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District of Columbia Water and Sewer Authority

Statement of Investment Policy

Amended May 1, 2014

District of Columbia Water and Sewer Authority

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District of Columbia Water and Sewer Authority

Statement of Investment Policy

Purpose

The purpose of this document is to set forth the investment and operational policies for the management of public funds of the District of Columbia Water and Sewer Authority ("DC Water").

These policies are designed to ensure the prudent management of Authority funds, the availability of operating and capital funds when needed, and an investment return competitive with comparable funds and financial market indices.

It shall be the policy of DC Water that all investments and investment practices meet or exceed all statutes governing the investment of public monies in the District of Columbia and any investment restrictions imposed by bond covenants. Further, accounting for DC Water Portfolio shall be consistent with guidelines of the Governmental Accounting Standards Board (GASB).

Scope of the Investment Policy

This investment policy is a comprehensive one that governs the overall administration and investment management of those monies held in DC Water's investment portfolio. This policy shall apply to such monies from the time of receipt until the time the monies ultimately leave DC Water's accounts. These monies include, but are not limited to, all operating funds, debt service funds, capital project funds, and grant money.

The guidance set forth herein is to be strictly followed by all those responsible for any aspect of the management or administration of these monies.

Investment Objectives

DC Water's Portfolio shall be managed to accomplish the following hierarchy of objectives:

- i) **Safety** – The safeguarding of principal shall be the foremost objective of the investment program, and other objectives shall be subordinated to the attainment of this objective.
- ii) **Liquidity** – The investment portfolio shall be managed at all times with sufficient liquidity to meet all daily and seasonal needs, as well as special projects and other operational requirements either known or which might reasonably be anticipated.
- iii) **Return on Investment** – The investment portfolio shall be managed with the objective of obtaining no worse than a market rate of return over the course of budgetary and economic cycles, taking into account the constraints contained herein and the cash flow patterns of DC Water.

Delegation of Authority

DC Water Board of Directors grants authority for the management of the investment program and for the investment of funds (within the constraints set by this policy) to the General Manager. By

letter of delegation, the General Manager may delegate responsibility for managing the investment program to a designee. The GM or designee shall establish written procedures for the operation of the investment program consistent with this investment policy. Procedures should include references to safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking services contracts.

Standard of Prudence

The standard of prudence to be applied to the investment of DC Water's Portfolio shall be the "Prudent Person" rule that states:

"Investments shall be made with judgment and care, under circumstances then prevailing which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived."

Ethics and Conflict of Interest

Consistent with any DC Water policies on ethics, employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial positions that could be related to the performance of the investment portfolio. Employees shall not undertake personal investment transactions with the same individual with whom business is conducted on behalf of DC Water.

Authorized Investments

DC Water shall be permitted to invest in any of the following securities.

- A) **U.S. Treasury Obligations.** United States Treasury bills, notes, or any other obligation or security issued by or backed by the full faith and credit of the United States Treasury. These securities shall be limited to a maximum maturity of five (5) years at the time of purchase.
- B) **Registered Investment Companies (Mutual Funds.)** Shares in open-end, no-load investment funds provided such funds are registered under the Federal Investment Company Act of 1940 and invest exclusively in the securities permitted under this investment policy provided that the fund is rated "AAAm" or "AAAm-G" or the equivalent by a NRSRO. The mutual fund must comply with the diversification, quality and maturity requirements of Rule 2(a)-7, or any successor rule, of the United States Securities and Exchange Commission.

Before investing in any mutual fund, the GM or designee will obtain a copy of the fund's prospectus and review permitted investments, fees, and management.

