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| **Policy No.:** 9 (Version 1) | **Policy Title**: Investment Policy |
| **Adopted Date:** 6/20/2024 | **Approval Resolution No**.: None |
| **Policy Description**: Investment Policy effective from July 1, 2024 to June 30, 2025 | |

## PURPOSE AND APPLICABILITY

The Santa Cruz Mid-County Groundwater Agency (MGA) establishes the Investment Policy. This policy is to guide the prudent investment of surplus MGA reserves.

This statement is submitted to the MGA Board of Directors to comply with Section 53646 of the California Government Code. It is intended to provide a guideline for the prudent investment of surplus cash reserves and to outline a policy for maximizing the efficiency of the MGA's cash management.

## POLICY

### 1.0 Policy

It is the policy of the MGA to invest public funds in a manner which will provide the highest investment return with the maximum security, while meeting the daily cash flow demands of the MGA and conforming to all state and local statutes governing the investment of public funds, such as the Government Code of California Section 53601, et. seq. (Appendix A & B).

### 2.0 Scope

This investment policy applies to all financial assets of the MGA as accounted for in the annual audited financial report. This policy applies to all funds under the Treasurer's span of control unless specifically exempted by statute or ordinance. The MGA accounts for its operations as an enterprise fund.

#### 2.1 Funds

General Reserve Fund (Wells Fargo Bank)

### 3.0 Prudence

As an investment standard, any investment shall be made with "judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence would 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."[1] All transactions shall be undertaken in the best interest of the MGA, and certainly not in the interest of broker-dealers.

3.1 The standard of prudence to be used by investment officials shall be the "prudent person" and/or "prudent investor" standard 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. (Appendix D)

## 4.0 Objective

The primary objectives, in priority order, of the MGA investment activities shall be:

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

4.2 **Liquidity**: The MGA's investment portfolio will remain sufficiently liquid to enable the Agency to meet all operating requirements which might be reasonably anticipated.

4.3 **Return on Investments**: The MGA's investment portfolio shall be designed with the objective of attaining a benchmark rate of return throughout budgetary and economic cycles, commensurate with the MGA's investment risk constraints and the cash flow characteristics of the portfolio.

## 5.0 Delegation of Authority

Authority to manage the MGA's investment program is derived from the Government Code of the State of California, Section 53600 et seq. The authority to invest public funds is expressly delegated to the Board of Directors or by subsequent redelegation to the Treasurer. The Treasurer shall establish written procedures for the operation of the investment program consistent with this investment policy. Procedures should include

[1] Prudent Person Rule set forth in the California Uniform Prudent Investor Act.

reference to: safekeeping, wire transfer agreements, banking service contracts and collateral/depository agreements. No person may engage in an investment transaction except as provided under the terms of this policy and applicable law.

## 6.0 Ethics & 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. Delegates and investment officials shall disclose to the Board any material financial interests in financial institutions that conduct business within this jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the MGA, particularly with regard to the time of purchases and sales.

## 7.0 Authorized Financial Dealers and Institutions

The Treasurer will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained as needed of approved security brokers/dealers selected by credit worthiness 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 - Appendix E). 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 Treasurer with the following: audited financial statements, proof of National Association of Security Dealers certification, trading resolution, proof of state/province registration, certification of having read the MGA's investment policy. An annual review of the financial condition and registrations of qualified bidders will be conducted by the Treasurer. A current audited financial statement is required to be on file for each financial institution or broker/dealer in which the MGA invests.

