

**LAKE ARROWHEAD
COMMUNITY SERVICES
DISTRICT**

POLICY AND PROCEDURES

**INVESTMENT
POLICY**

Fiscal Year July 2018 – June 2019

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SECTION 1.0

PURPOSE AND SCOPE

1.1 Purpose

- 1.1.1 This Investment Policy is intended to outline the guidelines and practices to be used in effectively managing the District's available cash and investment portfolio. It applies to all cash and investment assets of the District. District monies not required for immediate expenditure will be invested in compliance with governing provisions of law, (Government Code Section 53600 et seq.) and this policy.
- 1.1.2 Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the proper management of public funds; not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived. The standard of prudence to be used by the investment officials shall be the "prudent investor" standard (Government Code Section 53600.3) and shall be applied in the context of managing an overall portfolio.
- 1.1.3 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.
- 1.1.4 Cash with Fiscal Agents are exempt from the provisions of the Government Code Section 53600 et seq. and are therefore not covered under this Investment Policy, but rather they are governed by the debt agreement associated with the bond proceeds.

1.2 Investment Goal

- 1.2.1 The Board's ultimate investment goal is to enhance the District's financial condition while ensuring the safety of its funds invested and that funds are readily available when needed.
- 1.2.2 In so doing, the District will abide by Section 53600 et seq. of the Government Code, which establishes specific rules for investment of public funds by California public agencies.

1.3 **Objective**

1.3.1 The objective of this policy is to maximize return on investment of all idle funds through the optimum operation of the District’s “Cash Management System”. This system is designed to reliably forecast and monitor the cash needs of the District.

1.3.2 The Finance Manager will obtain the highest yield possible on District deposits consistent with the District’s policy of preserving principle and maintaining liquidity.

1.3.3 As specified in Government Code Section 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:

1.3.3.1 Safety:

Safety is the minimizing of risk associated with investing and refers to the attempt to reduce the potential for loss of principal, interest or a combination of the two.

Safety of principal is the foremost objective of the investment program. Investments of the Lake Arrowhead Community Services District shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio.

To attain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

All District investments are controlled by the restrictions contained in Section 53601 of the Government Code.

The First Level of risk control is to invest in instruments as described above that are the most credit worthy.

The Second Level of risk control is to invest in instruments that have maturities coinciding with dates of anticipated disbursements, thereby reducing the risk of loss of interest from an early disposition or withdrawal.

The Third Level of risk control is to invest in instruments that have the greatest potential for interest return, thereby avoiding the risk of lost earnings.

The District will only invest in those instruments that are considered very safe, in accordance with Government Code Section 53600 et. seq.

1.3.3.2 Liquidity

Liquidity refers to “the ability to easily sell” at any time with a minimal risk of loss of principle or interest.

Liquidity is an important quality for District investments since cash flow can be unpredictable.

The investment portfolio will remain sufficiently liquid to enable the Lake Arrowhead Community Services District to meet all operating requirements, which might be reasonably anticipated.

The District will attempt to maintain liquidity of investments in conjunction with safety and yield.

1.3.3.3 Return on Investments:

Yield or rate of return is the earnings an investment can provide.

The investment portfolio shall be designed with the objective of attaining a market rate of return throughout the budgetary and economic cycles, taking into account the investment risk constraints and the cash flow characteristics of the portfolio.

The District attempts to obtain the highest yield prudent when selecting an investment, provided that the criteria stated in this Policy for safety and liquidity are first met.

SECTION 2.0

AUTHORITY FOR INVESTMENT OF DISTRICT FUNDS

2.1 Authority

- 2.1.1 Authority to manage the investment program is derived from California Government Code Section 53600 et. seq. Management responsibility for the investment program resides with the Finance Manager.
- 2.1.2 No person may engage in an investment transaction except as provided under the terms of this policy.
- 2.1.3 The Finance Manager shall be responsible for all the transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials. Under the provisions of California Government Code Section 53600.3, the Finance Manager is a trustee and a fiduciary subject to the prudent investor standard.
- 2.1.4 All investment transactions or reporting conducted by the Finance Manager, shall be reviewed and approved by the Board of Directors within thirty (30) days or at the next scheduled Board meeting following the transaction or report date.

