

BAY AREA WATER SUPPLY AND CONSERVATION AGENCY

BOARD POLICY COMMITTEE

August 12, 2015 – 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 Charlie Bronitsky called the meeting to order at 1:30 pm. A list of Committee members who were present (9), absent (2) and other attendees is attached.

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

2. **Comments by the Chair:** Director Bronitsky welcomed the Committee members and thanked them for their service.
3. **Consent Calendar:** Approval of Minutes from the June 10, 2015 meeting

Director O’Connell made a motion, seconded by Director Vella, that the minutes of the June 10, 2015 Board Policy Committee meeting be approved.

The motion passed unanimously.

4. **Public Comments:**

Director Weed reported and provided a fact sheet on an Executive Order issued by the Federal Flood Risk Management Standard (FFMS) in January 2015. The order changes the current 100-year Base Flood Elevation (BFE), used to determine federal floodplain requirements, to a 500-year BFE.

The order has not been implemented yet, but it could impact each of the districts particularly those that have bayfronts or streams flowing through flat terrain.

Secondly, ACWA is looking for Committee appointments. There are numerous Committees which offers opportunities for constructive dialogue.

In response to Director Guzzetta, Ms. Sandkulla stated that BAWSCA Board members can attend the ACWA conferences on behalf of BAWSCA. BAWSCA allocates a budget for the attendance of up to two Board Members. Board Members who attend on behalf of BAWSCA register through BAWSCA. Board members can also choose to attend independently.

5. **Action Items:**

- A. **Resolution Approving Temporary Re-Appointment of Arthur Jensen as Special Counsel to the CEO/General Manager:** Ms. Sandkulla reported that Mr. Jensen was appointed as Special Counsel to the CEO/GM upon initiation of her administration in September of 2013. The Board approved a subsequent one-year temporary re-

appointment in 2014 for specific tasks included in the FY 2014-15 work plan that are critical to the agency.

While Ms. Sandkulla anticipates this temporary reappointment as the last, she stated that Mr. Jensen's service has and will continue to provide essential assistance in the negotiations with San Francisco related to the classification of assets under the Water Supply Agreement.

BAWSCA negotiated a Settlement Agreement with San Francisco which will expire in September 30, 2015. The negotiating team benefited from Mr. Jensen's expertise on the subject. His leadership on the technical side complimented General Counsel's leadership on the legal side, and allowed Ms. Sandkulla to manage the executive discussions with SFPUC General Manager, Harlan Kelly. The team created a very effective dynamic in moving the negotiations forward.

Ms. Sandkulla further explained that BAWSCA contracts with PERS and the appointment of Mr. Jensen as Special Counsel must include specific requirements for compliance including specified conditions of temporary appointment with limited hours of under 960 for the year. All the requirements are reflected in a resolution that the Board will be asked to adopt. Adoption of a resolution is also required by PERS.

Ms. Sandkulla reported that the adopted FY 2015-16 workplan allocates 520 hours and a budget of \$53,000 for Mr. Jensen's services. In actuality, his hour have been much less to date than planned. Typically, his hours have been 5-6 hours a week, which will continue until the negotiations are completed.

In the interest of the agency's return on investment, Director Vella asked how Mr. Jensen's services are evaluated.

Ms. Sandkulla stated that she evaluates the team's progress through their successful movement of the negotiations in the direction that is in the best interest of the agencies. A major part of the negotiations has been to review all the assets, identify their classification, agree on that classification, and agree that those classifications will be maintained for the life of the contract. The resolution of the settlement discussions will address the assets that were in question, as well as all the assets in the system that were not included in the 2009 Water Supply Agreement as this issue has not been previously significant. Achievement of those results in the negotiations is the agency's return on investment.

Director Vella made a motion, seconded by Director O'Connell, that the Committee recommend Board adoption of Resolution 2015-01 approving the reappointment of Arthur Jensen to the temporary position of Special Counsel to the CEO/GM and making associated finding in support of such an appointment.

The motion carried unanimously.

- B. Annual Review and Consideration of BAWSCA's Statement of Investment Policy:**
Ms. Sandkulla introduced BAWSCA's Investment Advisor, Mark Creger from BLX Group.

Sr. Administrative Analyst, Christina Tang reported that BAWSCA's Investment Policy requires the Board's annual review and consideration. The Policy was last reviewed in November 2014 with no changes made.

The current Policy reflects language consistent with State law, and no changes are recommended.

