



**MWD**

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

8-1

September 23, 1997

**To:** Board of Directors (Budget and Finance Committee--Action)  
**From:** General Manager  
**Submitted by:** Lambertus H. Becker  
Chief Financial Officer  
**Subject:** Pilot Investment Program with Small Banks and Savings and Loan  
Institutions

**RECOMMENDATION**

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It is recommended that your Board approve staff's recommendation to initiate a \$2 million pilot investment program with small banks and savings and loans in Metropolitan's service area.

**EXECUTIVE SUMMARY**

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As an investment program to assist small banks and savings and loan (S&Ls) institutions in Metropolitan's service area, staff is proposing a \$2 million pilot program to place an insured, \$100,000, one-year time deposit with each of 20 Federal Deposit Insurance Corporation (FDIC) - insured institutions. The \$100,000 limit represents the maximum amount insured by the FDIC. These deposits may be used for loans, investments and to increase reserves. Staff believes this program would help stimulate renewal, economic development and growth in local communities, all to the public's advantage. ~~The FDIC permits a maximum insured deposit of \$100,000.~~ This program can be implemented and administered at minimal cost to Metropolitan.

In discussing the economics of loans, staff has been advised by the banking community that there is a multiplier effect stemming from each deposit. Total deposits of \$2 million could result in total loans of \$6 million. Staff believes this program would have the potential of benefiting local communities because borrowing customers generally live, work and transact business in their community.

In order to be eligible to participate in this program, institutions must have deposits of \$150 million or less and be located in Metropolitan's service area. Selection of institutions responding to a Request for Proposal will be done on a competitive ~~interest~~ time deposit rate basis.

## **DETAILED REPORT**

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### **PILOT PROGRAM**

As an investment program to assist small banks and savings and loan institutions in Metropolitan's service area, staff is proposing a pilot program to place an FDIC - insured, \$100,000, one-year time deposit with each of 20 institutions. This would provide \$2 million in additional funds to these institutions to enhance their lending operations. Metropolitan's investment program may also encourage other governmental entities to establish similar programs.

In discussing the economics of loans, staff has been advised by the banking community that there is a multiplier effect stemming from each deposit. Depending on banking policies in effect, 80 to 90 percent of customer deposits may be loaned. The multiplier effect comes into play when customers deposit borrowed money which in turn can be loaned out again at the 80 to 90 percent level. The banking community indicates that this cycle of deposits, loans, and redeposits continues six to seven times. Total deposits of \$2 million could result in total loans of \$6 million as shown in the table below.

Cycle	Deposits/ Redeposits (\$ in Millions)	Loan Factor (Percent)	Loans (\$ in Millions)
1	\$ 2.000	80	\$ 1.600
2	1.600	80	1.280
3	1.280	80	1.024
4	1.024	80	.819
5	.819	80	.655
6	.655	80	.524
7	.524	80	.419
		Total	\$ 6.321

The funds could remain in the same institution or flow to other institutions in Metropolitan's service area, or flow outside the service area. Staff believes that deposits in small banks and savings and loans would have the potential of benefiting local communities because borrowing customers generally live, work and transact business in their communities.

### **COSTS OF PILOT PROGRAM**

Staff costs to implement and administer the pilot program range from \$1,800 to \$2,700. These costs are minimal and represent approximately 1 to 1 1/2 basis points of the total investment of \$2 million. In addition, it does not appear that any significant earnings would be lost by investing in these one-year time deposits versus alternative investments. The earnings rate of alternative investments such as negotiable certificates of deposit, federal agencies and corporate bonds currently range from 5.75 percent to 5.95 percent. A survey of 12 institutions eligible for the pilot program indicates that the highest rates for a one-year time deposit range from 5.75 to 6.06 percent. This survey indicates that Metropolitan should be able to obtain time deposit rates comparable to earnings rates of alternative investments.

### **BACKGROUND**

The Pilot Program was developed to increase Metropolitan investments in its service area and in response to past inquiries by small financial institutions for equity investments, i.e., purchasing an ownership interest in small financial institutions. Because of restrictions in the California Constitution, Government Code, Metropolitan is precluded from making equity investments in any entity. Such investments are attractive to banks and savings and loans because the monies may be utilized for any purpose, such as purchasing buildings and equipment, increasing working capital, building reserves, lending to customers, etc. While equity investments are not permitted, investments in time deposits in banks and savings and loan institutions are permitted by the California Government Code. The deposits may be used for loans, investments, and to increase reserves. Loans resulting from these deposits would help stimulate renewal, development and growth, all to the public's advantage.

To the extent a deposit is insured, the Government Code permits the Treasurer to waive collateral requirements. The requirement to collateralize public agency deposits often limits an institution's ability to make loans because collateral in excess of the value of the deposit must be purchased. Time deposits may be made up to five years per the Government Code. Metropolitan's internal investment policy limits these investments to a maximum maturity of one year. In order to waive collateral requirements, the Government Code specifies that deposits must be covered by insurance and that a contract must be entered into with each depository, stating, among other things,

that interest is (i) computed on the average daily balance of the deposit, (ii) paid monthly and (iii) computed on a 360 day basis.

### PILOT PROGRAM ELIGIBILITY

To be eligible for this program, banks and savings and loans must meet the following criteria:

- Be located in Metropolitan's six county service area.
- Have deposits of \$150,000,000 or less.
- Be insured by the Federal Deposit Insurance Corporation.
- Must respond to Metropolitan's Request for Proposal within four weeks with a competitive one-year time deposit rate.

Banks and S&Ls savings and loans (S&Ls) which have deposits of \$150 million or less have been identified by county within Metropolitan's service area as follows:

County	Total Banks/S&Ls	% of Total
Los Angeles	75	52
Orange	22	16
Riverside	8	6
San Bernardino	12	8
San Diego	19	13
Ventura	7	5
Total	143	100%

Source: Sheshunoff Information Services, Inc. as of 3/97.

### PILOT PROGRAM TIMELINE

Following is a macro timeline for the Pilot Program initialization and evaluation:

Deliverable Date	Activity
Aug 26, 1997	Diversity Steering Committee-Oral Report
Sept 8, 1997	Budget & Finance Committee-Presentation
Sept 9, 1997	Pending Letter to Board
<u>Oct 13, 1997</u>	<u>Budget &amp; Finance Committee Approval</u>
Oct 14, 1997	Board Approval of Pilot Program
Nov 1997	Implement Pilot Program
Mar 1998	Budget & Finance Committee-Oral Status Report
Jul 1998	Budget & Finance Committee-Oral Status Report
Sept 1998	Diversity Steering Committee-Oral Report
Oct 1998	Budget & Finance Committee- Staff Recommendations
Oct 1998	Board Approval of Staff Recommendations
Oct/Nov 1998	Implement Recommendations

After initialization of the pilot program, quarterly oral status reports will be given to the Budget and Finance Committee addressing the number of institutions enrolled, range of time deposit rates and any significant events. A formal Board letter will be presented at the October, 1998 Board meeting. It will discuss program status and recommend adjustments in the program as appropriate, e.g., increase the size of the program and/or adjust criteria for eligible banks and savings and loans.

### PILOT PROGRAM IMPLEMENTATION

Should the Board approve the pilot program, staff will send via U.S. mail, Requests for Proposals to eligible banks and savings and loans. The initial pilot program would be sized at \$2 million, thereby permitting deposits of \$100,000 in each of 20 eligible FDIC - insured banks and savings and loans. Interest ~~would be~~ will be computed on an average daily balance, computed on a 360-day basis and paid to Metropolitan monthly as required under the Government Code for non-collateralized insured deposits.

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