

**City of San Bernardino
Municipal Water Department
Investment Management Procedures**

Effective: 8/24/04
Resolution 645

1. Purpose

The purpose of these investment management procedures are to set forth procedures, consistent with the Municipal Water Department's Investment Policy (see Appendix A), to be used in managing the \$69,000,000 received by City of San Bernardino Municipal Water Department from the United States of America through the settlement of two consolidated lawsuits, the *City of San Bernardino, Municipal Water Department v. United States of America, CV 96-8867(MRP)* consolidated with *State of California, on behalf of the Department of Toxic Substances Control, v. United States of America CV 96-5205 (MRP)*.

2. Primary Investment Objective

The Municipal Water Department's primary investment objective is to achieve a reasonable rate of return on funds such that the Water Department will have sufficient cash flow to make all expenditures required under the settlement of the above-mentioned lawsuit, per the Consent Decree. This will require minimizing the potential for capital losses arising from market changes or issuer default. Although the generation of revenues through interest earnings on investments is necessary in order to generate the needed cash flow, the primary consideration in the investment of these funds is capital preservation. As such, the Municipal Water Department's yield objective is to achieve a reasonable rate of return on investments rather than the maximum generation of income which could expose the Water Department to unacceptable levels of risk.

In determining individual investment placements, as required by the Municipal Water Department's Investment Policy and detailed in Section 4 therein, the following factors shall be considered in priority order: safety, liquidity and yield.

3. Capital Preservation and Risk

Some level of risk is inherent in any investment transaction. Losses may be incurred due to issuer default, market price changes, or technical cash flow complications such as investments in non-marketable certificates of deposit. Investment in United States Treasury Securities and investments collateralized by United States Treasury Securities is the primary tool of the Water Department in minimizing investment risk and capital losses by safeguarding the overall portfolio from any individual loss. Diversification of the portfolio by institution, investment vehicle, and maturity term is the secondary tool.

4. Authorized Investment Officials

As stated in the Municipal Water Department's Investment Policy, Section 5 authority to manage the investment portfolio resides with the City Treasurer and responsibility for the operation of the investment management procedures is delegated to the Municipal Water Department's Director of Finance, who shall establish written administrative procedures and internal controls for the operation of the investment management procedures. Such written administrative procedures should include references to: safekeeping, delivery versus payment, investment accounting, repurchase agreements, wire transfer agreements, collateral/depository agreements and banking services contracts. These written administrative procedures will be maintained in a binder by the Municipal Water Department's Director of Finance. The City Treasurer will consult regularly with the Municipal Water Department's General Manager on all aspects of the Water Department's investment portfolio. The City Treasurer, the Municipal Water Department's Director of

Finance, and the Municipal Water Department's General Manager, or their written designees, comprise the authorized investment officials.

No person may engage in an investment transaction except as provided under the terms of these procedures established by the Municipal Water Department's Director of Finance. Although the Director may delegate these duties to another employee in the Municipal Water Department, every investment transaction must be reviewed and approved by the Director of Finance. Additionally, the Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinates.

5. Periodic Reviews by Investment Officials

At least semi-annually, the City Treasurer will consult with the Municipal Water Department's General Manager on all aspects of the Water Department's investment portfolio.

On an annual basis, and more frequently if deemed necessary, the City Treasurer, the Municipal Water Department's Director of Finance and the Municipal Water Department's General Manager will formally review the Investment Policy, Investment Management Procedures and the administrative procedures to ensure they are still current and accurate.

6. Trading

Sufficient internal controls shall be integrated into securities trading on behalf of the Municipal Water Department so that the risk of costly trade errors or of the theft, loss, or misuse of public monies, shall be minimized.

6.1. Authority to Trade

The only public employees who shall be authorized to buy and sell securities on behalf of the Municipal Water Department shall be the City Treasurer, the Municipal Water Department's Director of Finance and the Municipal Water Department's General Manager (see Section 4 herein, "Authorized Investment Officials").

The City Treasurer, the Director of Finance, and the General Manager shall engage in collective decision-making and consultation on all trades in order to make the best possible investment decisions.

Each trade shall be done in conformance with all applicable policies and procedures and shall be defensible in its own right.