Ms. Tang reported that all BAWSCA funds are invested in accordance with the Policy. The permitted investment instruments for bond proceeds associated with BAWSCA's revenue bond Series 2013 A and B include Money Market Mutual Funds, Certificates of Deposit, and Federal Securities.

The surcharge payments collected from member agencies and the balance held in the stabilization fund are currently invested in Bank of New York Money Market Funds, which is currently earning interest rates at 0.01%, and the US treasury securities with the current average yield of 0.26%.

In response to the Board inquiry about why the investment funds are earning low interests rates, Ms. Tang reported that the rates are reflective of the current low interest rate market, as well as the conservative assumptions made in the investment strategy. Ms. Tang added that for the first 2 years, BAWSCA decided to move forward with the most conservative investment strategy for the bond proceeds, in accordance with the agency's investment policy objectives of safety, liquidity and yield.

The current investment strategy is based on the following factors and assumptions.

Bond surcharges collected from the member agencies are used to make debt service payments twice a year, April 1st and October 1st, until October 1, 2034.

It is assumed that 70% of the annual surcharges will be collected on time, and 30% of the debt service payment will be supplemented by funds from the stabilization fund.

The maturity of the stabilization funds invested in the US Treasury Securities are timed to coincide with the debt service payment dates so that they can be used to pay up to a 30% shortfall from surcharge payments. The upcoming maturity dates are September 30, 2015, March 31, 2016, and September 30, 2016.

The level of investment yield is directly related to the investment horizons. To make the \$12 M stabilization funds available to use as debt service payments in case there are shortfalls from the surcharge payments, majority of the securities mature in less than 1 year. The securities generate an average yield of 0.26%.

Following September 30, 2015, the next maturity date of funds invested in the US Treasury Securities, the CEO will re-evaluate the investment strategy and re-consider the assumptions being used. The evaluation will be based on a full 2-year collection history, the current circumstances of BAWSCA member agencies, and current market conditions.

The last evaluation of the strategy occurred 5 months ago when BAWSCA re-invested the funds that matured on March 30th 2015. With a collection history of less than 2 years, BAWSCA did not make any changes to the investment strategy at that time.

BAWSCA will re-invest the matured funds based on the results of the evaluation and the objectives of the Investment Policy which include security, liquidity, and yield.

Director Weed asked how much money is being invested and whether a benchmark was established to measure against the current performance.

Ms. Tang stated that the \$12M stabilization fund balance is currently invested and targeted to supplement any potential shortfalls in the debt service payments. The money received in the principle and interest funds are invested in the money market fund until used for next scheduled debt service payment. This is the most cost-effective strategy found due to the low market interest rates.

Mr. Creger added that because the current investment strategy is targeting specific dates, there were no benchmarks established for comparison because the strategy is driven by fixed investment horizons as opposed to an open ended strategy.

In response to Director Guzzetta, Ms. Sandkulla stated the 30% shortfall is an initial assumption that has proven to be very conservative. There is concern with member agency revenues being impacted by the drought and any potential impact on BAWSCA. With the ongoing drought, there will be significant financial pressure on the agencies and it is important that those factors pose no negative effect on BAWSCA's financial situation. Additionally, BAWSCA does not have an alternative source of funds to use to make its debt service payments in the event of a revenue shortfall, therefore the 30% assumption is appropriate.

Ms. Sandkulla stated that she has discussed with BLX other investment options and the financial risks to BAWSCA if the agency has to liquidate a security early. Having a full 2-year history will be helpful in re-evaluating the investment strategy.

Director Guzzetta asked if BAWSCA looked at laddering and getting longer term securities that will mature on the targeted payment dates in order to get the benefit of better interest rates.

Mr. Creger responded that those options were the genesis of BAWSCA's current investment strategy given the concerns with revenue collection uncertainties and the drought. The laddering was structured based on the \$12 M stabilization fund, a 70% revenue assumption for each of those debt service payment amounts, and the plan to

use the \$12 M stabilization fund balance to invest out in periods of 6 months while filling in any potential void in debt service payments. The amount of capital that was able to be invested to get those higher yields was a function of the starting balance, plus the 70% assumption.

One mechanism for laddering out further, and still have targeted debt service dates, would be if the revenue assumptions were 80% or 90%.

Mr. Creger explained that once there is sufficient comfort in the expectations of surcharge revenue, other public agencies with stabilization funds move away from specifically targeting debt service dates, and take on a laddering strategy that mature between 1-3years, or 1-5years.

