

Date: March 28, 2007Committee Meeting Date: April 19, 2007Board Meeting Date: May 3, 2007**BOARD MEMORANDUM**ACTION  X  DISCUSSION   INFO  

**TO:** Administration and Finance Committee  
Santa Clara Valley Transportation Authority  
Board of Directors

**THROUGH:** Michael T. Burns  
General Manager

**FROM:** Jerry G. Mikolajczyk  
Chief Financial Officer

**SUBJECT:** Reaffirm the existing Investment Policy on Unrestricted and Restricted Funds

**RECOMMENDATION:**

Reaffirm the Investment Policy on Unrestricted and Restricted Funds.

**BACKGROUND:**

California Government Code 53646 and the Investment Policy reaffirmed by the VTA Board of Directors on June 1, 2006 require that a statement of investment policy be rendered annually to the Board.

Mercer Investments, our investment consultants, and the Association of Public Treasurers of the United States and Canada have reviewed the Investment Policy. There are no changes recommended at this time.

The objectives of VTA's investment program are, in order of priority: safety, liquidity, and return on investment (yield).

- 1) Safety. Safety of principal is the foremost objective of the investment program. The Authority's investments shall be undertaken in a manner that seeks to ensure preservation of capital in the portfolio.
- 2) Liquidity. The Authority's investment portfolio shall remain sufficiently liquid to enable the Authority to meet its cash flow requirements.

- 3) Return On Investment. The Authority's investment portfolio shall be designed with the objective of attaining a market rate of return on its investments consistent with the constraints imposed by its safety objective and cash flow considerations.

**DISCUSSION:**

In order to achieve the objectives of the Investment Program, VTA segregated its portfolio into two strategies: one is of a short duration (three months) to meet operating needs and the second is of an intermediate duration (three and a half years) to meet capital project obligations.

**FISCAL IMPACT:**

Absent the Investment Policy, investments would not be structured and therefore the safety and liquidity may be jeopardized with consequent loss of principal.

Attachment: Unrestricted and Restricted Investment Policy

Prepared by: Manny Bagnas, Investment Manager

Adopted April 4, 1996  
Amended June 4, 1998  
Amended April 6, 2000

Amended February 6, 2003  
Reaffirmed October 7, 2004  
Reaffirmed June 1, 2006

SANTA CLARA VALLEY TRANSPORTATION AUTHORITY  
INVESTMENT POLICY  
FOR  
UNRESTRICTED AND RESTRICTED FUNDS

I. INTRODUCTION

The purpose of this policy is to enhance opportunities for a prudent and systematic investment program and to organize and formalize investment-related activities.

The investment policies of the Santa Clara Valley Transportation Authority (VTA) shall be based on state law and prudent money management. All funds shall be invested in accordance with this Investment Policy and California Government Code Section 53601 et seq. related to the investment of public funds. The provisions of relevant bond documents shall further restrict the investment of bond proceeds.

II. SCOPE

It is intended that this policy cover all funds (except for any Amalgamated Transit Union Pension Funds) and investment activities under the direction of VTA.

III. PRUDENCE

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

The overall investment program shall be designed and managed with a degree of professionalism that is worthy of public trust. VTA shall recognize that no investment is totally riskless and that the investment activities of VTA are a matter of public record. Investment officers 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 in a timely fashion and appropriate action is taken to control adverse developments.

#### IV. OBJECTIVES

The primary objectives, in priority order, of VTA's investment activities shall be:

- 1) Safety. Safety of principal is the foremost objective of the investment program. VTA's investments shall be undertaken in a manner that seeks to ensure preservation of capital in the portfolio.
- 2) Liquidity. VTA's investment portfolio shall remain sufficiently liquid to enable VTA to meet its cash flow requirements.
- 3) Return On Investment. VTA's investment portfolio shall be designed with the objective of attaining a market rate of return on its investments consistent with the constraints imposed by its safety objective and cash flow considerations.