2.2 Policy Review

- 2.2.1 The Finance Manager or his/her designee shall review the policy annually, for approval of the Board of Directors.

2.3 Ethics and Conflicts of Interest

- 2.3.1 District officers and employees with delegated investment program responsibility shall refrain from personal investment activities, which could conflict with the proper execution of the investment program or impair their ability to make impartial decisions. Such activities include, but are not limited to:
 - 2.3.1.1 Knowingly using the same broker who is managing District investments for personal investments.
 - 2.3.1.2 Knowingly accepting gifts or entertainment from any broker who is managing District investments, or who has expressed a desire to manage District investments. The term “broker” here refers to an individual and not to a brokerage.

2.4 Bonding

2.4.1 The Finance Manager and any and all individuals involved in the investment practices and investment decisions of the District shall be bonded by a recognized insurance company, duly authorized to transact a general surety business in the State of California.

2.5 Liability Insurance

2.5.1 The District shall provide liability insurance for the protection of the Finance Manager and/or any authorized investment broker and other authorized individuals with fiduciary responsibility to the District's investments.

SECTION 3.0

INVESTMENT GUIDELINES AND STRATEGY

The Board hereby adopts the following investment guidelines and strategies for the investment of District funds:

3.1 Cash Availability

- 3.1.1** Five-year cash flow analysis will be developed to serve as a basis for determining cash requirements and cash available for investment.
- 3.1.2** Where practical, cash receipts will be invested on a pooled basis with separate accounting for Water, Wastewater, Deer Lodge Park and Rimforest Utilities.
- 3.1.3** All investment earnings (losses) will be allocated regularly based on cash balances of each such account.

3.2 Internal Controls Over Investments

- 3.2.1** The District shall develop an adequate system of internal investment controls and a segregation of responsibilities of the investment functions in order to safeguard assets of the District. The Finance Manager will be responsible for maintaining adequate internal controls over invested funds.
- 3.2.2** The Finance Manager, or his/her designee will continually monitor investment advisors, brokers and financial institutions used by the District to ensure that they continue to provide expertise, safety of investments with maximum return on investment at a reasonable price.
- 3.2.3** The Finance Manager, or his/her designee, will make every effort to enroll in continuing education programs to enhance knowledge and skills necessary to manage and oversee the District's investments and its advisors.
- 3.2.4** The District will only invest in those financial instruments that are authorized in the California Government Code in Section 53601 as amended and as specifically authorized in this investment policy.

- 3.2.5 The District will purchase financial instruments with idle funds and will periodically receive three (3) verbal quotes, except in cases where the State of California Local Agency Investment Fund is utilized.
- 3.2.6 The District may use the services of an investment advisor or broker; however, those advisors may at no time have autonomous control over District funds and those funds must be held by a third party financial institution.

3.3 Authorized Financial Institutions and Dealers

Investment advisors, brokers and financial institutions will be subject to the following requirements:

- 3.3.1 Section 53601.5 of the California Government Code states that the purchase by a local agency of any investment authorized pursuant to Section 53601 or 53601.1, not purchased directly from the issuer, shall be purchased either from an institution licensed by the state as a broker-dealer, as defined in Section 25004 of the Corporations Code, or from a member of a federally regulated securities exchange, from a national or state-chartered bank, from a savings association or federal association (as defined by Section 5102 of the Financial Code) or from a brokerage firm designated as a primary government dealer by the Federal Reserve bank.
- 3.3.2 Before engaging in investment transactions with a broker/dealer, the Finance Manager, or his/her designee, shall have received from said firm, a signed certification form. This form shall attest that the individual responsible for the District's account with that firm has reviewed the District's Investment Policy and that the firm understands the policy and intends to present only those investment recommendations and transactions to the District that are appropriate under the terms and conditions of the Investment Policy.
- 3.3.3 The advisor, broker or institutions must have offices or branches in California.
- 3.3.4 The Finance Manager, or his/her designee, will review the list of District financial advisors, brokers and financial institutions annually to ensure that they continue to be of the highest caliber in advice, safety and reputation.
- 3.3.5 The District's investments will be reviewed by the Finance Manager, or his/her designee, on a monthly basis, and will report on a quarterly basis the results of the review to the Board of Directors of the District.

3.4 Financial Instruments

The purchase of financial instruments will be made with the intent of holding the instruments to maturity unless market conditions dictate otherwise.

SECTION 4.0

AUTHORIZED INVESTMENT

4.1 Authorized and Suitable Investments

- 4.1.1** The District is empowered by California Government Code Section 53601 et. seq., which contains a detailed summary of the limitations and special conditions that apply to each of the allowed investment securities.
- 4.1.2** The Finance Manager or his/her designee may only invest in financial instruments as described in the California Government Code Section 53601 and in accordance with specific guidelines, which set forth the authorized financial instruments.
- 4.1.3** The table on the following page compares California Government Code allowed investments with District Policy as to limits of maturity and percentage allocation of total portfolio. Section 5 of this Investment Policy explains in detail the definition of the Investment types, as well as the legal authority for each.

| CGC SECTION | Investment Type | STATE CODE | | | DISTRICT POLICY | | |
|-------------|--|------------|----------------|-------------|-----------------|----------------|-------------|
| | | Max Matrty | Auth limit (%) | Reqd Rating | Max Matrty | Auth limit (%) | Reqd Rating |
| 53601 (a) | Local Agency Bonds | 5 yrs | None | None | 5 yrs | 10% | None |
| 53601 (b) | US Treasury bills, Notes or Bonds | 5 yrs | None | None | 5 yrs | None | None |
| 53601 (c) | State Registered Warrants, Notes or Bonds of this state | 5 yrs | None | None | 5 yrs | 10% | None |
| 53601 (d) | State Registered Warrants, Notes or Bonds of the other 49 states | None | None | N/A | None | None | |
| 53601 (e) | Notes & Bonds of other Local California agencies | 5 yrs | None | None | 5 yrs | None | None |
| 53601 (f) | U. S. Agencies | 5 yrs | None | None | 5 yrs | None | None |
| 53601 (g) | Bankers Acceptances (1) | 180 days | 40% | None | 180 days | 30% | None |
| 53601 (h) | Prime Commercial Paper (2) | 270 days | 10%or25% | AI/PI | 270 days | 10% | AI/PI |
| 53601 (i) | Negotiable Certificates of Deposit (3) | 5 yrs | 30% | None | 5 yrs | 30% | None |
| 53601 (j) | Repurchase Agreements* | 1 yr | None | None | Not Allowed | | |
| 53601 (j4) | Reverse Repurchase Agrmts* | 92 days | 20% | None | Not Allowed | | |
| 53601 (k) | Medium Term Corporate Notes | 5 yrs | 30% | A | 5 yrs | 10% | AAA |
| 53601 (m) | Money Market Mutual Funds & Mutual Funds** | 5 yrs | 25% | 2-AAA | 5 yrs | 15% | 2-AAA |
| 53601 (n) | Collateralized Bank Deposits | 5 yrs | None | None | 5 yrs | None | None |
| 53601 (o) | Mortgage Pass-Thru Securities | 5 yrs | 20% | AA | 5 yrs | 20% | AAA |
| 53601 (q) | International Bank Obligations | 5 yrs | 30% | AA | 5 yrs | 30% | AA |
| 16429.1 | Local Agency Inv. Fund (LAIF) | N/A | None | None | N/A | None | None |

* See California Government Code Section 53601 (j) for limits on the use of repurchase and reverse repurchase Agreements.

