

**BAY AREA WATER SUPPLY AND CONSERVATION AGENCY
BOARD POLICY COMMITTEE**

**December 13, 2017 – 1:30 p.m.
BAWSCA Offices – 155 Bovet Rd., San Mateo – 1st Floor Conference Room**

MINUTES

1. **Call to Order:** Committee Chair Gustav Larsson called the meeting to order at 1:30 pm. A list of Committee members who were present (8), participated via teleconference (1), and other attendees is attached.

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

2. **Comments by Committee Chair:** Committee Chair Larsson welcomed members of the Committee.

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

4. **Consent Calendar:** Approval of Minutes from the October 11, 2017 meeting.

Director Quigg made a motion, seconded by Director Kasperzak, that the minutes of the October 11, 2017 Board Policy Committee meeting be approved.

Director Benton abstained. The motion passed by roll call vote.

5. **Action Items:**

- A. Proposed Fiscal Year 2018-19 Bond Surcharges: Financial Manager, Christina Tang, presented the proposed Bond Surcharges for FY 2018-19 for the Board's consideration and adoption. BAWSCA's bond indenture requires BAWSCA to impose a fixed surcharge to each member agency on an annual basis, to cover the debt service payments and bond administration expenses, as well as replenish the stabilization fund as necessary.

There are no changes to the methodology used last year. The total proposed surcharge for FY 2018-19 is \$24,686,376. Assuming SFPUC's projected wholesale water consumption is 115 mgd, the surcharge is equivalent to \$0.44/ccf or \$192/AF.

Ms. Tang noted the bond issuance to prepay the capital debt owed to San Francisco saves member agencies over \$3.5 million collectively each year, until 2034.

Director Quigg made a motion, seconded by Director Kasperzak, that the Committee recommend Board approval of the proposed FY 2018-19 bond surcharges.

Director Kasperzak commented that "imposing" a "surcharge" seems so draconian for what the purpose of the surcharge is. He noted that BAWSCA's bond issuance pre-paid the capital debt that agencies owed San Francisco, which provides the agencies substantial savings in the long-term. The surcharge is the annual process that BAWSCA member agencies have to do to meet the obligations which the agencies agreed upon.

The motion passed by roll call vote.

6. Reports and Discussion :

- A. Overview of Current Investment Strategy of BAWSCA's Bond Proceeds Associated with Revenue Bonds Series 2013A & 2013B: Ms. Tang reminded the Committee that BAWSCA's bond funds are invested in accordance with the Bond Indenture and the Investment Policy. As of October 31, 2017, the total bond funds of \$18,068,680 are held by the Trustee, the Bank of New York.

The bond funds are comprised of \$5.6 million in surcharges collected from member agencies that are used for the semi-annual debt service payments, and \$12.5 million in stabilization funds that are designed as a reserve fund.

Based on prior evaluations by staff and BAWSCA's investment advisor, the current investment strategy is determined to provide BAWSCA the most appropriate balance of safety, liquidity, and yield, which have been the primary objectives of BAWSCA's investment policy.

The bond indenture specifies the permitted investment options for BAWSCA's bond funds. In November 2012, during the establishment of the bond structure, the Board amended the investment policy to further restrict the investment options for the bond funds to three specific vehicles; Federal Securities, Money Market Mutual Funds, and Certificates of Deposit.

To ensure that BAWSCA has sufficient funds to make the required debt service payments, the current strategy assumes that only 80% of the necessary bond surcharge revenues are collected and available for scheduled debt service payments. In other words, 20% of the required debt service payments must be available to be paid through the stabilization fund.

The current strategy involves a rolling of \$3.6 million in 6-month securities to cover 20% of the debt service payments. This short-term portion of the portfolio provides BAWSCA with sufficient reinvestment opportunities in any upward or downward trend of short-term investment rates.

The remaining stabilization fund is invested in a laddered structure with maturities of every 6 months. This longer-term portion of the portfolio provides BAWSCA with exposure to higher yield in securities.

This current investment strategy is considered the most appropriate because it provides the agency significant upfront liquidity, diversified exposure to the yield curve provided by the ladder structure, and attractive current yield.

BAWSCA has evaluated the strategy on a regular basis to determine whether any change in the agency's circumstances, surcharge collection experience, or market conditions would justify modifications to the strategy to better align the agency's objectives and risk tolerance.