#### V. DELEGATION OF AUTHORITY

The management responsibility for the investment program is hereby delegated to the General Manager who shall monitor and review all investments for consistency with this investment policy. The General Manager may delegate responsibility for day-to-day management of the portfolio. No person may engage in an investment transaction except as provided under the limits of this policy. The General Manager may also delegate the investment decision-making and execution authority to an investment advisor. The advisor shall follow the policy, which has been approved by the Board of Directors and such other written instructions as are provided.

#### VI. ETHICS AND CONFLICT OF INTEREST

Officers and employees involved in the investment process shall refrain from personal business activities that could conflict with proper execution of the investment program, or which could impair their ability to make impartial decisions. VTA employees and officers involved in the investment process shall disclose to the General Manager any material financial interests in financial institutions that conduct business with VTA, and they shall further disclose any personal financial/investment positions that could be related to the performance of the VTA's portfolio.

#### VII. INTERNAL CONTROLS

The General Manager or his designee shall establish a system of internal controls, which shall be documented in writing. The controls shall be designed to prevent losses of public funds arising from fraud, employee error, and misrepresentations by third parties or imprudent actions by employees or officers of VTA. The internal controls shall be reviewed with the internal auditor and the independent external auditor. The internal auditor shall perform a review of the internal controls at least on an annual basis.

VIII. SELECTION OF INVESTMENT MANAGERS, FINANCIAL INSTITUTIONS AND BROKER/DEALERS

VTA shall contract with investment manager(s). The investment manager(s) shall exercise its best efforts and discretion in negotiating the best security transaction executions available at the time, without regard to any broker designations or preferences for the exclusive benefit of the VTA. In applying this guideline, the value of research services offered by a brokerage firm may be taken into account in determining the best available source for transaction execution.

IX. PERMITTED INVESTMENT INSTRUMENTS

1. U.S. Treasury Obligations: United States Treasury notes, bonds, bills or certificates of indebtedness, or those obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest.
2. Obligations of Federal Agencies and U.S. Government Sponsored Enterprises: Obligations issued by Banks for Cooperatives, Federal Land Banks, Federal Intermediate Credit Banks, Federal Farm Credit Banks, Federal Home Loan Banks, the Federal Home Loan Bank Board, the Tennessee Valley Authority, or in obligations, participation's, or other instruments of, or issued by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association; or in guaranteed portions of Small Business Administration notes; or in obligations, participation's, or other instruments of, or issued by, a federal agency or a United States government-sponsored enterprise, or such agencies or enterprises which may be created.
3. State of California Obligations: Registered state warrants, treasury notes or bonds of the State of California, including bonds payable solely out of revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency or authority of this State.
4. Local Agency Obligations: Bonds, notes, warrants or other evidences of indebtedness of any local agency of the State, including bonds payable solely out of revenues from a revenue-producing property owned, controlled, or operated by the state or local agency or by a department, board, agency or authority of the State or Local agency. Such obligations must be rated A-1/P-1, or equivalent or better short-term; or Aa/AA or better long term by two national rating agencies.
5. Bonds issued by VTA: Bonds issued by VTA, including bonds payable solely out of revenues from a revenue-producing property owned, controlled, or operated by VTA or by a department, board, agency, or authority of the local agency.

The total of state and local obligations (items 3, 4, and 5) shall not exceed 30% of VTA's portfolio.

6. Bankers' Acceptances: Bills of exchange or time drafts drawn on and accepted by domestic or foreign banks, which are eligible for purchase by the Federal Reserve System, the short-term paper of which is rated in the highest letter and numerical rating (A-1/P-1) by Moody's Investors Services and by Standard & Poor's Corporation.

Purchases of Banker's Acceptances may not exceed 270 days maturity or 40 percent of VTA's portfolio. No more than five percent of VTA's portfolio may be invested in the Banker's Acceptances of any one commercial bank.

