

**SAN BERNARDINO VALLEY WATER CONSERVATION DISTRICT
MINUTES OF THE FINANCE & ADMINISTRATION COMMITTEE MEETING**

January 20, 2016
1:30 P.M.

Chairperson McDonald called the Finance & Administration Committee Meeting to order at 1:35 p.m.

FINANCE & ADMINISTRATION COMMITTEE MEMBERS PRESENT:

Melody McDonald, Chairperson
David E. Raley, Director

FINANCE & ADMINISTRATION COMMITTEE MEMBERS ABSENT:

None

STAFF PRESENT:

Daniel Cozad, General Manager
Jeff Beehler, Land Resources Manager
Angie Quiroga, Administrative Services Specialist

GUESTS PRESENT:

Ellen Clark, PFM Asset Management LLC
Lesley Murphy, PFM Asset Management LLC

1. PUBLIC PARTICIPATION

Chairperson McDonald announced this as the time for any persons present, who so desire, to make an oral presentation to the Committee. Hearing none, the meeting continued with published agenda items.

2. ADDITIONS/DELETIONS TO AGENDA

There were no additions or deletions to the agenda.

3. APPROVAL OF MEETING MINUTES FROM NOVEMBER 16, 2015

It was moved by Director Raley and seconded by Chairperson McDonald to approve the minutes of the November 16, 2015 Finance & Administration Committee Meeting. The motion carried with all members present voting in the affirmative.

Chairperson McDonald: Yes

Director Raley: Yes

4. PFM ASSET MANAGEMENT REVIEW OF DISTRICT'S STATEMENT OF INVESTMENT POLICY

Ellen Clark and Leslie Murphy, both Senior Managing Consultants at PFM Asset Management LLC (PFM), introduced themselves. Ms. Clark explained PFM was hired to assist with formulation of the plan to invest Wash Plan Habitat Conservation Plan monies that are being put into an endowment.

A portfolio planning survey was sent a couple of weeks ago to determine your risk perspective and objectives. This survey was the basis used to conduct PFM's Asset Allocation Study (Study). Melody McDonald noted the desired investment return is 4% plus inflation. Ms. Clark recommends striving to achieve a 4 ½% over inflation return to allow for a ½% cushion to cover investment fees that are associated with investing money. The Study is based on a 6 1/2 % return with inflation of 2%. Real rate of return is net of inflation and a nominal rate of return includes inflation. Total return includes dividends and interest as well as capital appreciation or in some cases depreciation. Ms. Clark stated the endowment will be invested in stocks and bonds and there will be some trading of stocks and bonds to take advantage of price increases and decreases and reallocation. PFM is hiring investment managers that may do some trading of your stocks and bonds. She discussed capital markets and segments of capital markets and different asset classes that PFM looks at to invest in.

Ms Clark stated there has been a bull (strong) market in bonds for the past 30 years but they don't anticipate this will continue. Their opinion is that the only way to get real return on our money is to invest in a diversified portfolio, limiting exposure to bonds in the intermediate period. She discussed the S&P 500 index as a measure of the U.S. market and the EAFE index as a measure of the world market comparing price/earnings ratios and yields. She explained these are some of the areas portfolio managers look at, determining relative value and risk, to decide where they should invest money. She discussed drivers of GDP growth and stated since the US and other countries like China don't have as many people coming into the work force as are coming out, a lot of GDP growth is not expected. The world GDP is currently being led by the emerging market economies. PFM is not currently investing in emerging markets because of the risk. From a price standpoint however they are getting more attractive. Ms. Clark showed diversification benefits. By blending domestic stocks with international stocks at a ratio of 65/35, studies show we can get similar to better returns with more muted or managed risk. Discussion ensued. She provided valuations: price/earnings ratios for S&P 500 stocks and the EAFE index and price/book ratios for emerging markets since 2001.

A small portion of the portfolio would be invested in International Small Cap stocks: small companies outside of the U.S. They provide a diversification benefit with a currency effect in which they tend to be only in their local currency and not multi-national. Depending on the stage of the investment cycle, small companies tend to lead the way out of recessions and potentially benefit from government stimulus. As far as stocks are concerned, risk is higher in emerging markets than developed markets and a little higher in developed markets than in domestic markets. Ms. Clark discussed fixed income investments such as bonds. She noted due to 30 years of declining rates in fixed income investments, the same push seen in balanced portfolios in recent years won't keep happening, By blending different types of bonds, we will have a diversification benefit and are able to manage risk and get a little better return. Discussion ensued.

PFM has recently sold out of their 2 ½% dedicated portfolio of high yield (risky) securities due to pricing, high default rates and credit worthiness of the companies behind the bonds. They are continuing to examine bank loans for a small allocation of the fixed income portfolio since bank loans typically give good yields and very reliable returns. Emerging market debt as a percentage of GDP has gone up dramatically, especially in China, since 2010. For this reason, PFM is not currently investing in emerging market debt. They are currently investing 3-4% of the portfolio in treasury inflation protection securities (TIPS), zero coupon bonds, which PFM believes will provide a cushion to the potential de-valuation of

the rest of the portfolio. David Raley stated his view is that we are looking for a steady return, not to maximize our profits by taking more risk. Discussion ensued.

A projected return table was provided which listed a few asset classes PFM believes will be able to achieve the 6 ½% return needed for the endowment. All factors that influence capital markets were taken into consideration. The options were discussed. PFM conducted a modeling exercise with three portfolio options using the following asset allocations (stocks/bonds): 50/50, 60/40, 70/30. Based on capital market assumptions, none of the portfolio options are expected to obtain 6 ½ % over the next 5 years. Long-term assumptions anticipate all options will obtain over 7%. Ms. Clark and Ms. Murphy recommend a 60/40 or 70/30 portfolio to get as close as possible to the return desired. In the future, you may be able to reduce stocks and increase bonds to reduce risk. Discussion ensued.

Once a decision is made regarding asset allocation, it will be memorialized in an investment policy. Mr. Cozad stated the Board of the non-profit, the District's Board and the Wash Plan stakeholders will all have to agree on the investment policy. Chairperson McDonald requested a second Finance and Administration Committee meeting take place prior to the February 10, 2016 Board meeting in order have more time to consider the three options before making a decision on what the Committee will recommend to the Board.

5. 2ND QUARTER ANNUAL UNAUDITED FINANCIALS REVIEW

It was moved by Chairperson McDonald and seconded by Director Raley to send the 2nd quarter financials to the Board for approval. The motion carried with all members present voting in the affirmative.

**Chairperson McDonald: Yes
Director Raley: Yes**

6. ADJOURN

It was moved by Director Raley and seconded by Chairperson McDonald to adjourn. The motion carried with all members present voting in the affirmative.

**Director Raley: Yes
Chairperson McDonald: Yes**

There being no further business, the meeting adjourned at 3:30 p.m.