APPROVED

BAY AREA WATER SUPPLY AND CONSERVATION AGENCY

BOARD POLICY COMMITTEE

October 10, 2012 – 1:30 p.m.
BAWSCA Offices, 155 Bovet Road, San Mateo, 1st Floor Conference Room

MINUTES

1. **Call to Order: 1:30 p.m.**
Committee Chair Larry Klein called the meeting to order at 1:30 pm. A list of Committee members present (8) and absent (2), and of other attendees is attached.

   The Committee took the following actions and discussed the following topics:

2. **Comments by Chair:** Chair Klein noted that the agenda includes a significant item on the bond issuance. He wants the committee to feel comfortable with its recommendation to the Board, and therefore expects a thorough discussion.

3. **Public Comments:** There were no public comments.

4. **Consent Calendar:** Approval of Minutes from the August 8, 2012 meeting.

   Director Anderson made a motion, seconded by Director O'Connell, that the minutes from the meeting of August 8, 2012, be approved. The motion carried with one abstention (McLeod).

5. **Action Items:**

   A. Potential Bond Issuance to Prepay Capital Debt Owed to SFPUC: Mr. Jensen pointed out additional details on the set of recommendations being presented to the Committee. He explained that:

      1) Work is continuing and the recommendations that will go to the Board in November will have more detail than what is currently available for presentation to the Committee.

      2) There are certain things that cannot be known or may remain unknown even by the November Board meeting. For example, Mr. Jensen noted that after the preliminary credit assessment becomes available, there may be potential opportunities to enhance the bond structure to improve the final credit rating. BAWSCA and its Finance team are working to set parameters that would need to be met before moving forward with a bond issuance.

      3) Lastly, one recommendation requests the authorization of the CEO/General Manager to execute financing documents at the appropriate time conditioned upon satisfaction of specified criteria. While the specified criteria were noted in the

memo, they were not included in the motion. Following discussion of the item, the Committee will be asked to act on the recommendation as listed on the agenda, but with the addition of 2 conditions:

a) The bond interest rates and final financing structure will need to result in a net present value savings of not less than $20 million over the term of the bonds.

b) San Francisco must provide, in advance of receiving any funds, a written pledge to use bond proceeds in a manner consistent with federal laws and regulations.

Mr. Jensen stated that his presentation will go through the key issues of interest to the board members and each agency's financial representatives, as well the current structure of the financial plan. There are some questions on which input is needed from the committee as an advisory body to the CEO and the Board.

Mr. Jensen began his presentation by emphasizing that the objective of the bond issuance remains the same; to help water customers by saving them money on cost of water purchased from San Francisco. This can be achieved if the following conditions are met:

- The bond issuance complies with all relevant laws and rules.
- By securing the best practical credit rating, issuing bonds at the lowest practical interest rates, and with the allocation of debt service being reasonably distributed among the member agencies.
- Financial risk to BAWSCA and its member agencies is low, or significantly greater than under the "no action" alternative.
- A guiding principle is whether the results compare favorably to the "no action" alternative, which is continuing to pay San Francisco at an interest rate of 5.13%.

Mr. Jensen emphasized that the credit ratings and interest rates must be practical because the goal is to strike a balance in enhancing credit ratings and lowering interest rates without spending too much money to do so. He also emphasized his choice of using the word reasonable over fair in reference to the allocation of debt among the member agencies, because the final results should be reasonable for all the member agencies.

In highlighting the objective of keeping the financial risks to BAWSCA member agencies low, and having the results comparable to the "no action" alternative, Mr. Jensen summarized the history of the existing $360 million debt being repaid to San Francisco through wholesale water rates.

<u>Background -- presentation on source or debt to be paid:</u>

In 1984, Wholesale Customers signed an agreement to pay San Francisco for their share of investments to the capital facilities. The method of repayment preferred by San Francisco at that time was Utility Method, in which San Francisco pays for facilities using current revenues or issuing bonds, and is responsible for paying the bonds off. The wholesale customers would repay San Francisco by paying depreciation and rate of return over the life of facility. A pumping unit has a 15 year lifetime, while a dam may have a lifetime of 200 years or more. Under the Utility Method, Wholesale Customers would repay San Francisco for facilities over several generations.

During the negotiation of the new Water Supply Agreement (WSA), KNN did a study that looked at changing from the Utility Method to a Cash Method. With the Cash Method, Wholesale Customers would pay San Francisco a proportionate share of revenue funded projects and a proportionate of debt service, if the SFPUC issued debt. The payments would be in real time.

At the time the old agreement was about to expire and the new agreement take effect, there was an unpaid debt of about $360 million for facilities that San Francisco had constructed, and for which the Wholesale Customers had not yet completely paid their share under the old contract. The member agencies and the SFPUC agreed to amortize the remaining debt over the 25-year term of the new agreement at an agreed upon interest rate of 5.13%.

The 2009 Water Supply Agreement also provided that the Wholesale Customers could prepay that debt through BAWSA, in whole or in part, without penalty.

In the fall of 2011, San Francisco proposed that BAWSCA examine prepaying the debt. San Francisco needed the money, and BAWSCA was likely able to borrow money at an interest rate less than 5.13% thereby saving the Wholesale Customers money.

Mr. Jensen clarified that the 5.13% interest rate is NOT a bond interest rate, but an interest rate that is embedded in the Wholesale Customers' agreement with San Francisco.

