INVESTMENT POLICY

REVISED FEBRUARY 14, 2019

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SECTION 1 - INVESTMENT POLICY

OVERVIEW

I. PURPOSE

This Investment Policy is set forth by Rancho California Water District (hereinafter referred to as "District") for the following purposes:

a. To establish a clear understanding for the governing Board, management, responsible employees, citizens and third parties of the objectives, policies and guidelines for the investment of the District's idle and surplus funds;

b. To offer guidance to investment staff and any external investment advisers on the investment of District funds; and

c. To establish a basis for evaluating investment results.

The District establishes investment policies that meet its current investment goals. The District shall review this policy annually and may change its policies as its investment objectives change.

II. SCOPE

This investment policy applies to all financial assets and investment activities of the District with the following exceptions:

a. The Deferred Compensation Plan is excluded because it is managed by a third party administrator and invested by individual plan participants; and

b. Proceeds of debt issuance shall be invested in accordance with the general investment philosophy of the District as set forth in this policy; however, such proceeds are invested in accordance with permitted investment provisions of their specific bond indentures.

III. DELEGATION OF AUTHORITY

Section 53600 *et seq.* of the Government Code provides legal authorization for the investment or deposit of funds of local agencies. All investments of Rancho California Water District shall conform to the restrictions of those laws. In addition, further requirements shall be established taking into consideration prudent investment standards.

The District may engage the services of an external investment manager to assist in the management of the District's investment portfolio in a manner consistent with the District's objectives. Such external manager may be granted discretion to purchase and sell investment securities in accordance with this Investment Policy. Such manager must be registered under the Investment Advisers Act of 1940.

IV. PRUDENT INVESTOR STANDARD

The Prudent Investor Standard shall be used by investment officials, and shall be applied in the context of managing an overall portfolio. Investment staff 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 within 30 days and appropriate action is taken to control adverse developments.

The **Prudent Investor Standard:** When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. Within the limitations of this section and considering individual investments as part of an overall strategy, a trustee is authorized to acquire investments as authorized by law.

V. ETHICS AND 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.

VI. OBJECTIVES

The primary objectives, in priority order, of investment activities shall be safety, liquidity and return. In order to achieve these objectives, the District has segregated its funds into three portfolios. The Construction Fund is structured to meet a schedule of payouts for capital expenditures. The Cash Management Account is invested in short-term securities to meet operating needs. The Operating Reserve is invested in somewhat longer-term securities in order to provide for future needs.

VII. SAFETY

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

VIII. LIQUIDITY

The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands (static liquidity). Furthermore, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity). A portion of the portfolio also may be placed in money market mutual funds or local government investment pools, which offer same-day liquidity for short-term funds.

IX. RETURN

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

X. BENCHMARKS

The District shall develop market benchmarks that are similar in characteristics to the District's portfolios, and shall compare the total return of the District's portfolio to the appropriate benchmarks.

Specifically, the benchmarks for the Construction Fund and Cash Management Account shall be LAIF and a market index of 3-month U.S. Treasury Bills (ICE BofA Merrill Lynch: G0O1 Index). The benchmark for the Operating Reserve portfolio shall be a market index of U.S. Treasury and agency securities with a maturity of 1-10 years (ICE BofA Merrill Lynch 1-10 Year U.S. Treasury and Agency Index: G5A0 Index).

XI. PROHIBITED INVESTMENT VEHICLES AND PRACTICES

State law notwithstanding, any investments not specifically described herein are prohibited, including, but not limited to, mutual funds (other than government money market funds), unregulated and/or unrated investment pools or trusts, and futures and options.

In accordance with Government Code Section 53601.6, investment in inverse floaters, range notes, or mortgage derived interest-only strips is prohibited.

Investment in any other security that could result in a zero interest accrual if held to maturity is prohibited.

Trading securities for the sole purpose of speculating on the future direction of interest rates is prohibited.

Purchasing or selling securities on margin is prohibited.

The use of reverse repurchase agreements, securities lending, or any other form of borrowing or leveraging is prohibited.

The District pursues prudent active management strategies in order to enhance return and reduce risk as market conditions change over time.

XII. MITIGATING CREDIT RISK IN THE PORTFOLIO

Credit risk is the risk that a security or a portfolio will lose some or all of its value due to a real or perceived change in the ability of the issuer to repay its debt. The District shall mitigate credit risk by adopting the following strategies:

No more than 5 percent of the total portfolio may be invested in securities of any single bank, bank holding company, or other non-governmental issuer other than Government Money Market Mutual Funds that may have no more than 10 percent in any one fund for more than 7 consecutive days unless otherwise specified in this policy.