** Mutual Funds maturity may be defined as the weighted average maturity; money market mutual funds must have an average maturity of 90 days or less, per SEC regulations.

(1) No more than 30% of surplus funds may be invested in Bankers Acceptances of any one commercial bank.

(2) Commercial paper issuers must be organized and operating within U. S. and have total assets in excess of \$500 million, and have "A" or higher rating for issuer's debt, other than commercial paper, by Moody's or Standard and Poor's. Purchases may not exceed 10% of outstanding paper of an issuing corporation.

(3) Prohibited if the CD's are issued by a state or federal credit union if a member of the legislative body 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 union committee or the supervisory committee of the state or federal credit union issuing the negotiable CD's.

4.2 Collateralization

4.2.1 All Certificates of Deposits must be collateralized by U. S. Treasury Obligations. Collateral must be held by a third party trustee and valued on a monthly basis. The percentage of collateralization on repurchase and reverse repurchase agreements will adhere to the amount required under California Government Code Section 53601(i)(2).

4.3 Safekeeping and Custody

4.3.1 All security transactions entered into by the District shall be conducted on a delivery-versus-payment (DVP) basis. All securities purchased or acquired shall be delivered to the District by book entry, physical delivery or by third party custodial agreement, as required by California Government Code Section 53601.

4.4 Diversification

4.4.1 It is the policy of the District to diversify its investment portfolio. Assets shall be diversified to eliminate the risk of loss resulting from over concentration of assets in a specific maturity, a specific issuer or a specific class of securities. Diversification strategies shall be determined and revised periodically. In establishing specific diversification strategies, the following general policies and constraints shall apply:

4.4.1.1 Portfolio maturities shall be matched versus liabilities to avoid undue concentration in a specific maturity sector.

4.4.1.2 Maturities selected shall provide for stability of income and liquidity.

4.4.1.3 Disbursement and payroll dates shall be covered through maturities investments, marketable U. S. Treasury bills or other cash equivalent instruments such as money market mutual funds.

4.5 Reporting

4.5.1 In accordance with CGC Section 53646(b)(1), the Finance Manager, or his/her designee, shall submit to each member of the Board of Directors a quarterly investment report. The report shall include a complete description of the portfolio, the type of investments, the issuers, maturity dates, par values and the current market values of each component of the portfolio, including funds managed for the Lake Arrowhead Community District by third party contracted managers. The report will also include the source of the portfolio valuation. As specified in CGC Section 53646(e), if all funds are placed in LAIF, FDIC-Insured accounts and/or in a County investment pool, the foregoing report elements may be replaced by copies of the latest statements from such institutions. The report must also include a certification that (1) all investment actions executed since the last report have been made in full compliance with the Investment Policy, and (2) the Lake Arrowhead Community Services District will meet its expenditure obligations for the next six months, as required by CGC Section 53646(b)(2) and (3) respectively. The Finance Manager, or his/her designee, shall maintain a complete and timely record of all investment transactions.

4.6 Prohibited Investments

4.6.1 Under the provisions of CGC Sections 53601.6 and 53630, the Lake Arrowhead Community Services District shall not invest any funds covered by this Investment Policy in inverse floaters, range notes, or mortgage-derived, interest-only strips.

SECTION 5.0

EXPLANATION OF INVESTMENT TYPES

5.1 State and Local Agencies

5.1.1 *Definition:* These are bonds, notes, warrants or other evidences of indebtedness of any local or State agency, including the District's own bonds, within the State of California. This includes bonds payable solely out of the revenues from a revenue producing property owned, controlled or operated by the local or State agency, or by a department, board, agency, or authority of the local agency or State.