6.2. Development of Trading Strategies

The City Treasurer, the Director of Finance and the General Manager shall consider the following factors while developing the Municipal Water Department's trading strategies:

- The "City of San Bernardino Municipal Water Department Investment Policy" that identifies approved transactions, instruments, issuers, maturity limits, and concentration limits.
- The Water Department's Schedule of Quarterly Cash Flow Requirements (detailed in Section 9, herein).
- The present Municipal Water Department's portfolio structure.

These factors should be evaluated within the overall context of passive portfolio management, although selective active management may occasionally be required.

7. Internal Controls

The City Treasurer is responsible for ensuring compliance with the Municipal Water Department's Investment Policy as well as for establishing systems of internal control designed to prevent losses due to fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, or imprudent actions by Municipal Water Department employees. Additionally, the Municipal Water Department is responsible for the physical security of investments and shall use custodial safekeeping for negotiable and bearer instruments whenever possible. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

The internal control structure shall be premised upon the following three elements:

7.1. Segregation of Duties

The cornerstone of the internal control structure for trading shall be a separation of the transaction and the recordkeeping functions. The duties of executing trades; approving trades; and confirming and recording trades shall not be concentrated in a single employee. A system of checks and balances shall be established by separating the functions of treasury from those of accounting.

If two parts of a transaction are done by different employees, then embezzlement, fraud; or concealment of errors can only occur through collusion. Consequently, the following four duties shall always be segregated from one another in order to create a system of dual controls:

- Approving the purchase and sale of securities.
- Buying and selling securities, including the execution of wire transfers.
- Having custody of cash and investments.
- Making general ledger entries and receiving and reconciling monthly bank statements.

Specifically, the following employees shall have separate and distinct duties with respect to securities trading:

7.1.1. City Treasurer

- Soliciting, negotiating, executing and documenting trades
- Storing trade documentation

7.1.2. Director of Finance

- Reviewing and approving trades including wire transfers

7.1.3. Senior Accountant

- Receiving trade tickets
- Verifying trade terms
- Interfacing with the Trustee on trades

7.1;4. Finance Manager

- Entering trades into the accounting system

7.1.5. Accounting Technician

- Receiving and verifying custodial safekeeping statements
- Reconciling monthly trustee and custodial statements with the investment portfolio returns

If one of the above employees is not available, then the Director of Finance may substitute another employee so long as it does not violate policy restrictions on trading authority.

7.2. Procedural Controls

Internal controls in the form of procedures are intended to ensure that:

- The Municipal Water Department only acquires investments that are permitted by law.
- The Municipal Water Department investment program is integrated with expenditure requirements.
- The level and nature of approvals that are required to purchase or sell investments are specified.
- The investment staff seeks competitive quotes for investment purchases.
- Access to bank accounts, wire transfers, cash and investments are limited only to specified employees. Outside investment advisors and broker/dealers shall not be authorized to initiate wire transfers on the Municipal Water Department's behalf.
- Public employees who are in treasury operations are insured or bonded.
- Yields on investments are maximized, AFTER safety and liquidity have been considered.

7.3. Custodial Controls

These internal controls, which relate to the possession and transfer of securities that the Municipal Water Department has bought or sold, are intended to ensure that:

- All of the Municipal Water Department's trades are done on a delivery-versus-payment ("DVP") basis.
- All of the securities that the Municipal Water Department owns are registered in its name.

8. Individual Placement of Investments

Individual placement of investments with eligible financial institutions shall be based on the following practices and procedures:

- Investments shall only be placed with financial institutions maintaining offices within the United States.
- Except for repurchase agreements and placements with the State's local agency investment pool (LAIF), investments shall be awarded based on competitive process. Documentation relating to investment quotes shall be maintained for six months.

- Negotiable investments shall not be purchased or sold from the institution which provides custodial safekeeping for Municipal Water Department investments.

9. Determination of Cash Flow Requirements

At least once each year, the Water Board will approve a "Schedule of Quarterly Cash Flow Requirements - O&M" and a "Schedule of Quarterly Cash Flow Requirements - Construction" to pay for expenditures required by the Consent Decree. The Water Department will either purchase an insurance policy guaranteeing these expenditures can be met or an investment providing the level of liquidity needed to meet these schedules. The schedules may be changed as frequently as deemed necessary by the Water Board.