- C) **Repurchase Agreements.** Contracts for the present purchase and subsequent resale at a specified time in the future of specific securities at specified prices at a price differential representing the interest income to be earned by DC Water. Such contracts shall be invested in only if the following conditions are met:
 - 1) the Repurchase Agreement has a term to maturity of no greater than ninety (90) days;

- 2) the contract is fully secured by deliverable U.S. Treasury and Federal Agency obligations as described in (A) and (B) above (without limit to maturity), having a market value at all times of at least one hundred two percent (102%) of the amount of the contract;
 - 3) a Master Repurchase Agreement or specific written Repurchase Agreement governs the transaction;
 - 4) the securities are held free and clear of any lien by an independent third party custodian acting solely as agent for DC Water, provided such third party is not the seller under the repurchase agreement;
 - 5) a perfected first security interest under the Uniform Commercial Code in accordance with book entry procedures prescribed at 31 C.F.R. 306.1 et seq. or 31 C.F.R. 350.0 et seq. in such securities is created for the benefit of DC Water;
 - 6) for repurchase agreements with terms to maturity of greater than one (1) day, DC Water will value the collateral securities daily and require that if additional collateral is required then that collateral must be delivered within one business day (if a collateral deficiency is not corrected within this time frame, the collateral securities will be liquidated);
 - 7) the counterparty is a:
 - a) primary government securities dealer who reports daily to the Federal Reserve Bank of New York, or
 - b) a bank, savings and loan association, or diversified securities broker-dealer having \$5 billion in assets and \$500 million in capital and subject to regulation of capital standards by any state or federal regulatory agency; and
 - 8) the counterparty meets the following criteria:
 - a) has long-term credit rating of at least 'AA' or the equivalent from a Nationally Recognized Statistical Rating Organization ("NRSRO"),
 - b) has been in operation for at least 5 years, and
 - c) is reputable among market participants.
- D) **Federal Agency Obligations.** Bonds, notes, debentures, or other obligations or securities issued by a federal government agency or instrumentality, except Collateralized Mortgage Obligations, with a rating of at least "AA" or equivalent from two (2) major rating agencies. These obligations shall be limited to a maximum maturity of five (5) years at the time of purchase.
- E) **Bankers' Acceptances** issued by a domestic bank or a federally chartered domestic office of a foreign bank, which are eligible for purchase by the Federal Reserve System may be purchased if the following conditions are met:
- 1) the maturity is no greater than one hundred-eighty days (180); and
 - 2) the short-term paper of which is rated not lower than 'A-1' or the equivalent by a NRSRO.
- F) **Commercial Paper.** Unsecured short-term debt of U.S. corporations may be purchased if the following conditions are met:
- 1) the maturity is no greater than two hundred-seventy days (270)
 - 2) the issuing corporation, or its guarantor, has a short-term debt rating of no less than "A-1" (or its equivalent) by at least two of the NRSROs; and
 - 3) the total holdings of an issuer's paper do not represent more than ten percent (10%) of the issuing corporation's total outstanding commercial paper.
- G) **Collateralized Certificates of Deposit** in state chartered banks or federally chartered banks. Deposits with savings and loans associations or District and Federal Credit Unions shall not exceed the greater of the total net worth or \$500,000. Collateralized Certificates of Deposit

shall be collateralized at 102%. Please refer to the DC Water's collateralization policies under Collateralization of Bank Deposits.

- H) **Corporate Notes:** High quality corporate notes that meet the following criteria:
 - 1) a rating of at least 'AA' (or its equivalent) from at least one NRSRO and a rating of at least 'A' (or its equivalent) from a second NRSRO; and
 - 2) the final maturity shall not exceed a period of five (5) years from the time of purchase.
- I) **FDIC insured Certificates of Deposit** obtained thru Certificate of Deposit placement services including the Certificate of Deposit Account Registry Service (CDARS).
- J) **Federal Agency Mortgage-Backed Securities** issued by Fannie Mae, Freddie Mac, or the Government National Mortgage Association (GNMA) that meet the following criteria:
 - 1) a rating of at least "AA" (or its equivalent) by two NRSROs.
 - 2) the weighted average life (WAL) shall not exceed a period of five (5) years from the time of purchase.
- K) **Negotiable Certificates of Deposit and Bank Deposit Notes** of domestic banks and domestic offices of foreign banks with:
 - 1) ratings of at least 'A-1' (or its equivalent) by two NRSROs for maturities of one (1) year or less; and
 - 2) a rating of at least 'AA' (or its equivalent) from at least one NRSRO and a rating of at least 'A' (or its equivalent) from a second NRSRO for maturities over one (1) year; and
 - 3) the final maturity shall not exceed a period of five (5) years from the time of purchase.
- L) **Supranational Bonds:** Obligations, participations or other instruments of any Federal agency, instrumentality or United States government-sponsored enterprise, including those issued or fully guaranteed as to the principal and interest by Federal agencies, instrumentalities or United States government sponsored enterprises, provided that:
 - 1) at time of purchase the maturity does not to exceed five (5) years; and
 - 2) have a rating of at least 'A' (or its equivalent) from at least two NRSROs.
- M) **Municipal Obligations.** Bonds, notes and other evidences of indebtedness of the District of Columbia, or of any state or local government upon which there is no default that meet the following criteria:
 - 1) have a final maturity on the date of investment not to exceed five (5) years.
 - 2) rated in either of the two highest rating categories by a NRSRO; and
 - 3) the total holdings of any single issue do not represent more than 25% of the total issue.