7. Commercial Paper: Commercial paper of "prime" quality of the highest ranking or of the highest letter and numerical rating (A-1/P-1) as provided by Moody's Investors Service, Inc. and Standard & Poor's Corporation; provided that the issuing corporation is organized and operating within the United States, has total assets in excess of \$500 million and has an "A" or higher rating for its long-term debt, if any, as provided by Moody's or Standard & Poor's.

Purchases of eligible commercial paper may not exceed 180 days maturity nor represent more than 10 percent of the outstanding paper of an issuing corporation.

Purchases of commercial paper may not exceed 15 percent of VTA's portfolio. An additional 15 percent, or a total of 30 percent of VTA's portfolio, may be invested only if the dollar-weighted average maturity of the entire amount does not exceed 31 days. No more than five percent of VTA's portfolio may be invested in Commercial Paper of any one corporation pursuant to this section.

8. Repurchase and Reverse Repurchase Agreements: Investments in repurchase agreements and reverse repurchase agreements may be utilized only as short-term investments, not to exceed 90 days.

Repurchase agreements may be utilized only when all of the following conditions are met:

- (a) The term of repurchase agreements shall be for 90 days or less.
- (b) VTA shall have properly executed a Public Securities Association (PSA) Master Repurchase Agreement with each firm with which it enters into Repurchase Agreements.
- (c) Repurchase agreements shall only be made with counter parties that are primary dealers of the Federal Reserve Bank of New York rated "A" or better by two nationally recognized rating services.

- (d) The market value of securities that underlay a Repurchase Agreement shall be valued at 102 percent or greater of the funds borrowed against those securities and the value shall be reviewed weekly unless market conditions warrant daily valuation. Each time there is a substitution of collateral, the market value must be calculated and VTA must be notified of the substitution.
- (e) Collateral shall be limited to obligations of the U.S. Government and its agencies and U.S. Government sponsored enterprises as described in #1 and #2 of this section.
- (f) Collateral shall be delivered to a third party custodian in all cases, and VTA shall obtain a perfected first security interest in all collateral.

Investments in reverse repurchase agreements may be utilized only to cover temporary cash flow shortages and when all of the following conditions are met:

- (a) The security to be sold on reverse repurchase agreement has been owned and fully paid for VTA for a minimum of 30 days prior to the sale; and
  - (b) The total of all reverse repurchase agreements on investments owned by VTA does not exceed 20% of the base value of the portfolio; and
  - (c) The agreement does not exceed a term of 90 days, unless the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement and the final maturity date of the same security.
9. Medium-term Corporate Notes: Medium-term corporate notes of a maximum of five years maturity issued by corporations organized and operating within the United States or by depository institutions licensed by the U.S. or any state and operating within the U.S. Notes eligible for investment shall be rated in a category "A" or its equivalent or better by a nationally recognized rating service.
- Purchase of medium-term corporate notes may not exceed 30 percent of VTA's portfolio and shall be limited to five percent in any one issuer.
10. Insured Savings/Money Market Accounts: Federal Deposit Insurance Corporation (FDIC)-insured savings accounts or Securities and Exchange (SEC)-registered money funds.
11. Negotiable certificates of deposit or deposit notes issued by a nationally- or state-chartered bank or a state or federal savings and loan association or by a

state-licensed branch of a foreign bank. Such obligations must have long-term ratings of Aa/AA or better by two national rating agencies.

Purchases of negotiable certificates of deposit may not exceed 30 percent of VTA's portfolio and shall be limited to five percent in any one issuer. (Deposit notes and bank notes shall be included with negotiable certificates of deposit in calculating allowable maximum percentages.)

