

San Antonio Water System
San Antonio, Texas

INVESTMENT POLICY
December 2010

1-0. **PURPOSE:**

The purpose of the Investment Policy of the San Antonio Water System Board of Trustees (the “Board”) is to establish a framework for and provide guidance to management in developing and implementing procedures for the investment of funds of the San Antonio Water System (the “System”). All funds of the System are to be governed by this policy and no funds of the System are excluded from the policy. Provisions of the Investment Policy are designed to be consistent with guidelines set forth in City Ordinance No. 75686 which discusses investment of funds under management and control of the Board and are designed to be within the limitations of the Public Funds Investment Act (the “Act”) and any amendments thereto.

2-0. **OBJECTIVES:**

The Investment Policy has five objectives which are stated in order of priority.

- 2-1. Legality - Funds of the System shall be invested in accounts or instruments that are provided for by law.
- 2-2. Safety - Funds of the System shall not be invested in accounts or instruments which expose the assets of the System to undue or unreasonable risk.
- 2-3. Liquidity - Funds of the System shall be invested in accounts or instruments that mature in such a manner that cash is provided as required to finance daily maintenance and operation expenditures, construction costs, or other asset acquisitions.
- 2-4. Diversification - The System should attempt to reduce investment risk by participating in a variety of authorized investment instruments and financial institutions.
- 2-5. Yield - Funds of the System shall be invested in accounts or instruments that ensure a competitive rate of return after considering all other objectives of the Investment Policy. Active portfolio management may be practiced to enhance portfolio yield without a resulting increase in risk.

3-0. **AUTHORITY FOR INVESTMENT:**

Authority for the investment of funds of the System in accordance with this policy is placed with the SVP-Chief Financial Officer, and the Manager's of Finance.

4-0. **INVESTMENT TRAINING:**

The SVP-Chief Financial Officer, and the Manager's of Finance are the designated Investment Officers for the System. In order to ensure the quality and capability of investment management in compliance with the Public Funds Investment Act, the System shall provide periodic training in investments for the designated Investment Officers and other investment personnel through courses and seminars offered by professional organizations, associations, and other independent sources. The Investment Officers of the System must comply with the following training requirements as required by the Public Funds Investment Act.

4-1. The Investment Officers must attend 10 hours of investment training within 12 months of taking office.

4-2. The Investment Officer must attend 10 hours of investment training within every two years.

4-3. The Investment Officer's training must be from an independent source that relates to the Investment Officer's responsibilities and must comply with the Public Fund Investment Act. The independent training source can be from, but is not limited to the following:

- Government Treasurers Organization of Texas
- Texas Municipal League
- TEXPO
- Government Finance Officers Association
- Universities
- Consultant Firms

5-0. **STANDARD OF CARE**

Investment Officers of the System who are related by blood, marriage or have a personal business relationship with a business organization offering to engage in an investment transaction with the System shall file a statement disclosing that relationship or personal business interest with the System and the Texas Ethics Commission as required by the Public Funds Investment Act. Investments shall be made with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived. Investment of funds shall be governed by the objectives stated in section 2-0. In determining whether an Investment Officer has exercised prudence with respect to an investment decision, the

determination shall be made taking into consideration the investment of all funds, or funds under the System's control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment and whether the investment decision was consistent with the written approved investment policy of the System.

6-0. **PERMISSIBLE TYPES OF INVESTMENT:**

The Public Funds Investment Act, as subsequently amended, direct and authorize specific investment parameters for the investment of public funds. Listed below are authorized investments by this statute and in which available funds of the System may be invested. Investment of System funds in any instrument or security not authorized for investment under the Public Funds Investment Act and by this investment policy is prohibited.