The monies of individual funds may be commingled for investment purposes. Investment income will be allocated to the various funds based on their respective participation and in accordance with generally accepted accounting principles.

Prohibited Investments and Investment Practices

DC Water is prohibited from:

- 1) Investment in reverse repurchase agreements;
- 2) Short sales (selling a specific security before it has been legally purchased);
- 3) Borrowing funds for the sole purpose of reinvesting the proceeds of such borrowing;

- 4) Investment in complex derivatives such as range notes, dual index notes, inverse floating rate notes and deleveraged notes, or notes linked to lagging indices or to long-term indices.
- 5) Investing in any security not specifically permitted by this Policy.

Collateralization of Bank Deposits

DC Water requires that all cash and other deposits maintained in any financial institution be collateralized, including bank deposits and collateralized certificates of deposit. Collateral will be secured in accordance with the following policy:

- 1) collateralization on all deposits of DC Water monies in excess of the amount protected by federal deposit insurance,
- 2) collateralization with any of the following (i) U.S. Treasury obligations, (ii) Federal Agency obligations, or (iii) a Letter of Credit issued by a Federal Home Loan Bank the amount of which shall be 102% of the deposits held.

In order to anticipate market changes and provide a level of security for all monies, the collateralization level shall be 102% of the market value of principal, plus accrued interest or as required by the terms of outstanding DC Water bond issues, municipal bond insurance policies and/or other financing agreements, which may pertain to DC Water's monies. Collateral shall always be held by an independent third-party custodian. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to DC Water and retained by the GM or designee. The right of collateral substitution is allowed.

Portfolio Diversification

DC Water's Portfolio shall be diversified by security type and institution. The maximum percentage of the portfolio (book value at the date of acquisition) permitted in each eligible security is as follows:

Permitted Investment	Sector Limit	Issuer Limit
Collateralized Bank Deposits	100%	100%
A. U.S. Treasury Obligations	100%	100%
B. Registered Money Market Mutual Funds	100%	50%
C. Repurchase Agreements	100%	50%
D. Federal Agency Obligations	80%	40%
E. Bankers' Acceptances	40%	5%
F. Commercial Paper	35%	5%
G. Collateralized Certificates of Deposit	30%	5%
H. Corporate Notes	30%	5%
I. FDIC-Insured Certificates of Deposit	30%	5%
J. Mortgage Backed Securities	30%	5%
K. Negotiable Certificates of Deposit	30%	5%
L. Supranational Bonds	30%	5%

M. Municipal Obligations	20%	5%
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Maximum Maturity

Maintenance of adequate liquidity to meet the cash flow needs of DC Water is essential. Accordingly, the portfolio will be structured in a manner that ensures sufficient cash is available to meet anticipated liquidity needs. Selection of investment maturities must be consistent with the cash requirements of DC Water in order to avoid the forced sale of securities prior to maturity.

For purposes of this Investment Policy, assets of DC Water shall be segregated into three categories based on expected liquidity needs and purposes — short-term operating monies, the core portfolio and bond proceeds.