Whenever a Schedule of Quarterly Cash Flow Requirements is revised, within two weeks of the Water Board's official approval, the City Treasurer will make recommendations to the Water Board on whether any changes to the "Investment Instructions," further described in Section 11 herein, are necessary in order to provide appropriate liquidity.

10. Flow of Funds

The Consent Decree established two accounts to be owned and managed by the City, the "O&M Escrow" and the "Construction Escrow". Further, as provided in the Consent Decree the United States will pay \$59,000,000 to the O&M Escrow and \$10,000,000 to the Construction Escrow at a date yet to be determined.

From 2004 until 2034, funds from the O&M Escrow and Construction Escrow will be used to purchase an insurance policy from AIG Environmental. This insurance policy will provide the Municipal Water Department with adequate funds to meet all expenditures. Additionally, funds from the O&M Escrow and Construction Escrow will be used to purchase a Guaranteed Investment Contract with AIG Matched Funding Corporation. Payments from this Guaranteed Investment Contract are scheduled to begin at the expiration of the insurance policy. At that time, funds will be held in the form described below by a Trustee to be selected one year prior to the expiration of the previously mentioned insurance policy. At that time, the Municipal Water Department will enter into a Trust Agreement which shall control the flow of funds. The Trustee shall be selected in accordance with the Municipal Water Department's Investment Policy, Section 7.1.

The Trustee will hold two separate funds, called the "O&M Escrow Fund" and the "Construction Escrow Fund". Each Fund will consist of two types of accounts: an investment account and a cash account. Each type of account will be invested according to written Investment Instructions as described in Section 11 herein. The Trustee may transfer cash and securities between accounts so long as the portfolios in each account conform at all times to the Investment Instructions for that account.

The remainder of this Section and Section 11 herein will apply once a Trustee has been selected and following the expiration of the insurance policy.

10.1. Payment Process

By the fifteenth day of each fiscal quarter (July 15, October 15, January 15 and April 15), the Municipal Water Department will forward to the Trustee a funds request for each Fund showing the amount needed, if any, to be paid to the Municipal Water Department on the first business day of the following quarter (October 1, January 1, April 1 or July 1). If no funds are to be paid, no invoice is required.

By the twentieth day of each quarter (July 20, October 20, January 20 and April 20), the Trustee will confirm in writing to the Municipal Water Department's Director of Finance that the amount requested in any funds request is not more than the amount listed in the Schedule of Quarterly Cash Flow Requirements for that Fund.

On the first business day of each quarter (October 1, January 1, April 1 or July 1}, for each Fund, the Trustee will pay to the Municipal Water Department by check or wire, the amount requested in any confirmed funds request.

10.2. Balancing the Cash Accounts

Fifteen days in advance of the first business day of each quarter (September 15, December 15, March 15 or June 15), for each Fund, the Trustee will determine what percentage the balance in each cash account is relative to the amount needed on the first business day of the following quarter, according to the Schedule of Quarterly Cash Flow Requirements for that Fund.

If the balance in the cash account is less than 100% of such amount, the Trustee will transfer the needed difference from the investment account. Should the Trustee need to liquidate an investment in the investment account in order to transfer an appropriate investment (given the Investment Instructions) or cash to the cash account, the Trustee will follow the Transaction Request procedure below.

If the balance in the cash account is more than 110% of the amount needed on the first business day of the following month according to the Schedule of Quarterly Cash Flow Requirements for that Fund, the Trustee will transfer the excess cash or securities to the investment account. Should the Trustee need to purchase an investment in the investment account in order conform the investments held in the investment account to the Investment Instructions, the Trustee will follow the Transaction Request procedure, described in Section 10.2.1, below.