Director McLeod asked that if the bond issuance moves forward, would BAWSCA member agencies have influence on what San Francisco spends the money on? Mr. Jensen stated that BAWSCA can impose certain requirements: 1) The money cannot be spent on investments that will have a net effect of increasing Wholesale Customers' rates, and 2) there are legal restrictions that San Francisco will have to abide by in the use of tax-exempt proceeds.

Director McLeod asked if there are any other major winners in this transaction besides San Francisco and the Wholesale Customers. Legal Counsel, Allison Schutte, and Financial Counsel, David Brodsly, stated that BAWSCA and the SFPUC would get the direct benefits of the bond issuance.

Director Weed commented that in an auditor's perspective, it can be anticipated that San Francisco will have a separate account for the bond funds, which can report how the money in the account is being invested. Mr. Brodsly stated that he expects there would be a separate account for tax purposes since the funds would be subject to rebate.

Ms. Schutte explained that as part of the closing, San Francisco will be required to sign an agreement that dictates where the money will be spent. There will be a suite of projects in the agreement, and BAWSCA will be checking in on San Francisco to ensure they adhere to the terms of the agreement.

Mr. Jensen explained that the bond issuance is for Wholesale Customers to pay the money they owe San Francisco. If BAWSCA and its member agencies choose the "no action" alternative, San Francisco will still receive payments from the Wholesale Customers and spend the money at its own discretion. BAWSCA's requirement of how San Francisco spends the funds from the bond issuance is to the extent that San Francisco complies with the law so that it does not violate BAWSCA's bond covenants.

Ms. Schutte stated that there will be a reporting requirement for San Francisco that can be further highlighted for the Board in November.

Director Weed expressed his concern that the funds will be spent in such a way that will increase wholesale water rates, and suggested to restrict the use of funds on the WSIP projects only.

Mr. Jensen stated that wholesale water rates will be affected if the money is spent on the regional water system for expenses that have not already been anticipated in the rate projection. BAWSCA is working with San Francisco so that there are no unintended consequences that results to higher rates for the Wholesale Customers. Mr. Jensen stated that there will be an attachment to the agreement with San Francisco listing what the expected expenditures will be.

The committee agreed with Director Breault's summary that the intention of the bond issuance is to get the Wholesale Customers' debt to San Francisco acknowledged as "paid" without an unintended consequence of Wholesale Customer rates going up.

Mr. Jensen reported that BAWSCA and its financial team are working to ensure written documents for the bond issuance comply with all applicable laws and rules. The staff memo provided to the Committee identifies the various necessary documents, and included drafts of the Revenue Bond Indenture, First Supplemental Indenture, and Continuing Disclosure Certificate for the Committee's review.

An action item for the Board in November is to authorize the CEO/General Manager to select a Trustee through an RFP process, and authorize the selected Trustee to receive the money. The relationship with the Trustee is codified in the Revenue Bond Indenture.

BAWSCA is securing the best practical credit ratings to ensure member agencies are able to save money. BAWSCA has asked the bond rating agency to evaluate a conservative structure and provide a preliminary credit assessment. Possible enhancements could be considered before requesting a final credit rating.

Some of the characteristics for achieving a positive credit outlook include having a reserve balance equal to 50% of the maximum annual debt service and a secure revenue stream. Mr. Jensen explained that having a secure revenue stream was the reason behind AB 2167. The legislation allows the BAWSCA Board, if it chooses, to authorize San Francisco to do the revenue collection. This is important to the bond buyers as San Francisco's historical billing system is seen as a secure revenue stream.

Mr. Jensen emphasized that the preliminary credit assessment will provide a basis for evaluating potential credit enhancements. BAWSCA wants to issue bonds at the lowest practical interest rate.

In response to Director Klein's question, Mr. Brodsly said that it is not yet possible to know how the bonds will be rated. He reported that Standard and Poor had a positive reaction with BAWSCA's credit picture, and Mr. Brodsly stated that he is confident BAWSCA will get an A or A+ rating.

Mr. Brodsly stated that to get a higher rating, it might be at an additional cost or at the expense of a portion of the savings, and since the goal is to maximize savings as opposed to getting the highest bond rating, a bit of compromise with the rating is practical.

In response to Director O'Connell's question, Mr. Brodsly confirmed that Cal Water has an A+ credit rating. Mr. Brodsly briefly explained that a rating methodology for some entities involves a "bottom-up" look where individual member agencies are looked at for their average credit rating. BAWSCA's bond issuance will be looked at "Top-down" as it is a regional water agency that provides the service to a sizable, productive and largely affluent region.

Mr. Jensen went over a table of the Overall Plan of Finance reflecting assumptions and market conditions as of September 25th. The total proceeds of $383 million from the bond issuance are broken down into Tax Exempt and Taxable Bonds. The total proceeds from the prepayment funds amount to $367 million. The difference between the bond proceeds and the prepayment funds covers the estimated $2.1 million cost of issuance and a stabilization fund. Mr. Jensen noted that the stabilization fund is 50% of annual debt services. He emphasized that it is a revenue stabilization fund as opposed to a rate stabilization fund, and noted that the revenue stabilization fund is important to rate agencies and bond buyers when assessing the risks, determining the credit rating, and establishing interest rates.

The net present value savings for member agencies is estimated to be $20-$34 million over the 21 ½ year term of the bonds. The annual present value savings is $1.0 - $2.1 million spread out among the 26 member agencies.