This type of strategy is when the concept of using a market based benchmark such as Bank of America 1-3 year treasury index or a 1-5 year index, because the agency is not targeting specific future dates. This strategy is then managed towards a market based index.

BAWSCA's current investment strategy to target specific debt service dates protects BAWSCA from any potential interest rate risks. If interest rates rise, the market value of fixed income securities, the treasury securities and the portfolio is going to decline. Because BAWSCA has no need to access the stabilization funds except for those specific debt service dates, it doesn't have to realize a potential loss if interest rates decline.

Alternatively, if BAWSCA moves away from targeted specific future debt service dates, there is the potential for losses in the future if bonds have to be sold under adverse market conditions.

Director Mendall commented that while the current strategy protects BAWSCA from the risks of fluctuating interest rates, it also guarantees a much lower return than the agency can otherwise get. For example, if BAWSCA did a 30 year security, the worst case scenario would be to sell early and deal with the interest rate fluctuations.

He commented that BAWSCA is being more conservative than it needs to be, not only with the 30% shortfall assumption, but with the laddering as well. A fixed amount of money that is equivalent to 30%, and rotates every 6 months should protect the agency. The rest of the funds can be put in longer term securities.

Director Mendall stated that BAWSCA's extremely conservative mechanism is costing at least an estimate of 0.50% in earnings a year on the stabilization fund balance. He suggested that the agency can do better than earning an average of 0.26% with its investments, and perhaps earn up to 0.4%, which can bring in approximately \$60-\$70K a year or 2% of the operating budget.

Mr. Creger noted two important considerations, which are 1) BAWSCA's debt service payment amounts are different with the October payment including principle and

interest, which makes it much larger than the April payments that includes interests only. 2) If BAWSCA assumes the maximum of any annual year's debt service, whether it is 30% or 20%, and the balance is moved out of the yield curve in pursuit of higher yields, the important question becomes, what amount of interest rate risk is within BAWSCA's risk tolerance.

BLX can work with BAWSCA to facilitate an analysis of how much risk the agency is comfortable taking with its investment strategy.

While acknowledging the benefits of gaining higher interest earnings associated with taking additional interest rate risks, Mr. Creger emphasized the potential risks that BAWSCA should be aware of if it moves away from the specific targeted dates. It is very important that BAWSCA identifies the risks the agency is comfortable with as it moves towards slightly more aggressive strategies.

Mr. Creger explained that the stabilization fund balance, which is approximately \$12.3 M, must be maintained as the reserve requirement. The total amount will change slightly overtime as the bonds amortize. The amount that needs to be held in that stabilization fund will decline later in its life as specified in the bond documents.

Ms. Sandkulla clarified that the committee action is to recommend Board re-affirmation of the current investment policy.

The investment strategy operates and is implemented by the CEO within the framework of the current Policy which sets forth the permitted securities and the objectives of security, liquidity, and yield.

Ms. Sandkulla stated that for the early stages of the bonds, it is critical to operate under the investment policy's objectives of security and liquidity. Unlike BAWSCA member agencies, BAWSCA does not have a long history of investments nor does BAWSCA have alternative funds or assets available to make debt service payments. BAWSCA staff will continue to work with the BLX team to evaluate the alternative investment strategies and for the CEO to make a decision, if any, in the investment strategy used by BAWSCA.

Following discussions, the Committee supported the CEO's objective for security in the investment policy, and suggested to have a clear distinction between the Investment Policy, which the Board acts on, and the investment strategy being used to which the Board may provide input on as part of a decision by the CEO. The Committee agreed that Board input on the investment strategy can serve as a process for 1) recognizing the changes in the financial market, and 2) documenting what the CEO/General Manager has discussed with the Board in determining the level of risks the agency is willing to take.

Ms. Sandkulla will continue to implement an investment strategy within the realm of the investment policy. For the Board's information and discussion purposes, she will

provide a layout of the investment strategy, as well as the risks associated with potential alternatives at the September Board meeting.

Legal Counsel, Allison Schutte, advised the CEO/General Manager to ensure that the Investment Policy continues to create a clear distinction between the Reserve Funds that BAWSCA operates on and the bond proceeds. The subsection of the policy for the Reserve Funds are more restrictive.

Ms. Sandkulla agreed and stated that the Investment Policy is reviewed by the Board on an annual basis. Given the questions that came up regarding investment returns, the review of the Investment Policy provided an opportunity to report on the current investment strategy for the bond stabilization fund and have a discussion with the Board. The annual review of the Investment Policy and the Quarterly Investment Reports can serve as the means for the Board to provide input.