10.2.1. Transaction Request Procedure

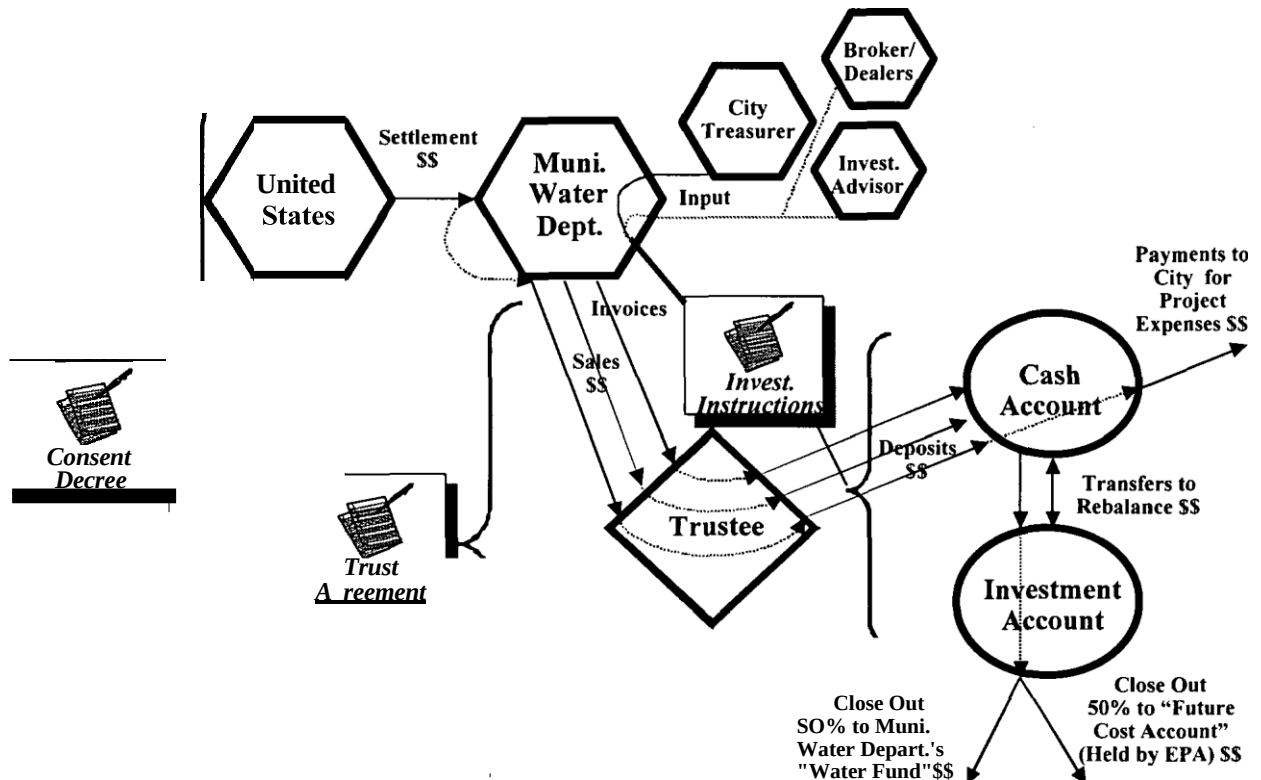
The Trustee will contact the Municipal Water Department's Director of Finance by telephone and promptly follow up with a written request to authorize a transaction and will proceed only with, and precisely according to, the written confirmation signed by the City Treasurer, the Municipal Water Department's Director of Finance and the Municipal Water Department's General Manager. The City Treasurer, the Director of Finance and the General Manager may consult with Investment Advisors or broker/dealers. Notwithstanding such advice, it will be in the discretion of these three investment officials to determine the appropriate method for buying and selling any investments, in accord with the Municipal Water Department's approved Investment Policy and Investment Management Procedures.

Monthly, the Trustee will issue account statements to the Municipal Water Department.

Annually, the Trustee will confirm that fund requests have been made from each Fund at least once during the preceding twelve months, and if not, make a written inquiry to the Municipal Water Department's Director of Finance to confirm as to whether the Fund should remain open or if the balance in the subject Fund should be dispersed and the Fund closed.