The evaluation made in September 2015 changed the on-time surcharge collection assumption from 70% to 80% based on the past collection experience.

The evaluation made in October 2017 re-affirmed the 80% assumption based on the limited history of the collection experience, and a recent delayed surcharge deposit to the trustee account.

As previously reported to the Board, San Francisco changed their 20-year old financial system to Peoplesoft effective July 1, 2017. BAWSCA's surcharge payment of \$2 million was deposited into the wrong trustee account for September, and caused a delay in the surcharge deposit. This event confirms BAWSCA's decision to keep the 80% assumption, and re-evaluate the assumption after San Francisco has completed a full fiscal year of accounting under Peoplesoft.

To further evaluate BAWSCA's investment performance, staff looked at the average market yield and weighted average maturity of four member agencies with varying size of investment portfolios as of the end of October 31, 2017. The comparison shows that investments with longer maturities generate higher yield. However, Ms. Tang noted that each agency has different circumstances, permitted investment vehicles, and approved maximum investment duration dictated by its own investment policy.

BAWSCA CEO will re-evaluate BAWSCA's circumstance and investment tools permitted by the Bond Indenture prior to October 2018, before the entire maturity structure is re-balanced and when San Francisco will have completed a full fiscal year with their new accounting system. The result of the evaluation will be reported to the Board as part of the quarterly surcharge collection report. Any changes will be implemented by the CEO in accordance with the current investment policy.

Committee discussions ensued on opportunities for higher rates of return for BAWSCA's stabilization funds.

Ms. Sandkulla explained that BAWSCA's stabilization fund is focused solely on the bonds and is dictated by a bond covenant that is associated with a bond indebtedness. BAWSCA's ability to invest its stabilization fund is dictated by what the Bond Indenture allows, and what the Board approves. The current investment policy's objectives are safety, liquidity, and yield.

Ms. Sandkulla stated that when the full list of permitted vehicles for investment purposes for the stabilization fund is examined and re-evaluated with the financial advisors prior to October 2018, BAWSCA will look into the long-term bond investments with AAA ratings that other municipalities are using, as part of the evaluation.

Director Mendall noted that the investment changes made 2 years ago is providing approximately \$100,000 per year in increased returns than if the investments were kept in the money market funds. The question he suggests for consideration in October 2018, when the strategy is re-evaluated, is whether the four "ladders" is the right number, or should there be added "ladders", with some going perhaps out to 2.5 years? How do we build on to what we currently have?

Director Benton suggested looking at investing in LAIF, which provides liquidity as well as access to investment vehicles with higher rates of return compared to money market funds.

Secondly, he suggested considering putting the \$12.5 million, the portion designed to function as a reserve fund, into a longer-term investment than 3-6 months, for a higher rate of return. The funds will always be accessible. The only disadvantage is the loss of short-term returns if the funds are tapped into prematurely.

Ms. Tang stated that BAWSCA will explore the possibilities of moving the money, which is required to be deposited into the Trustee account, into LAIF investments.

Ms. Sandkulla added that BAWSCA's investment advisors currently recommends not to tie the funds up too much for too long, because of rising interest rates. All indications suggests that rates will continue to rise up for the next few quarters, at which time BAWSCA will be re-evaluating the current investment structure.

Director Mendall noted that Hayward's financial advisors provide similar advise.

Ms. Sandkulla expressed appreciation for the discussion and stated that this item will be brought back to the Committee when BAWSCA begins the re-evaluation process in Fall of 2018.

Director Pierce noted that bond financing and having additional funds that can be put into investments to generate income is a new situation for BAWSCA. Investing is something BAWSCA did not previously do, and it is good to continue to evaluate BAWSCA's circumstances and look for opportunities. Balancing between safety and liquidity, which is what BAWSCA has done in its existence, is important. While she supports continuing to evaluate investment opportunities, it is also important to be aware of where the agency came from.

Director Kasperzak added that the preservation of capital is what is important. It's not about making money. The intention is not to lose money due to inflation. Any income is a hedge against the inflation or a loss, instead of making a net return on investment. Most governments are in the preservation of capital, that is why there are State restrictions.

