SECTION 2 – APPENDIX 2

INVESTMENT POLICY

Little Thompson Water District ("District") is organized and functions as a Colorado Special District and a quasi-municipal corporation under the laws of the State of Colorado. The District has formed an Enterprise entitled the (Little Thompson Water District Water Activity Enterprise"). The District has established and has agreed to continue to maintain its water system ("System") as an "enterprise" within the meaning of Article X, Section 20 of the Colorado Constitution, and as a "water activity enterprise".

I. Scope

This policy is to establish guidelines for the efficient management of Little Thompson Water District's (the "District") funds and for the purchase and sale of investments. This investment policy governs the investment activities of the District with the exception of retirement funds and deferred compensation funds.

II. General Guidelines

The District funds available for investment shall be commingled into a common investment portfolio whenever feasible so that investment activities may be performed as efficiently as possible. The earnings on these investments will be allocated to the various accounts according to internal District procedures. It shall be the District's policy to refrain from making specific investments of amounts less than $100,000 unless otherwise deemed necessary.

III. Delegation of Authority

In accordance with Section 203 of the District Rules and Regulations, the responsibility for conducting investment transactions resides with the District Manager/Assistant District Treasurer. No person may engage in an investment transaction except as provided under the terms of this policy. The Assistant District Treasurer may delegate the authority to the appropriate staff for the day-to-day investment decisions.

IV. Objectives

The overall objectives of the District's investment program, in order of priority are first to provide for the safety of principal, second, the provision of liquidity to meet daily cash flow requirements and lastly, attaining a market rate of return.

In order of priority the objectives shall be:

A. Safety

Protection of principal is the primary objective of District investment activities and is the single most important factor in determining the investment decisions of the authorized investment officer. Investments shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The two most significant risks for the purpose of this policy are:

1. *Credit Risk* is the risk of loss of principal and/or interest due to the failure of the security issuer or backer. Due to limitations on the time, information resources, and expertise of District staff, reliance shall be placed upon nationally recognized credit rating agencies in evaluating the credit risk of obligations not issued by the U. S. government and Federal instrumentalities (Agencies and Government Sponsored Enterprises). The District's preference is to utilize the credit rating services of Moody's or Standard and Poor's. Credit risk shall be limited by restricting the credit ratings on securities that may be purchased and through diversification to reduce exposure to any one security type or issuer.

2. *Interest Rate Risk* is the risk that the market value of securities in the investment portfolio will increase or decrease due to changes in market interest rates. Since most of the District's investments are held to their maturity date this is not a major risk to the District. To mitigate this risk, the policy places limits on the type and maturities of permitted securities.
    a. Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity.
    b. Diversifying the investment portfolio so that potential losses on individual securities will be minimized.

B. Liquidity

The investment portfolio shall be sufficiently liquid so as to meet all reasonably anticipated operating cash flow needs. Investments shall be managed to avoid, but not prohibit, sale of securities before their maturities to meet foreseeable cash flow requirements. Since all possible cash demands cannot be anticipated, the portfolio should hold a significant quantity of securities with active secondary or resale markets. Ideally, 10 percent of the portfolio shall be invested in overnight instruments, money market funds, Colorado local government investment pools, or in marketable securities, which can be sold to raise cash within one day's notice. The remaining 90 percent will be in longer term instruments based on a requirement of funds schedule developed and update annually.

C. Yields

The investment portfolio shall be managed with the objective of attaining a market rate of return throughout interest rate cycles. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. Core investments are limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed. The benchmark, against which the District's portfolio shall be compared, will be the 1-year US Treasury Constant Maturity Index published by the Federal Reserve Board.

V. Standards of Care

A. Prudence

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 primary objective of safety as well as the secondary objective of earning market rates of return. The standards of prudence to be used by investment officials shall be the "prudent person standard" and shall be applied in the context of managing an overall portfolio. Investment officials acting in accordance with procedures and exercising due intelligence shall be relieved of personal responsibility for an individual security's credit risk or market price fluctuations provided that deviations from expectation are reported in a timely manner to the District Manager/Assistant Treasurer, and reasonable and appropriate action is taken to control adverse developments.