For comparison, Mr. Jensen noted that the Wholesale Revenue Requirement that San Francisco collects each year is currently in the neighborhood of $200 million and will be going up to $300 million and above, as the WSIP is completed. The repayment of the $360 million is approximately 10% of the current annual Wholesale Revenue Requirement.

Mr. Jensen stated that an important discussion is how the debt service, and therefore savings, is distributed among the agencies. BAWSCA and the financial team are working to ensure the allocation of debt service is reasonably distributed.

Mr. Jensen continued his presentation explaining that there are two issues to be considered.

The first issue is how to set a surcharge for recovering the debt service from member agencies. The second is how to allocate the interest expense among the member agencies.

Two contrasting methods can be used for setting the surcharge. One method would be to use a volumetric approach, where each agency is charged based on the amount of water purchased during the year. A second method would be to charge each agency a fixed amount, regardless of how much water were used in a particular period.

Each method has advantages and disadvantages.

San Francisco currently uses a volumetric approach to allocating the Wholesale Customers' payments for use of the Regional Water System, including repayment of old debt. The SFPUC's current method for setting wholesale water rates allocates costs proportionate to the amount of water purchased by each agency.

This method can result in under or over collection of revenue, depending on how much water an agency purchases in a given year. Wet years, dry years, economic boom or decline, and conservation efforts can all affect the amount of water purchased. The potential under collection of revenue is seen as a risk to the bond buyers.

A more appealing method to bond buyers would be for agencies to be charged a fixed amount, regardless of how much water is purchased. This approach is certain to recover the necessary revenue each year. This method, however, would differ significantly from the "no action" alternative in that agencies might pay more or less than they would have paid the SFPUC under the "no action" alternative.

Mr. Jensen presented a slide demonstrating that each individual agency's percentage of total purchases from San Francisco changes overtime, but cannot be predicted.

The Financing Team has come up with a method that exhibits the advantages of both approaches. The recommended and an anticipated approach to pursue is a modified volumetric approach, in which fixed allocations are set each year, and reconciled the following year based on how much water each agency actually purchased form the SFPUC.

The surcharge could be set for each agency by multiplying the (fixed) annual debt service by each agency's percentage of total purchases in a prior year (also a fixed, known number).

Each spring, the surcharge could be calculated. Because the amount of revenue received form each agency would not reflect that agency's purchases made during the current year, reconciliation would be made so that all members would pay their fair share over the term of the bonds.

Mr. Jensen stated that this approach would appeal of the low risk to the bond buyers, and should result in a low bond interest rate. The method should also appeal to the member agencies because the percentage of the debt they would pay would more closely match the percentage they would pay San Francisco under the base case.

Mr. Jensen emphasized that the agencies' total purchases from San Francisco changes over time because their usage varies over time. Whether it goes up or down, how much agencies are charged will be adjusted. If for example, San Francisco interrupted water service to San Jose and Santa Clara, the amount they had been paying would have to be made up by the remaining agencies. Director Breault commented that it would be the same scenario with the existing revenue requirement, only at a 5.13% interest rate. Mr. Jensen agreed.

Mr. Jensen noted that in developing a structure for setting the charges, it is important to have a plan that works today and that can be modified in the future. If, for example, Santa Clara and San Jose's services were interrupted, or ACWD's consumption goes down as much as 50%, the board should have the ability to consider revisions to the method for setting surcharges.

Mr. Jensen noted it would be to the member agencies' advantage if the allocation of debt service was not a part of the bond covenant. If it were, it would be locked in for 21 ½ years and cannot be changed. Additionally, if the board chooses to finalize the allocation of debt service before it acts on the bond issuance, the potential chances to enhance the credit rating would be eliminated.

Director McLeod asked about the potential loss of the interest earnings if there is a major difference between agencies' payments and later adjustment. She noted that if an agency takes a big step down, they are going to lose the value of that money for the next 2 years, and get the old value following reconciliation.

Mr. Jensen stated that such effects should be relatively small and that the value of fine-tuning the calculations would be less than the effort to do so.

Director Guzzetta suggested the Committee keep in mind the magnitude of the dollars being discussed in comparison to the $300 million revenue requirement that Wholesale Customers have to pay San Francisco every year. That amount increases every year. The distribution of savings amounts to less than 2%.

Director McLeod stated that for some jurisdictions and their annual budget, some of those small incremental numbers mean whether or not to close a library. It is worth having the discussion and having everyone realize and agree in the end, that the money could be lost over time. Director McLeod pointed out that even though it's an incremental amount of money, it's real money for some jurisdictions.

Mr. Jensen acknowledged the importance of the dollars for each jurisdiction, and noted that the Board will be provided information that shows the estimated savings to each agency.

Director Guzzetta stated that while he understands that one can look at the dollar savings in the context of their annual budget, it would be difficult to estimate the demand within the level of accuracy of what this dollar savings will be.

Director O'Connell commented that without the bond issuance, BAWSCA member agencies will have no savings, plus an increasing revenue requirement every year.

Mr. Jensen continued his presentation explaining the second issue is how interest expenses could be distributed among the member agencies.

Mr. Jensen noted that BAWSCA's bond issuance will include both taxable and tax-exempt bonds, which have different interest rates. The question is how should interest costs be allocated to member agencies.

Mr. Jensen explained that San Francisco has been generally able to issue tax-exempt bonds for nearly all the cost of the WSIP because the total purchases of Cal Water and Stanford from the Regional Water System amount to less than 10% of system-wide water sales. San Francisco has issued a small amount of taxable debt in recent years.