The District may elect to sell a security prior to its maturity and record a capital gain or loss in order to improve the quality, liquidity or yield of the portfolio in response to market conditions or the District's risk preferences.

If securities owned by the District are downgraded to a level below the minimum quality required by this Investment Policy, it shall be the District's policy to review the credit situation and make a determination as to whether to sell or retain such securities in the portfolio. For the purposes of this investment policy, credit ratings shall be interpreted by their category and any references to Nationally Recognized Statistical Ratings Organization (NRSRO) shall include Moody's, Standard and Poor's and Fitch or their successors. If a decision is made to retain a downgraded security in the portfolio, its presence in the portfolio will be monitored and reported quarterly to the governing Board.

The diversification requirements described herein, and as shown in the Table on Page 6 are designed to mitigate credit risk in the portfolio. The minimum quality required in the Table on Page 6, requires one qualifying credit rating by a nationally recognized credit rating organization.

XIII. MITIGATING MARKET RISK IN THE PORTFOLIO

Market risk is the risk that the portfolio will decline in value (or will not optimize its value) due to changes in the general level of interest rates. The District recognizes that, over time, longer-term portfolios achieve higher returns. On the other hand, longer-term portfolios have higher volatility of return. The District shall mitigate market risk by providing adequate liquidity for short-term cash needs, and by marking some longer-term investments only with funds that are not needed for current cash flow purposes. The District further recognizes that certain types of securities, including variable rate securities, securities with principal pay downs prior to maturity, and securities with embedded options, will affect the market risk profile of the portfolio differently in different interest rate environments. The District, therefore, adopts the following strategies to control and mitigate its exposure to market risk.

The Board of Directors (Board) has approved the purchase of securities with maturities in excess of 5 years for the Operating Reserve portfolio. Purchases of such securities shall not exceed 40 percent of surplus funds unless prior approval is given by the Board.

The maximum stated final maturity of individual securities in the portfolio shall be thirty (30) years, as defined more specifically in this policy;

The duration of each portfolio shall typically be equal to the duration of its market benchmark, plus or minus 10 percent.

XIV. REPORTING

a. **Monthly.** The Assistant General Manager-CFO/Treasurer and/or Investment Officer shall prepare a monthly investment report for review and approval by the governing Board, 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 governing Board to ascertain whether investment activities during the reporting period have conformed to the investment policy.

b. **Quarterly.** On a quarterly basis, the District's Assistant General Manager-CFO/Treasurer and/or Investment Officer shall prepare a report in compliance with Government Code Section 53646 the detailed listing of individual securities held in the District's investment portfolio. The report will include the following:

   1. Listing of individual securities held at the end of the reporting period;
   2. Cost and market value of all securities, including realized and unrealized market value gains or losses in accordance with GASB requirements;
   3. Average weighted yield to maturity of portfolio;
   4. Listing of investment by maturity date;
   5. Percentage of the total portfolio, which each type of investment represents;
   6. Statement of compliance with Investment Policy, including an explanation of any compliance exceptions (CGC Section 53646); and
   7. Certification of sufficient liquidity to meet budgeted expenditures over the ensuing six months (CGC Section 53646).

c. **Semi-Annual**. On a semi-annual basis, the District's Investment Adviser shall report the total rate of return on each of the District's portfolios to the governing Board, together with a comparison to each portfolio's market benchmarks. For the Cash Management and Construction Funds, total return on an unrealized basis shall be reported; for the Operating Reserve Portfolio, both realized and unrealized returns will be reported.

d. **Annually.** On an annual basis, the District's Assistant General Manager-CFO/Treasurer shall present the Investment Policy, together with any proposed amendments, to the governing Board for its consideration.