When the Municipal Water Department determines that either all O&M or Construction work has been completed as required by the Consent Decree, the Municipal Water Department will notify the Trustee in writing that the remaining balances in the appropriate Fund should be paid out in two parts, 50% to the United States Environmental Protection Agency's Future Cost Account, established by the Consent Decree and 50% to the City of San Bernardino Municipal Water Department's Water Fund. Each party at its option may elect to receive cash and/or securities from the Fund being dispersed.

The diagram below attempts to represent the flow of funds as described.



11. Investment Instructions

At least once a year, and as often as necessary the City Treasurer will present to the Water Board his recommendations for Investment Instructions - Cash Accounts, and Investment Instructions - Investment Accounts. The Water Board will adopt Investment Instructions at least once a year and may revise them as often as necessary. These Investment Instructions will be transmitted promptly and incorporated as an appendix to the Trust Agreement.

These Investment Instructions will provide direction to the Trustee on the manner in which securities will be purchased and sold, authorized types of investments, maximum allowable maturities, average duration of the portfolios in each Fund, percentage of each Fund's portfolio represented by each investment category, and any other information the Water Board deems necessary.

These Investment Instructions must be in compliance with the Investment Policy and be based on a reasonable conclusion that they will allow the Schedules of Quarterly Cash Flow Requirements to be met.

12. Selection of Financial Services Providers

If needed, the Municipal Water Department may engage Trustees or Investment Advisors, as provided in Section 7.1 of the Investment Policy. Such engagement must be the result of a competitive selection process designed to ensure fairness to candidates and the best value for the Municipal Water Department. Once a financial services provider is initially selected, a similar competitive process will be used as needed to fill a vacancy or to replace the existing provider. The

Director of Finance shall be responsible for the development of the selection process.

12.1. Proposal Process

The Director of Finance shall maintain an active file on all prospects that wish to bid for the Municipal Water Department's Trustee or Investment Advisory services, to be used if a Request for Proposals ("RFP") process is used to select financial services providers. Such RFP process shall consist of the following steps:

- 1) Distribution of RFP
- 2) Pre-Proposal Conference
- 3) Proposal Submission
- 4) Proposal Review
- 5) Interview with Top Proposers
- 6) Proposals Accepted by Board of Water Commissioners
- 7) Notification to Proposers
- 8) Implementation

12.2. Technical Evaluation

The Director of Finance shall be responsible for doing a comparative technical evaluation of all RFPs that the Water Department receives.

12.3. Water Board & City Treasurer Review

The Director of Finance shall present the recommendations to the Water Board and City Treasurer for review and approval.

13. Monthly Reporting

Beginning in 2035, once the insurance policy expires, the Director of Finance shall prepare an investment report at least monthly, including a management summary that provides an analysis of the status of the current investment portfolio and transactions made over the last month. This management summary will be prepared in a manner which will allow the Municipal Water Department to ascertain whether investment activities during the reporting period have conformed to the Investment Policy. The report should be provided to the Water Board and the City Treasurer. The report will include the following:

- Issuer or broker/dealer (financial institution)
- A listing of individual securities held at the end of the reporting period by authorized investment category.
- Average life and final maturity of all investments listed.
- Coupon, discount or earnings rate.
- Par value, Amortized Book Value and Market Value.
- Percentage of the portfolio represented by each investment category.
- A description of the compliance with the Investment Policy.

- Information demonstrating that the Water Department's expenditure requirements can be met in the following year.
- Other information regarding the Water Department's portfolio as appropriate.

14. **Evaluation of Investment Performance**

As previously indicated, it is the Water Department's primary investment objective to achieve a reasonable rate of return on public funds while minimizing risks and preserving capital. In evaluating the performance of the Water Department's portfolio in achieving this objective, it is expected that yields on Water Department investments will regularly meet or exceed the average return on the Lehman Government Bond Index (a Benchmark index made up of the Treasury Bond Index and the Agency Bond Index as well as the 1-3 Year Government Index and the 20+ Year Treasury Index).

15. **Annual Review by Water Board and City Council**

As often as necessary, and at least annually, the Water Board shall review the Investment Policy and Investment Management Procedures. Should the Board deem any revisions to the Investment Policy necessary, it should recommend such revisions to the City Council in time for its annual review. Should the Board deem any revisions to the Investment Management Procedures necessary, it shall approve them.