BAWSCA would not be able to do issue only tax-exempt bonds because Cal Water and Stanford's purchases from the Regional Water System amount to more than 20% of the purchases of the BAWSCA agencies alone (not counting San Francisco). As a result, BAWSCA's bond issuance will need to issue some taxable debt.

With a uniform distribution of interest payments among all the members, publicly-owned agencies would pay a portion of the higher taxable interest rates. BAWSCA and the Finance Team analyzed the significance of the different types of approaches.

A comparison was made between a blended or uniform debt service allocation and a non-blended debt service allocation, where public agencies would pay the tax-exempt interest rate and Cal Water and Stanford would pay the taxable interest rate. The difference in savings represents $5 million in present value over the 21 ½ years.

The exact size of the additional increment to public agencies depends on various factors including how the debt service is allocated.

Mr. Jensen presented a table that showed the comparison of savings for the public agencies and the private agencies when using the blended versus non-blended debt service allocation.

Mr. Jensen stated that he is presenting the conclusions and considerations gathered from the analysis to provide the committee with objective information and to obtain the Committee's input to the CEO and the Board.

The analysis shows that all agencies would save money with either approach under current market conditions. Currently, the taxable and tax-exempt interest rates are fairly close. If the taxable interest rate were to rise significantly, it would be less advantageous for Cal Water and Stanford to participate. In the extreme, they might be better off continuing to pay San Francisco 5.13% interest. This possibility appears unlikely at this time.

Mr. Jensen went over the following issues that should be considered before making a decision:

- What is the principal behind privately-owned utilities being charged a different interest rate?

  The simple answer is because they are profit-making organizations. However, under California Public Utility Commission (CPUC) regulation, privately-owned utilities are only allowed to make a rate of return on capital investments they make in their own water systems, as an incentive to maintain and improve their infrastructure. The CPUC does not allow privately-owned utilities to mark-up operating costs, such as the cost of buying water from the SFPUC. Those costs are passed on directly to the residential or business customers. Because BAWSCA's surcharge to pay debt service would be considered an operating cost, Cal Water will make no profit from BAWSCA's issuance of bonds.

- Does the SFPUC issue taxable debt and how are interest costs allocated?

Mr. Jensen reported that San Francisco has issued taxable debts in the form of commercial paper. The difference in interest rates, while small, has been allocated to all Wholesale Customers through the uniform wholesale water rates set by the SFPUC.

- What would be the significance of interest rates to a typical residential water bill?

  The difference between a blended and non-blended interest rate for a typical residential water bill would be about $0.25 per month. That value represents an average over the service area, based on average water use in FY 2010-11.

- Are there other inherent subsidies in the existing SFPUC rates, and in any water utilities' rates?

  Mr. Jensen stated that while this is not an issue over which BAWSCA has authority, it is important to recognize that Wholesale Customers currently pay a uniform rate to San Francisco to cover all costs of running and maintaining the Regional Water System, including their two-thirds share of the $3.6 billion for rebuilding the system.

Mr. Jensen noted that the Board has never had to deal with the issue of interest rate allocation before. In the past, the board has set charges by allocating costs in proportion to usage amongst the membership, as has been done for annual assessments, and as was done for the water management charge. On other issues, such as subscription water conservation programs, the Board has allocated costs to the beneficiaries of those programs. The Board retains the authority over how future water management charges might be allocated.

Mr. Jensen asked for the Committee's comments and discussion of the issues presented.

Director Klein stated that he had the same concerns that were raised by Committee members during the presentation, but feels that when taking into account the present value, some of the fine tuning of the process would require more accounting expense than the savings. He stated that government subsidies widely exist, and that at some point the analysis should stop so that the quest for a perfect result does not prevent achieving a good result.

In response to Director Weed's questions, Mr. Brodsly stated that the bond issuance will be two series of bonds, one tax-exempt and one taxable. Both series of bonds will be secured by the same revenue pledge. Mr. Brodsly stated that one large pool would create a stronger credit than two entirely separate pools.

From the standpoint of the taxable bonds, Director Weed asked if there would be some way that the issuance of bonds for privately-owned entities could be structured as a capital investment, on which they would pay higher interest but be able to make a rate of return.

Mr. Brodsly stated no, for the same reason that the expense is going to be viewed as an operating cost for both the publicly-owned agencies and the privately-owned agencies, rather than as a capital investment.

Director Weed pointed out that in the overall structure, San Francisco is still going to get the money and have the freedom to spend it, with limited restrictions.

Director O'Connell noted that the bond issuance is to pay money owed to San Francisco that Wholesale Customers would be paying under the "no action" alternative. The difference is, it is at a better interest rate for the Wholesale Customers.

Director Weed stated a traditional bond is pledged against a certain asset. Even though it stays within the water enterprise, as Mr. Brodsly stated, the money San Francisco gets from the bond issuance is still not pledged against an asset, which is what a traditional use of a bond is.

Director Anderson commented that the important point he got from reading the documents is that the agencies are not individually liable. The rest of the reading requires professional explanation but he feels comfortable to make a motion for recommendation #4A) authorize the GEO/General Manager to execute these financing documents at the appropriate time conditioned upon satisfaction of specific criteria.

Mr. Jensen clarified that recommendation #4A includes two provisions which are conditions on the CEO/GM to enable or trigger the bond sale.