XV. INVESTMENT LIMITATIONS

SUMMARY OF INVESTMENT LIMITATIONS				
Type of Security	**% Limit Per Issuer**	**% Limit Per Type of Security**	**Minimum Quality***	**Maturity Limit**
U.S. Treasuries	n/a	100%	n/a	30 years
Federal Agencies:		100%	n/a	30 years
GNMA	50			
Farm Credit	30			
FHLB	30			
FHLMC	30			
FNMA	30			
TVA	30			
Other Agencies	30% each			
Supranationals	10% each (IBRD, IFC and IADB)	30%	AA	5 years
State of California, LAIF		Allowable Maximum		
County of Riverside Treasurer's Pooled-Investment Fund (TPIF)	No more than one half the maximum allowable by LAIF	No more than one half the maximum allowable by LAIF	AAA	n/a
California State and Local Agencies obligations	5%**	Allowable Maximum 20%	A	30 years
Bankers' Acceptances	5	40	A1/P1	180 days
Commercial Paper	5	25	A1/P1	270 days
Negotiable Certificates of Deposits	5	30	A1/P1	5 years
Corporate Medium Term Notes	5	30	A	5 years
Time Certificates of Deposit	5	40	A1/P1	5 years
Government Money Market Mutual Funds (Shares of beneficial interest in money market funds)	5***	20	AAA	5 years
Mutual Fund****	10%	Allowable Maximum 20%	AAA	
Repurchase Agreements	5	10	n/a	1 year
Collateralized Mortgage Obligations (CMOs) and Mortgage-Backed Securities (MBS), Asset Backed Securities (ABS)	5	20% combined CMOs, MBS', and ABS'	AA	5 years

* *Securities/Issuers with credit ratings requirements are required to be rated by at least one NRSRO.*

** *No per Issuer limit for RCWD obligations.*

*** *Government Money Market Mutual Funds that may have no more than 10 percent in any 1 fund for more than 7 consecutive days.*

**** *Have retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience investing in the securities and obligations authorized by California Government Code, Section 53601 and with assets under management in excess of $500 million.*

Guaranteed Investment Contracts (GICs). The Board has authorized the investment of bond proceeds (project and reserve funds) in GICs from providers rated a minimum of "AA" by a NRSRO. Collateralization requirements shall be determined at the time the investment agreement is made, based on market conditions and the District's objectives.

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SECTION 2 - RETIREMENT MEDICAL BENEFITS PLAN INVESTMENT OBJECTIVES AND GUIDELINES

ADOPTED FEBRUARY 8, 2018

I. INVESTMENT OBJECTIVES

The primary objectives for investment of the Rancho California Water District's Retirement Medical Benefits Plan monies is to ensure contributions to the plan are available to meet the obligations of the plan at the same time producing a return consistent with the long-term stated goal. In order to achieve these objectives, the District has selected the following investment guidelines:

- Long-term Growth of Assets: The Trust's objective is to grow over time and increase its purchasing power by earning a total return equal to or in excess of the long-term actuarial investment return rate of 6.75 percent. The Investment Manager will seek to minimize risk through diversification.

- Preservation of Capital: Another of the Trust's objectives is to protect principal. Exposing the Trust to undue risk is to be avoided; however, the assumption of an appropriate level of risk, commensurate with the growth objective, is warranted in pursuit of the investment goals. The investment manager and the Board further recognize that financial assets fluctuate in value and that near-term results can diverge from long-term stated goals. The investment manager will seek to minimize risk through diversification. The Investment Manager will advise the Board from time to time on the reasonableness of their objectives in light of capital market conditions.

- Liquidity: To provide sufficient liquidity for periodic cash requirements.

These objectives are to be considered in conjunction with guidelines and restrictions set forth in this Policy.

II. INVESTMENT GUIDELINES

The Investment Manager shall allocate Trust assets consistent with the stated investment objectives in Section I above and in accord with the asset allocation set forth in this section. The allocation of Trust assets shall be maintained within the "Policy Asset Class Ranges" noted in the table below. The Investment Manager will be responsible for determining the asset allocation within these bands and rebalancing as necessary.

ASSET CLASS	ACCEPTABLE RANGE
Equities	30% - 55%
Domestic	30% - 50%
International	0% - 30%
Real Estate	0% - 20%
Domestic	0% - 20%
International	0% - 10%
Commodities	0% - 10%
Bonds	30% - 60%
Domestic	30% - 60%
Investment Grade	20% - 60%
High Yield	0% - 15%
International	0% - 10%
Cash	0% - 10%

It is understood that deviations will occur as a result of market impact and cash flow. The actual asset allocation will be monitored by the District and the Investment Manager. At least quarterly, the Investment Manager will rebalance portfolio allocations to assure the asset allocation proportions remain within the permitted range.

III. ELIGIBLE INVESTMENTS AND DIVERSIFICATION

Investments may be placed in the following asset classes:

- Equity securities of U.S. and non-U.S. issuers.
- Fixed Income securities of U.S. and non-U.S. issuers.
- Real Estate Investment Trusts (REITs).
- Commodities (Investments must be made in a pooled-investment vehicle).