- B. Mid-Year 2017-18 Work Plan and Budget Review: Ms. Sandkulla explained that the mid-year budget and workplan review process ensures that BAWSCA is on track to achieve the critical results set out for the current year and beyond. It is also an opportunity to update the Board on the agency's progress and to identify areas where change might be needed.

The staff memo provides a table that presents status reports on all areas of the FY 2017-18 work plan. There are two modest changes to the work plan scope that will be recommended to the Board. The changes have no impact to the budget. The committee is asked for direction on the recommended action.

Ms. Sandkulla presented the recent developments in the critical areas of the workplan.

BAWSCA has been working diligently for the past 2 years to increase its level of involvement with the SFPUC's development of its 10-year CIP. She was pleased to report that BAWSCA has had significant increased involvement with SFPUC staff on its CIP's early development stages which provides BAWSCA the opportunity to see early work products, ask questions and suggest modifications. The program will be

brought to the Commission in February 2018, where BAWSCA will be able to make comments.

As part of the ongoing discussion efforts with San Francisco on the 10-year CIP, BAWSCA have had a benchmarking study in its work plan since FY 2016-17 that is focused on SFPUC's operational efficiency and asset management. The SFPUC has recently expressed an interest in taking part in BAWSCA's benchmarking study as a way to look at their process of developing the 10-year CIP, and comparing it with other utilities. This opportunity presents a significant progress for BAWSCA's efforts to really be engaged in SFPUC's process and having the opportunity to provide input.

Ms. Sandkulla stated that the first recommended work plan modification is to adjust the current benchmarking study to be a CIP benchmarking study in coordination with the SFPUC. This effort is currently being scoped for completion in FY 2018-19.

Additional work plan progress includes pre-feasibility studies on potential purified water projects anticipated for completion this fiscal year. These projects were initiated and expedited during the drought. The next steps will be reflected in the work plan for FY 2018-19.

Progress of the pilot water transfer was impacted by the drought, and is now continuing development. Necessary agreements are in progress between BAWSCA, EBMUD, Hayward and SFPUC with the concept of doing a transfer during a planned shutdown at Hetchy Hetchy for work on Mountain Tunnel in FY 2018-19 or FY 2019-20.

Additionally, BAWSCA has been working with neighboring Bay Area agencies through the Bay Area Regional Reliability Partnership (BARR). BARR was recently awarded a Federal grant to test water supply efforts such as water transfers. While a decision has yet to be made, BAWSCA's pilot water transfer plan has a good chance of being used as the pilot for a larger regional water supply project. The effort expanding to larger agencies in the region has been a significant development for BAWSCA's pilot water transfer as it can provide the information needed to know what it would take to execute a water transfer.

Progress on the development of the Regional Water Supply Model is ongoing with the base model scheduled for completion this fiscal year.

The second recommended work plan modification is to postpone the development of the principles for Tiers 1 and 2 drought allocation plans.

The Tier 1 plan is the drought allocation between San Francisco and the wholesale customers. The Tier 2 Plan is the drought allocation among the member agencies. Tier 2 expires in December 2018, and the preparation for a temporary extension was in the work plan. However, both Tier 1 and Tier 2 plans must align with State new requirements that are not yet finalized.

Ms. Sandkulla reported that the Governor's "Making Water Conservation A Way of Life" requirements were encompassed in two pieces of legislations which failed to pass in September. It has now become a 2-year bill that will be picked up by the

Board Policy Committee Minutes

December 13, 2017

Legislature in January 2018. It is expected to move very quickly as the Governor, members of the Legislature, and the State Water Resources Control Board, are committed to it.

Efforts to develop principles for Tier 1 and Tier 2, and to identify the options for extending the Tier 2 plan will begin in Spring 2018 when further legislation information becomes available.

Ms. Sandkulla explained that one of BAWSCA's role in addressing "Making Water Conservation A Way of Life" is to do an assessment of how member agencies will meet the requirements. The assessment will be completed in January and will be discussed by BAWSCA and the member agencies in a workshop. Information gained from the workshop will be used in BAWSCA's outreach on the legislation, as well as in developing a Conservation Strategic Plan that will identify the roles and responsibilities of BAWSCA and the member agencies to meet the requirements.

As the final piece of the effort to learn from the recent drought, a workshop on Water Utility Financial Best Management Practices During Drought is being planned for Spring of 2018. The workshop will include discussions on rate structures in normal and drought years, issues with Prop 218, and what agencies would have done differently in hindsight. The output of the Spring Workshop will include a compilation of the reports and presentations given.