The two provisions are:

1) The bond interest rates and final financing structure will need to result in a net present value savings of not less than $20 million over the term of the bonds; and 2) San Francisco must provide, in advance of receiving any funds, a written pledge to use bond proceeds in a manner consistent with federal laws and regulations.

For the first criterion, Mr. Jensen asked for input on what number might represent the lowest acceptable net savings for proceeding with the bonds. He said the lower estimate of potential savings is $20 million, but it would not make sense to abandon the effort if the savings would be only $19.9 million. Should the Board consider $10 million? Mr. Jensen stated that the number can't be determined on a savings per agency basis but rather, on the aggregate. Whatever the number is, it ought to be several times larger than the cost of issuance estimated at $2.1 million.

The second criterion relates to tax laws that restrict how San Francisco may use proceeds from tax-exempt bonds. The criteria can reference the agreement BAWSCA is currently negotiating with the SFPUC. This provision of that agreement will protect BAWSCA and its member agencies against unintended consequences.

Director Guzzetta pointed out that if Cal Water were charged the higher interest rate, it would have no effect on the company or its shareholders. It would affect its customers because the cost is a simple pass through from Cal Water to its customers. The fairness issue is that Cal Water customers should pay the same as all the other customers.

Director Pierce commented that all Wholesale Customers are currently paying its debt owed to San Francisco at a uniform 5.13% interest rate.

Director O'Connell noted that the recommendation does not include a decision on setting the rates, and asked when it will be brought to the board.

Mr. Jensen explained that the Board will receive a specific recommendation at its November meeting. At this time the matter before the Committee does not include a recommendation on the how debt service should be allocated because work has been ongoing and input from the Committee is desired at this time.

Mr. Jensen also stated that the Board should not take an action that might limit BAWSCA's ability to enhance its credit rating once the preliminary credit assessment has been received. If there are opportunities to enhance the credit rating, it would be in the agencies collective interest to allow the CEO/General Manager to achieve that. The wording of recommendations to the Board should avoid limiting the Board's ability to make prudent revisions over the 21-year term of the bonds.

Mr. Jensen stated that he is not asking the Committee or the Board to provide an open-ended authorization, nor is he intending to take a move or action that would be perceived as unfair to any of the agencies. But it is in the agencies' collective interest not to restrict its flexibility by being overly specific at this time.

Mr. Brodsly stated that the modified volumetric approach is technically the stronger credit and will translate into additional savings. It might be in the form of a higher credit rating or a lower reserve requirement, or even in the form of market recognition. But, to be able to confidently present to the rating agencies will bring a positive credit result.

Mr. Brodsly added that the tax issue will not be a credit factor for the rating agencies. The rating agencies' investors will care about how they get paid back. They will not necessarily care how what the method of pay back is, but if we want to have the advantage of the modified volumetric method, BAWSCA would have to commit to a billing system in which a fixed amount is levied against each member every year.

Director Klein expanded on Mr. Jensen's comments and stated that while there are four specific recommendations for the Committee to act on under the agenda item #5A, additional motions or motions to amend a recommendation by members of the Committee is appropriate.

Director Weed made 3 points of clarification. First, that the proposed savings be expressed as a percentage with an approximate dollar value. A percentage is an easier reference point than just a dollar amount. Second, to clarify that the length of the bond is the same as the length of payback, which is 21 ½ years. Third, that BAWSCA should have the ability to refinance the bonds in 10 years.

After discussion, the committee agreed to amend the wording of the first criteria under recommendation #5A-4 based on Director Weed's clarification point about the percentage of savings.

Director Weed made a motion, seconded by Director McLeod, to amend the first criteria under recommendation #5A-4 so that it states that the result savings will include a percentage value of 4% of the present outstanding debt owed to San Francisco, or $15 million. The Committee approved the motion with 7 ayes and 1 abstention (Anderson).

Director Weed added that in November, the Board should be presented with the anticipated bond structure with a term equal to the payback length of 21 ½ years, and with the ability to refinance after the standard period of 10 years. This is a guideline as opposed to conditions.

Ms. Schutte noted that these issues are fundamental to the structure of the bond deal and will be in the draft bond documents. She will work with Mr. Jensen to ensure that in November, the Board is presented with the clear structure of the bond, including the term, call provisions and other critical items.

Director Breault made an observation about the table that compares the blended and non-blended approach for allocating interest. The blended approach provides public agencies that represent 75% of water purchases, with 75% of the savings. Cal Water and Stanford represent 25% of water purchases, and would receive a 25% of the savings. The non-blended approach provides Cal Water and Stanford with a 10% savings, and the public agencies with 90% of the savings. Director Breault suggested the savings be presented in a way that reflects the effect on retail water customers.

Chair Klein brought back the motion made by Director Anderson, seconded by Director Pierce, that the Committee recommend Board approval of four actions in November.

Discussion on the motion:

Chair Klein noted that the blended versus non-blended rate is not a part of the motion. It is for a later time, unless a member of the committee wants to make a motion to give direction to staff, that would be appropriate.

Director Breault stated that the motion implies that the committee is not directing the CEO/General Manager whether to use the blended or non-blended approach. He pointed out that whether or not this item will come back for the Committee's discussion, it is best to be clear with what the Committee advises the CEO/General Manager.

Director O'Connell pointed out that the motion includes no recommendation on the surcharge setting or interest expense allocation.

Mr. Jensen stated that if the Committee wants to act on the debt service allocation, he recommends the Modified Volumetric approach on the matter of setting the charge, provided that the Board does not act on it as a condition for the sale of the bonds. Doing so will remove the Board's ability to change it later, and set it for the next 21 ½ years. It could be added to the recommendation as #5.