Annually, the City Treasurer, in accord with Government Code Section 53646, shall submit a statement of Investment Policy for the Municipal Water Department to the City Council, for consideration at a public meeting.

16. **Annual Audit**

As required by the Consent Decree, the Funds held at the Trustee will be subject to an audit in accord with OMB A-133, as well as being subject to the City's standard annual audit.

Policy Review

Established:

Minor changes GM approved:

Minor spacing/grammar changes, added title header (HR:

No changes:

8/24/2004

7/2022

7/2023

7/2024

**CITY OF SAN BERNARDINO
MUNICIPAL WATER DEPARTMENT
INTEROFFICE MEMORANDUM**

TO: Bernard C. Kersey, General Manager

FROM: David S. Erickson, Director, Administration and Finance

SUBJECT: **WATER DEPARTMENT INVESTMENT POLICY APPLYING TO THE PROCEEDS OF THE SETTLEMENT AGREEMENT WITH THE UNITED STATES OF AMERICA (CIVIL ACTIONS NO. CV 96-8867(MRP) AND CV 96-5205(MRP) CONSOLIDATED).**

DATE: August 16, 2004

BACKGROUND:

For the past four years, the City of San Bernardino Municipal Water Department has been in negotiations with the United States Department of the Army and the Environmental Protection Agency involving groundwater contamination. The City of San Bernardino has entered into a settlement for two cases entitled *State of California, on behalf of the Department of Toxic Substances Control v. United States, et al., CV 96-5205(MRP)* and *City of San Bernardino, Municipal Water Department v. United States, et al., CV 96-8867(MRP)*. The settlement agreement will be in the form of a consent decree. The City of San Bernardino and the Water Department must implement an investment policy which effectively deals with the extended time period involved in this settlement (over 50 years).

Department staff has been working with Government Financial Services Inc., the City Treasurer, the City Attorney's Office, and special legal counsel to develop an investment policy and an investment procedure specifically for investments that will be necessary to meet the long-term obligations set forth in the settlement agreement. All other city and Water Department investments will continue to be pooled with the city's investments managed by the City Treasurer.

California Government Code, Sections 53601 through 53659, sets forth the types of investments and maturities for all government entities in California. Because of the duration of obligations pursuant to the settlement agreement, specific authority to invest with maturities greater than five (5) years is required by a government agency's legislative body before those investments are made, no less than three months prior to the investment.

The major differences between the City of San Bernardino Investment Policy and the proposed Water Department Investment Policy are the following:

Continued...

Investment Policy
August 16, 2004
Page Two of Two

The Water Department will be authorized to hold investments in excess of five years to better match the cash flow needs of this settlement.

This policy will delegate authority for the operation of the Water Department's investment program from the City Treasurer to the Water Department Director of Administration and Finance, who shall establish written administrative procedures and internal controls for the operation of the investment management program.

The Director of Administration and Finance will have the responsibility to submit an investment report to the Board of Water Commissioners and the City Treasurer on a monthly basis.

The Water Department is authorized to invest in any security guaranteed by, or supported by, a pledge of any of the securities allowed under the City Investment Policy, including insurance and a Guaranteed Investment Contract.

The second document is the City of San Bernardino Municipal Water Department Investment Management Procedures. The purpose of these investment management procedures is to set forth procedures consistent with the Municipal Water Department's Investment Policy to be used in managing the funds received from the United States through the settlement agreement. The procedures establish authorized investment officials, controls for trading, internal controls designed to prevent losses, selection of financial services providers, evaluation of investment performance, and annual reviews by auditors.

RECOMMENDATION:

Staff recommends that the Board of Water Commissioners approve the following actions:

adopt the attached resolution approving the proposed City of San Bernardino Municipal Water Department Investment Policy effective when approved by Mayor and Common Council;

adopt the attached resolution approving the proposed City of San Bernardino Investment Management Procedure effective when the Water Department Investment Policy is approved by the Mayor and Common Council; and

authorize staff to submit the City of San Bernardino Water Department Investment Policy jointly with the City Treasurer to Mayor and Common Council for approval.

Respectfully submitted,

David S. Erickson
Director, Administration and Finance