

CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK (I-Bank)

STAFF REPORT

ISSUE: The I-Bank's current investment policy, was adopted on April 27, 2010 (2010 Investment Policy). (See Attachment 1 – I-Bank Investment Policy as of April 27, 2010). The 2010 Investment Policy contains a requirement for the Board to review the policy annually. Prior to this meeting, the 2010 Investment Policy was provided to Board members for review. Staff is not recommending any changes at this time. The continued use of the 2010 Investment Policy is proposed as consent item number 4.

Alternatively, to the extent the Board wishes to propose changes, they would be brought for Board consideration at the next meeting.

BACKGROUND: Although there is no requirement in State law for the I-Bank Board to adopt an investment policy, it is considered a standard of “best investment practices”¹ for government agencies to have a written investment policy, to review it annually and to have frequent reporting of investment activities. The I-Bank's investment policy was first approved by the Board in March 2006 (2006 Investment Policy), and was reviewed by the Board in March 2007 and 2008 with no amendments.

Although the 2006 Investment Policy required an annual review, no review was conducted by the Board in March 2009, principally due to staff undertaking a thorough and significant internal review of the 2006 Investment Policy. On April 27, 2010, the I-Bank Board approved amendments summarized in Attachment 2, and adopted the 2010 Investment Policy.

Expert Assistance Received for the Investment Policy Review. Staff has obtained input on the 2010 Investment Policy from the external investment advisor under contract with the I-Bank, Bond Logistix (BLX), and from Public Financial Management, Inc./PFM Asset Management, Inc. (PFM), a financial advisory firm also under contract with the I-Bank.

Both firms have more than 25 years providing investment advice and portfolio management for government and not-for-profit organizations, corporations, pension funds and other institutions.

Neither firm had any comments or recommended amendments to the 2010 Investment Policy. BLX commented, “In general, the investment policy is well designed, comprehensive and provides clarity with respect to its scope, investment objectives, risks, and responsibilities.”

¹ Source: California Debt and Investment Advisory Commission's California Public Fund Investment Primer.

RECOMMENDATION

Staff recommends that the Board reflect its annual review of the 2010 Investment Policy by approving consent item number 4.

**CALIFORNIA INFRASTRUCTURE AND
ECONOMIC DEVELOPMENT BANK**

INVESTMENT POLICY

Dated April 27, 2010

**California Infrastructure and Economic Development Bank
Investment Policy**

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California Infrastructure and Economic Development Bank Investment Policy

1.0 Policy

This Investment Policy and the related Exhibits (collectively, the Policy) are intended to provide guidelines for the prudent investment of funds authorized to be deposited or invested by the California Infrastructure and Economic Development Bank (I-Bank) and outline the policies for maximizing the efficiency of the I-Bank's cash management system. The ultimate goal is to enhance the I-Bank's financial return consistent with the prudent protection of the I-Bank's investments while conforming to all applicable state statutes governing the investment of these public funds.

2.0 Scope

It is intended that this Policy cover the deposit or investment of monies in the following funds:

- Monies in or belonging to the California Infrastructure and Economic Development Bank Fund (CIEDB Fund).
 - Includes monies that are held in the State of California's (State) centralized treasury system (State Treasury), but does not include monies annually appropriated by the Legislature to the Business, Transportation and Housing Agency, which include funds for the annual administration of the I-Bank and certain local assistance activities.
 - Includes monies that are held by the trustee of the Infrastructure State Revolving Fund (ISRF) Program Revenue Bonds (ISRF Program Bonds).
- Monies in or belonging to the California Infrastructure Guarantee Trust Fund (Guarantee Trust Fund).
 - Includes monies that are held in the State Treasury, and monies that may be held by the trustee of any bonds guaranteed by the I-Bank (Guarantee Trust Fund Bonds).
- Monies the investment of which is directed by the I-Bank (Other Bonds Directed Investments).
 - Includes monies held by trustees for other bonds issued by the I-Bank that are to be invested at the direction of the I-Bank, such as those related to the State School Fund Apportionment Lease Revenue Bonds (School Bonds).

This Policy does not cover the deposit or investment of funds of entities for which the I-Bank serves as the conduit issuer of bonds.