Director O'Connell made a motion, seconded by Director Breault, that the Committee recommend Board re-affirmation of the current Statement of Investment Policy.

The motion carried unanimously.

- C. Review and Consideration of BAWSCA's General Reserve Policy: Christina Tang reported that an annual review of the agency's General Reserve Policy is not required by existing policy or government regulations. This review was requested during the development of the FY 2015-16 Budget, due to concerns with the projected level of the General Reserve at the end of FY 2014-15

Prior review of the General Reserve Policy was done in November 2014. No changes were recommended to the Policy at that time.

Ms. Tang explained that the General Reserve Policy is designed to protect the agency against unanticipated deviations in revenue and expenditure, and to stabilize variations in assessments to member agencies. The guideline for the General Reserve balance is 20% to 35% of the annual operating expenses. There are no recommended changes to the current Policy.

The General Reserve serves several key purposes. It funds urgent and unanticipated needs to avoid the imposition of special assessments or additional costs to the operating budget, and one-time, non-recurring expenses to moderate variations in the annual assessments. Examples include legal services needed for the settlement with San Francisco regarding asset classification, and the work associated with regional water demand and conservation projections.

The current Policy is consistent with the Government Financial Officers Association (GFOA) recommendations and publications. Because there are no standardized general reserve guideline for various types of local government or water agencies, BAWSCA contacted the same agencies it contacted from its prior review. The agencies surveyed follow a guideline of 25% - 50% of their operating budget.

Director Pierce stated that the design of the policy to protect the agency speaks to the way she understands the purpose of a General Reserve. She commented that the previous use of the General Reserve for legal services and the one-time study for regional water demand and conservation projections should be emphasized as the function of the policy's design, rather than its purpose.

Director Mendall made a motion, seconded by Director O'Connell, that the Committee recommend Board adoption of Resolution 2015-02 to re-affirm the current General Reserve Policy.

The motion carried unanimously.

6. Reports:

Water Supply Conditions: Ms. Sandkulla reported that the system's water bank storage level is at the lowest point of 18.1% as of August 9, 2015. While precipitation remains low, there is a slight increase in comparison to last year's as a result of recent thunderstorms.

Ms. Sandkulla was pleased to report that the 9-County Bay Area Lowest Per Capita Consumption for June 2015 is comprised of mostly BAWSCA member agencies and San Francisco. Ms. Sandkulla stated that the numbers are reflective of the investment in water conservation, water use-efficiency, and the response of customers.

Director Weed commented that there is a dramatic spread in the amount of per capital consumption among the member agencies due to many contributing factors. The universal push for water conservation may have mitigated the variables. He questions how much farther can water use reduction go for one district and not the other.

In response, Ms. Sandkulla stated that demographics play a large role in the per capita difference between two neighboring communities, as do the number of people in a household, the types of home, the lot size, and the weather. The combination of these factors help explain a major portion of the residential per capita differences.

While the region has not hit bottom, Ms. Sandkulla stated that there are some communities that cannot reduce further, particularly those who are in the range of 37 – 48 gpcpd.

In response to Director Guzzetta, Ms. Sandkulla stated that the numbers represent residential usage only and are the numbers reported to the State by the member agencies.

Director Guzzetta commented that the source of the data has to be looked at carefully because agencies account for water usage in various ways. Additionally, when a household goes down to 50 gpcpd or below, there is not much left for water use outdoors or for further reduction.

Ms. Sandkulla agreed and referred to the Total Deliveries graph which demonstrates the region's significant reduction in outdoor water use during the summer months. She noted that the pattern is "unbelievable" but BAWSCA will continue to push for water use cut backs because sufficient supply of water is not available.

Director Weed commented that San Francisco has a lot of water to sell if they had customers for it. Ms. Sandkulla emphasized that the supply the Regional Water System currently has is what is available for its current customers. The system is in a water shortage condition today. The system has no access to the State Water Project, Federal Project, or significant amounts of groundwater supply. The conservation the region is doing today is critically important to make the supply last. As much as the rate impacts will be unpleasant, it is a factor that BAWSCA would rather deal with over having no water available.

Director Guzzetta commented that the current demand is so low that making supply projections 1-5 years from now will be difficult. The rebound will not be the same as in past droughts because permanent switches to water-efficient landscaping have been made. The 1977 drought had a slow rebound, and it will be even slower this time because of the permanent changes to outdoor water use.