Short-Term Operating Monies. Assets categorized as short-term monies will be invested in permitted investments maturing in twelve (12) months or less. Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio will be continuously invested in readily available funds such as money market mutual funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained to meet ongoing obligations.

Core Portfolio. The operating fund core portfolio will be invested in permitted investments with a stated maturity of no more than five (5) years from the date of purchase (with the exception of Federal Agency Mortgage-Backed Securities which must have a weighted average life (WAL) of no more than five (5) years). To control the volatility of the core portfolio, the GM or designee will determine a duration target, not to exceed three (3) years.

Bond Proceeds. Proceeds from the sale of bonds will be invested in compliance with the specific requirements of the bond covenants without further restriction as to the maximum term to maturity of securities purchased. However, in no case will bond proceeds be invested in securities with a term to maturity that exceeds the expected disbursement date of those monies. Reserve funds and other funds with longer-term investment horizons may be invested in securities exceeding five (5) years if the maturity of such investment is made to coincide as nearly as practicable with the expected use of funds. The intent to invest in securities with longer maturities shall be disclosed in writing to the Budget and Finance Committee.

Selection, Approval of Brokers, Qualified Financial Institutions

The GM or designee shall maintain a list of financial institutions and broker/dealers that are approved for investment purposes ("Qualified Institutions"). All Qualified Institutions who desire to provide investment services to DC Water will be provided with current copies of DC Water's Investment Policy. Receipt of this policy, including confirmation that it has been reviewed by persons dealing directly with DC Water, will be received prior to any organization providing investment services to the DC Water.

Qualified Institutions should supply the GM or designee with information sufficient to adequately evaluate the financial capacity and creditworthiness of the firm. The following information should be provided: (i) audited financial statements, (ii) regulatory reports on financial condition, (iii) proof of National Association of Security Dealers certification and proof of state registration, and (iv) any additional information to allow the GM or his designee to evaluate the creditworthiness of the institution.

Only firms meeting the following requirements will be eligible to serve as broker/dealers for DC Water:

- 1) "primary" dealers and regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 (uniform net capital rule);
- 2) capital of no less than \$10,000,000;
- 3) registered as a dealer under the Securities Exchange Act of 1934;
- 4) member of the Financial Industry Regulatory Authority (FINRA);
- 5) registered to sell securities in the District of Columbia; and
- 6) the firm and assigned broker have been engaged in the business of effecting transactions in U.S. government and agency obligations for at least five (5) consecutive years.

The GM or designee shall conduct an annual review of the financial condition and registrations of Qualified Institutions.

Engagement of Investment Managers

The GM may engage one or more qualified firms to provide investment management services for DC Water. All investment management firms who desire to provide investment services will be provided with current copies of DC Water's Investment Policy. Before an organization can provide investment services to DC Water, it must confirm in writing that it has received and reviewed this Policy. The GM or his designee will conduct appropriate due diligence in the selection of qualified investment management firms and will periodically confirm a manager's qualifications by periodically visiting that manager's operational facilities that provide services to DC Water.

Only firms meeting the following requirements will be eligible to serve as an investment manager:

- 1) Registered with the SEC under the Investment Advisers Act of 1940;
- 2) Registered to conduct business in the District of Columbia;
- 3) Have proven experience in providing investment management services to entities with similar investment objectives as DC Water.

Any firm engaged by DC Water to provide investment services will:

- 1) Provide to DC Water an annual updated copy of Form ADV, Part II;
- 2) Maintain a list of approved security brokers/dealers selected by creditworthiness who are authorized to provide investment services in the District of Columbia;
- 3) Provide monthly reports of transactions and holdings to the GM or his designee;
- 4) Provide quarterly performance reports that display investment performance in comparison to DC Water's investment benchmarks;
- 5) Periodically show that the manager has solicited at least three bids for any security purchased or sold on behalf of DC Water; and
- 6) Not collect any soft dollar fees from any broker/dealer or other financial firm in relation to services provided to DC Water.