On the matter of using a blended versus non-blended approach for the allocation of interest expense, he would need a clear recommendation from the Committee or the freedom to act in the best interests of all member agencies.

Chair Klein will open further discussion on the debt service allocation, following a vote on the motion at hand: **Director Anderson's motion that the Committee recommend Board approval of four actions in November, with the revisions to 4A, seconded by Director Pierce:**

Chair Klein called for a vote on the motion:

1. **Authorize the CEO/General Manager to amend the contract with KNN for their financial advisory services until the completion of the financing.**

2. **Authorize the CEO/General Manager to appoint a bank to be selected through a RFP process as the Trustee for the bonds.**

3. **Adopt a Resolution approving in substantially final form the various financing documents, including the Revenue Bond Indenture, First Supplemental Indenture, the Continuing Disclosure Certificate, the Preliminary Official Statement, a Prepayment and Collection Agreement with the SFPUC and the Bond Purchase Agreement.**

4. **Authorize the CEO/General Manager to execute these financing documents at the appropriate time conditioned upon satisfaction of specified criteria.**

a. *The bond interest rates and final financing structure will need to result in a net present value savings of not less than 4% or about $15 million over the term of the bonds.*

b. *San Francisco must provide, in advance of receiving any funds, a written pledge to use bond proceeds in a manner consistent with federal laws and regulations.*

The motion carried unanimously.

Director O'Connell made an additional motion to provide an advisory to the CEO/General Manager to pursue the modified volumetric approach. Director Pierce seconded the motion. There was no discussion on the motion. The motion carried unanimously.

Director Pierce commented that the presentation to the Board in November should be done in a way that allows people to understand the information within the context of the memberships' current percentages in savings. She noted that rate payers are currently paying equally, and if that can be continued, or not, the information should be presented both ways so that the Board can make the necessary policy decisions.

Mr. Jensen appreciated the questions and comments from members of the Committee, and noted that it was critical to present the methodologies and the numbers for the Committee's discussion, as well as the Board's consideration in November. He acknowledged Director Breault's suggestion to present the information based on the percentages of savings distributed in the context of the end-user's perspective.

Mr. Jensen will work with Legal Counsel in determining whether the methodologies should be included in the motion, and whether it is included or not, the information will be presented to the Board so that there is transparency and the opportunity to discuss.

Chair Klein stated that the interest expense allocation and whether to use blended versus non-blended is a policy issue, and is a matter that should be discussed and decided by the Board.

Chair Klein made a motion that the Committee make a recommendation that the Board adopt the blended approach in allocating the interest expense. The motion was seconded by Director O'Connell.

Discussion on the motion:

Director McLeod stated that private and public agencies function differently with different drivers and issues. There is the overall concept of rate structures and changing rates to customers. She expressed her concern that there has not been enough discussion and additional factors should considered by the Committee for it to make a recommendation to the Board about the methods. She felt that more information should be provided and that the item should be deferred for further discussion by the full Board.

Mr. Jensen explained that the ability to move quickly to issue the bonds in January is for the purpose of taking advantage of the market conditions. He and the financial team agree that the BAWSCA Board should make fully informed decisions and that additional information can be brought to the Board in November. While there are no indications that market conditions will change in the January, deferring decisions to the January Board meeting would have adverse impacts.

Director McLeod made a substitute motion that information be provided to the Board for further discussion at the November Board meeting, with no recommendation from the Committee. Mr. Anderson seconded the motion.

Discussion and Comments on the substitute motion:

Director Guzzetta believed that the Committee should provide some guidance to the full Board. He noted that the current process for the existing obligation is that everybody pays the same. Using a method other than the blended method will be a major change in the way member agencies have been servicing the existing debt with the SFPUC. Director Guzzetta stated that it would be appropriate to make a recommendation to not change the process, and allow the full Board to make the decision to support the recommendation, or not.

Chair Klein stated that he will vote against the substitute motion because the Committee's role is to make recommendations to the full Board.

Chair Klein called the vote on the substitute motion. The motion failed by 5 noes (Breault, Guzzetta, Klein, O'Connell, Pierce) , and 3 ayes (Anderson, McLeod, Weed).

Chair Klein brought back the main motion he made to recommend the blended approach to the Board.

In response to Director McLeod, Director Guzzetta further explained Cal Water's rate structure and how it will be affected by the bond issuance. He stated that with a non-blended allocation of interest expense all member agencies would save money, but Cal Water's customers would save less than customers of a public agency.

Mr. Jensen clarified that the details being presented to the Committee about the rate setting and interest cost allocation became available after the staff memo was finalized for the committee. These details will be included in the memo for the board in November.

Mr. Jensen acknowledged Director McLeod's comments about the inherent differences in the make-up of private and public agencies, and suggested the underlying policy issue is whether the company would experience financial gain at the expense of public agencies.

Mr. Jensen asked Director McLeod if it would be helpful to provide, in the memo to the Board, clarification that Cal Water's rates are regulated such that Cal Water does not make profit from the interest rate allocation, and that the impact would be directly on the rate payers, businesses and residence served by both the public and private agencies. Director McLeod agreed that would be helpful.

Director Pierce noted that including the similarities and differences of the methods and how the debt has been paid for by the agencies in the past would be a helpful comparison for the Board in looking at the blended and non-blended analysis.