B. Ethics and Conflicts of Interest
Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with the proper execution and management of the investment program, or that could impair their ability to make impartial decisions. Employees and investment officials shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to the performance of the investment portfolio. Employees and officers shall refrain from undertaking personal investment transactions with the same individual with which business is conducted on behalf of the District.

C. Delegation of Authority
Authority to manage the investment program is granted to the District Manager/Assistant Treasurer and derived from following the District Rules and Regulations. Responsibility for the operation of the investment portfolio may be delegated to an investment officer, who shall act in accordance with established written procedures and internal controls for the operation of the investment program consistent with this investment policy. Procedures should include references to: safekeeping, delivery vs. payment, investment accounting, repurchase agreements, wire transfer agreements, and collateral/depository agreements. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the investment officer. The investment officer shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

VI. Reporting

The District Treasurer, or designee, must prepare a monthly report on investment activity and yields. Such report shall contain the following:

A. A summary of investment holdings and transactions, yields, weighted average yield, dollar amounts at cost and maturity dates.

B. Realized gains and losses resulting from the sale of securities in the portfolio.

C. A comparison of the weighted average yield to the portfolio's designated benchmark.

D. Percentage of the portfolio in which each type of investment is represented.

E. A summary of significant cash flows.

VII. Suitable and Authorized Investments

A. LIST OF LEGAL INVESTMENTS OF PUBLIC FUNDS.
The following descriptions are summaries only, current as of April 1999. When consulting the Colorado Revised Statutes, be certain to use the most current edition. Section CRS § 24-75-601.1(1) defines the maximum maturity of a security as five years or less, from the date of purchase, unless the governing body authorizes, by resolution or ordinance, a longer maturity period. CRS § 24-75-601.1 lists the following eligible securities:

1. Direct obligations of the United States.

2. Obligations of U.S. Government Agencies. Specifically mentioned in the law are securities issued by FNMA (federal national mortgage association) “Fannie Mae”; by GNMA (government national mortgage association) “Ginnie Mae”; by FHLMC (federal home loan mortgage corporation) “Freddie Mac”; by the federal farm credit bank; by the federal land bank; and by the export-import bank.

3. Securities of entities or organizations not listed above, but created by, or authorized to be created by legislation of, the U.S. congress where the issuing agency is subject to control by the federal government at least as extensive as that which governs the agencies listed above. All of these securities must be rated in the highest category by one or more nationally recognized rating agencies.

4. Securities of the World Bank, the inter-American development bank, the Asian development bank, or the African development bank. These securities must be rated in the two highest rating categories by one or more nationally recognized rating agencies.

5. General obligations of any state of the United States, the District of Columbia, the territorial possessions of the U.S., or political subdivisions of any state. These securities must be rated in the highest three rating categories by one or more nationally recognized rating agencies.

6. Revenue obligations of any state of the United States, the District of Columbia, the territorial possessions of the U.S., or political subdivisions of any state. These securities must be rated in the highest two rating categories by one or more nationally recognized rating agencies.

7. Certain bankers’ acceptances. Banks issuing bankers’ acceptances must meet capital and surplus requirements, their deposits must be insured and their debt must be rated.

8. Commercial paper rated in the highest rating category by one or more nationally recognized rating agencies.

9. The investing local government's own securities including certificates of participation and lease obligations.

10. Any interest in a local government investment pool pursuant to CRS § 24-75-701, et seq.

11. Repurchase agreements for any of the U.S. Government and agency securities listed in paragraphs one and two above, under certain conditions, including that the securities must be marketable; that the market value of such securities at all times must be at least equal to the funds invested by the investing public entity; and that the title must be transferred and the securities must actually be delivered.

12. Certain money market funds. Statutes impose several conditions including registration of the fund under the federal “Investment Company Act of 1940”; that the fund seeks to maintain a constant share price; the fund charges no sale or load fees; the fund invests only in securities listed above, with a few specific exceptions; the securities have maximum maturity as specified in rule 2a-7 of the federal “Investment Company Act of 1940” with additional limitations; the fund has assets of a certain amount; or has the highest current rating from a nationally recognized rating agency; or consists of certain securities; and the dollar-weighted average portfolio maturity meets requirements of rule 2a-7 with additional limitations.

13. Certain guaranteed investment contracts purchased only with debt, certificates of participation, or lease-purchase agreement proceeds, but no refunding proceeds.

