File No.: 17-0841 **Agenda Date:** 12/12/2017
Item No.: 4.2.

BOARD AGENDA MEMORANDUM

SUBJECT:
Amend Fiscal Year (FY) 2017-2018 District Investment Policy to Incorporate Socially Responsible Investment (SRI) Objectives.

RECOMMENDATION:
Approve the Amended FY 2017-2018 District Investment Policy to incorporate socially responsible investment objectives.

SUMMARY:
On May 19, 2017, the Board adopted the FY 2017-2018 District Investment Policy, which prioritizes safety, liquidity and yield of the District's pooled investment fund. The proposed amendment to the Investment Policy would incorporate objectives to encourage investments in corporate securities, banking institutions and state agencies considering moral, ethical, environmental, social, and governance (ESG) guiding principles. This approach is in response to Board direction provided to staff during the October 24, 2017 Board meeting.

Staff recommends Board approval of adding the following socially responsible investment objectives to the District's Investment Policy:

3.4 In addition to the investment objectives of safety, liquidity, and yield, the District encourages investing in corporate securities, banking institutions and state agencies that meet the ESG factors. The District shall use best efforts to follow the ESG Guiding Principles and utilize the Investment Evaluation Scorecard to evaluate and approve such investments to ensure compliance with the ESG factors.

3.4.1 The ESG factor shall include considerations for local California based businesses.

3.5 To the extent permitted by California Government Code, while meeting the District's investment objectives for safety, liquidity and yield, the District encourages investing in Negotiable Certificates of Deposit issued by California based banks, up to the Federal Deposit Insurance Corporation limit at the time of such investment which is currently set at $250,000, as amended

The Board also directed staff to evaluate socially responsible vendor selection and procurement

process. Staff is currently working with the District Counsel's Office to evaluate options which would stay in compliance with state and federal public contracting parameters. Staff will present the results of this analysis to the Board for consideration at a future date.

Background

On May 8, 2017, staff presented information regarding the principles of socially responsible investment policy to the Board Policy and Planning Committee (BPPC). The BPPC directed staff to present this information to each of the three Board Advisory Committees and solicit feedback. The table below summarizes feedback from each of the Board Advisory Committees:

Board Advisory Committee	Meeting Date	Action Taken	Comments
Agricultural Water	6/26/2017	Do Not Support	Committee members were concerned about retaining investment flexibility; loss of interest income; political issue; and screening criteria boundaries.
Environmental and Water Resources	7/3/2017	Support	Majority of committee members were very supportive of this policy because it helps promote environmental impact investing; a few members expressed concern regarding loss of interest income
Water Commission	7/26/2017	No Action	Some committee members expressed support while other members expressed various concerns regarding flexibility of investment options; loss of income; additional costs in staff time to implement such a policy; and retaining safety of the investments. A few members recommended that any such policies be described as "Socially Preferable Policy", instead of a strict guideline to prohibit investment options.

On August 28, 2017, the BPPC unanimously voted to provide the Socially Responsible Investment Policy to the full Board for consideration during the October 24, 2017 annual Governance Policy and strategic planning session. Furthermore, the BPPC does not recommend suspending investments in corporations and state agencies located in states subject to the District's travel ban pursuant to AB1887 for the following reasons:

- This may be viewed as unfairly targeting businesses and state agencies for being headquartered in states where their State legislature and/or the Governor have passed and enacted legislation which are below the standards of the District, and the State of California's expectations for the treatment of its residents and for protections of our traveling employees.

- There may be unintended consequences and conflicts in enforceability of such policies while conducting District business. For example, enforceability may be challenged for companies such as Southwest and American Airlines which are headquartered in Texas and subject to the District's travel ban. The District’s travel policy requires that the lowest cost airfare be purchased for District business travel which often means purchasing airfare from Southwest and American Airlines. This may lead to challenges on spending District dollars on such companies and conflict with the Socially Responsive Investment Policy.
- Furthermore, the businesses which would be the target of such a potential ban on investment would not have control of or a vote in the decision of their state legislature, and would be subject to the ban simply due to the residency of their headquarters.
- Finally, this action may result in the District Board receiving negative publicity for its consideration of a policy that goes much further than its local government counterparts and the State of California.

Socially Responsible Investment Principles

The Government Finance Officers Association (GFOA) defines Socially Responsible Investing (SRI) as an investment approach where certain sectors or business activities are excluded from the portfolio through negative screening for ESG reasons. Examples of implementing SRI include impact investing in projects, companies, funds or organizations with the express goal of generating and measuring mission-related social, environmental, or economic change alongside financial return, as well as divestment of specific business sectors or companies that do not comply with the SRI principles (e.g. divestment of fossil fuel companies). The ESG factors that are currently commonly considered include the following; a detailed description of each factor is included in Attachment 3 - ESG Factors.

