Board Questions 10-29-20

p. 49: Social distancing seems like it would make it impractical to hold confined space rescue drills. Does Confined Space Rescue training currently have a drill component?

- The annual training requirement was not waived like the hearing and fit test; training was required so we could continue to enter confined spaces.
- Training was held outdoors, with masks and no staff was closer than 6 feet for more than 15 minutes. Maximum separation of staff was maintained except where necessary. For example, when cranking the winch and guiding the winch.
- There is an annual drill.

p 78: "Corona Road representatives have 31 out of 41 signatures on a petition and have submitted the petition with a letter requesting that the District help them hire and manage consultants to perform the environmental and engineering tasks in order to move forward with an Assessment District to construct a sewer in the neighborhood."

If the 10 refuseniks don't connect now, how will their charges be figured when they want to or must connect later?

The short answer is that they will be charged on the tax roll even if they refuse to sign the petition. Formation of an Assessment District requires a public hearing conducted by the legislative body, an Engineer's Assessment Report and testimony from property owners. A ballot is taken and tabulated. A simple majority is required to proceed. If a majority protest does not exist the legislative body may adopt the resolution confirming the assessments and approving financing.

The Corona Road Assessment District is for the infrastructure improvements only. If the 10 "refuseniks" do not connect now that's their choice. They will commence payment for Assessment bond now. They will pay connection fee when they do decide to connect. And, they will pay user fees after connection.

Will the connection fees of those who connect later be the same actual value as the connection fees of those who connect at inception, or the same nominal value, or some other value based on reassessment of the values of CAWD's assets?

The connection fee will be whatever is approved for the year they connect, that is to say, if they connect in 2025, they will be charged the 2025 rate. Typically the Board approves connection fees annually.

p. 94: "A $500K investment in the CEPPT could potentially yield $25K in investment earnings over the course of a year as opposed to an estimated $10K in the Monterey County Treasury."

As opposed to the County Treasury, could it potentially yield less? Could it potentially yield negatively?

Yes, it could yield less. The yield is not guaranteed.
However, the longer the funds are in the trust the probability of it returning a negative decreases. In addition, to rate of return, it has a risk factor with a standard deviation which has a 68% likelihood that in any one-year time period the returns would land in that range. The expected volatility is 8.72% (per CalPERS) meaning a range of -3.72 to 13.72. The likelihood of positive return is much more apparent than negative. In terms of running a Section 115 trust CalPERS has 13 years of experience and their lowest return was 4.71%. Additionally, it is highly unlikely to be negative in successive years. Even during the global financial crisis of 2008 the return was 5.15%.

"While the District is long term strategically positioning itself to meet its significant future capital needs, managing CalPERS liabilities should be part of that strategy."

Was it ever not? As a member of the budget committee who proposed raising funds for what surely was to be an impending contribution increase, I find the statement above erroneous.

Perhaps it would have been more accurate to state that this policy originated with the Budget Committee.

Perhaps? Delete "perhaps".

p. 109: Which CEPPT investment strategy is it proposed that the board select?

I am not making any recommendation at this time. The recommendation is that the strategy selection start in the Pension Committee and then be reported to the full Board (Item #5 under staff report Recommendation).

Nonetheless, in selecting a strategy the District should ask what its goal is – build a reserve or maintain cash flow to make annual payments. Best practices (per CalPERS) would be to have funds in LAIF or County Treasury and then split funding equally into Strategy 1 and Strategy 2. Strategy 1 is more growth focused and Strategy 2 is still growth, but less aggressive.

For the purposes of this staff report that would mean $250K into Strategy 1 and $250K into Strategy 2. The funds can be reallocated at any time if desired.

CalPERS made a decision some time ago to use leverage. Their last CEO departed a few months ago after a brief tenure. I think the decision to leverage was adopted by its board while he was in office.

Are CEPPT programs insulated from leverage?

Yes, the investment policy for CalPERS pension and CEPPT are different. CEPPT does not allow for leverage.

What are the potential conflicts of interest in having our pension fund also manage our auxiliary fund(s)?

Any conflict is mitigated by CEPPT not competing with CalPERS directly. Our expected rate of returns only 4-5% vs pension. Pension, as wells as CEPPT, have different have different standard deviation of risk. Pension has better long term rates with higher risk associated. CEPPT portfolio characteristic of high liquity unlike PERS which is long term. And, the only way anyone gets any money out of CalPERS is via a benefit payments to employee. CEPPT is structured to allow employer to make the decision on how money is paid out.

Is there possibly a benefit to be realized from widening our portfolio by contracting with another provider? There could be a sort of "house" investment philosophy in any one or all of these providers that makes a portfolio approach beneficial.