## 8.0 Authorized & 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 Santa Cruz Mid-County Groundwater Agency is empowered by statute to invest in the following types of securities:

1. Government securities and debt obligations issued by the U.S. Government or its agencies and are the highest quality investments available in terms of safety and liquidity. Among these are U.S. Treasury Bills and Notes; Federal Agency investments such as Government National Mortgage Association (Ginnie Mae);

Federal National Mortgage Association (Fannie Mae); Federal Land Bank (FLB); and Federal Farm Credit Banks; State of California bonds and California local agency bonds. These investments are, however, subject to the prohibition against inverse floaters, range notes, interest-only strips derived from a pool of mortgages, and securities that could result in zero-interest accrual in Section 53601.6 (exempting mutual funds). The MGA will require safekeeping documentation of the treasury instruments in an acceptable safekeeping account in the MGA's name. All interest will be deposited into the account or accounts that will best ensure the preservation of capital.

2. Certificates of Deposit (CD) must be fully insured by the Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), Securities Investor Protection Corporation (SIPC), or fully collateralized to 110% of market value of principal and accrued interest for governmental securities and 150% of market value of principal and accrued interest for first mortgage collateral. Further to be considered by the MGA:
    a. The issuer must be a nationally or state-chartered bank, savings association, federal association, state or federal credit union, or a federally or state-licensed branch of a foreign bank with a branch in California.
    b. It must have been in existence at least five years.
    c. Eligibility for deposits shall be limited to those financial institutions that maintain a rating equivalent to Moody's or Standard & Poor's rating of "A" or higher.

    Funds invested through a CD Placement Service are not subject to (a), (b), or (c) above, however each individual CD will be limited to the amount that is fully insured by the FDIC, NCUA, SIPC, or fully collateralized as discussed above.

The maximum to be invested with any one institution will be up to the federally insured amount with the exception of:

1. The MGA's Wells Fargo Bank Account No. XXXXXXX698 designated to be the MGA's Depository.
2. The State Local Agency Investment Fund (LAIF) if applicable.

Interest earned on all accounts will be paid monthly unless the principal sum is under the federally insured maximum and deposited into the account or accounts that will best ensure the preservation of capital.

The MGA does not buy stocks; it does not speculate; it does not deal in futures, options, or security loan agreements; it does not invest or place funds in other than the areas outlined above.

## 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 provide the following information:

- 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 deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings.
- Whether reserves, retained earnings, etc. are utilized by the pool/fund.
- A fee schedule, and when and how it is assessed.
- Whether the pool/fund is eligible for bond proceeds and/or whether it will accept such proceeds.

## 10.0 Collateralization

Collateralization will be required on any Certificate of Deposit not fully insured by the Federal Depository Insurance Corporation (FDIC), National Credit Union Administration (NCUA) or Securities Investment Protection Corporation (SIPC). To anticipate market changes and provide a level of security for all funds, the collateralization level will be 110% of market value of principal and accrued interest for governmental securities and 150% of market value of principal and accrued interest for first mortgage collateral.

Collateral will always be held by an independent third party with whom the entity has a current written custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the MGA and retained. The right of collateral substitution is granted.

## 11.0 Safekeeping and Custody

All security transactions entered into by the MGA shall be conducted on a delivery-versus-payment (DVP) basis and held in safekeeping pursuant to a safekeeping agreement. Securities will be held by a third-party custodian designated by the Treasurer and evidenced by safekeeping receipts.

## 12.0 Diversification

The MGA will diversify its investments by security type and institution. No more than 50% of the MGA's total investment portfolio may be invested in a single security type or with a single financial institution other than U.S. Treasury securities and authorized investment pools. The maximum allowable percentage for each type of security is set forth as follows:

| Security | Maximum % of Portfolio | Maximum Maturity | |
|---|---|---|---|
| U.S. Treasury & Agency Securities | 100% | 5 years | |
| State of CA & CA Agency Securities | 100% | 5 years | |
| Local Agency Pools | 100% | N/A | |
| Bankers Acceptances | 40% | 180 days | No more than 30% of the surplus funds may be in Bankers Acceptances in any one commercial bank |
| Commercial Paper – Non-Pooled Funds | 25% | 270 days | No more than 10 percent of the MGA's money may be invested in any one issuer's commercial paper. |
| Negotiable Certificate of Deposit | 30% (combined with placement service CDs) | 5 years | Subject to conflict of interest limitation |
| CD Placement Service | 30% | 5 years | |
| Medium Term Corporate Notes | 30% | 5 years | "A" Rating |
| Mutual Funds | 20% | N/A | No more than 10% of surplus funds may be invested in any one mutual fund; 2 or more "AAA" ratings |
| Collateralized Mortgage Obligations | 20% | 5 years | "AA" Rating |
| Money Market Funds | 20% | N/A | |