Investments may be placed in the following investment vehicles:

- Mutual Funds that invest in permitted asset classes.
- Exchange Traded Funds (ETF) that invest in permitted asset classes.
- Commingled funds that are consistent with the aforementioned asset classes.
- Individual Fixed Income Securities must meet the criteria defined below:
    - U.S. Dollar Denominated.
    - U.S. Treasury Securities or securities guaranteed by the full faith and credit of the U.S.
    - U.S. Agency Securities or Instruments of the U.S. Government. Examples of issuers include Federal Farm Credit Bank, Federal Home Loan Bank,

Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Government National Mortgage Association, Tennessee Valley Authority,

- Supranational obligations that are U.S. dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank. The securities must be rated in a rating category of "AA" or its equivalent or better by a NRSRO.
- Other non-U.S. governmental issuers of securities with a rating of at least AAA by a NRSRO.
- Corporate securities rated investment grade by a NRSRO.
- Bank certificates of deposit, bank Eurodollar time deposits and Eurodollar certificates of deposit rated in one of the two highest categories by Thompson Bankwatch, and rated in the highest short-term category by a NRSRO.
- Banker's Acceptances Issued by Banks rated in the highest short-term category by a NRSRO.
- Money market mutual funds with a minimum of $500 million in assets, which invest in permissible securities.
- MBS, CMO, and ABS with a rating of at least "AAA" by a NRSRO or issued by a Government Sponsored Enterprise (GSE).

Prohibited Transactions

- Direct short sales of individual securities (the Investment Manager may buy commingled funds that employ short sale techniques).
- Direct margin purchases (see glossary for a definition. The Investment Manager may buy commingled funds that employ margin).
- Direct investment in commodities futures contracts (the Investment Manager may buy commingled funds that use futures contracts).
- Direct investments in real estate or direct real estate lending.
- Hedge funds (see glossary for a definition).

The District's assets will be invested in investment securities noted above. All the investment funds generally will be fully invested. The invested funds of any single issuer will be less than five (5) percent of the total assets of the overall fund, with the exception of the pooled-investment vehicles, U.S. government, U.S. government agency, and supranational obligation.

IV. PERFORMANCE STANDARDS

The primary performance goal is to earn the long-term actuarial investment return rate of 6.75 percent. The Investment Manager will make time-weighted rate of return measurements at quarterly intervals for the portfolio as a whole and for each separate asset class in compliance with GIPS® (Global Investment Performance Standards).

Performance will be measured against an appropriate blended benchmark, which is consistent with the portfolio's policy target. Emphasis will be placed on performance over a market cycle.

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SECTION 3 - RANCHO CALIFORNIA WATER DISTRICT SECTION 115 PENSION TRUST

ADOPTED JUNE 14, 2018

I. PURPOSE

Rancho California Water District (hereinafter referred to as "District") has established the Rancho California Water District Section 115 Trust ("Trust"). This Trust is intended to provide funding for the District's retirement benefits provided through the California Public Employees' Retirement System ("CalPERS") for those eligible employees that meet any specified age, service, and other requirements. The District hereby adopts this Funding Policy Statement ("Policy Statement") for the purposes set forth herein.

The purpose of the Trust is to achieve long-term growth of Trust assets by maximizing long-term rate of return on investments and minimizing risk of loss to fulfill the District's stated objectives for the Trust to fund the District's Pension Obligations, as defined under the Rancho California Water District Section 115 Trust Agreement ("Trust Agreement").

The purpose of this Policy Statement is to establish clear guidelines on how the returns achieved from the investment of the Trust assets will be applied.

The District has separately established investment policies that meet its current investment goals. Refer to the most current Investment Policy for more detailed information regarding the investment standards and procedures applicable to the Trust.

II. SCOPE

This Policy Statement applies exclusively to the Trust.

III. OBJECTIVES

Consistent with the main objective for the Trust, it is the District's intent and determination that the corpus of the Trust shall remain intact unless otherwise determined by the District's Board of Directors (Board). Such intent is for the purpose of ensuring that the District has the necessary funds to meet its Pension Obligations irrespective of the economic conditions at any given time.

The annual earnings achieved from the investment of the Trust's assets, determined as of June 30 of each fiscal year, shall be allocated in accordance with the following guidelines, as determined by the District:

1. If the funded ratio of the District's CalPERS pension plan is below 70 percent, then 100 percent of the Trust's annual earnings will be paid directly to CalPERS as an additional payment towards the District's Unfunded Accrued Liability ("UAL").

2. If the funded ratio of the District's CalPERS pension plan is at least 70 percent but less than 80 percent, then the Trust's annual earnings will be applied as follows:

   a. 75 percent of the Trust's annual earnings will be paid directly to CalPERS as an additional payment towards the District's UAL.
   b. The remaining 25 percent of the Trust's annual earnings will be added to the Trust's corpus.