12. Mortgage and Asset-Backed Obligations: Any mortgage pass-through security collateralized mortgage obligation, mortgage-backed or other pay-through bond, equipment lease-backed certificate, consumer receivable-backed bond of a maximum of five years maturity. Such obligations must be rated Aa/AA or better long term by two national rating agencies and the issuer of such obligations must be rated Aa/AA or better by two national rating agencies. Purchases of securities authorized by this section may not exceed 20 percent of VTA's portfolio, which may be invested pursuant to this section and shall be limited to five percent in any one non-governmental issuer.
13. Mutual Funds: Shares of beneficial interest issued by diversified management companies, as defined in Section 23701m of the Revenue and Taxation Code, investing in the securities and obligations authorized by sections a through 1 of Government Code section 53601. To be eligible for investment pursuant to this subdivision these companies shall either: (1) attain the highest ranking letter or numerical rating provided by at least two of the three largest nationally recognized rating services or (2) have an investment advisor registered with the Securities and Exchange Commission with at least five years experience investing in securities and obligations authorized by Government Code Section 53601 and with assets under management in excess of \$500,000,000. The purchase price of shares of beneficial interest purchased pursuant to this subdivision shall not include any commission that these companies may charge and VTA may not use any fund that assesses fees for deposits or withdrawals.

The purchase price of shares shall not exceed 15 percent of VTA's portfolio.

14. State of California's Local Agency Investment Fund (LAIF): In accordance with Section 16429.1 of the California Government Code, VTA may invest up to the maximum amount permitted by law in LAIF. The LAIF portfolio, including its average maturity, credit quality and Investment Policy shall be reviewed annually.
15. Santa Clara County Investment Pool: VTA may invest funds in the Santa Clara County Investment Pool. The Pool portfolio, including its average maturity, credit quality and Investment Policy, shall be reviewed annually.
16. Investment Agreements: VTA may invest, or direct its bond trustee on its behalf to invest, any trustee held bond funds in Investment Agreements

meeting the terms of this section. The Investment Agreement must be (1) approved by VTA's Chief Investment Officer and (2) be (a) with, or guaranteed by, a financial institution that is rated at least Aa/AA by two national rating agencies on an uncollateralized basis or (b) with a financial institution that has an investment grade rating from two national rating agencies and that pledges U.S. Treasury and/or Agency collateral in an amounts sufficient to maintain Aa/AA ratings from at least two national rating agencies. Uncollateralized Investment Agreements must incorporate downgrade provisions that require the financial institution, if it falls below Aa/AA ratings, either to post U.S. Treasury and/or Agency collateral at levels sufficient to maintain Aa/AA ratings from at least two national rating agencies or to permit VTA or the trustee to withdraw funds under the Investment Agreement without penalty. Investment Agreements shall also include "Forward Delivery Agreements" in which a financial institution with an investment grade rating agrees to sell to VTA or bond trustee U.S. Treasury or Agency Obligations in amounts and at times that satisfy bond indenture requirements.

17. Qualified Structured Investment: Qualified Structured Investment means any investment with a swap counterpart, with a minimum rating in the "Aa/AA" category by at least two national rating agencies, the purpose of which is to provide VTA with a cash flow that meets VTA's repayment obligations under a structured transaction, such as a leveraged lease, a Japanese operating lease or a service contract. Examples of a Qualified Structured Investment include a (1) "prepaid swap" (also known a fixed swap or a zero-coupon swap) in which VTA swaps a cash deposit for a future cash flow in specified amounts on specific dates or (2) an "asset swap" in which VTA purchases securities that qualify as Permitted Investment Instruments and swaps the cash flow associated with those securities cash flow for a cash flow that meets its defeasance schedule. Qualified Structured Investments shall incorporate downgrade provisions that permit VTA to require the counter party, if it falls below the Aa/AA rating category, (1) to post U.S. Treasury and/or Agency collateral at levels sufficient to maintain Aa/AA ratings from at least two national rating agencies, (2) to assign the Qualified Structured Investment to a counter party that meets the minimum rating criterion and/or (3) to return the invested funds to VTA or its custodian without penalty.

Credit criteria listed in this section refer to the credit of the security or the issuing organization at the time the security is purchased.