- 6-1. Direct obligations of the United States or its agencies and instrumentalities of the United States of America.
- 6-2. Direct obligations of the State of Texas or its agencies and instrumentalities.
- 6-3. Other obligations, the principal of and interest on which are unconditionally guaranteed or insured by the United States or its agencies and instrumentalities or the State of Texas.
- 6-4. Obligations of states and cities of any state having been rated as to investment quality by a nationally recognized investment rating firm and having received not less than an "A" rating or its equivalent.
- 6-5. Certificates of Deposit and Share Certificates, where investments in certificates of deposit or share certificates are in accordance with the Public Funds Investment Act and meets the following criteria:
 - 6-5.1 Certificate of deposit issued by depository institutions that have their main office or a branch office in the state of Texas that are:
 - guaranteed or insured by the Federal Deposit Insurance Corporation or its successor, or the National Credit Union Share Insurance Fund or its successor;
 - secured by obligations that are described by sections 6-1 through 6-4 above that have a market value of not less than the principal amount and accrued interest of the certificates.
 - secured in any other manner and amount provided by law for deposits of the System.
 - 6-5.2. In addition to the authority to invest funds in certificates of deposit as stated above, an investment in certificates of deposit made in accordance with the following conditions is an authorized investment:

- the funds are invested by the System through a depository institution that (a) has its main office or a branch office in the State of Texas; (b) authorized to offer services through Certificates of Deposit Account Registry Service, “CDARS”; and (c) is selected by the System:
- the depository institution selected by the System arranges for the deposit of the funds in certificates of deposit in one or more federally insured depository institutions, wherever located including out of state. Each of the certificates of deposit will be issued for the account of the System as the beneficial owner of the certificate of deposit;
- the full amount of the principal and accrued interest of each of the certificates of deposit is insured by the United States or an instrumentality of the United States; in effect the Federal Deposit Insurance Corporation (FDIC). Each certificate of deposit will be issued in an amount within the FDIC insurance coverage limit. The total amount of the System’s investment will be allocated among a number of financial institutions. The System’s investment will thus be fully protected against the failure of any of the institutions issuing the certificates of deposit;
- the depository institution selected by the System acts as custodian for the System with respect to the certificates of deposit issued for the account of the System with respect to the certificates of deposit. Under this provision, when the certificates of deposit issued by other institutions to the System mature, the payment of the principal and accrued interest will be made by those institutions through the selected depository institution in the state of Texas; and
- at the same time that the funds are deposited and the certificates of deposit are issued for the account of the System, the depository institution selected by the System receives an amount of deposits from customers of other federally insured depository institutions, wherever located, that is equal to the amount of the funds invested by the System through the depository institution. The economic effect of investments by the System made in accordance with this procedure will be that the selected depository institution in the state of Texas will have on deposit the amount of funds initially invested by the System.
- the amount of funds that may be invested by the System with any one depository institution that meets the requirements set out above may not exceed \$10,000,000.

6-5.3. All such collateral must be fully documented, approved by an authorized System representative and held at an authorized third party institution. An authorized System representative shall mean person(s) designated by the Board of Trustees by execution of a formal written authorizing document. With respect to certificates of deposit in which the System has invested pursuant to the provisions listed above for CDARS, the depository institution selected by the System is an approved third party institution.

- 6-6. Commercial paper with a stated maturity of 270 days or less from its issuance that either:
- is rated at least "A-1", or "P-1" or the equivalent by at least two nationally recognized credit rating agencies; or
 - is rated at least "A-1", "P-1" or the equivalent by at least one nationally recognized credit rating agency and is fully secured by an irrevocable letter of credit issued by a bank organized and existing under the laws of the United States of America.
- 6-7. Fully collateralized direct repurchase agreements having a defined termination date, secured by obligations described herein pledged with a third party, approved by the System and placed through a primary securities dealer, as defined by the Federal Reserve or a bank doing business in the State of Texas. Reverse repurchase agreements must not have a term to exceed 90 days. Money received under the terms of a reverse repurchase agreement may not be used to purchase any investment whose final maturity date exceeds the expiration date of the reverse.
- 6-8. SEC-regulated and registered, no load money market mutual fund with a dollar-weighted average stated maturity of 90 days, and includes in its investment objectives the maintenance of a stable net asset value of \$1 for each share.
- 6-9. No-load mutual funds with a weighted average maturity of up to two years are allowable as long as they are registered with the Securities and Exchange Commission. They must be invested exclusively in obligations authorized by the Public Funds Investment Act, and are continuously rated by at least one nationally recognized investment rating firm of not less than "AAA" or its equivalent. Investments in this type of mutual fund may be no more than 15 percent of the total operating funds (excluding bond proceeds, reserves and debt service funds).
- 6-10. Banker's Acceptance with a stated maturity of 270 days or less from its issuance that either:
- will be, in accordance with its terms, liquidated in full at maturity; or
 - is eligible for collateral for borrowing from a Federal Reserve Bank; and
 - is accepted by a bank organized and existing under the laws of the United States or any state, if the short-term obligations of the bank, or of a bank holding company of which the bank is the largest subsidiary, are rated not less than A-1 or P-1 or an equivalent rating by at least one nationally recognized credit rating agency.
- 6-11. Investment Pools, where the investment pool shall invest funds it receives from the System in authorized investments as permitted by the Public Funds Investment Act and meets the following criteria:

6-11.1. An investment pool must furnish the System an offering circular or other similar disclosure instrument that contains, at a minimum, the following information:

- the types of investments in which money is allowed to be invested;
- the maximum average dollar-weighted maturity allowed, based on the stated maturity date, of the pool;
- the maximum stated maturity date any investment security within the portfolio has;
- the objectives of the pool;
- the size of the pool;
- the names of the members of the advisory board of the pool and the dates their terms expire;
- the custodian bank that will safekeep the pool's assets;
- whether the intent of the pool is to maintain a net asset value of one dollar and the risk of market price fluctuation;
- whether the only source of payment is the assets of the pool at market value or whether there is a secondary source of payment, such as insurance or guarantees, and a description of the secondary source of payment;
- the name and address of the independent auditor of the pool;
- the requirements to be satisfied for the System to deposit funds in and withdraw funds from the pool and any deadlines or other operating policies required for the System to invest funds in and withdraw funds from the pool; and
- the performance history of the pool, including yield, average dollar-weighted maturities, and expense ratios.

6-11-2. An investment pool must maintain its eligibility with the System by furnishing the following to the System:

- investment transaction confirmations; and
- a monthly report that contains, at a minimum, the following information:
 - the types and percentage breakdown of securities in which the pool is invested;

- the current average dollar-weighted maturity, based on the stated maturity date, of the pool;
- the current percentage of the pool's portfolio in investments that have stated maturities of more than one year;
- the book value versus the market value of the pool's portfolio, using amortized cost valuation;
- the size of the pool;
- the number of participants in the pool;
- the custodian bank that is safekeeping the assets of the pool;
- a listing of daily transaction activity of the System;
- the yield and expense ratio of the pool;
- the portfolio managers of the pool; and
- any changes or addenda to the offering circular.

6-11.3. The System by contract may delegate to an investment pool the authority to hold legal title as custodian of investments purchased with its funds.

6-11.4. An investment pool shall calculate "Yield" in accordance with regulations governing the registration of open-end management investment companies under the Investment Company Act of 1940, as promulgated from time to time by the federal Securities and Exchange Commission.

6-11.5. A public funds investment pool created to function, as a money market mutual fund must mark its portfolio to market daily, and, to the extent reasonably possible, stabilize at a \$1 net asset value. If the ratio of the market value of the portfolio divided by the book value of the portfolio is less than 0.995 or greater than 1.005, portfolio holdings shall be sold as necessary to maintain the ratio between 0.995 and 1.005.

6-11.6. A public funds investment pool must have an advisory board composed:

- equally of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool, for a public funds investment pool; or
- of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool, for other investment pools.

