisition cost less amortization of premium or accretion of discount.

**BROKER:** A broker acts as an intermediary between a buyer and seller for a commission and does not trade for his/her own risk and account or inventory.

**CALLABLE SECURITIES:** A security that can be redeemed by the issuer before the scheduled maturity date.

**CALIFORNIA ASSET MANAGEMENT PROGRAM (CAMP):** A local government investment pool organized as joint powers authority in which funds from California local agency investors/participants are aggregated together for investment purposes.

**CASH EQUIVALENTS (CE):** Highly liquid and safe instruments or investments that can be converted into cash immediately. Examples include bank accounts, money market funds, and Treasury bills.

**DIVERSIFICATION:** Dividing investment funds among a variety of securities offering independent returns and risk profiles.

**DURATION:** A measure of the timing of the cash flows, such as the interest payments and the principal repayment, to be received from a given fixed-income security. This calculation is based on three variables: term to maturity, coupon rate, and yield to maturity. Duration measures the price sensitivity of a bond to changes in interest rates.

**EFFECTIVE RATE OF RETURN:** The annualized rate of return on an investment considering the price paid for the investment, its coupon rate, and the compounding of interest paid.  $(\text{Total Earnings} / \text{Average daily balance}) \times (365 / \# \text{ of days in the reporting period})$

**FACE VALUE:** The principal amount owed on a debt instrument. It is the amount on which interest is computed and represents the amount that the issuer promises to pay at maturity.

**FAIR VALUE:** The amount at which a security could be exchanged between willing parties, other than in a forced or liquidation sale. If a market price is available, the fair value is equal to the market value.

**FANNIE MAE:** Trade name for the Federal National Mortgage Association (FNMA), a U.S. Government sponsored enterprise.

**FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC):** A federal agency that provides insurance on bank deposits, guaranteeing deposits to a set limit per account, currently \$250,000.

**FEDERAL FARM CREDIT BANK (FFCB):** Government-sponsored enterprise that consolidates the financing activities of the Federal Land Banks, the Federal Intermediate Credit Banks and the Banks for Cooperatives. Its securities do not carry direct U.S. government guarantees.

**FEDERAL FUNDS RATE:** The rate of interest at which Federal funds are traded. This rate is considered to be the most sensitive indicator of the direction of interest rates, as it is currently pegged by the Federal Reserve through open-market operations.

**FEDERAL GOVERNMENT AGENCY SECURITIES:** 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.

**GOVERNMENT ACCOUNTING STANDARDS BOARD (GASB):** A standard-setting body, associated with the Financial Accounting Foundation, which prescribes standard accounting practices for governmental units.

**GUARANTEED INVESTMENT CONTRACTS (GICS):** An agreement acknowledging receipt of funds, for deposit, specifying terms for withdrawal, and guaranteeing a rate of interest to be paid.

**INDEX:** An index is an indicator that is published on a periodic basis that shows the estimated price and/or yield levels for various groups of securities. Examples of relevant indices for Metropolitan include, but not limited to, ICE BofAML, 3-Month Treasury Bill Index, and ICE BofAML, 1 - 5 years AAA-A US Corporate and Government Index

**INTEREST RATE:** The annual yield earned on an investment, expressed as a percentage.

**INTEREST RATE RISK:** The risk of gain or loss in market values of securities due to changes in interest-rate

counties, government retirement plans, school Agencies, state universities, sewer agency, municipally owned utilities and authorities running bridges, airports and other transportation facilities

**MUTUAL FUND:** An entity that pools money and can invest in a variety of securities that are specifically defined in the fund's prospectus.

**NEGOTIABLE CERTIFICATE OF DEPOSIT:** A large denomination certificate of deposit that can be sold in the open market prior to maturity.

**NET PORTFOLIO YIELD:** Calculation in which the 365-day basis equals the annualized percentage of the sum of all Net Earnings during the period divided by the sum of all Average Daily Portfolio Balances.

**NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO):** is a credit rating agency that issues credit ratings that the U.S. Securities and Exchange Commission permits other financial firms to use for certain regulatory purposes.

**PAR VALUE:** The amount of principal which must be paid at maturity. Also referred to as the face amount of a bond. See FACE VALUE.

**PORTFOLIO:** The collection of securities held by an individual or institution.

**PREMIUM:** The difference between the par value of a bond and the cost of the bond, when the cost is above par.

**PRIMARY DEALER:** A group of government securities dealers who 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. These dealers are authorized to buy and sell government securities in direct dealing with the Federal Reserve Bank of New York in its execution of market operations to carry out U.S. monetary policy. Such dealers must be qualified in terms of reputation, capacity, and adequacy of staff and facilities.

**PRIME (SHORT TERM RATING):** High-quality ratings for short-term debt such as commercial paper. Prime ratings are as follows: P1 (Moody's), A1 (S&P), and F1 (Fitch).