## X . SEGREGATED INVESTMENTS

Investments in instruments permitted in Government Code 53601 may be made where cash flow or other factors warrant segregation of funds from the VTA commingled pool. Examples of funds that may warrant such segregation are Retiree Health Care Program funds, Workers Compensation reserve funds, Public liability property damage reserve funds, Investment Agreements, and Qualified Structure Investments.

In accordance with Government Code Section 53620-53622, the assets of the VTA Retiree Health Care Program funds may be invested in a manner similar to those made by pension funds, including purchase of common stocks, equities through mutual funds, other permitted investments or through the direct purchase of common stocks and fixed income securities by a money management firms approved by the Board of Directors.

#### XI. INELIGIBLE INVESTMENTS

Any security type or structure not specifically approved by this policy is hereby specifically prohibited. Security types which are prohibited include,

- (a) Inverse floaters, range notes, dual index notes, leveraged or deleveraged floating-rate notes, or interest-only strips that are derived from a pool of mortgages.
- (b) Any security that could result in zero interest accrual if held to maturity.
- (c) Any security with an unusually high degree of interest rate sensitivity or credit risk.

#### XII. RATING DOWNGRADES

VTA may from time to time be invested in a security whose rating is downgraded. In the event of a downgrade, the General Manager or his designee shall report the downgrade to the Board at the next scheduled presentation of the portfolio. In the event of a downgrade below the minimum credit rating criteria permitted by this investment policy, the designated investment manager shall immediately report the downgrade to the General Manager. The General Manager or his designee shall report to the Board, at their next regularly scheduled meeting, both the downgrade and the action that has been taken.

#### XIII. DIVERSIFICATION

Investments shall be diversified to eliminate the risk of loss resulting from over concentration of assets in a specific maturity, specific issue, or specific class of securities.

The following diversification limits shall apply (excluding Retiree Health and Qualified Structured Investments):

<b>Instruments</b>	<b>Maximum % Portfolio</b>
U.S. Treasuries	100%
Federal Agencies & U.S. Government Sponsored Enterprises	100%
State of California & Local Agencies	30%
Bankers Acceptances	40%
Commercial Paper	
If weighted average maturity of all CP is >31 days	15%
If weighted average maturity of all CP is <=31 days	30%
Negotiable Certificates of Deposit	30%
Repurchase Agreements	100%
Reverse Repurchase Agreements	20%
Medium-Term Notes	30%
Savings/Money Market Accounts	15%
Mutual Funds	15%
Mortgage and Asset-Backed Obligations	20%
State of California Local Agency Investment Fund (LAIF)	<i>Max. limit by law</i>
Santa Clara County Pool	100%
Inverse floaters, range notes, or interest-only strips that Are derived from a pool of mortgages.	None
Any security that could result in zero interest accrual If held to maturity.	None
Any security with unusually high interest rate sensitivity or credit risk	None

## Issuer/Credit Diversification

<b>Issuer/Credit Rating</b>	<b>Maximum % Portfolio</b>
Any one federal agency or government sponsored enterprise	25%
Any one repurchase agreement or other collateralized Counter party name	10%
Any one corporation, bank, local agency, or other name	5%

### XIV. SALES PRIOR TO MATURITY

In the effort to maximize portfolio performance, VTA may, from time to time, sell securities that it owns in order to better reposition its portfolio assets in accordance with updated cash flow schedules or better market opportunities.

### XV. MAXIMUM MATURITY

To the extent necessary, VTA shall match investments with anticipated cash flow requirements. Investment maturities greater than eleven years required approval of the Chief Financial Officer. Long-term securities of more than five years shall be limited to 40% of the portfolio.

Notwithstanding the foregoing, VTA may invest in Permitted Investment Instruments with maturity of greater than eleven years in connection with Investment Agreements for debt offerings and in connection with structured financing, such as leveraged leases, operating leases or service contracts, as needed to pre-fund VTA's obligations there under.