- 6-11-7. An investment pool must be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service with a weighted average maturity no greater than 90 days.
- 6-12. Securities Lending Program, where the program must meet the Public Funds Investment Act requirements and the following criteria:
- the value of the securities loaned under the program must be not less than 102 percent collateralized, including accrued income;
 - a loan made under the program must allow for termination at any time;
 - a loan made under the program must be secured by:
 - pledged securities authorized by the Act, Section 2256.009;
 - pledged irrevocable letters of credit issued by a bank that is:
 - organized and existing under the laws of the United States or any other state; and
 - continuously rated by at least one nationally recognized investment rating firm at not less than A or its equivalent;
 - cash invested in accordance with the Act;
 - the terms of a loan made under the program must require that the securities being held as collateral be:
 - pledged to the System;
 - held in the System's name; and
 - deposited at the time the investment is made with the System or with a third party selected by or approved by the System;
 - a loan made under the program must be placed through:
 - a primary government securities dealer as defined by 5 C.F.R. Section 6801-102 (f), as that regulation existed on September 1, 2003; or
 - a financial institution doing business in the state of Texas; and
 - an agreement to lend securities is executed under this section and has a term of one year or less.

6-13. Guaranteed Investment Contract, where the guaranteed investment contract meets the Public Funds Investment Act requirements and the following criteria:

6-13.1. A guaranteed investment contract is an authorized investment for bond proceeds if the guaranteed investment contract:

- has a defined termination date;
- is secured by obligations described by Section 2256.009(a)(1) of the Act, excluding those obligations described by Section 2256.009(b), in an amount at least equal to the amount of bond proceeds invested under the contract; and
- is pledged to the System and deposited with the System or with a third party selected and approved by the System.

6-13.2. Bond Proceeds, other than bond proceeds representing reserves and funds maintained for debt service purposes, may not be invested in a guaranteed investment contract with a term of longer than five years from the date of issuance of the bonds.

6-13.3. To be eligible as an authorized investment:

- the governing body of the System must specifically authorize guaranteed investment contracts as an eligible investment in the order, ordinance, or resolution authorizing the issuance of bonds;
- the System must receive bids from at least three separate providers with no material financial interest in the bonds from which proceeds were received;
- the System must purchase the highest yielding guaranteed investment contract for which a qualifying bid is received;
- the price of the guaranteed investment contract must take into account the reasonably expected drawdown schedule for the bond proceeds to be invested; and
- the provider must certify the administrative costs reasonably expected to be paid to third parties in connection with the guaranteed investment contract.

6-14. Overnight investment sweep products that invest in securities stated in Section 6-0, items 6-1 through 6-3.

6-15. There is no limit on the amount that may be invested in U.S. Treasury securities, government-guaranteed securities, or government-sponsored entity securities, with the exception of a maximum of 50% of the total investment portfolio in any one government-sponsored entity issuer. Furthermore, any other investment in non-government issues is limited to 5% of the total investment portfolio unless it is fully collateralized by securities stated in Section 6-0, items 6-1 through 6-3.

- 6-16. An Investment that requires a minimum rating under this section does not qualify as an authorized investment during the period the investment does not have the minimum rating. The System shall take all prudent measures that are consistent with this policy to liquidate an investment that does not have the minimum rating.

7-0. **MATURITY OF INVESTMENTS:**

Investments shall have maturities no longer than the date the funds can reasonably be expected to be needed for the purpose for which they are being held. Investments of the Reserve Fund shall be invested to mature no later than the final maturity date of the Senior Lien Obligations.

8-0. **SECURITY OF INVESTED FUNDS:**

Investments in Time Deposit Accounts, Certificates of Deposit, and repurchase agreements shall be fully secured by insurance of the Federal Deposit Insurance Corporation or by obligations described in Section 6-0, items 6-1 through 6-3.