3. If the funded ratio of the District's CalPERS pension plan is at least 80 percent but less than 100 percent, then the Trust's annual earnings will be applied as follows:

   a. 50 percent of the Trust's annual earnings will be paid directly to CalPERS as an additional payment of the District's UAL.
   b. The remaining 50 percent of the Trust's annual earnings will be added to the Trust's corpus.

4. If the funded ratio of the District's CalPERS pension plan is at 100 percent but the annual earnings of the Trust are insufficient to reimburse 100 percent of the District's annual employer contributions to CalPERS, then the Trust's annual earnings will be applied as follows:

   a. 50 percent of the Trust's annual earnings will be used to reimburse to the District for its annual employer contributions.
   b. The remaining 50 percent of the Trust's annual earnings will be added to the Trust's corpus.

5. If the District's CalPERS pension plan is 100 percent funded and the annual earnings of the Trust are sufficient to reimburse 100 percent of District's annual employer contributions to CalPERS, then 100 percent of the District's annual employer contributions (for fiscal year June 30) are to be reimbursed provided that 50 percent of the annual earnings would be added to the Trust's corpus until the losses from previous years have been fully recovered. For this purpose, "losses" is defined as a reduction in the Trust's corpus as a result of negative investment returns.

For the purpose of applying this policy, the most recently available actuarial study, or other most recent District-specific communication from CalPERS, shall be the basis for determining the status of the District's funded ratio on its pension plan, and the amount of District-required employer contributions.

IV. INVESTMENT OBJECTIVES

The primary objectives for investment of the Rancho California Water District Section 115 Pension Trust are to help fund ongoing pension payments to meet the District's obligations. In order to achieve these objectives, the District has selected the following investment guidelines.

- Long-term Growth of Assets: The Trust's objective is to grow over time and increase its purchasing power by earning a total return equal to or in excess of the investment return goal of seven (7) percent. The Investment Manager will seek to minimize risk through diversification.

- Preservation of Capital: Another of the Trust's objectives is to protect principal. Exposing the Trust to undue risk is to be avoided; however, the assumption of an appropriate level of risk, commensurate with the growth objective, is warranted in pursuit of the investment goals. The investment manager and the Board further recognize that financial assets fluctuate in value and that near-term results can diverge from long-term stated goals. The investment manager will seek to minimize risk through diversification. The Investment Manager will advise the Board from time to time on the reasonableness of their objectives in light of capital market conditions.

- Liquidity: To provide sufficient liquidity for periodic withdrawals from the Trust as needed.

These objectives are to be considered in conjunction with guidelines and restrictions set forth in this Policy.

V. INVESTMENT GUIDELINES

The Investment Manager shall allocate Trust assets consistent with the stated investment objectives in Section I above and in accord with the asset allocation set forth in this section. The allocation of Trust assets shall be maintained within the "Policy Asset Class Ranges" noted in the table below. The Investment Manager will be responsible for determining the asset allocation within these bands and rebalancing as necessary.

ASSET CLASS	ACCEPTABLE RANGE
Equities	50% - 70%
Domestic	40% - 70%
International	0% - 35%
Real Estate	0% - 15%
Domestic	0% - 15%
International	0% - 5%
Commodities	0% - 5%
Bonds	30% - 50%
Domestic	20% - 50%
Investment Grade	20% - 50%
High Yield	0% – 15%
International	0% - 15%
Cash	0% - 5%

It is understood that deviations will occur as a result of market impact and cash flow. The actual asset allocation will be monitored by the District and Investment Manager. At least quarterly, the Investment Manager will rebalance portfolio allocations to assure the asset allocation proportions remain within the permitted range.

VI. ELIGIBLE INVESTMENTS AND DIVERSIFICATION

Investments may be placed in the following asset classes:

- Equity securities of U.S. and non-U.S. issuers.
- Fixed Income securities of U.S. and non-U.S. issuers.
- Real Estate Investment Trusts (REIT).
- Commodities (Investments must be made in a pooled-investment vehicle).

Investments may be placed in the following investment vehicles:

- Mutual Funds that invest in permitted asset classes.
- Exchange Traded Funds (ETF) that invest in permitted asset classes.
- Commingled funds that are consistent with the aforementioned asset classes.

