APPROVED
by the Board of Directors of
The Metropolitan Water District
of Southern California
at its meeting held

OCT 13 1998

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EXECUTIVE SECRETARY

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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

September 23, 1998

To: Board of Directors (Budget and Finance Committee--Action)

From: for General Manager [signature: Edward G. Means III]

Submitted by: Lambertus H. Becker
for Chief Financial Officer [signature: Antoinette Christovale]

Subject: Investment Program with Small Banks and Savings and Loan Institutions

RECOMMENDATION(S)

It is recommended that the Board continue the investment program with small banks and savings and loans in Metropolitan's service area. It is also recommended that the size of the program be increased from $2 million to $3 million annually.

EXECUTIVE SUMMARY

In September 1997, the Board approved a $2 million pilot investment program to assist small banks and savings and loan (S & L) institutions in Metropolitan's service area. In December 1997, 18 financial institutions qualified for the program and Metropolitan placed a $100,000, one-year time deposit with each of the Federal Deposit Insurance Corporation (FDIC) insured institutions. The $100,000 limit represents the maximum amount insured by the FDIC. These deposits were available for institutions to provide loans, investments and to increase reserves. Staff believes this program has helped to stimulate renewal, economic development and growth in local communities, all to the public's advantage. This program was implemented and administered with minimal cost to Metropolitan.

Staff recommends continuing the program for another year and increasing the program size to $3 million. In order to be eligible to participate in this program, staff recommends a change in the institutions' size from deposits of $150 million to $175 million or less and they be located in Metropolitan's service area. This should broaden participation in the program. A Request for Proposal will be sent to all eligible institutions. Selection of institutions responding to the Request for Proposal will be done on a competitive time deposit rate basis. The rates that were locked in last year were competitive to alternative market instruments.

Staff believes this program would continue to benefit local communities because borrowing customers generally live, work and transact business in their community.

DETAILED REPORT

In September 1997, the Board approved a pilot Investment Program with small banks and savings and loan institutions to increase Metropolitan's 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, 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.

In December 1997, 18 financial institutions qualified for the program and Metropolitan placed a $100,000, one-year time deposit with each of the Federal Deposit Insurance Corporation (FDIC) insured institutions. The $100,000 limit represents the maximum amount insured by the FDIC.

Staff is recommending investment in banks and savings and loans with deposits of $175 million or less. The criteria last year was deposits of $150 million or less but due to many institutional mergers and increases to the deposit base, $175 million would be prudent.

COST OF PROGRAM

Program costs to implement and administer the investment program for fiscal year 1997-98 totaled approximately $4,000. Costs for fiscal year 1998-99 are estimated to range from $4,000 to $5,000 (if the program size increases to $3 million). In addition, it does not appear that any significant earnings would be lost by investing in one-year time deposits versus alternate investments. The earnings rate of alternative investments such as negotiable certificates of deposit, federal agencies and corporate bonds currently range from 5.14 percent to 5.30 percent. A survey of 12 institutions currently involved in the program indicated that their rates for one year time deposits would range from 5.00 to 5.45 percent.

INVESTMENT PROGRAM

As an investment program to assist small banks and savings and loan institutions in Metropolitan's service area, staff is proposing to continue this program by placing an FDIC insured, $100,000, one-year time deposit with up to 30 institutions. This would provide $3 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 $3 million could result in total loans of $9.5 million.

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 benefit local communities because borrowing customers generally live, work and transact business in their communities.

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 $175,000,000 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 which have deposits of $175 million or less have been identified by county within Metropolitan's service area as follows:

County	Total Banks/S&Ls	% of Total
Los Angeles	65	53.3
Orange	15	12.3
Riverside	6	4.9
San Bernardino	10	8.2
San Diego	16	13.1
Ventura	10	8.2
Total	**122**	**100%**

Source: Sheshunoff Information Services, Inc. as of March 3, 1998.

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