14. U.S. dollar denominated corporate or bank debt, issued by a corporation or bank organized and operating within the United States with a net worth in excess of $250,000,000; the debt matures within three years; the debt must carry at least two ratings not below “AA- or Aa3” from any nationally recognized rating agencies; and the book value of the local government's investment in this type of debt shall at no time exceed 30% of the government's investment portfolio, or five percent of the book value if the debt is issued by a single corporation or bank.

15. Certificates of Deposit as permitted by Colorado statute and in accordance with the Public Depositors’ Protection Act or the Savings and Loan Public Depositors’ Protection Act. To qualify as a depository, financial institutions must be listed as eligible depositories by the State Commissioner of Financial Services or the State Division of Banking and must collateralize deposits in accordance with:
    a. C.R.S. Section 11-10.5-101, et seq., The “Public Deposit Protection Act of 1975” or
    b. C.R.S. Section 11-47-101, et seq., The “Savings and Loan Association Public Deposit Protection Act”.

VIII. Investment Limitations

A. Diversification
Investments shall be diversified by:

1. Limiting investments to avoid over concentration in securities from a specific issuer or business sector (excluding U.S. Treasury securities),

2. Limiting investment in securities that have higher credit risks,

3. Investing in securities with varying maturities, and

4. Continuously investing a portion of the portfolio in readily available funds such as local government investment pools (LGIPs), money market funds or overnight repurchase agreements to ensure that appropriate liquidity is maintained in order to meet ongoing obligations.

B. Maturity
To the extent possible, the District shall attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the District will not directly invest in securities maturing more than three (3) years from the date of purchase or in accordance with state and local statutes and ordinances. The District shall adopt weighted average maturity limitations (which often range from 90 days to 3 years), consistent with the investment objectives. Because of inherent difficulties in accurately forecasting cash flow requirements, a portion of the portfolio should be continuously invested in readily available funds such as LGIPs, money market funds, or overnight repurchase agreements to ensure that appropriate liquidity is maintained to meet ongoing obligations.

C. Sale of investments prior to maturity
Investments may be sold prior to their maturity date if the investment official determines that it is in the best interest of the District. Sales shall not be made to speculate upon future market trends. It is the intent to purchase and hold securities until maturity; however, from time to time it may become necessary to sell a security at a loss to meet cash flow requirements or certain security exchange advantages.

D. Derivatives
Securities that derive their value from an underlying asset, group of assets, reference rate, or index value will not be permitted investments under this policy.

IX. Financial Institutions

Financial institutions will be required to meet the following criteria in order to receive District funds for investment:

A. **Collateral**
Deposits in excess of $100,000 insurance limits shall be collateralized by securities or

mortgages in the amount equal to at least market value of that amount of funds in accordance with the Public Depositors' Protection Act and the Savings & Loan Public Depositors' Protection Act in the Colorado statute.

GLOSSARY OF INVESTMENT TERMS

Agency Securities – The securities issued by U.S. Government agencies, such as the Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, etc. These securities have high credit ratings but are not backed by the full faith and credit of the U.S. Government.

Basis Point (bp) – The smallest measure used in quoting yields or returns. One basis point is 0.01% of yield, 100 basis points equals 1%. A yield that changes from 4.75% to 5.50% has increased by 75 basis points.

Benchmark – A standard unit used as the basis of comparison; a universal unit that is identified with sufficient detail so that other similar classifications can be compared as being above, below, or comparable to the benchmark.

Bid – the price offered by a buyer of securities.

Book Entry – a system of recording securities ownership through electronic accounts.

Broker – A broker brings buyers and sellers together for a commission.

Capital Gain – Also known as capital appreciation, capital gain measures the increase in value of an asset over time.

Certificates of Deposit (CD's) – A debt instrument issued by banks usually paying interest with maturities ranging from seven days to several years.

Collateral – Underlying securities that are pledged to secure deposits of public funds. Also used in conjunction with repurchase agreements to protect the entity from default by the counter party.

Current Yield – The relationship between the annual coupon interest rate and the market price of a fixed income security. In calculating current yield, only the coupon interest payments are considered; no consideration is given to capital gain/loss or interest on interest.