- 8-1. The market value of collateral shall at all times equal or exceed the principal amount plus accrued interest on all Time Deposit Accounts or Certificates of Deposit in excess of FDIC coverage. Market value shall mean the bid or closing price as quoted in the most recent "The Wall Street Journal" or as quoted by another recognized pricing service.
- 8-2. Collateral shall either be delivered to the System or held in joint safekeeping at the Federal Reserve Bank or at another bank not affiliated with the depositing bank for the account and in favor of the San Antonio Water System Board of Trustees.
- 8-3. Substitutions and decreases in the amount or types of securities pledged as collateral or any other transaction that may decrease the value of the pledge shall have the written approval of the SVP-Chief Financial Officer, or in the event the SVP-Chief Financial Officer is not available within a reasonable time under the circumstances, either one of the following: President/Chief Executive Officer, SVP-Chief Operating Officer, SVP-Facilities Engineering & Strategic Resources and the VP-Customer Service prior to their execution.
- 8-4. The type and market value of collateral shall be monitored weekly.
- 8-5. Collateral shall not be required with respect to purchase and investment in direct obligations of the United States of America or its instrumentalities.

9-0. **PAYMENT FOR INVESTMENT:**

Payment shall be made by the System for investment in direct obligations of the United States of America or its instrumentalities, the State of Texas or its instrumentalities upon delivery thereof to the System or to a custodial bank, or in the case of a book-entry transaction when purchased securities are credited to the custodial bank's Federal Reserve System account held in favor of the System. All investment transactions must be settled on a delivery versus payment basis with the exception of investment pools and mutual funds and shall be confirmed in writing.

10-0. **INVESTMENT STRATEGIES:**

In order to enhance return and fulfill all of the objectives of the Board, the portfolio may be directed toward an active versus a passive investment strategy. The risk-return relationship will be maintained and controlled through direct compliance with this policy. Risks will be minimized by adequate collateralization and delivery versus payment procedures at all times. The maximum weighted average maturity (WAM) applicable to all System funds will be no more than three (3) years. Investment strategies such as swaps and trading may be considered in order to provide incremental income. However, no strategies which will result in an accounting loss will be transacted without the approval of the SVP-Chief Financial Officer.

10-1. The following are the System's investment strategies for each particular fund:

10-1.1. System Funds - Investments should be structured to meet the various operating expenses of the System including Payroll, Vendor, Customer Service Refunds and other costs associated with daily operations. Funds should be invested in instruments that are considered to be safe and short-term in nature with maturities generally no greater than one year. Additionally, these instruments should consist of a diversified group of approved investments that are intended to maximize yield. Instruments should be marketable if the need arises to liquidate them before they mature.

10-1.2. Debt Service Funds - Investments should be structured to mature in conjunction with System debt requirements, and to ensure compliance with any pertinent covenants and legal requirements contained in related bond ordinances. Funds should be invested in a diversified group of safe and approved instruments intended to maximize yield and liquidity. All investments must be marketable should the need arise to liquidate them before they mature. Due to definitive debt service schedules, the nature of these funds allows for precise forecasting of required cash flows.

10-1.3. Reserve Funds - Investments should be structured to pay the principal and interest on any Senior Lien Bonds if the amounts in the Debt Service Fund are insufficient for such purpose, and may be used for retiring the last of any outstanding Senior Lien Bonds. Funds should be invested in a diversified group of safe and approved instruments intended to maximize yield and liquidity. All investments must be marketable should the need arise to liquidate them

before maturity. The maturity of these investments should be based on a laddered structure to mature up to five years.

10-1.4. Project Funds - Investments should be structured to meet the System's construction projects obligations. Funds should be invested in a diversified group of safe and approved instruments intended to maximize yield and liquidity. Investments must be marketable should the need arise to liquidate them before maturity. The maturity of these investments should be based on projections and information related to construction expenditures, with maturity terms coordinated with and timed to meet the construction draw schedule requirements.

10-1.5. Renewal & Replacement Funds - Investments should be structured to meet the various capital expenditures of the System, along with any unexpected or extraordinary expenses that occur where System Funds are not available. Funds should be invested in a diversified group of safe and approved instruments intended to maximize yield and liquidity. All investments must be marketable should the need arise to liquidate them before they mature. The maturity of these investments should be based on a laddered structure to mature up to two years.

10-2. The stated investment strategies must be in accordance with the objectives stated in section 2-0.