3.0 Objectives

The overall program shall be designed and managed with a degree of professionalism worthy of the public trust. Consistent with Government code Section 53600.5², which establishes investment objectives for municipal entities, the primary objectives, in order of priority of the I-Bank's investment activities shall be:

- 1) Safety.** Safety of principal is the foremost objective of the investment program. The I-Bank's investments shall be undertaken in a manner that seeks to ensure preservation of capital in the overall portfolio through the mitigation of credit risk and interest rate risk. Credit risk is the risk of loss due to the failure of the security issuer or backer. Interest rate risk is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates.
- 2) Liquidity.** The I-Bank's investments will remain sufficiently liquid to enable the I-Bank to meet reasonably anticipated cash flow requirements.
- 3) Return on Investment.** The I-Bank seeks to optimize the yield on its investments, consistent with constraints imposed by its safety and liquidity objectives.

4.0 Prudence

The Executive Director, as the individual authorized to make investment decisions on behalf of the I-Bank shall be held to the prudent investor standard applicable to California municipal entities: "When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, 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."³

5.0 Delegation of Authority

Consistent with its authority under Government Code Sections 63023(a), (b) and (g), 63025.1(v), 63052, and 63062, and pursuant to Resolution 10-19 adopted by the I-Bank Board of Directors (Board), the Executive Director is authorized to deposit and invest those funds that are within the scope of this Investment Policy as set forth in Section 2.0 (collectively, the I-Bank Investment Funds). The Executive Director shall assume full responsibility for those transactions until the delegation of authority is revoked by the Board. The Executive Director shall determine when it is

² Government Code section 53600.5 establishes overall objectives for investment by local government entities. While this section does not specifically apply to the I-Bank, it articulates the Legislature's overarching policy guidance on the investment of public funds: "When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, the primary objective of a trustee shall be to safeguard the principal of the funds under its control. The secondary objective shall be to meet the liquidity needs of the depositor. The third objective shall be to achieve a return on the funds under its control."

³ Government Code section 53600.3.

appropriate to use the services of an external investment advisor to provide funds management and advisory services to the I-Bank based on the complexity or uniqueness of the investment or complexities resulting from market conditions (such as a disruption in a particular type of security).

The Assistant Executive Director and at least two I-Bank managers shall constitute the Investment Advisory Committee, and shall advise the Executive Director regarding the deposit, investment and management of the I-Bank Investment Funds. Upon the request of the Executive Director, an external investment advisor may also advise the internal investment advisory committee and the Executive Director regarding the deposit, investment and management of the I-Bank Investment Funds. The Executive Director shall make all deposit and investment decisions in strict accordance with applicable State law and this Policy and any other written instructions as are subsequently adopted by the Board.

The Executive Director shall designate certain staff members and, when authorized, an external investment advisor to perform the day-to-day funds management operations of the I-Bank. All deposits and investments shall be made in strict accordance with the deposit and investment decisions of the Executive Director.

6.0 Internal Controls

The Executive Director shall be responsible for all transactions undertaken by the I-Bank's staff or its external investment advisor, and shall establish a system of controls to regulate the activities of internal staff and any external investment advisors. No person may engage in any deposit or investment transaction pertaining to the I-Bank Investment Funds except as provided under the terms of the control procedures established by the Executive Director.

7.0 Ethics and Conflicts of Interest

The Executive Director, the members of the Advisory Committee, and I-Bank employees and investment advisors involved in funds management operations shall operate in a manner that is consistent with applicable conflict of interest and incompatible activity laws of the State and any statements of incompatible activities enacted by the Business, Transportation and Housing Agency and the I-Bank that applies to them. They shall refrain from personal business activities that could conflict with the proper execution of the funds management program, or which could impair their ability to make impartial investment decisions, advise on investment decisions, or perform their fund management activities impartially, as applicable.

8.0 Authorized Financial Institutions, Depositories, and Broker/Dealers

It shall be the I-Bank's policy when engaging directly in the purchase or sale of securities to do so only with properly licensed institutions and firms that have been approved by the State Treasurer's Office (STO). If an external investment advisor is authorized to conduct investment transactions on the I-Bank's behalf, the investment advisor shall use its own list of approved broker/dealers and financial institutions for investment purposes.

All deposits made by the I-Bank or its external investment advisor shall be made in qualified public depositories as established by State law.

For any bond related funds that are outside of the State Treasury, a competitive bid process which counsel to the I-Bank advises is in compliance with Federal Tax law shall be used to place any guaranteed investment agreement, repurchase agreement, reverse repurchase agreement or similar investment transaction.

9.0 Safekeeping and Custody

All security transactions entered into by the I-Bank shall be conducted on a delivery-versus-payment basis to ensure that securities are deposited in an eligible financial institution prior to the release of funds.