The motion carried with 5 ayes (Breault, Guzzetta, Klein, O'Connell, Pierce), 2 noes (McLeod, Weed), and 1 abstention (Anderson).

B. <u>Amendments to the BAWSCA Investment Policy:</u>

Mr. Jensen reported that the Investment Policy must be consistent with the Bond documents. The Committee is being asked to recommend Board adoption of the proposed revisions.

Mr. Jensen stated that the revisions maintain the objectives the Board established when the policy was first adopted. The objectives, in the order of priority, are Safety of principal, Liquidity, and Return on Investment.

Ms. Schutte reported that the current policy is extremely conservative and serves the function of a bank account in Local Agency Investment Fund (LAIF). She went over the four categories that would need to be added to the Policy, as noted in the staff memo. They include:

1. Federal Securities,
2. FDIC insured deposits,
3. Bonds, debentures, notes or other evidence of indebtedness issued or guaranteed by federal agencies, and
4. Money market mutual funds rated AAA by Standard and Poor's or Moody's.

Ms. Schutte explained that these categories continue to be conservative. The policy comes to the Board for review each year, and the Board can choose to review and revise the policy more often, if it chooses.

Director O'Connell made a motion, seconded by Director Anderson.

<u>Discussion on the substitute motion:</u>

Director McLeod suggested the Committee consider including social responsibility as an additional investment objective. She recognized that doing so can put the policy in the political realm, but, it provides a way to identify an issue of concern, subject to the Board's further discussion. It also provides general guidance to staff in looking at potential portfolios, and establishes a clear direction that social responsibility is a consideration in the use of public funds.

Director Guzzetta commented that it can really complicate things when it comes time to invest, and questioned what criteria would be used to identify the areas of concern in a portfolio?

In response to Director Guzzetta's question, Ms. Schutte stated that in her experience with other agencies, social responsibility has not been a part of their investment policies.

Director Klein questioned the purpose of the four categories. Ms. Schutte explained that the categories need to be added to the policy to make it consistent with the Bond Indenture. Because the current policy is so conservative, it wouldn't allow BAWSCA to take advantage of many the investment possibilities contained in the Bond Indenture.

Ms. Schutte further explained that since BAWSCA has never issued bonds before, the categories being added were not necessary in the current policy.

Mr. Brodsly clarified that the bond proceeds will result to at least $13 million in the reserve that will be with the bond trustee. The bond trustee is subject to BAWSCA's investment policy.

Mr. Jensen stated that the Committee does not have to act on a recommendation to the Board. He proposed to move the item to the Board with further information and the revised and red-lined version of the policy for the Board's discussion and consideration in November.

Given the pressing time to complete all requirements for the bond issuance, Mr. Jensen suggested taking the issue of social responsibility under discussion at a later time.

Director O'Connell stated that it's not clear from the memo that if the Investment Policy does not include the four categories being proposed, the $13 million from the bond issuance will sit at conservative interest rates. To best address the bond issuance, staff is recommending that the four categories be added. With that in mind, Director O'Connell moved to add all four categories to BAWSCA's Investment Policy. Director Anderson seconded.

Director McLeod made a friendly amendment to the motion, that when the item comes back to the Board in November, that there be some potential discussion on the issue of social responsibility in the policy. She is concerned that the issue will get lost, and would like to see some direction for the staff to make the referral.

Chair Klein and Director Pierce suggested that a separate motion be made.

Mr. Jensen pledged to note in the staff memo for the Board, that there was discussion of whether or not the investment policy, now or in the future, should include a consideration of social responsibility. He would need to review how the issue has been treated by other agencies and become familiar with it before committing to include the issue in the policy's objective.

The Committee agreed to include the issue in the next BPC agenda.

Director Klein stated his concern with the obscurity of the language used in the four categories. He pointed out that Federal Securities is very broad and noted that some are riskier than others. There are some federal securities that are not secured by the full faith and credit of the United States, and it is unclear whether those will be excluded. He has similar concerns with the mention of bonds, debentures and notes issued or guaranteed by federal agencies. There can be real differences between ones that are issued, but not guaranteed.

Director Weed made a substitute motion to revise the recommendation to say, "The types of permitted investments may be revised to be consistent with the Revenue Bond Indenture." and that the details on investment provisions will be further discussed at the Board meeting. The substitute motion was seconded by Director Anderson.

<u>*Discussion on the substitute motion:*</u>

Director O'Connell stated that the revisions to the policy have to satisfy the objectives established by the Board; Safety, Liquidity, and Return on Investment. She argued that if there was a federal security that was not secured, that would be disqualified because it does not satisfy the policy's objective for Safety.

Director Klein stated that while that is a valid point, BAWSCA may not want to be as aggressive as the bond holders would like to allow us to be.

Director Guzzetta felt that the Committee does not have the information to make a logical recommendation on what appropriate investments should be. There were some good points raised and questions left unanswered. The Investment Policy must be a document that provides good guidance for BAWSCA, and while he is not against revising the policy, he cannot support the proposed revisions without further discussion.

Director Weed suggested that it would be most efficient for the Committee to develop the definitive language of the investment policy for the Board's consideration. In response to his question of when the policy needs to be finalized for the purpose of the bond issuance, Mr. Brodsly stated that the policy should be finalized before the bond issuance.

Director McLeod said that the item should come to the Board in November as a potential item for action, and not just as an informational item, so that if the Board feels confident in moving forward with the additional information provided, then action can be taken.