Competitive Selection of Investment Instruments

It will be the policy of DC Water to transact all securities purchases and sales only with Qualified Institutions through a formal and competitive process requiring the solicitation and evaluation of at least three bids/offers. Electronic bids will be accepted. DC Water may also purchase or sell securities using electronic trading systems. The DC Water will accept the bid which (a) offers the highest rate of return within the maturity required; and (b) optimizes the investment objective of

the overall portfolio. When selling a security, DC Water will select the bid that generates the highest sale price.

Primary fixed price Federal Agency offerings may be purchased from the list of Qualified Institutions without competitive solicitation if it is determined that no Agency obligations meeting DC Water's requirements are available in the secondary market at a higher yield.

Investment of Bond Proceeds

DC Water will comply with all applicable sections of the Internal Revenue Code of 1986, Arbitrage Rebate Regulations and bond covenants with regard to the investment of bond proceeds. Accounting records will be maintained in a form and for a period of time sufficient to document compliance with these regulations.

Safekeeping and Custody

All investment securities purchased by DC Water or held as collateral on deposits or investments shall be held by DC Water or by a third-party custodial agent who may not otherwise be counterparty to the investment transaction.

All securities in DC Water's Portfolio shall be held in the name of DC Water and will be free and clear of any lien. Further, all investment transactions will be conducted on a delivery-vs.-payment basis. The custodial agent shall issue a safekeeping receipt to DC Water listing the specific instrument, rate, maturity and other pertinent information. On a monthly basis, the custodial agent will also provide reports that list all securities held for DC Water, the book value of holdings and the market value as of month-end.

Appropriate DC Water officials and representatives of the custodial agent responsible for, or in any manner involved with, the safekeeping and custody process of DC Water shall be bonded in such a fashion as to protect DC Water from losses from malfeasance and misfeasance.

Internal Controls

The GM or designee shall establish a system of internal controls governing the administration and management of DC Water's Portfolio, and these controls shall be documented in writing. Such controls shall be designed to prevent and control losses of DC Water monies arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by any personnel. DC Water shall establish an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures.

Performance Standards

The investment portfolio shall be designed and managed with the objective of obtaining a market rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and cash flow needs of DC Water. The return on DC Water investments will be compared to an index of U.S. Treasury securities having a similar duration or other appropriate benchmark on a quarterly basis. For funds having a duration or weighted average maturity of greater than 90 days, performance will be computed on a total return basis.

Reporting

On a monthly basis, the GM or designee will submit an investment report to the Finance & Budget Committee. This investment report shall include: (i) a listing of the existing portfolio in

terms of investment securities, maturity date, yield, market value and other features deemed relevant, (ii) the total investment earnings for the reporting period, (iii) a listing of all transactions executed during the quarter, and (iv) a statement on compliance with this Policy and any applicable bond resolutions.

Investment Policy Adoption

This policy is adopted by the Board of Directors of the District of Columbia Water and Sewer Authority this 1st day of May 2014.

Glossary

Agencies: Federal agency securities and/or government-sponsored enterprises.

Bankers' Acceptance: 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.

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.

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.

Dealer: A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

Delivery versus Payment: 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.

Diversification: Dividing investment funds among a variety of securities offering independent returns.

Liquidity: A liquid asset is one that can be converted easily and rapidly into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

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

Master Repurchase Agreement: A written contract covering all future transactions between the parties to repurchase—reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller borrower.

Maturity: The date upon which the principal or stated value of an investment becomes due and payable.

Nationally Recognized Statistical Rating Organization (NRSRO): A credit rating agency which issues credit ratings that the U.S. Securities and Exchange Commission (SEC) permits other financial firms to use for certain regulatory purposes.

Portfolio: Collection of securities held by an investor.

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.

Repurchase Agreement (RP or REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions.

Securities and Exchange Commission (SEC): Agency created by Congress to protect investors in securities transactions by administering securities legislation.

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 10 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 10 years.

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. Income/current yield is obtained by dividing the current dollar income by the current market price for the security. 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.