Source: California Government Code Sections 53601 & 53635 (a-n)
Note: The government code requires that specific criteria for the selection of both mutual funds and money market funds be met, and makes impermissible exchange-traded funds (EFTs) for public investment portfolios. SB882, Local Government Omnibus Act of 2023, amended Government Code section 53601 to clarify limitations imposed on investment in privately issued mortgage passthrough and asset back securities, which is reflected in the maximums for collateralized mortgage obligations above.

## 13.0 Maximum Maturities

To the extent possible, the MGA will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the MGA will not directly invest in securities maturing more than one year from the date of purchase, with the exception of government securities and debt obligations issued by the US Government or its agencies. Government securities may be purchased for a period not to exceed three years.

Reserve funds may be invested in securities exceeding three years if the maturity of such investments is made to coincide as nearly as practicable with the expected use of the funds.

Section 53601 provides that the maximum term of any investment authorized under this section, unless otherwise stated, is five years as measured from the settlement date to final

maturity. However, the governing body may grant express authority to make investments either specifically or as a part of an investment program approved by the governing body that exceeds this five-year maturity limit. Such approval must be issued no less than three months prior to the purchase of any security exceeding the five-year maturity limit. No security may be purchased with a forward settlement date exceeding 45 days from the time of the investment.

## 14.0 Internal Control

The Treasurer shall establish an annual process of independent review by an external auditor. This independent analysis shall review internal control, account activity and 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.

15.1 Market Yield (Benchmark): The MGA's investment strategy is passive. Given this strategy, the basis used by the Treasurer to determine whether market yields are being achieved shall be the 6-month U.S. Treasury Bill and the Federal Funds rate. These indices are considered benchmarks for low-risk investment transactions and therefore comprise a minimum standard for the portfolio's rate of return.

## 16.0 Reporting

In accordance with Section 53646(b) (1-4) of the Government Code of California, the Treasurer shall provide to the Board of Directors quarterly investment reports, which provide a clear picture of the status of the current investment portfolio. The report may 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 if applicable.

Schedules in the quarterly report will include the following:

- A listing of individual securities held at the end of the reporting period by authorized investment category to include investment type, issuer, maturity, par value, and dollar amount invested.
- Average life and final maturity of all investments listed.
- Market Value as of the date of the report.
- Percentage of the Portfolio represented by each investment category.

## 17.0 Investment Policy Adoption

The Santa Cruz Mid-County Groundwater Agency's Investment Policy shall be ***adopted*** by the MGA's Board of Directors. The policy shall be reviewed annually by the Board of Directors no later than the first Board Meeting each fiscal year of the year to which it applies, or in the event of meeting cancellation the next regularly scheduled Board Meeting after, and any modifications made thereto must be approved by the Board of Directors.

# Glossary

**Agencies:** Federal agency securities or State agency securities.

**Asked:** The price at which securities are offered.

**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.

**Bid:** The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See Offer.

**Bond Proceeds:** The money paid to the issuer by the purchaser or underwriter of a new issue of municipal securities. These monies are used to finance the project or purpose for which the securities were issued and to pay certain costs of issuance as may be provided in the bond contract.

**Broker:** A broker brings buyers and sellers together for a commission.

**Certificate of Deposit (CD):** A time deposit with a specific maturity evidenced by a certificate. Large denomination CD's are typically negotiable.