The Committee concurred.

Chair Klein made a motion, seconded by Director O'Connell, that the amendments to the Investment Policy be forwarded to the Board in November as a report with potential for action by the Board if it so chooses. Otherwise, the item will go back to the Committee for further discussion in December and the Board's final action in January.

The motion carried unanimously.

C. Authorization to Negotiate and Execute a Contract Amendment with PG&E for the Washing Machine Rebate Program: Ms. Sandkulla reported that the administration of the Washing Machine Rebate Program (WMRP) is included in the FY 2012-13 work plan adopted by the Board in May. The action before the Committee is to recommend Board authorization to negotiate and execute a contract amendment with PG&E to extend its administrative services for the implementation of the WMRP.

Ms. Sandkulla explained that PG&E's contract is on a calendar basis, and will end as of December 31, 2012. The contract includes a 6 month closeout period of up to June 30, 2012.

The contract amendment will extend PG&E's administrative services to implement the WMRP through calendar year 2013. There are no major program changes expected, and rebate levels will stay the same.

Ms. Sandkulla reported that the program has grown from issuing 1,000 rebates per year in 2002, to a current 7,000 rebates per year among all participating agencies. Participation is at a 100% among the BAWSCA membership, with Santa Clara agencies participating through SCVWD, and ACWD participating independently.

Director Pierce made a motion, seconded by Director McLeod, that the Committee recommend the Board to authorize the CEO/General Manager to negotiate and execute a contract amendment with PG&E for administrative and rebate processing services through June 30, 2014 associated with implementation of the Washing Machine Rebate Program from January 1 through December 31, 2013; and offer participation to member agencies through June 30, 2014. The motion carried unanimously.

6. **Brief Reports:**

   A. Proposal to Drain Hetch Hetchy:. Mr. Jensen stated that BAWSCA's position remains the same. He reported that he spoke on BAWSCA's position with Cities Association of Santa Clara County (CASCC), and will be making the same presentation to City/County Association of Governments (C/CAG) on October 11th. Mr. Jensen noted that he is happy to speak to interested groups in the service area of Hayward and ACWD.

   B. Mid-Year Budget Review: Mr. Jensen reported that an assessment of the budget will be provided to the Board Policy Committee in December highlighting the progress made in the current fiscal year. Any adjustments or additions to the work plan will be included in the report, and recommendations as to what to do with the General Reserve will be addressed during the budget process.

7. **Comments by Committee Members**: Director Weed noted that the Calaveras Dam project is relocating approximately 3 million cubic yards of additional earth, which would need approval from the Division of Safety of Dams (DOSD). He expressed his concerns with the implications to Wholesale Customers that might result from the SFPUC's bond issuance against a project that does not have state approval for the construction.

   Ms. Sandkulla explained that the additional grading work is to move a hill on the left abutment because it was determined that during a seismic event, that hill would become unstable and hit the Dam. The SFPUC is working very closely with DSOD through the entire process and they have received staff and expert approval on their approach.

   Ms. Sandkulla has discussed the issue with the SFPUC several times, and the SFPUC is confident that DSOD is on board with their approach. DSOD has not issued a written approval because their process requires them to make their own assessment, and this can take time. While there is a slight risk to moving forward without the written approval, the alternative is to wait and stop.

   Ms. Sandkulla further explained that the SFPUC has been issuing bonds since the beginning of the WSIP, and there were no approval to do a majority of the projects at the outset of the program. The WSIP was launched without approval by any of the CEQA documents, DSOD, Fish and Game, and Fish and Wildlife. And only just recently did the SFPUC get approval from DSOD for the Calaveras Dam Project. While this is an issue of concern, the SFPUC has had significant records of issuing bonds in advance of getting final approval for their projects.

   BAWSCA will continue to follow the Calaveras Dam Project and will provide a report to the Board in November.

8. **Adjournment**: The meeting was adjourned at 4:11pm. The next meeting is December 12, 2012.

Respectfully submitted,

Arthur R. Jensen, Chief Executive Officer and Secretary

ARJ/le
Attachments: 1) Attendance Roster

BAY AREA WATER SUPPLY AND CONSERVATION AGENCY

BOARD POLICY COMMITTEE – August 8, 2012

Roster of Attendees:

Committee Members Present

Larry Klein, City of Palo Alto (Chair)

Rob Guzzetta, California Water Service Company (Vice-Chair)

Robert Anderson, Purissima Hills Water District

Randy Breault, City of Brisbane/GVMID

Jamie McLeod, City of Santa Clara

Irene O'Connell, City of San Bruno (BAWSCA Vice-Chair)

Barbara Pierce, Redwood City (BAWSCA Chair)

John Weed, Alameda County Water District

Committee Members Absent

Ruben Abrica, City of East Palo Alto

Tom Piccolotti, North Coast County Water District

BAWSCA Staff:

Art Jensen	CEO/General Manager
Nicole Sandkulla	Water Resources Planning Manager
Anona Dutton	Water Resources Planner
Christina Tang	Sr. Administrative Analyst
Lourdes Enriquez	Assistant to the Chief Executive Officer
Allison Schutte	Legal Counsel, Hanson Bridgett, LLP
David Brodsly	KNN Public Finance (by teleconference)

Public Attendees:

Tarun Narayan	City of Palo Alto
Nico Procos	City of Hayward
Michelle Sargent	San Francisco Public Utilities Commission
Michael Yee	Alameda County Water District