The CEPPT is actually a very diversified portfolio. (Consider that they have over 8,000 holdings in global equities alone). There is no benefit diversifying between different providers, the benefit would be in the portfolio holdings. CEPPT has so many different categories that it allows considerable diversification compared to a provider that only offer say 40 options (example only).

Has the pension committee received presentations from other fund providers?

The Pension Committee received a presentation from PARS. PARS is the primary competitor for CalPERS Section 115 Trust. The other competitors that I'm aware of are

Keenan and PRM, much smaller players in the market so we did not entertain a presentation. (Interestingly Keenan is our health insurance broker.)

CalPERS is so much larger than any of its competitors that they can offer the advantages of scale to smaller employers. PARS fees are higher than CalPERS CEPPT.

Has the pension committee made informed comparisons of CEPPT with the programs of other providers of these services to ascertain whether their risk-return profiles are sufficient to defray administrative costs and potential transfer fees and end up in the same or better position?

The Committee invited PARS to make a presentation and looked at their services and profile. Their investment options included 5 active and 5 passive options, but for the moderate option it was similar to CEPPT. (We would not be likely to recommend either a low or a high-risk option. We're all about moderation on the Committee). All things being equal, the fee structure was a major factor in making a decision.

Should CAWD leverage its investment in CEPPT? If the likelihood of positive return "is much more apparent than negative", would that be a tactic to consider?

Are you referring to pension obligation bonds? You can potentially get an issue at lower rate then turn it around and use that money in pension where you're supposed to get higher rates. It is not a operating procedure currently advised as best practices from Treasury Associations because of risk. You're gambling in a sense.

p. 113: In what sense are these risk:return comparisons "efficient" and "frontier"?

For those that are unfamiliar with the term let me offer a brief definition: The efficient frontier is a set of optimal portfolios that offer the highest expected return for a defined level of risk or the lowest risk for a given level of expected return. Portfolios that lie below the efficient frontier are sub-optimal because they do not provide enough return for the level of risk. Portfolios that cluster to the right of the efficient frontier are sub-optimal because they have a higher level of risk for the defined rate of return. An efficient frontier graph typically plots the expected return on the y-axis and risk as measured by standard deviation on the x-axis.

The graph on page 113 refers to the creation of CEPPT and why CalPERS chose strategies 1 and 2 in terms of 4% and 5% expected return. It speaks to how CalPERS designed the program. In order to be efficient, they wanted to be better than LAIF/County Treasure but to not compete with PERS. On the graph you see that 3.5%

is not very efficient because the line is nearly vertical. But at 5% you start to see the line flattening a bit. To get greater return one has to be willing to accept more volatility. At 5.5% it starts to compete with CalPERS pension. They did not want to compete with the pension plan itself. If that were the case one would just put money into CalPERS and allow it to work, no point in creating a program that is identical.

pp. 120 – 124: Please supply explanation.

Page 120 is to show the power of compound interest model. If you leave the money in for more than 3 years you start to experience the benefits of compounding.

Page 121 is about the duration of investments and expectations. Assuming 5% return, and you contribute $17.5M than in 8 years you would have $25.9M. Saves approximately $8.4M from general funds. Additionally, it shows that the normal contribution today (19-20) is $20.1M

Page 122 also shows the power of compounding interest and how the more time you leave funds invested the less money you have to come up with. And agency can invest $16.3M knowing that in 10 years they will need to use it and have $27.9M.

FYI: Normal costs are the costs that are created for the employer to keep funding day-in day-out expense of keeping employees in CalPERS. Also known as the actuarially determined present value of retirement benefits earned by plan participants in the current period based on existing pension benefit formula.

Page 123 is the same concept as page 122 except this time instead of Normal Cost it is UAL. If an agency deposited $43.7M in eight years they could have $64.5M saving themselves $20.8M

Page 124 is similar to page 123. The tie frame starts to pick up and be more beneficial. One could use the money as soon as costs ae incurred, but the longer you wait the better for benefits of compounding.

p. 127: <u>Annualized</u> 25 bp fee skimmed daily?

Daily
25 basis points divided by 365 x $ assets managed on that day

Funds are locked into trust. Fees increase. Are our options to move to another administrator or let our UAL increase and pay it down with the funds to zero out our participation?

Three ways to change:

1. Stop contributions and liquidate assets as debt is incurred
2. Stop contributions and transfer all funds to pension
3. Stop contributions and transfer to another administrator

p. 146: How will the investment committee interact with the budget committee to propose increases or absence of increases in further contributions?

The same way the pension committee currently interacts – its meetings are reported to the full board and open to questions. While not written in stone, I see the pension committee reporting to the full board and making recommendations.