All cash and securities in the I-Bank's portfolio shall be held for safekeeping in the I-Bank's name by a third party financial institution trust department, acting as agent for the I-Bank under the terms of a custody agreement executed by the third party financial institution and the I-Bank. The only exception to the foregoing shall be depository accounts and securities purchases made with: (i) funds held in the State Treasury, (ii) permitted money market mutual funds, and (iii) permitted structured investment products used for bond fund investments which by their terms are not deliverable. Evidence of each of these investments will be maintained by the I-Bank's Executive Director.

10.0 Authorized Investments and Deposits – I-Bank Investment Funds in the State Treasury

CIEDB Fund. In accordance with Government Code Section 63052(d) as to I-Bank Investment Funds held in the CIEDB Fund within the State Treasury, the I-Bank may:

- Direct the STO to invest such I-Bank Investment Funds that are not required for its current needs in any eligible security specified in Government Code section 16430 (the terms of which are set forth in Exhibit A to this Policy) provided that such investments shall be limited as provided in the underlined text in Exhibit A. The percentage holding limits set forth in Exhibit A are to be applied at the time of purchase. In addition to the direction as to percentages set forth in Exhibit A, purchases of individual securities shall be diversified by security type and institution to avoid incurring unreasonable and avoidable risks regarding specific security types or individual financial institutions.
- Direct the STO to deposit such I-Bank Investment Funds in any interest-bearing accounts in any bank or savings and loan association in California.
- Require the transfer of funds to the State's Surplus Money Investment Fund (SMIF), a State investment fund which is managed by the STO under the direction of the Pooled Money Investment Board for investment pursuant to Article 4 (commencing with Section 16470) of Chapter 3 of Part 2 of Division 4 of Title 2 of the Government Code. There is no limitation as to the percentage of the funds in the CIEDB Fund that may be invested in the SMIF.

Guarantee Trust Fund. In accordance with Government Code 63062(a) and (b) as to I-Bank Investment Funds held in the Guarantee Trust Fund within the State Treasury, the I-Bank may:

- Direct the STO to invest such I-Bank Investment Funds that are not required for its current needs in any eligible security specified in Government Code Section 16430 subject to the percentage limitations shown as underlined text in Exhibit A.
- Direct the STO to deposit such I-Bank Investment Funds in any interest-bearing accounts in any bank or savings and loan association in California.
- Direct the STO to invest such I-Bank Investment Funds in any other eligible securities listed in Government Code Section 63062(a) as set forth in Exhibit B.
- Require the transfer of such I-Bank Investment Funds to SMIF. There is no limitation as to the percentage of the funds in the Guarantee Trust Fund that may be invested in the SMIF.

11.0 Authorized Investments and Deposits – I-Bank Investment Funds held by Bond Trustees Outside of the State Treasury

In accordance with Government Code Sections 63052(e), 63062(b) and 5922(d) as to I-Bank Investment Funds that are proceeds of bonds or are set aside and pledged to secure payment of bonds and are held by bond trustees⁴, the I-Bank may:

- Direct the deposit or investment of such I-Bank Investment Funds in accordance with the provisions of the applicable bond indenture, trust agreement or other similar agreement entered into pursuant to a resolution of the Board.
- When the provisions of the applicable bond indenture, trust agreement or other similar agreement entered into pursuant to a resolution of the Board are silent as to the investment of funds, direct the deposit or investment of such I-Bank Investment Funds that belong to the CIEDB Fund or the Guarantee Trust Fund as authorized in Section 10.0 above.

12.0 Prohibited Investments

Any investment or deposit not specifically authorized pursuant to Section 10.0 or 11.0 above (including Exhibits A and B referenced therein), but otherwise permitted by law, is prohibited unless otherwise approved by prior action of the Board. Investments in inverse floaters, range notes, interest-only strips that are derived from a pool of mortgages, or any security that could result in zero interest accrual if held to maturity are specifically disallowed.

13.0 Maximum Maturities

It is the objective of the I-Bank to accurately monitor and forecast revenues and expenditures so that the I-Bank can invest funds to the fullest extent possible. Funds of the I-Bank will be invested in accordance with sound treasury management principles.

No investment shall be made in any security, other than a collateral security underlying a repurchase agreement or collateral for any permitted investment agreement, that at the time of the investment

⁴ Including the investment of certain funds pertaining to ISRF Program Bonds and Other Bonds Directed Investments.

has a term remaining to maturity in excess of five years, unless otherwise authorized herein or the Board has granted express authority to make that investment or has authorized an investment program of a longer maturity that is applicable to such investment.