Director Pierce asked about building re-development and growth projections.

Ms Sandkulla stated that re-development and new constructions are coming with much more efficient designs that use less water in the long-term. There is a level of investment in long-term changes in building codes, recycled water and gray water use as a result of improved technology that are now available as well.

A question is how long will it take to recover from the drought. Ms. Sandkulla stated that history has shown that there is never a full rebound to the pre-drought level, despite population growth. She stated that discussion on this topic is occurring in many venues including emergency planning.

Director Guzzetta commented that as water managers, the numbers should not be seen as a “free board” because there will be population growth to consider for the next time when there is a drought cutback. Cutting back from 150 gpcpd to 100 gpcpd is different than reducing use from 75gpcpd to 40 gpcpd. As water managers, we have to have supply that is extremely reliable so that future needs for cutbacks will not be extreme.

Director Weed commented that there is water for purchase from the agricultural sector that would take care of the 10% urban water use statewide.

Ms. Sandkulla presented additional data on the region’s water reduction performance. With the State Water Resources Control Board (SWRCB) regulations, the overall target reduction for the BAWSCA agencies is 15%, and the Statewide target is 25%.

Ms. Sandkulla was pleased to report that BAWSCA agencies and their customers achieved a 33% reduction for the month of June. The state achieved 27% reduction, slightly over its 25% target.

Sixty-one percent of the agencies statewide did not achieve their target, while 96% of BAWSCA agencies did. The one exception was Westborough Water District who had a

shopping center that was demolished in June 2013. The center is now fully occupied and using water which increased Westborough's use compared to June 2013.

Ms. Sandkulla added that for the BAWSCA agencies where there is already low water use, the only place for significant savings is reducing outdoor irrigation during the summer months. In fact, 80% of the savings in 2014 were achieved between June and October. The 33% reduction achieved in June is exactly where the region needs to be in order to achieve the overall annual savings.

Moving forward, BAWSCA member agencies should continue their efforts to stay on track in achieving the overall annual target and State mandated targets.

BAWSCA is monitoring ongoing SWRCB activities related to drought and water supply. Staff is working with ACWA and the State Board to keep engaged in the discussions on local supply and reliability investments, and how those investments reconcile with the Governor's call for demand reduction as opposed to supply reduction.

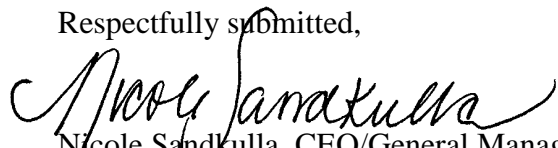
BAWSCA is continuing to support the member agencies' conservation efforts with the implementation of new regional programs such as the Free Sprinkler Nozzles Program and the Water Conservation 101 Education Program.

Lastly, BAWSCA strives to accept speaking invitations from regional groups to promote both local and regional programs administered by BAWSCA and its member agencies.

7. **Comments by Committee Members:** There were none.

8. **Adjournment:** The meeting was adjourned at 2:47pm. The next meeting is October 14, 2015.

Respectfully submitted,



Nicole Sandkulla, CEO/General Manager

NS/le

Attachments: 1) Attendance Roster

BAY AREA WATER SUPPLY AND CONSERVATION AGENCY

BOARD POLICY COMMITTEE – August 12, 2015

Roster of Attendees:

Committee Members Present

Charlie Bronitsky, City of Foster City (Chair)
Randy Breault, City of Brisbane/GVMID (BAWSCA Chair)
Rob Guzzetta, California Water Service Company
Gustav Larsson, City of Sunnyvale
Al Mendall, City of Hayward (BAWSCA Vice Chair)
Irene O’Connell, City of San Bruno
Barbara Pierce, City of Redwood City
Louis Vella, Mid-Peninsula Water District
John Weed, Alameda County Water District

Committee Members Absent

Kirsten Keith, City of Menlo Park (Vice Chair)
Jerry Marsalli, City of Santa Clara

BAWSCA Staff:

Nicole Sandkulla	CEO/General Manager
Andree Johnson	Water Resources Specialist
Christina Tang	Sr. Administrative Analyst
Lourdes Enriquez	Assistant to the Chief Executive Officer
Deborah Grimes	Office Manager
Allison Schutte	Legal Counsel, Hanson Bridgett, LLP

Public Attendees:

Mark Creger	BLX Group
Fan Lau	San Francisco Public Utilities Commission