Timing is the issue. Would the pension committee make recommendations on a timely basis such that they are acted upon by the board before the budget committee deliberates on the budget? They will certainly make every effort. Currently the Pension Committee meets quarterly; however, there is nothing that precludes the committee from meeting more frequently if required.

This idea of investing outside of our pension investment vehicles to bolster our returns to defray some of our obligations previously was suggested for our smaller pension pot. Will that be proposed in future? Are you referring to the SAM plan? If so, the Pension Committee has decided on a strategy of "income and growth". If you look back at the SAM returns it has done nearly as well as CalPERS with a Total Weighted Return 01/01/20 to 07/20/20 of 3.92%. There was some discussion earlier this year to change the mix from 60/40 stocks/bonds to 70/30 but analysis showed the shift would only result in approximately a 1% difference over the prior year. Speaking solely for myself, I prefer to be fairly conservative with the SAM because it is a pension fund with current and relatively short-term obligations to pay out. The time horizon on CalPERS obligations is much longer. At this time there have not been any Pension Committee discussions to invest the SAM outside of its current parameters.

Is there an immediate need to enroll in this plan given that we skinned our budget down this year to accommodate Covid derived economic disruptions to the community and reasonably can expect to tap reserves for unknowns and budget overruns? We have $15M in our reserves. It is unlikely we will need to utilize the entire $15.6M. The recommended contribution is 3.25% of reserves – a small percentage. The benefit of enrolling now is the case for compound earnings. We are earning very little at Monterey County (June 30, 20 yield = 1.8%) I believe I would quote Ben F. and say that in this case "don't put off until tomorrow what can be done today"

Why would we not enroll in seven months after we incorporate the funds into our next budget? This is a fund transfer from the County to a Section 115 plan. It would not be a budgeted item, and therefore there is no reason to wait for next year's budget.

What is the size of CPPT relative to CalPERS' pension fund?

Size of CEPPT	$12M
Size of CERPT	$12B
Size of CalPERS	$400B

p. 147: What is the immediate source of the $500k?

District Reserves, currently $15M (see page 12 of board packet)

Please Note: there will be a representative from CalPERS available to answer questions on Thursday morning.

Prefer to hear things from you. Your explanations demonstrate your understanding. Your reputation stands behind any decision that you propose and the board adopts. The CalPERS representative's reputation would not suffer similarly if the end result is worse than is forecast.

The CalPERS representative is an investment "expert". Their presence is intended only to give the Board an opportunity to ask any additional questions directly to CalPERS, if they wish. If you have no questions for them that's fine too.

Board Questions 10-29-20

1 As the District extends its collection system out into Carmel Valley are we upsizing lines? Is the line size sufficient for future users?

The short answer is yes. The District has had Capacity Studies performed by V&A Consulting Engineers in 1999 and West Yost Associates in 2015-present. As a part of its Hydraulic Study, West Yost Associates identified capacity deficiencies for our long-term capital program. The draft hydraulic study Tech Memo was completed in December 2016. That information was updated in June 2018 and incorporated into the District's Asset Management Plan completed in Dec 2018. Going forward the District will utilize current flow data to evaluate the system for future projects and to appropriately size the system for future users.

2 P. 94 Complimented staff on supporting rationale behind "Fiscal Impact" section of staff report

3 P. 60 Please add a dollar amount for #20-06 Collections 20-Yr CIP

Staff will correct this item on next agenda packet.

Program Year	Gravity Sewer $	Pump Station $	Force Main $	Total Cost $
Years 1-5	4,996,000	775,000	500,000	6,271,000
Years 6-10	4,919,000	975,000	150,000	6,044,000
Years 11-15	5,070,000	325,000	-	5,395,000
Years 16-20	5,002,000	325,000	-	5,327,000
Subtotals	19,987,000	2,400,000	650,000	
Total Construction Costs [a]				**23,037,000**
30% Engineering, Legal, Administration, etc.				6,911,100
Total Capital Costs				**29,948,100**
[a] Includes 30 percent construction cost contingency				

In January 2018, the Board accepted the Wastewater Collection System Asset Management Plan (AMP) prepared by West Yost Associates. In the AMP, West Yost identified over $58M in pipeline repairs/replacements needed throughout the system, including engineering and contingencies. Of the $58M identified, 8% of the system was identified as "high risk" with an attached cost of $9.8M and 25% of the system was identified as "medium-high risk" with an attached cost of $23.3M. District staff is prioritizing projects in the budget such that these projects are scheduled for repair/replacement prior to lower risk projects.

In addition, a risk assessment was completed for the District's pump stations and associated force mains. Rehabilitation of Calle la Cruz and Bay/Scenic pump stations were the highest priority for the next five years. Costs associated with recommended rehabilitation of the pump stations, associated force mains and gravity sewers for the next twenty years is shown above (staff report 01-31-18)