- Individual Fixed Income Securities must meet the criteria defined below:
    - U.S. Dollar Denominated.
    - U.S. Treasury Securities or securities guaranteed by the full faith and credit of the U.S.
    - U.S. Agency Securities or Instruments of the U.S. Government. Examples of issuers include Federal Farm Credit Bank, Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Government National Mortgage Association, and Tennessee Valley Authority.
    - Supranational obligations that are U.S. dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank. The securities must be rated in a rating category of "AA" or its equivalent or better by a NRSRO.
    - Other non-U.S. governmental issuers of securities with a rating of at least AAA by a NRSRO.
    - Corporate securities rated investment grade by a NRSRO.
    - Banker's Acceptances Issued by Banks rated in the highest short-term category by a NRSRO.
    - Money market mutual funds with a minimum of $500 million in assets, which invest in permissible securities.
    - Mortgage Backed Securities (MBS), Collateralized Mortgage Obligations (CMO) and Asset Backed Securities (ABS) with a rating of at least "AAA" by a NRSRO or issued by a GSE.

Prohibited Transactions

- Direct short sales of individual securities (the Investment Manager may buy commingled funds that employ short sale techniques).
- Direct margin purchases (see glossary for a definition. The Investment Manager may buy commingled funds that employ margin).
- Direct investment in commodities futures contracts (the Investment Manager may buy commingled funds that use futures contracts).
- Direct investments in real estate or direct real estate lending (the Investment Manager may buy commingled funds that invests in real estate or engages in real estate lending).

- Hedge funds (see glossary for a definition).

The District's assets will be invested in the investment securities noted above. All the investment funds generally will be fully invested. The invested funds of any single issuer will be less than seven (7) percent of the total assets of the overall fund, with the exception of the pooled-investment vehicles, U.S. government, U.S. government agency and supranational obligation and money market funds.

VII. PERFORMANCE STANDARDS

The primary performance goal is to earn the long-term actuarial investment return rate of seven (7) percent. The Investment Manager will make time-weighted rate of return measurements at quarterly intervals for the portfolio as a whole and for each separate asset class in compliance with GIPS® (Global Investment Performance Standards).

Performance will be measured against an appropriate blended benchmark, which is consistent with the portfolio's policy target. Emphasis will be placed on performance over a market cycle.

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SECTION 4 - GLOSSARY OF INVESTMENT TERMS©

Agencies. Shorthand market terminology for any obligation issued by *a government-sponsored entity (GSE),* or a *federally related institution*. Most obligations of GSEs are not guaranteed by the full faith and credit of the U.S. government. Examples are:

FDIC. The Federal Deposit Insurance Corporation provides insurance backed by the full faith and credit of the U.S. government to certain bank deposits and debt obligations.

FFCB. The Federal Farm Credit Bank System provides credit and liquidity in the agricultural industry. FFCB issues discount notes and bonds.

FHLB. The Federal Home Loan Bank provides credit and liquidity in the housing market. FHLB issues discount notes and bonds.

FHLMC. Like FHLB, the Federal Home Loan Mortgage Corporation provides credit and liquidity in the housing market. FHLMC, also called "Freddie Mac" issues discount notes, bonds and mortgage pass-through securities.

FNMA. Like FHLB and Freddie Mac, the Federal National Mortgage Association was established to provide credit and liquidity in the housing market. FNMA, also known as "Fannie Mae," issues discount notes, bonds and mortgage pass-through securities.

GNMA. The Government National Mortgage Association, known as "Ginnie Mae," issues mortgage pass-through securities, which are guaranteed by the full faith and credit of the U.S. Government.

PEFCO. The Private Export Funding Corporation assists exporters. Obligations of PEFCO are not guaranteed by the full faith and credit of the U.S. government.

TVA. The Tennessee Valley Authority provides flood control and power and promotes development in portions of the Tennessee, Ohio and Mississippi River valleys. TVA currently issues discount notes and bonds.

Asked. The price at which a seller offers to sell a security.

Asset Backed Securities. Securities supported by pools of installment loans or leases or by pools of revolving lines of credit.

Average life. In mortgage-related investments, including CMOs, the average time to expected receipt of principal payments, weighted by the amount of principal expected.

Banker's acceptance. A money market instrument created to facilitate international trade transactions. It is highly liquid and safe because the risk of the trade transaction is transferred to the bank, which "accepts" the obligation to pay the investor.

Benchmark. A comparison security or portfolio. A performance benchmark is a partial market index, which reflects the mix of securities allowed under a specific investment policy.

Bid. The price at which a buyer offers to buy a security.

Broker. A broker brings buyers and sellers together for a transaction for which the broker receives a commission. A broker does not sell securities from his own position.

Certificate of Deposit (CD). A time deposit with a specific maturity evidenced by a certificate. Large denomination CDs may be marketable.

Collateral. Securities or cash pledged by a borrower to secure repayment of a loan or repurchase agreement. Also, securities pledged by a financial institution to secure deposits of public monies.