Investments with embedded "put" features shall be measured to the put date, while instruments with a "call" feature shall be measured to the final maturity. The maturity of asset backed securities shall be considered the estimated maturity date of the tranches.

Portfolio maturities shall be staggered in such a way that avoids undue concentration of assets in a specific maturity sector. Maturities shall be selected which provide for stability of income and reasonable liquidity.

## XVI. REPORTING REQUIREMENTS

The General Manager or his designee shall annually render to the Board a statement of investment policy, which the Board shall consider at a public meeting.

The designated investment manager shall, quarterly, render an investment report to the General Manager, internal auditor and Board of Directors. The quarterly report shall be submitted within 30 days following the end of the quarter covered by the report.

Type of investment instrument (i.e. Treasury Bill, medium-term note)  
Issuer names (i.e., General Electric Credit Corp.)  
Purchase date (trade and settlement date)  
Maturity date  
Par value  
Purchase price  
Coupon rate (if applicable)  
Call/refunding date and price (if applicable)  
Discounts or premiums, if any  
Accrued interest paid at purchase, if any  
Accrued interest to date  
Amortization of premium/discount  
Overall portfolio yield based on cost  
Yield at market  
Book value  
Current market value and the source of the valuation  
Current credit rating of each security other than U.S. Treasuries  
Average maturity or duration  
Unrealized market value gain or loss (i.e., market value-book value)  
Broker/dealer from whom the security was purchased  
Other special features, characteristics, or comments

The quarterly report also shall (i) state compliance of the portfolio to the statement of investment policy, or manner in which the portfolio is not in compliance, (ii) include a description of any of VTA's funds, investments or programs that are under the management of contracted parties, including lending programs, and (iii) include a statement denoting the ability of VTA to meet its expenditure requirements for the next six months, or provide an explanation as to why sufficient money shall, or may, not be available.

VTA shall establish the following reporting and accounting standards for callable securities. (these are securities with a stated maximum maturity date that could, at the issuer's option, be retired at a date or number of dates prior to maturity): All securities holdings reports for VTA shall disclose the maximum maturity liability to VTA (the stated maturity) as well as the first call date of each callable security held. The weighted average maturity as well as computation of the yield on each callable security in VTA's portfolio shall be calculated using professional

judgment as to the most likely principal redemption date. If the investment's coupon rate is sufficiently greater than market levels, and then the security shall be valued to the next call date, otherwise the security shall be valued to the maturity date. In any case, the "yield to worst" shall be calculated and disclosed.

If VTA has placed all of its investments in the Santa Clara County Pool or the Local Agency Investment Fund or any combination of these, the designated investment manager may render to the General Manager, Board of Directors, and the internal auditor the most recent statement or statements received by VTA from these institutions in lieu of the information required in the preceding paragraphs.

#### XVII. SAFEKEEPING AND CUSTODY

All securities owned by VTA shall be kept in safekeeping with "perfected interest" in the name of VTA by a third-party bank trust department, acting as agent for VTA under the terms of a custody agreement executed between the bank and VTA.

All securities shall be received and delivered using standard delivery versus payment procedures.

#### XVIII. PERFORMANCE STANDARDS

The investment portfolios shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles commensurate with the investment risk constraints and cash flow needs of VTA. VTA shall establish performance benchmark indices for specific funds for performance evaluation purposes, which shall include indices for short term and intermediate funds.

##### Short Term Funds

The short term funds index shall be the "Taxable Money Market Index" and shall be used to evaluate the performance of the investments when liquidity and assurance of return of principal is essential. Examples of such investments are funds earmarked to underwrite operating deficits and local share of capital projects during the next twelve months.

##### Intermediate Term Funds

The intermediate term funds index shall be the Lehman Brothers U. S. Government Intermediate. This index shall be used to evaluate the performance of investments, which are not required during the next twelve months. Examples are funds that are earmarked for the settlement of self-insured claims (workers compensation and general liability).