MINUTES OF THE SPECIAL MEETING
OF THE
BOARD OF DIRECTORS
OF THE
EL TORO WATER DISTRICT
October 19, 2018

President Goldman called the meeting of the Board of Directors of the ELTORO WATER DISTRICT to order at 7:00 o'clock a.m. on October 19, 2018 at the El Toro Water District Administrative Offices, 24251 Los Alisos Boulevard, Lake Forest, California.

Director Freshley led in the Pledge of Allegiance to the flag.

Directors M. SCOTT GOLDMAN, JOSE F. VERGARA, MARK MONIN, FRED ADJARIAN, and KATHRYN FRESHLEY were present.

Also present were ROBERT R. HILL, General Manager/Secretary, DENNIS P. CAFFERTY, Assistant General Manager/District Engineer, JUDY CIMORELL, Human Resources Manager, NEELY SHAHBAKHTI, Finance Manager/Controller, POLLY WELSCH, Recording Secretary, GILBERT J. GRANITO, General Counsel and Richard Babbe, PFM Investment Advisor.

Oral Communications - Public Comments

President Goldman stated that at this time members of the public may address the Board or they may reserve this opportunity with regards to an item on the agenda, until the Board discusses said item later in today's meeting.

There were no public comments.

Items Received Too Late to be Agendized

President Goldman asked if there were any items received too late to be agendized. Mr. Hill replied no.

Investment Workshop

Cash Reserve Investment Workshop

Mr. Hill stated that at the August 16th Special Board meeting the Board directed the District's Investment Advisor, PFM to report on their evaluation of a change in investment strategy that takes into consideration the current and forecasted interest rate environment, current investment maturity dates, and any opportunities to prudently move to shorter term investments.

Mr. Babbe stated that to effect a change in strategy, they will either need to sell existing securities in the portfolio at their current market value or wait for the securities to mature and then reinvest the funds at the then current interest rate levels.

Mr. Babbe stated that interest rates have risen quite rapidly over the past two years, and further increases are expected but will depend on how economic conditions actually develop. He further stated that the strategy has been to actively manage the portfolio using the 1-3 year U.S. Treasury Index as the benchmark, which intends to provide higher average returns over time than a short-term investment with less market risk.

Mr. Babbe stated that to minimize negative impact on earnings, they recommend only selling securities that can be reinvested at a high enough rate to recover any loss on the sale.

Mr. Babbe stated that the third quarter marked the 10th straight quarterly rise in the 2-year yield as the economy remained strong and the Federal Reserve continue to raise interest rates.

Mr. Babbe stated that when evaluating a portfolio's performance, it is important to understand the difference between earnings on a Market Value basis or an Accrual basis. He further stated that Market Value Earnings = Income received + realized and unrealized changes in value. Accrual Earnings = Income received + realized change in value.

Mr. Babbe stated that rising interest rates have two key impacts on a portfolio of securities; 1) they cause market value depreciation of the existing securities in the portfolio which lowers the total return, and 2) the yield on the portfolio will lag current interest rates until the existing securities mature or are sold and reinvested at current interest rate levels.

Mr. Babbe stated that over longer periods of time longer-term portfolios have historically provided higher average returns, and shorter-term portfolios adjust more rapidly to changes in interest rates and often outperform longer-term portfolios when interest rates are rising.

Mr. Babbe stated that the analysis estimates whether the District would earn more by holding existing securities to maturity or by selling the securities and reinvesting the funds under different interest rate scenarios. He further stated that the Hold to Maturity Option assumes that existing securities will be held to maturity and then reinvested at the current reinvestment rate.

Mr. Babbe stated that the Sell/Reinvest Option assumes that a security will be sold and reinvested at the assumed interest rate scenario. He further stated that the analysis used a short-term pool or 6-month commercial paper/negotiable certificates of deposit as the reinvestment option.