Collateralized Mortgage Obligations (CMO). Classes of bonds that redistribute the cash flows of mortgage securities (and whole loans) to create securities that have different levels of prepayment risk, as compared to the underlying mortgage securities.

Commercial paper. The short-term unsecured debt of corporations.

Commodity. A basic good used in commerce that is interchangeable with other commodities of the same type. Commodities are most often used as inputs in the production of other goods or services. The quality of a given commodity may differ slightly, but it is essentially uniform across producers. When they are traded on an exchange, commodities must also meet specified minimum standards, also known as a basis grade.

Cost yield. The annual income from an investment divided by the purchase cost. Because it does not give effect to premiums and discounts which may have been included in the purchase cost, it is an incomplete measure of return.

Coupon. The rate of return at which interest is paid on a bond.

Credit risk. The risk that principal and/or interest on an investment will not be paid in a timely manner due to changes in the condition of the issuer.

Current yield. The annual income from an investment divided by the current market value. Since the mathematical calculation relies on the current market value rather than the investor's cost, current yield is unrelated to the actual return the investor will earn if the security is held to maturity.

Dealer. A dealer acts as a principal in security transactions, selling securities from and buying securities for his own position.

Debenture. A bond secured only by the general credit of the issuer.

Delivery vs. payment (DVP). A securities industry procedure whereby payment for a security must be made at the time the security is delivered to the purchaser's agent.

Derivative. Any security that has principal and/or interest payments which are subject to uncertainty (but not for reasons of default or credit risk) as to timing and/or amount, or any security which represents a component of another security which has been separated from other components ("Stripped" coupons and principal). A derivative is also defined as a financial instrument of the value of which is totally or partially derived from the value of another instrument, interest rate or index.

Discount. The difference between the par value of a bond and the cost of the bond, when the cost is below par. Some short-term securities, such as T-bills and banker's acceptances, are known as **discount securities**. They sell at a discount from par, and return the par value to the investor at maturity without additional interest. Other securities, which have fixed coupons, trade at a discount when the coupon rate is lower than the current market rate for securities of that maturity and/or quality.

Diversification. Dividing investment funds among a variety of investments to avoid excessive exposure to any one source of risk.

Duration. The weighted average time to maturity of a bond where the weights are the present values of the future cash flows. Duration measures the price sensitivity of a bond to changes in interest rates. (See modified duration).

Equity. Also referred to as stock or any other security representing an ownership interest.

Exchange-Traded Fund (ETF). A security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange.

Federal funds rate. The rate of interest charged by banks for short-term loans to other banks. The Federal Reserve Bank through open-market operations establishes it.

Federal Open Market Committee: A committee of the Federal Reserve Board that establishes monetary policy and executes it through temporary and permanent changes to the supply of bank reserves.

Guaranteed Investment Contract (GIC). Insurance contracts that guarantee the owner principal repayment and a fixed or floating interest rate for a predetermined period of time. Since the issuer guarantees of the contact it does have credit risk.

Haircut: The margin or difference between the actual market value of a security and the value assessed by the lending side of a transaction (i.e. a repo).

Hedge Fund: An aggressively managed portfolio of investments that uses advanced investment strategies such as leveraged, long, short, and derivative positions in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark). Legally, hedge funds are most often set up as private investment partnerships that are open to a limited number of investors and require a very large initial minimum investment. Investments in hedge funds are illiquid, as they often require investors keep their money in the fund for at least one year.

Investment Grade. A rating that indicates a municipal or corporate bond has a relatively low risk of default. Bond credit rating firms, such as Standard & Poor's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality and are commonly referred to as "high yield bonds."

Leverage. Borrowing funds in order to invest in securities that have the potential to pay earnings at a rate higher than the cost of borrowing.

Liquidity: The speed and ease with which an asset can be converted to cash.

Margin: The difference between the market value of a security and the loan a broker makes using that security as collateral.

Market risk. The risk that the value of securities will fluctuate with changes in overall market conditions or interest rates.

Market value. The price at which a security can be traded.

Marking to market. The process of posting current market values for securities in a portfolio.

Maturity. The final date upon which the principal of a security becomes due and payable.

Medium term notes. Unsecured, investment-grade senior debt securities of major corporations, which are sold in relatively small amounts on either a continuous or an intermittent basis. MTNs are highly flexible debt instruments that can be structured to respond to market opportunities or to investor preferences.

Modified duration. The percent change in price for a 100 basis point change in yields. Modified duration is the best single measure of a portfolio's or security's exposure to market risk.