**PRINCIPAL:** The face value or par value of a debt instrument, or the amount of capital invested in a given security.

**PRIVATE PLACEMENTS:** Securities that do not have to be registered with the Securities and Exchange Commission because they are offered to a limited number of sophisticated investors.

**PROSPECTUS:** A legal document that must be provided to any prospective purchaser of a new securities offering registered with the Securities and Exchange Commission that typically includes information on the issuer, the issuer's business, the proposed use of proceeds, the experience of the issuer's management, and certain certified financial statements (also known as an "official statement").

**PRUDENT INVESTOR STANDARD:** A standard of conduct for fiduciaries. Investments shall be made with judgment and care, under circumstances then prevailing, 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.

**PUBLIC DEPOSIT:** A bank that is qualified under California law to accept a deposit of public funds.

**PURCHASE DATE:** The date in which a security is purchased for settlement on that or a later date. Also known as



sustainable economic growth. The California Government Code allows local agencies to purchase the United States dollar-denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank.

**TIME DEPOSIT:** A deposit with a California bank or savings and loan association for a specific amount and with a specific maturity date and interest rate. Deposits of up to \$250,000 are insured by FDIC. Deposits over \$250,000 are collateralized above the insurance with either government securities (at 110% of par value), first trust deeds (at 150% of par value), or letters of credit (at 105% of par value).

**TOTAL RATE OF RETURN:** A measure of a portfolio's performance over time. It is the internal rate of return that equates the beginning value of the portfolio with the ending value, and includes interest earnings and realized and unrealized gains and losses on the portfolio. For bonds held to maturity, total return is the yield to maturity.  $(\text{Net Invested Income} / \text{Time Weighted Invested Value}) \times (365 / \# \text{ of days in the reporting period})$

**TRUSTEE OR TRUST COMPANY OR TRUST DEPARTMENT OF A BANK:** A financial institution with trust powers that acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

**UNDERWRITER:** A dealer which purchases a new issue of municipal securities for resale.

**U.S. GOVERNMENT AGENCY SECURITIES:** Securities issued by U.S. government agencies, most of which are secured only by the credit worthiness of the particular agency. See AGENCIES.

**U.S. TREASURY OBLIGATIONS:** Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are the benchmark for interest rates on all other securities in the U.S. The Treasury issues both discounted securities and fixed coupon notes and bonds. The income from Treasury securities is exempt from state and local, but not federal, taxes.

**TREASURY BILLS:** Securities issued at a discount with initial maturities of one year or less. The Treasury currently issues three-month and six-month Treasury bills at regular weekly auctions. It also issues very short-term "cash management" bills as needed to smooth out cash flows.

**TREASURY NOTES:** Intermediate-term coupon-bearing securities with initial maturities of one year to ten years.

**TREASURY BOND:** Long-term coupon-bearing securities with initial maturities of ten years or longer.

**UNREALIZED GAIN (OR LOSS):** Gain or loss that has not become actual. It becomes a realized gain (or loss) when the security in which there is a gain or loss is actually sold. See REALIZED GAIN (OR LOSS).

**VOLATILITY:** Characteristic of a security, commodity or market to rise or fall sharply in price within a short-term period.

**WEIGHTED AVERAGE MATURITY:** The average maturity of all the securities that comprise a portfolio that is typically expressed in days or years.

**YIELD:** The annual rate of return on an investment expressed as a percentage of the investment. See CURRENT YIELD; YIELD TO MATURITY.

**YIELD CURVE:** Graph showing the relationship at a given point in time between yields and maturity for bonds that

## RATING DESCRIPTION TABLE

Long Term Debt Ratings			
Credit Quality	Moody's	S&P	Fitch
<b>Strongest Quality</b>	Aaa	AAA	AAA
<b>Strong Quality</b>	Aa1/Aa2/Aa3	AA+/AA/AA-	AA
<b>Good Quality</b>	A1/A2/A3	A+/A/A-	A
<b>Medium Quality</b>	Baa1/Baa2/Baa3	BBB+/BBB/BBB-	BBB
<b>Speculative</b>	Ba1/Ba2/Ba3	BB+/BB/BB-	BB
<b>Low</b>	B1/B2/B3	B+/B/B-	B
<b>Poor</b>	Caa	CCC+	CCC
<b>Highly Speculative</b>	Ca/C	CCC/CCC-/CC	CC
Short Term Debt Ratings			
Credit Quality	Moody's	S&P	Fitch
<b>Strongest Quality</b>	P-1	A-1+	F1
<b>Strong Quality</b>		A-1	
<b>Good Quality</b>	P-2	A-2	F2
<b>Medium Quality</b>	P-3	A-3	F3

Note: Investment Grade ratings apply to securities with at least a medium credit quality or higher by one of the nationally recognize statistical rating organization; anything below the medium credit quality is non-investment grade.