Mr. Babbe stated that at this time, PFM's recommendation is that the District sell only those securities that would generate additional earnings if reinvested at current interest rate level. He further stated that they also recommend using the pool option to provide the District with maximum investment flexibility even though it might provide slightly lower earnings than using commercial paper/negotiable certificates of deposit.

Mr. Babbe stated that if interest rates continue to rise, the District could generate additional earnings by selling a greater portion of the portfolio now; however if rates did not rise as much as expected, the District would be worse off than if it held the securities to maturity.

Mr. Hill stated that the Board should provide direction to PFM as to their recommendation for handling the portfolio.

Director Monin stated that currently 1-year CD's are yielding 2.6%, money market is 2.18%, and 1-year commercial paper is at 3%. He asked Mr. Babbe what is the average maturity of the portfolio duration. Mr. Babbe replied that the average is 632 days as of September 30, 2018, and the duration is 1.55 years.

Director Monin asked if PFM could purchase CD's. Mr. Babbe replied no because they don't do FDIC insured because of how the government code is structured.

Director Monin asked Mr. Babbe if PFM is a RIA (registered investment advisor). Mr. Babbe replied yes PFM is an RIA.

Director Monin asked who they clear with. Mr. Babbe replied US Bank which is the District's custodian.

Director Monin asked what the 13% sell off is comprised of. Mr. Babbe replied they would be the securities with the closest to maturity with smallest loss.

Director Monin asked if PFM uses a benchmark, and if so what is it. Mr. Babbe replied that PFM uses Merrill Lynch's 1-3 year US Treasury total return index of 54 basis points for the quarter.

Director Monin asked if the interest rate could increase in December. Mr. Babbe replied that it could increase and continue trending in 2019 depending on the economy.

Director Monin asked if there is anything in hindsight that PFM could have done differently to the portfolio. Mr. Babbe replied that he looks at the long-term effectiveness for the average maturity return on investments.

President Goldman asked if we could move investments once the market changes. Mr. Babbe replied yes.

Director Adjarian asked if PFM recommends that we stay in the pool between 0-1% to get long-term investments rather than purchasing the commercial paper for short-term. Mr. Babbe replied yes.

Director Freshley asked if we go with PFM's recommendation, do we earn approximately $3,000 a year in the portfolio. Mr. Babbe replied that would be better than doing nothing.

Vice President Vergara asked how much money are we talking about in the portfolio. Mr. Babbe replied that on the managed portfolio's market value was slightly over $9 million.

President Goldman asked for a Motion.

Motion: Director Monin made a Motion, seconded by Director Adjarian, and Motion carried 4-1, to 1) follow PFM's recommendation that the District sell only those securities (13% of the portfolio) that would generate additional earnings if reinvested at the current interest rate level, and 2) use the pool option (CAMP/LAIF) to provide the District with maximum investment flexibility even though it might provide slightly lower earnings than using commercial paper/negotiable certificates of deposit.

Roll Call Vote:

Vice President Vergara	aye
President Goldman	aye
Director Monin	aye
Director Adjarian	aye
Director Freshley	no

At approximately 8:07 o'clock a.m. Mr. Babbe left the meeting.

Phase III Recycled Water Project Opportunities

Mr. Cafferty stated that there are potential opportunities for a next phase of Recycled Water. He further stated that based on the 2017/18 fiscal year we sold over 1,000 acre feet of recycled water to the distribution system.

President Goldman asked what phase of recycled water. Mr. Cafferty replied this was from Phase 1 actual sales.

Mr. Cafferty stated that the Tertiary Treatment Plant produced over 3,000 acre feet, over 3,200 acre feet to the distribution system, over 1,200 acre feet to the golf course, for a total close to 4,800 acre feet, or 1.5 billion gallons of recycled water since the inception of the Tertiary Treatment Plant.

Mr. Cafferty stated that the total annual debt service for Phase 1, and now Phase 2 amounts to approximately $2 million.. He further stated that when we look at the performance of potential future projects we will look at the debt ratio. Mr. Cafferty stated that we have a contractual requirement for the SRF loan for the debt coverage ratio of no less than 1.2. He further stated that there is significant cushion between the current generation of restricted reserves and the required amount necessary to supplement recycled water revenues.