BAWSCA continues its efforts to effectively implement the Water Supply Agreement and administer BAWSCA's bond issuance.

The mid-year review also looks at expenditures and identifies budgetary issues. Ms. Sandkulla reported that all current and projected expenditures are within the approved budget. Expenses associated with legal activities are being closely monitored.

Ms. Sandkulla reported that the General Reserve is currently higher than the budgetary guideline of 35% of the operating budget. There are no recommended changes at this time. The information is being provided to the Committee and will be provided to the Board in January as it is anticipated to be important in the upcoming discussions on funding the FY 2018-19 work plan and budget.

The recommended workplan modifications are based on the developments in the areas of the workplan. The Committee was asked for direction and input on the recommendation.

Director Quigg commented that the current legal activities are the agency's biggest challenge for the budget and workplan development.

Director Schmid noted that since he has joined the Board in 2015, he has seen a shift from monitoring actions taken by the SFPUC to focusing on State activities and their impacts to the BAWSCA region. He asked whether BAWSCA should re-think its long-term outlook and need for expertise.

Ms. Sandkulla stated that each year, BAWSCA's development of its workplan and budget starts with an evaluation of long-term challenges and risks to the agency and

water customers. Of all the issues that were anticipated in each year's budget development process, only the conservation legislation came as a surprise.

BAWSCA's foresight in developing the annual budget and workplan has been helpful in bringing in and supporting the formation of certain expertise.

Ms. Sandkulla explained that the hiring of Adrienne Carr serves as an example. BAWSCA knew 10 years ago that it would need a hydrology expert for the FERC process. But as the FERC process was delayed, the need for a hydrology expert was put off until BAWSCA needed to hire a Senior Water Resource Analyst and found Adrienne Carr who fit the position qualifications along with having the hydrology expertise BAWSCA needed. Ms. Carr is now working directly with Legal Counsel on the FERC process.

In response to Director Larsson's question about the Tier 2 plan, Ms. Sandkulla explained that in the Water Supply Agreement (WSA), the process for adoption of the Tier 2 plan identifies the member agencies as the collective body that would originally adopt the plan in 2009. If the member agencies fail to adopt a plan, the BAWSCA Board can take action. If that fails, the SFPUC has the authority to act.

The WSA states no process for when the plan expires. BAWSCA will be working closely with Legal Counsel to identify the best plan of action. The analysis will be done during the balance of the current fiscal year because if the BAWSCA Board have to act, the action must occur in the beginning for FY 2018-19.

The existing Tier 2 plan was adopted by each individual member agency in 2009. The Board has never dealt with the Tier 2 plan, and therefore, will be provided with details of the necessary actions once they are identified. Ms. Sandkulla has briefed agencies' technical staff about the anticipated efforts.

In response to Directors Schmid and Benton's inquiries, Ms. Sandkulla stated that there will be a summary of the conservation legislation provided to the Board at the January meeting. She explained that having 2 competing bills; one from the Assembly and one from the Senate, was a contributing issue to its failure to pass in the legislature in September. Additionally, during the last few days of the legislative session, there were continual amendments to both bills to ensure that water agencies, like ACWA, were not opposed to the bills.

Ms. Sandkulla explained that while member agencies will be able to meet the per capita conservation requirements, the bills put a significant administrative burden on the member agencies. To date, BAWSCA's concerns with the administrative burden are strongly embedded in the governor's interests in the bill. Additionally, the SWRCB is convinced that the level of detail in the agencies' calculations and reporting to the State are necessary, and both the Governor and the State Board have sufficient support to put it through.

BAWSCA did provide input during the development of the legislations until July 2017. While some key issues were resolved, it was evident that BAWSCA's base concern with the bills were not going to change.

Ms. Sandkulla stated that BAWSCA's assessment on how agencies will meet the conservation requirements of "Making Water Conservation a Way of Life" will provide some very specific accounting and dollar value to what it is going to take for agencies to implement what the legislation proposes.