Money market. The market in which short-term debt instruments (T-Bills, discount notes, commercial paper and banker's acceptances) are issued and traded.

Mortgage pass-through securities. A securitized participation in the interest and principal cash flows from a specified pool of mortgages. Principal and interest payments made on the mortgages are passed through to the holder of the security.

Municipal Securities. Securities issued by state and local agencies to finance capital and operating expenses.

Mutual fund. An entity that pools the funds of investors and invests those funds in a set of securities, which is specifically defined in the fund's prospectus. Mutual funds can be invested in various types of domestic and/or international stocks, bonds and money market instruments, as set forth in the individual fund's prospectus. For most large, institutional investors, the costs associated with investing in mutual funds are higher than the investor can obtain through an individually managed portfolio.

Nationally Recognized Statistical Ratings Organization (NRSRO). The formal term to describe credit rating agencies that provide credit ratings that are used by the U.S. government in several regulatory areas. Ratings provided by NRSRO are used frequently by investors and are used as benchmarks by federal and state agencies. Example are Moody's, Standard and Poor's and Fitch credit ratings services.

Negotiable CD. A short-term debt instrument that pays interest and is issued by a bank, savings or federal association, state or federal credit union, or state-licensed branch of a foreign bank. Negotiable CDs are traded in a secondary market and are payable upon order to the bearer or initial depositor (investor).

Premium. The difference between the par value of a bond and the cost of the bond, when the cost is above par.

Prepayment speed. A measure of how quickly principal is repaid to investors in mortgage securities.

Prepayment window. The time period over which principal repayments will be received on mortgage securities at a specified prepayment speed.

Primary dealer. A financial institution (1) that is a trading counterparty with the Federal Reserve in its execution of market operations to carry out U.S. monetary policy, and (2) that participates for statistical reporting purposes in compiling data on activity in the U.S. Government securities market.

Prudent person (Prudent investor) rule. A standard of responsibility that applies to fiduciaries. In California, the rule is stated as "Investments shall be managed with the care, skill, prudence and diligence, under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of like character and with like aims to accomplish similar purposes."

Real Estate Investment Trust (REIT). A security that sells like a stock on the major exchanges and invests in real estate directly, either through properties or through mortgages.

Realized yield. The change in value of the portfolio due to interest received and interest earned and realized gains and losses. It does not give effect to changes in market value on securities, which have not been sold from the portfolio.

Regional dealer. A financial intermediary that buys and sells securities for the benefit of its customers without maintaining substantial inventories of securities and that is not a primary dealer.

Repurchase agreement (RP, Repo). Short-term purchases of securities with a simultaneous agreement to sell the securities back at a higher price. From the seller's point of view, the same transaction is a **reverse repurchase agreement**.

Safekeeping. A service to bank customers whereby securities are held by the bank in the customer's name.

Structured note. A complex, fixed income instrument, which pays interest, based on a formula tied to other interest rates, commodities or indices. Examples include inverse floating rate notes which have coupons that increase when other interest rates are falling, and which fall when other interest rates are rising, and "dual index floaters," which pay interest based on the relationship between two other interest rates - for example, the yield on the ten-year Treasury note minus the Libor rate. Issuers of such notes lock in a reduced cost of borrowing by purchasing interest rate swap agreements.

Supranational. A Supranational is a multi-national organization whereby member states transcend national boundaries or interests to share in the decision making to promote economic development in the member countries.

Total rate of return. A measure of a portfolio' performance over time. It is the internal rate of return, which equates the beginning value of the portfolio with the ending value; it includes interest earnings, realized and unrealized gains, and losses in the portfolio.

U.S. Treasury obligations. Securities issued by the U.S. Treasury and backed by the full faith and credit of the United States. Treasuries are considered to have no credit risk, and are the benchmark for interest rates on all other securities in the U.S. and overseas. The Treasury issues both discounted securities and fixed coupon notes and bonds.

Treasury bills. All securities issued with initial maturities of one year or less are issued as discounted instruments, and are called Treasury bills. The Treasury currently issues three- and six-month T-Bills at regular weekly auctions. It also issues "cash management" bills as needed to smooth out cash flows.

Treasury notes. All securities issued with initial maturities of two to ten years are called Treasury notes, and pay interest semi-annually.

Treasury bonds. All securities issued with initial maturities greater than ten years are called Treasury bonds. Like Treasury notes, they pay interest semi-annually.

Volatility. The rate at which security prices change with changes in general economic conditions or the general level of interest rates.

Yield to Maturity. The annualized internal rate of return on an investment, which equates the expected cash, flows from the investment to its cost.