Notwithstanding the prior paragraph, bond reserve funds and bond revenue funds may be invested beyond five years if prudent in the opinion of the Executive Director.

14.0 Credit Criteria

In the event a security in which I-Bank funds are invested is subject to a rating change that brings it below the minimum credit ratings specified in this Policy or the applicable bond indenture or other applicable bond document, the Executive Director shall notify the Board of the change at their next regularly scheduled meeting along with the funds management decision taken or proposed to be taken. Such funds management decisions will be made by the Executive Director on a case-by-case basis, considering such factors as the reason for the change, prognosis for recovery or further rating drops, and the market price of the security..

15.0 Performance

For funds held in the State Treasury, the I-Bank seeks to attain market rates of return on its investments throughout economic cycles, consistent with constraints imposed by its safety and liquidity objectives.

For funds held by bond trustees, the I-Bank seeks to optimize the return on its investments consistent with constraints imposed by its safety and liquidity objectives, arbitrage rebate regulations, and market conditions.

16.0 Reporting

The Executive Director shall submit a monthly deposit and investment transaction report and a quarterly investment report to the Board. Except for funds invested in SMIF, the quarterly report shall include the following information for each individual investment: description of investment instrument, issuer name, maturity date, credit rating, coupon rate, effective yield, purchase price, par value, book value, current market value and the source of the valuation.

The quarterly investment report shall also identify whether any investment fails to comply with this Policy and the plan for bringing that investment into compliance, and include a statement denoting the ability of the I-Bank to meet its expenditure requirements for the next six months, or provide an explanation as to why sufficient money may or may not be available. The quarterly investment report shall be submitted the later of 30 days following the end of the month covered by the report, or the next scheduled I-Bank Board meeting.

The Executive Director shall monitor the status of the funds held by the trustees for the ISRF Program Bonds and any I-Bank Other Bonds Directed Investments to ensure that each issue's

arbitrage rebate status is tracked and reported in compliance with the provisions of the Internal Revenue Code and related Treasury Regulations.

17.0 Policy Adoption

This Policy shall be reviewed annually by the Board. Any change in the Policy shall be reviewed and approved by the Board at a regularly scheduled meeting.

Exhibit A
Government Code 16430 Permitted Investments

Note: the underlined text represents additional criteria established by the I-Bank that is not listed in Government Code Section 16430.

Government Code Section 16430:

- a. Bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest. There is no limitation as to the percentage of the portfolio⁵ that may be invested in this category.
- b. Bonds or interest-bearing notes on obligations that are guaranteed as to principal and interest by a federal agency of the United States. There is no limitation as to the percentage of the portfolio that may be invested in this category; however, the amount invested in any one issuer, including related entities, may not exceed 30 percent of the portfolio.
- c. Bonds, notes and warrants of this state, or those for which the faith and credit of this state are pledged for the payment of principal and interest. A maximum of 30 percent of the portfolio may be invested in this category.
- d. Bonds or warrants, including, but not limited to, revenue warrants, of any county, city, metropolitan water district, California water district, California water storage district, irrigation district in the state, municipal utility district, or school district of this state. A maximum of 30 percent of the portfolio may be invested in this category. The amount invested with any one issuer, including related entities, shall not exceed 10 percent of the portfolio.
- e. Bonds, consolidated bonds, collateral trust debentures, consolidated debentures, or other obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended (12 U.S.C. Sec. 2001 et seq.), debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended (12 U.S.C. Sec. 2001 et seq.), in bonds or debentures of the Federal Home Loan Bank Board established under the Federal Home Loan Bank Act (12 U.S.C. Sec. 1421 et seq.), in stock, bonds, debentures and other obligations of the Federal National Mortgage Association established under the National Housing Act as amended (12 U.S.C. Sec. 1701 et seq.), and bonds of any federal home loan bank established under that act, obligations of the Federal Home Loan Mortgage Corporation, in bonds, notes, and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act as amended (16 U.S.C. Sec. 831 et seq.), and other obligations guaranteed by the Commodity Credit Corporation for the export of California agricultural products under the Commodity Credit Corporation Charter Act as amended (15 U.S.C. Sec. 714 et seq.). There is no limitation as to the percentage of the portfolio that may be invested in this category; however, the amount invested in any one issuer, including related entities, may not exceed 30 percent of the portfolio.