Custody – The service of an organization, usually a financial institution, of holding (and reporting) a customer's securities for safekeeping. The financial institution is known as the custodian.

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

Derivative – A security that derives its face value from an underlying asset, group of assets,

reference rate, or an index value. Some derivative instruments can be highly volatile and result in a loss of principle in changing interest rate environments.

Discount Securities – Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value (e.g., U.S. Treasury Bills).

Discount – the amount by which a bond sells under its par (face) value.

Diversification – dividing investment funds among a variety of securities, offering independent returns, to reduce risk inherent in particular securities.

Federal Deposit Insurance Corporation (FDIC) – A federal agency that insures bank deposits – currently up to $100,000 per depositor.

Federal Funds Rate – the interest rate charged by the Federal Reserve district bank to banks needing overnight loans to meet reserve requirements. The federal funds rate is the most sensitive indicator of the direction of interest rates since it is set daily.

Floating Rate Note – A fixed principal instrument which has a long or even indefinite life and whose yield is periodically reset relative to a reference index rate to reflect changes in short-or intermediate-term interest rates.

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

Market Value – The price at which buyers and sellers trade similar items in an open marketplace.

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

Maturity Date – the date on which the principal amount of a bond or other debt instrument becomes payable or due.

Money Market Fund – An open-ended mutual fund that invests in commercial paper, bankers' acceptances, repurchase agreements, government securities, certificate of deposit, and other highly liquid and safe securities and pays money market rates of interest. The funds net asset value remains a constant $1/share – only the yield goes up or down.

Money Market – the market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

Net Asset Value (NAV) – the total assets minus liabilities, including any gains or losses on

investments or currencies, and any accrued income or expense, used in account valuation.

Offer – the price asked by a seller of securities.

Par Value – the stated or face value of a bond. Specifies the payment amount at maturity.

Rate of Return – The amount of income received from an investment, expressed as a percentage. A market rate of return is the yield that an investor can expect to receive in the current interest-rate environment utilizing a buy-and-hold to maturity investment strategy.

Repurchase Agreements (Repos) – An agreement to purchase securities from an entity for a specified amount of cash and a simultaneous agreement to resell the securities to the entity at an agreed upon price and time. Repos are widely used as a money market instrument.

Reverse Repurchase Agreements (Reverse Repos) – an agreement to sell securities to an entity in return for a specified amount of cash and repurchase the securities at an agreed upon price and time. A reverse repurchase agreement is the sellside of the repurchase agreement transaction.

S & P Ratings – AAA – The debt having the highest rating assigned by Standard and Poor's. It has the highest capacity to pay interest and its ability to repay principal is extremely strong.
AA – this debt, which is the lowest rating assignable to investment grade securities, is regarded as having an adequate protection parameters, adverse economic conditions or changing circumstances are more likely to lead to weakened capacity to pay interest and repay principal for debt in this category than in high rated categories. The debt having a very strong capacity to pay interest and repay principal and differs from the high rated issues only in small degrees.
A – This debt has a strong capacity to pay interest and repay principal although it is somewhat more susceptible to the adverse effects of change in circumstances and economic conditions that debt in high rated categories.
BBB – This debt, which is the lowest rating assignable to investment grad securities, is regarded as having an adequate capacity to pay interest and repay principal.
BB, B, CCC, and CC – these rating are regarded, on balance, as predominately speculative with respect to capacity to pay interest and repay principal in accordance to the terms of the obligation.
C – This is reserved for income bonds on which no interest is paid.
D – This rating is for debt that is in default. No interest or principal payments are being made.

Safekeeping – A procedure where securities are held by a third party acting as custodian for a fee.

Treasury Bill (T-Bill) – short-term, highly liquid government securities issued at a discount from the face value and returning the face amount at maturity.

Treasury Bond or Note – debt obligations of the federal government that make semiannual coupon payments and are sold at or near par value in denominations of $1,000 or more.

Variable Rate Note – Floating rate notes with a coupon rate adjusted at set intervals, such as daily, weekly or monthly based on different interest rate indices, such as LIBOR, Fed Funds, and Treasury Bills.

Yield – the rate of annual income return on an investment, expressed as a percentage. Income yield is obtained by dividing the current dollar income by the current market price of the security. Net Yield or Yield to Maturity is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.