BAWSCA will use this information as part of its efforts with the legislations. However, Ms. Sandkulla is not hopeful for change because the calculations have been a part of the Governor's and SWRCB's core strategy from the very beginning. This was the foundation of the conservation legislation. The State believes that water agencies have to do a better job in calculating their water needs in a unified fashion, and managing and presenting the information to the State so that the agencies can be held accountable. In the absence of this information, the State is unable to hold agencies to a common standard, which they are unwilling to do.

The Committee supported the recommendations to:

1. Scope Reduction/Delay:

- a. Postpone development of principles for a new Tier 1 and Tier 2 drought allocation plan pending ongoing legislative activity with anticipated completion in FY 2018-19**

2. Scope Modification:

- a. Conduct benchmarking study of the SFPUC's CIP development process instead of evaluating the SFPUC's RWS operational efficiency and cost effectiveness**

7. Reports:

- A. Water Supply Conditions: Ms. Sandkulla reported that the region's water supply conditions are currently in a good position with both local and Tuolumne systems at above the normal percent of maximum storage for this time of the year. While it has been dry, it is too early to forecast the water year.

The member agencies' water use continue to be 12% less than it was in October of 2013.

- B. FY 2018-19 Work Plan and Operating Budget Preparation and Planning: Ms. Sandkulla reported that the January Board meeting will include a planning session for the development of the FY 2018-19 Work Plan and Budget. The long-term issues and objectives will be presented to the Board for discussion and feedback.

A draft preliminary work plan and budget will be presented to the Committee in February for Board consideration in March. A draft proposed Work Plan and Budget will be presented to the Committee in April, for Board consideration and approval at its meeting in May.

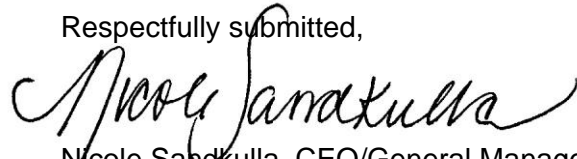
This sequence follows the same process that has been done in the past 2 years, which have been effective for both the Board and BAWSCA staff in going through the details.

Ms. Sandkulla noted that the work plan deliverables and preliminary budget information are presented to the member agency staff in March.

Director Pierce suggested to check with Board members on any concerns with the current General Reserve level, as there has been a push in the past to rigidly adhere to the policy guidelines. Having seen BAWSCA's practice on budget expenditures to achieve critical results, Director Pierce understands why the reserve is at the level that it is, given the uncertainties the agency faces at this time. It, however, might be worthwhile to re-evaluate what the appropriate General Reserve level should be, or the appropriate duration for the reserve to be at a certain level given the potential significant legal issues faced by the agency today.

8. **Closed Session:** The meeting adjourned to Closed Session at 2:52pm
9. **Open Session:** The meeting convened to open session at 3:06pm. Legal Counsel, Catherine Groves, reported that no action was taken during Closed Session.
10. **Comments by Committee Members:** There were no further comments from the Committee members.
11. **Adjournment:** The meeting was adjourned at 3:07 pm. The next meeting is February 14, 2018.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Nicole Sandkulla", written in a cursive style.

Nicole Sandkulla, CEO/General Manager

NS/le

Attachments: 1) Attendance Roster

BAY AREA WATER SUPPLY AND CONSERVATION AGENCY

BOARD POLICY COMMITTEE – December 13, 2017

Roster of Attendees:

Committee Members Present

Gustav Larsson, City of Sunnyvale (Chair)
Tom Zigterman, Stanford (Vice Chair)
Jay Benton, Town of Hillsborough
Mike Kasperzak, City of Mountain View
Al Mendall, City of Hayward (BAWSCA Chair)
Barbara Pierce, City of Redwood City (BAWSCA Vice Chair) *by teleconference*
Dan Quigg, City of Millbrae
Gregg Schmid, City of Palo Alto

Committee Members Absent:

Randy Breault, City of Brisbane/GVMID (Immediate Past BAWSCA Chair)

BAWSCA Staff:

Nicole Sandkulla	CEO/General Manager
Adrienne Carr	Sr. Water Resources Specialist
Andree Johnson	Sr. Water Resources Specialist
Christina Tang	Finance Manager
Deb Grimes	Office Manager
Lourdes Enriquez	Assistant to the Chief Executive Officer
Catherine Groves	Legal Counsel, Hanson Bridgett, LLP
Bud Wendell	Management Communications

Public Attendees:

Michelle Novotny San Francisco Public Utilities Commission