⁵ A “portfolio” means all monies in a fund, such as the CIEDB Fund or the Guarantee Trust Fund, or individual bond issuances related to I-Bank Other Bonds Directed Investments.

- f. (1) Commercial paper of "prime" quality as defined by a nationally recognized organization that rates these securities, if the commercial paper is issued by a corporation, trust, or limited liability company that is approved by the Pooled Money Investment Board that meet the conditions in either subparagraph (A) or subparagraph (B):
- (A) Both of the following: (i) Organized and operating within the United States. (ii) Having total assets in excess of five hundred million dollars (\$500,000,000).
- (B) Both of the following conditions: (i) Organized within the United States as a special purpose corporation, trust, or limited liability company. (ii) Having program wide credit enhancements including, but not limited to, overcollateralization, letters of credit, or surety bond.
- (2) Purchase of eligible commercial paper may not exceed 180 days' maturity, represent more than 10 percent of the outstanding paper of an issuing corporation, trust, or limited liability company, exceed 30 percent of the resources of an investment program. At the request of the Pooled Money Investment Board, this investment shall be secured by the issuer by depositing with the Treasurer securities authorized by Section 53651 of a market value at least 10 percent in excess of the amount of the state's investment. The amount invested in commercial paper of any one issuer in combination with any other securities from that issuer, including related entities, shall not exceed 10 percent of the portfolio.
- g. Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers acceptances, that are eligible for purchase by the Federal Reserve System. A maximum of 40 percent of the portfolio may be invested in this category. The amount invested in bankers acceptances with any one financial institution in combination with any other securities from that financial institution, including related financial institutions, shall not exceed 10 percent of the portfolio.
- h. Negotiable certificates of deposits issued by a federally or state-chartered bank or savings and loan association, a state-licensed branch of a foreign bank, or a federally or state-chartered credit union. For the purposes of this section, negotiable certificates of deposits are not subject to Chapter 4 (commencing with Section 16500) and Chapter 4.5 (commencing with Section 16600). The amount invested in negotiable certificates of deposits with any one financial institution in combination with any other securities from that financial institution, including related financial institutions, shall not exceed 10 percent of the portfolio.
- i. The portion of bank loans and obligations guaranteed by the United States Small Business Administration or the United States Farmers Home Administration. A maximum of 10 percent of the portfolio may be invested in this category.
- j. Bank loans and obligations guaranteed by the Export-Import Bank of the United States. A maximum of 10 percent of the portfolio may be invested in this category.
- k. Student loan notes insured under the Guaranteed Student Loan Program established pursuant to the Higher Education Act of 1965, as amended (20 U.S.C. Sec. 1001 and following) and eligible for resale to the Student Loan Marketing Association established

pursuant to Section 133 of the Education Amendments of 1972, as amended (20 U.S.C. Sec. 1087-2). A maximum of 10 percent of the portfolio may be invested in this category.

- l. Obligations issued, assumed, or guaranteed by the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the International Finance Corporation, or the Government Development Bank of Puerto Rico. A maximum of 10 percent of the portfolio may be invested in this category.
- m. Bonds, debentures, and notes issued by corporations organized and operating within the United States. Securities eligible for investment under this subdivision shall be within the top three ratings of a nationally recognized rating service. A maximum of 30 percent of the portfolio may be invested in this category. The amount invested in corporate notes of any one issuer in combination with any other securities from that issuer, including related entities, shall not exceed 10 percent of the portfolio.
- n. Negotiable Order of Withdrawal Accounts (NOW Accounts), invested in accordance with Chapter 4 (commencing with Section 165500).

Exhibit B
Government Code 63062(a) Permitted Investments

Government Code 63062(a) (in part):

The I-Bank may direct the Treasurer to invest monies:

- By entering into repurchase agreements or reverse repurchase agreements, which, for purposes of this section, shall mean agreements for the purchase or sale of eligible securities pursuant to which the seller or buyer agrees to repurchase or sell back the securities on or before a specified date and for a specified amount;
- In the subordinated securities of the I-Bank, a special purpose trust, or a sponsor; or
- In investment agreements with corporations, financial institutions, or national associations within the United States that are rated by a nationally recognized rating service within the top three rating categories of the service. For purposes of this section, investment agreements shall mean any agreement for the investment of monies whether at fixed or variable interest rates, and may include, but not be limited to, repurchase agreements, notes, uncollateralized time deposits, certificates of deposit, and the subordinated securities of the I-Bank, a special purpose trust, or a sponsor.