11-0. **WRITTEN CONTRACTS:**

Written contracts are required for Time Deposit Accounts, Certificates of Deposit, and custodial undertakings. With respect to the purchase of direct federal or state obligations of the United States of America and its instrumentalities the interest of the System will be adequately protected by conditioning payment on the physical delivery of the purchased securities to the System or custodial bank, or in the case of book-entry transactions on the crediting of purchased securities to the custodial bank's Federal Reserve System account held in favor of the System. All purchases will be confirmed in writing to the System.

12-0. **DESIGNATION OF CUSTODIAL BANK:**

The custodial bank shall be the bank then currently serving the System as its general depository bank.

13-0. **QUALIFICATIONS OF INVESTMENT PROVIDER:**

For purposes of this Investment Policy investment providers are defined as a banking corporation, association, individual bank, investment banker, investment advisor, primary registered securities dealer or a regional brokerage firm which underwrites U. S. Government Agency Issues. To qualify as an investment provider a bank must not be in receivership

and/or be under the management and control of any Federal or State banking agency. Investment bankers must be listed in the Bond Buyer's Municipal Marketplace "Red Book". Concentration of investments in only one financial institution should be avoided if at all possible. Securities dealers must be in good standing with the regulatory agencies.

- 13-1. When direct obligations of the United States of America or the State of Texas are purchased, the seller shall be required to deliver the securities to the System or to the custodial bank versus payment.
- 13-2. There should always be at least three competitive offers or bids from three different Investment Providers for all individual security purchases and sales, excluding transactions with money market mutual funds and investment pools or banks under contract as approved by the Board.
- 13-3. All investment providers will provide a written acknowledgement of receipt and thorough review of the Investment Policy and will attest to having implemented reasonable procedures and controls in an effort to preclude imprudent investment activities arising from investment transactions as required by the Public Funds Investment Act.
- 13-4. The System will create an internal investment committee that shall, at least annually, review, revise, and adopt a list of qualified brokers/dealers with whom it may do business.

14-0. **INVESTMENT MANAGEMENT FIRMS:**

The System may contract with an investment management firm or firms for the management of its funds. The firm must be registered under the Investment Advisers Act of 1940 (the "1940 Act") or, if the firm is not subject to the 1940 Act, it must be registered with the State Securities Board. An investment management contract may be for a term of up to two years with any renewal or extension approved by the San Antonio Water System Board of Trustees. A written copy of the System's investment policy must be given to the investment management firm. An officer or principal of the investment management firm will serve as a qualified representative who will provide the System with a written instrument acknowledging receipt and compliance with the investment policy as required by the Public Funds Investment Act.

15-0. **OPERATIONS AND REPORTING:**

The purchase and sale of securities shall be done through a competitive bid process. Certificates of Deposit may be purchased from the general depository bank. Contracts for purchase of Certificates of Deposit from banks other than the general depository banks shall be established.

- 15-1. The SVP-Chief Financial Officer, and the Manager's of Finance, are authorized to approve and award the purchase of securities and Certificates of Deposit to the best qualified bid.
- 15-2. The SVP-Chief Financial Officer is authorized to execute contracts for Certificates of Deposit.
- 15-3. One of the following method(s) will be used to monitor the market price of acquired investments:
 - 15-3.1. The System may contract with a service provider to furnish online real-time market posting of securities as needed.
 - 15-3.2. At month end, a list of outstanding investments owned by the System will be sent (either by fax, or another electronic medium) to either one of the following entities:
 - the System's general depository bank
 - one of the System's approved Broker/Dealer firms
 - any entity contracted by the System to provide this service.
 - 15-3.3. The selected entity will provide the market price of each security as of month end on the outstanding list and return it to the System.
 - 15-3.4. The System will then use the month end outstanding list to compute the market value of each security and prepare a monthly report displaying all investment activity and balances for all securities and funds.
- 15-4. Each Monthly Financial Report will contain a written report of investment activities and performance as required by the Public Funds Investment Act.
- 15-5. The investment policy must be reviewed by the governing body of the System at least once a year. It will adopt a written instrument reviewing the policy and record the changes made to the policy.