Mr. Cafferty stated that alternatives could include Gate 11, Mill Creek, 5 Lagunas Mall, Gate 14, and East I-5 freeway. He further stated that considerations include cost effectiveness, and debt which assumes an SRF loan, at a 2% interest rate, and a 35% grant component. Supply reliability and water quality are also considerations.

Mr. Cafferty stated that Gate 11 is a feasible project which would include conversion of 37 meters supplying a demand of approximately 85 acre feet, Mr. Cafferty further stated that the project would involve the construction of 9,300 feet of distribution system pipeline with total project costs of nearly $4 million.

Mr. Cafferty stated that further conversion of irrigation demand to recycled water could have an impact on potable water quality which will be reviewed during the upcoming Master Plan. He further stated that we are currently performing system flushes due to nitrate buildup and chlorine residual decay in certain parts of the potable water distribution system consumption.

Mr. Cafferty stated that the economic analysis of the Gate 11 project suggests the project would require that a Restricted Reserves draw of $20,000 in the first year with the payback taking 8 years.

Mr. Cafferty stated that Mill Creek combined with Gate 11 makes more sense than Mill Creek alone. He further stated that the debt service is conservative.

Director Monin asked when we will have the Master Plan ready. Mr. Cafferty replied that the RFP is in process and staff has met with several consultants, and should be finalized in another 6 months.

Mr. Cafferty stated that the 5 Lagunas Mall project would convert 46 meters and supply 100 acre feet of recycled water. He further stated that the distribution system would require 26,500 feet of pipe and cost slightly over $9 million.

Mr. Cafferty stated that the 5 Lagunas project would involve a 20 year loan and a $162,000 Restricted Reserves Draw the first year with a payback of 27 years.

Mr. Cafferty stated that Gate 14 project would require the conversion of 13 meters and supply 85 acre feet of recycled water through 5,600 feet of new

distribution pipeline. He further stated that this project would require a pump station because of pressure issues, and the total cost would be just under $5 million.

Mr. Cafferty stated that this project would require $56,000 of Restricted Reserves Draw in the first year, and payback would be in 24 years.

Director Freshley asked if MNWD could provide recycled water to Gate 14 because they already have recycled water pipes in the area. Mr. Cafferty replied that MNWD would charge retail rate to ETWD for the use of their recycled water, and they are facing demand challenges too.

Mr. Cafferty stated that the East I-5 project would require adding a pipeline during CalTrans' reconstruction of the Los Alisos bridge across the freeway. He further stated that the District would have to design the pipeline, and then make a commitment to build the system. Other challenges for this project include crossing the railroad tracks, and building pump stations.

Mr. Cafferty stated that Pheasant Creek could be another part of the East I-5 project.

Director Adjarian asked if there is time allowable to obtain the permits needed for each of these projects. Mr. Cafferty replied that it would be a consideration.

Mr. Cafferty stated that we need to decide if the projects are worth doing in the near future.

President Goldman asked if staff has discussed projects with IRWD for irrigation participation, or connecting with their system.

Adjournment

There being no further business to come before the Board, the following motion was duly made and passed.

Motion: Director Adjarian moved, seconded by Director Monin and unanimously carried across the Board that today's meeting be hereby adjourned at 9:20 o'clock a.m.

President Goldman called for a Roll Call vote.

Roll Call Vote

Director Monin	aye
Director Adjarian	aye
President Goldman	aye
Vice President Vergara	aye
Director Freshley	aye

Respectfully submitted,

POLLY WELSCH
Recording Secretary

APPROVED:

M. SCOTT GOLDMAN, President of
the El Toro Water District and the
Board of Directors thereof

ROBERT R. HILL, Secretary
of the El Toro Water District and
the Board of Directors thereof