Environmental	**Social**	**Corporate Governance**
Climate change	Stakeholder relations	Board composition
Energy & material efficiency	Labor relations	Executive compensation
Waste management	Working conditions	Shareholder rights
Air quality/pollution	Health and safety	Accountability & audit quality
Water use & management	Supply chain management	Cyber/Information Security
Chemicals	Product safety	Transparency
Land use management	Treatment of customers	
	Local/California business	

Implementing SRI has financial and non-financial impacts. The financial impacts include assessing ESG factors to optimize risk-adjusted returns, influencing corporate behavior to enhance long-term outcomes, and contributing to the integrity of the financial market. The non-financial impacts include assessing the long-term investment horizon to reflect concerns and values of stakeholders and managing the reputation and business risk of the organization.

Additional research on sustainable investing principles are summarized in the report 'The 21st Century Investor: CERES Blueprint for Sustainable Investing" ("Blueprint"). The Blueprint summarizes ten action steps for sustainable investment strategy:

1. Establish a commitment to sustainable investment through a Statement of Investment Beliefs
2. Establish board level oversight of sustainability policies and practices
3. Identify sustainability issues material to the fund
4. Evaluate material sustainability risks to the portfolio
5. Integrate sustainability criteria into investment strategies
6. Require sustainable investment expertise in manager and consultant procurement
7. Evaluate manager performance against sustainable investment expectations
8. Establish engagement strategies and proxy voting guidelines consistent with sustainable investment goals
9. Support policies and market initiatives that promote a sustainable global economy
10. Integrate sustainable investment approaches across all asset classes and strategies.

Local Agency Investment Practices

Per a March 26, 2014 report on local government efforts to implement socially responsible investment policy prepared by the City of Portland, 23 local government agencies were contacted for a survey on social responsibility investment practices. Of the 11 responses received, six agencies reported they have documented social criteria in their investment policies, and five agencies do not apply social criteria. Additionally, six of the 11 agencies do not invest in corporate securities, thus limiting their investments to U.S government securities. Of note are the City and County of San Francisco and Denver and Harvard University who have adopted formal social responsibility criteria in its investment policy (Attachment 4).

District Investment Policy

In accordance with Executive Limitation 4.9 regarding treasury and investment management, and pursuant to Title 5, Division 2, Part 1, Chapter 4, Articles 1 and 2 of the California Government Code, as amended from time to time (the "Government Code"), the District Board of Directors annually adopts the resolution delegating authority to deposit and invest funds to the Treasurer or her designee and approves the Investment Policy in May of each year for implementation on July 1 of each new fiscal year. The FY 2017-18 Investment Policy was approved by the Board on May 9, 2017.

The current Investment Policy includes a Climate Divestment Investment Restriction to prohibit any investments in the top 200 fossil fuel companies. Furthermore, on March 14, 2017, the Board approved the suspension of Wells Fargo Bank from the District's negotiated debt sale underwriter pool through September 27, 2017.

Given the various limitations imposed by the Government Code on allowable investments, staff recommends Board approval of amending the District Investment Policy by adding Sections 3.4 and 3.5 noted above to incorporate the additional investment objectives.

FINANCIAL IMPACT:
Staff estimates the potential financial impact of implementing the socially responsible investment policy is between $9,000 to $200,000 in lower annual interest earnings due to divestment of such securities that are not in compliance with the ESG Guiding Principles. This represents 0.2% to 5% of the FY 2017-18 investment portfolio interest income projection of approximately $4 million.

Staff utilized the Investment Evaluation Scorecard (Corporates) to analyze 12 corporate bonds rated 'AA-' or better, and determined that 9 corporates would meet the proposed ESG Guiding Principles. The removal of 3 securities from the list of eligible corporate bonds may result in an annual reduction of $27,000 in interest earnings, or 0.675% of the FY 2017-18 investment portfolio interest income projection (Attachment 2- Examples #1 and 2, and Attachment 5).

Staff also developed an Investment Evaluation Scorecard (Municipals) tailored for municipal bonds which was used to analyze Texas A&M University bond (Attachment 2 - Example #3). This analysis demonstrates the potential financial impact should the Board approve the prohibition of investments in states that are subject to the travel ban. For Texas A&M, such prohibition would result in a potential loss of approximately $9,000 in annual interest income, up to $40,000 over the 4.5 year term of the bond.

The financial impact analysis presented in this report is based on comparisons of the market price for the bonds and the equivalent treasury yield. The actual financial impact may vary depending on availability of the bonds and investment options available at the time the investment decisions are made based on the District's safety and liquidity requirements.

In addition to the financial impacts associated with investing in specific securities, additional staffing resources may need to be allocated to support this additional work effort. The level of service supporting the socially responsible investment policy will correspond to the level of staffing allocated to it. Staffing needs will be evaluated as part of the FY 2019 Budget process, in conjunction with the overall staffing needs of the Financial Planning and Management Services Division.

CEQA:
The recommended action does not constitute a project under CEQA because it does not have a potential for resulting in direct or reasonably foreseeable indirect physical change in the environment.

ATTACHMENTS:
Attachment 1: Amended FY 2018 District Investment Policy (redlined)
Attachment 2: Investment Evaluation Scorecard
Attachment 3: Environmental, Social, and Governance Factors
Attachment 4: Local Agency Investment Practices
Attachment 5: Corporate SRI Evaluation Summary

UNCLASSIFIED MANAGER:
Darin Taylor, 408-630-3068