Legal Authority: Section 53601 (a,c,d,e) of the Government Code authorizes local and State agencies to purchase these bonds with no limitations as to the amount that can be owned.

5.2 U. S. Treasuries

5.2.1 *Definition:* These are instruments in which the full faith and credit of the United States Government is pledged. They are designated as Bills, Notes, or Bonds, depending on their maturity.

Legal Authority: Section 53601(b) of the Government Code authorizes local agencies to purchase U. S. Treasuries with no limitations as to the amount that can be owned of each.

5.3 Specified Bank Obligations

5.3.1 *Definition:* This category includes securities issued by federally owned or sponsored agencies that have the backing of the full faith and credit of the Federal Government. These securities are very liquid and marketable and they offer a wide range of available maturities. Bank obligations in this category are limited to certain federally owned or sponsored agencies such as Banks for Cooperatives, Federal Land Banks, Federal Intermediate Credit Banks, and Federal Home Loan Banks. Also included are obligations, participations, or other instruments of, issued by, or fully guaranteed by the Federal National Mortgage Association, guaranteed portions of Small Business Administration notes, and obligations, participations, or other instruments of, or issued by, a Federal agency or a United States government-sponsored enterprise.

Legal Authority: Section 53601 (f) of the Government Code allows public agencies to invest in obligations issued by banks for these federally sponsored agencies.

5.4 **Bankers' Acceptance**

5.4.1 Definition: A Bankers' Acceptance (BA) is a time draft drawn on and accepted by a bank for payment of the shipment or storage of merchandise. The initial obligation of payment rests with the drawer, but the bank substitutes its credit standing for that of the borrower and assumes the obligation to pay face value at maturity.

Legal Authority: Section 53601 (g) limits investments in this category to those Bankers' Acceptances, which are eligible for purchase by the Federal Reserve System and not exceeding 180 days maturity. In addition, no more than 40% of the District's surplus funds may be invested in BA's, and no more than 30% may be invested in any one bank.

5.5 **Commercial Paper**

5.5.1 Definition: Commercial paper consists of promissory notes of large business concerns of high credit standing, usually maturing in four to six months. These Corporate IOU's are bought and sold in the open market. Large companies raise short-term capital needs with this type of instrument.

Legal Authority: Section 53601 (h) of the Government Code allows public agencies to invest in only "prime" quality Commercial Paper issued with the highest rating provided by Moody's Investors' Service, Inc. or Standard and Poor's Corporation. Eligible paper is further limited to issuing corporations: (1) organized and operating within the United States, (2) having total assets in excess of \$500 million dollars and (3) having an "A" or highest rating for the issuer's debt, other than commercial paper, if any, as provided for by Moody's or Standard and Poor's. Commercial Paper may not exceed 270 days maturity and must not represent more than 10% of the outstanding paper of the issuing corporation. In addition, the amount invested in this type of instrument cannot exceed 25% of the total funds available to the District.

5.6 Negotiable Certificates of Deposit

5.6.1 *Definition:* A CD is a negotiable instrument evidencing a time deposit with a bank at a fixed rate of interest for a fixed period. CD's of this type are not collateralized and should be considered an unsecured deposit.

Legal Authority: Section 53601 (i) of the Government Code allows public agencies to invest a maximum of 30% of surplus funds in the CD's of State or Federal associations, credit unions or State licensed foreign banks. Section 53601 (i) also stipulates that these investments are not allowed if anyone on the legislative body, its officers or staff with oversight or signing authority also serves on its Board of Directors or a committee of the credit union. Section 53638 stipulates that negotiable CD's may not exceed the shareholder's equity of the bank, and that the amount of CD's purchased from a State or Federal association may not exceed the total of the net worth of that association unless the purchase amount is less than \$500,000 and the deposits are insured or secured as required by law.