**CD Placement Services:** A large sum of money is deposited into one bank that in turn places the funds in CDs issued by other banks in the same network in increments less than the current FDIC maximum so that both principal and interest are eligible for complete FDIC protection.

**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.

**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 payment date.

**Credit Risk:** The risk of loss due to failure of the issuer of a security.

**Custodian:** A Bank or other financial institution that keeps custody of stock certificates and other assets.

**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/Receipt:** 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.

**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 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.

**Farm Credit System (FCS):** Nationwide cooperative system of banks and associations providing credit to farmers, agricultural concerns, and related businesses. The system is comprised of the Banks for Cooperatives, which makes loans to farmer-owned marketing, supply, and service cooperatives, and rural utilities; the **Farm Credit Banks**, which make short and intermediate term farm loans secured by real estate; and the Federal Farm Credit Banks Funding Corp., which acts as a conduit through which the FCS issues debt in the credit markets. The Farm Credit Banks were created by merger of the old Federal Intermediate Credit Banks, making intermediate term farm loans, and the **Federal Land Banks.** The Farm Credit System, originally capitalized by the federal government, is now self-funding and owned by its member-borrowers.

**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 bank deposits, currently up to $250,000 per deposit.

**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 Home Loan Banks (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. The mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

**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, as the corporation is called, 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 Open Market Committee (FOMC):** Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

**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):** Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. The security holder is protected by the full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FMHA mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

**Liquidity:** A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. Short-term securities, such as Treasury bills that are easily sold to other investors at relatively narrow spreads between bid and asked quotes, and in reasonably large trading volumes, are said to be highly liquid.

**Local Agency Investment Fund (LAIF):** The aggregate of all funds from local State of California agencies that are placed in the custody of the State Treasurer for investment and reinvestment.

**Market Risk:** Market value fluctuations due to overall changes in the general level of interest rates.

**Market Value:** The price at which a security is trading and could presumably be purchased or sold.

**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.

**National Credit Union Administration (NCUA):** Independent federal agency established by federal law in 1970 to charter and supervise federal credit unions.

**Offer:** The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked and Bid.

**Open Market Operations:** Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit: sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

**Par Value:** The amount of principal that must be paid at maturity. Also referred to as the face amount of a bond, normally quoted in $1,000 increments per bond.

**Portfolio:** Combined holding of more than one stock, bond, commodity, real estate investment, cash equivalent, or other asset. The purpose of a portfolio is to reduce risk by diversification.

**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. Primary dealers include Securities and Exchange Commission (SEC) registered securities broker-dealers, banks, and a few unregulated firms.

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

**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.

**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.

**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 or the current income return.

**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 issues following the initial distribution.

**Security:** A document indicating ownership or creditorship, a stock certificate or bond.

**Securities & Exchange Commission:** Agency created by Congress to protect investors in securities transactions by administering securities legislation.

**Securities Investor Protection Corporation (SIPC):** Nonprofit, government sponsored membership corporation chartered in 1970 to protect the customer of insured broker-dealers, up to $500,000 per account.

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

**Structured Notes:** Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations that 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.

**Student Loan Marketing Association (SLMA):** Publicly traded corporation established in 1972 to increase the availability of student loans by purchasing loans in the secondary market. The corporation, also know as Sallie Mae, guarantees college education loans under the federal Guaranteed Student Loan Program, and under the Health Education Assistance Program.

**Time Deposits:** Interest bearing deposits at a savings institution that has a specific maturity date.

**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 ten 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 ten years.

**Trustee or trust company or trust department of a bank:** A financial institution with trust powers which acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond contract.

**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.

References*

A. Government Code of California Section 53600-53609

B. Government Code of California Section 53630-53649

C. Probate Code of California Section 16045-16054  The Prudent Investor Rule

D. Securities & Exchange Commission Rule 15C3-1 (Uniform Net Capital Rule)

*Documents available upon request