5.7 Repurchase Agreements

5.7.1 *Definition:* A Repurchase Agreement (Repo) involves two simultaneous transactions. One transaction involves the sale of securities (collateral) by a borrower of funds, typically a bank or broker/dealer in governments or agencies, to a lender of funds. The lender can be any investor with cash to invest. The second transaction is the commitment by the borrower to repurchase the securities at the same price plus a predetermined amount of interest on an agreed future date.

Legal Authority: Section 53601 (j) of the Government Code permits Repos in any security that is allowed for purchase as defined in that same section of the Code and for a term of one year or less. It also places restrictions on the transactions. The value of underlying securities must be at least 102% of the funds borrowed against those securities and transactions must be made only with primary dealers of the Federal Reserve Bank of New York. Subject to fluctuations in the market, if the value falls below 102%, the value must be brought back up by the next business day.

5.8 Medium Term Corporate or Bank Notes

5.8.1 *Definition:* A Medium Term Note is a promise to pay, issued by a corporation or a bank at a fixed interest rate for a fixed period of nine months to fifteen years. Most are unsecured, although some are collateralized or carry other credit enhancements such as letters of credit.

Legal Authority: Section 53601 (k) of the Government Code allows public agencies to invest a maximum of 30% of surplus funds in the MYN's for a maximum of five years maturity. The notes must be issued by an U. S. Corporation or by a depository institution licensed by the United State or any State. To minimize risk, the notes must be rated in a rating category of "A" or better by a nationally recognized rating service, like Moody's Investors' Service, Inc. or Standard and Poor's Corporation.

5.9 Designated Mutual Funds

5.9.1 Definition: These are companies that are defined under IRS Code 26 U.S.C. 851, which are typically mutual funds that make diversified investments for their shareholders.

Legal Authority: Section 53601 (l) of the Government Code authorizes investments in mutual funds as long as the mutual companies are investing only in those securities and obligations otherwise authorized for direct investment by public agencies. Additionally, these companies must have attained the highest rating provided by at least two of the three largest nationally recognized rating services, or have an investment advisor registered with the SEC with assets under management in excess of \$500 million and with at least five (5) years experience investing in statutorily permitted securities. Investments in this category are also limited to 15% of total funds available.

5.10 Non-negotiable Certificates of Deposit (CD)

5.10.1 Definition: A Non-negotiable CD is an instrument evidencing a deposit with a financial institution for a fixed period of time and normally for a fixed rate of interest. They can be collateralized with securities or mortgages or, if issued in denominations of \$100,000 or less, they can be insured by the Federal Deposit Insurance Corporation if issued by a bank, or the Federal Savings and Loan Insurance Corporation if issued by a savings and loan association.

Legal Authority: Section 53601 (n) of the Government Code allows public agencies to invest in Non-negotiable CD's of banks or savings and loan associations with no limitations.

5.11 Mortgage Backed Securities

5.11.1 *Definition:* Mortgage Backed Securities are issued by U. S. Government agencies and are collateralized by home loans which create mortgage pools which are purchased and serve as payment pass-through obligations.

Legal Authority: Section 53601 (o) of the Government Code allows public agencies to invest in mortgage pass-through and mortgage backed securities issued by an issuer having an “A” or higher rating for the issuer’s debt as provided by a nationally recognized rating service and rated in a rating category of “AA” or better by a nationally recognized rating service. Purchases of CMO securities are allowed for the District; they must carry a rating category of “AAA” or better, may not exceed 20% of the District’s surplus money that may be invested, and the term may not exceed five years.

5.12 Local Agency Investment Fund (LAIF)

5.12.1 *Definition:* The Local Agency Investment Fund (LAIF) is a special fund in the State of California Treasury created by law. The law permits local government agencies (cities, counties, and special districts) to pool idle monies in this fund and utilize the trained personnel in the State Treasurer’s Office for its investment.

Legal Authority: Section 16429.1 of the Government Code authorizes local agencies to invest through LAIF to a maximum of Forty Million Dollars (\$40,000,000) per agency.