

**MINUTES OF THE
MOULTON NIGUEL WATER DISTRICT
FINANCE & INFORMATION TECHNOLOGY
BOARD OF DIRECTORS' MEETING**

JANUARY 19, 2011

The regular meeting of the Finance & Information Technology Board of Directors was held at the District office, 27500 La Paz Road, Laguna Niguel, California, at 9:00 a.m. on Wednesday, January 19, 2011. There were present and participating:

DIRECTORS

RICHARD S. FIORE	President
SCOTT COLTON	Director
DON FROELICH	Vice President
LARRY R. LIZOTTE	Director
LARRY MCKENNEY	Director
BRIAN PROBOLSKY	Director

Also present and participating were:

STAFF MEMBERS

ROBERT C. GUMERMAN	General Manager
DAVID D. CAIN	Director of Finance/Treasurer
MATT COLLINGS	Director of Engineering
CHARLES J. ROY	Director of Customer Service
NANCY DESAI	Controller
JANE NGUYEN	MNWD
LESLIE GRAY	MNWD
KARREN MADDOX	MNWD
MARK MOUNTFORD	MNWD
FRANI BAILEY	MNWD

DISTRICT CONSULTANTS

JENNIFER FARR	Mayer Hoffman McCann
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Absent was:

GARY R. KURTZ	Director
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President Richard Fiore called the meeting to order and Frani Bailey recorded the minutes thereof.

ACTION ITEMS

Financial Policies

- **President Fiore asked Mr. Cain and Ms. Desai to contact CalPERS and get an answer to Director Lizotte's question regarding risk management.**

APPROVAL OF MINUTES OF DECEMBER 15, 2010 FINANCE & INFORMATION TECHNOLOGY BOARD OF DIRECTORS MEETING

President Fiore requested approval of the minutes of the December 15, 2010 Finance & Information Technology Board of Directors meeting.

THEREAFTER, UPON A MOTION DULY MADE BY DIRECTOR MCKENNEY AND SECONDED BY DIRECTOR FROELICH, THE MINUTES OF THE DECEMBER 15, 2010 FINANCE & INFORMATION TECHNOLOGY BOARD OF DIRECTORS MEETING WERE UNANIMOUSLY APPROVED AS PRESENTED.

PUBLIC COMMENTS

President Fiore inquired if there were any members of the public who wished to comment. Hearing none, he closed the public comments portion of the meeting.

PRESENTATION ITEMS

None

DISCUSSION ITEMS

Discuss Investment Policy

President Fiore commented that Mr. Ted Pirokowski from Chandler Asset Management is in attendance via teleconference for purposes of contributing to the discussion on the District's Investment Policy. He turned the discussion over to Mr. David Cain.

Mr. Cain reported that at the Investment Board meeting on Monday Mr. Pirokowski presented an update of the quarterly return and reviewed two items in the Investment Policy. He reported that one of the areas Mr. Pirokowski discussed was Section IV-C on Page 3. Mr. Cain reported that Mr. Pirokowski explained that this section is in conflict with the remainder of the Investment Policy, which talks about the District's desire to invest out to ten years, and that the remainder of the Investment Policy relates to market cycle. He explained that in order to comply with Section IV-C Chandler would potentially have to sell some of the District's longer-term securities immediately to shorten the duration, which could result in a loss to the principal. If

Section IV-C were removed it would allow Chandler over a market cycle to make adjustments over a period of time.

Mr. Cain reported that Mr. Pirokowski recommended that Section IV-C be removed from the Investment Policy. President Fiore commented that on Monday the Board was considering three options for dealing with Section IV-C: making no change, changing “one year” to “market cycle,” and changing “one year” to a longer period, such as three years. He reported that the Board asked staff on Monday to come back with a recommendation as to which of those three options it would ask the Board to adopt. Mr. Cain reported that based on the feedback from the Board staff had further discussions with Mr. Pirokowski regarding what the recommendation should be and Mr. Pirokowski provided staff with some historical charts outlining what took place when those situations occurred in the past. Mr. Cain reported that the charts indicated that in every instance at some point the market came back; therefore, if the District were to remove Section IV-C and open it to a market cycle it would allow staff to at least protect the principal portion of the District’s investments.

President Fiore asked Mr. Pirokowski to review the risk he discussed on Monday relating to how Chandler would have to potentially sell off assets in a low interest rate environment in order to comply with the Investment Policy as it is currently stated. Mr. Pirokowski explained that in order to mitigate the possibility of failing to meet the investment performance objective Chandler would have to sell securities to shorten the risk profile. He explained that in the past Chandler has been able to manage through this constraint because of the much higher interest rate environment; however, given the present duration of approximately 3.43 years, if the District were to experience a 200 basis point parallel move the portfolio would sustain an unrealized loss of 6.86%. Mr. Pirokowski reported that the portfolio’s book income is 3.11% and the District would realize something higher than this because as rates rise the yield would increase slightly; however, the portfolio would still experience a 2% to 3% loss.

Mr. Pirokowski reported that Chandler feels that interest rates could go up and probably won’t go down much lower and the portfolio is at risk based on this provision of the Investment Policy. He reported that no one is sure why Section IV-C was included in the Investment Policy; however, it could have been a reaction to the Orange County Bankruptcy. Mr. Pirokowski explained that in today’s environment the District does not have the buffer of income to offset

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the rising rate risk and Section IV-C makes it prohibitive for Chandler to manage the portfolio without changing its overall risk profile, which would require shortening the duration.

President Fiore commented that Mr. Pirokowski indicated on Monday that among the municipal agencies Chandler represents Section IV-C is an uncommon provision and recommended that Section IV-C be removed from the Investment Policy.

Director Probolsky arrived at 9:12 a.m.

President Fiore commented that when Mr. Pirokowski reviewed the Investment Policy he had only two recommendations, the second of which pertained to Section VI-B-3 on Page 5. Mr. Cain reported that this section currently reads “Over a market cycle, the duration of the Operating Reserve Fund may vary within a range...,” and Mr. Piorowski suggested that “may” be changed to “typically will.” A discussion ensued and the Board concurred with Mr. Piorowski’s recommendations and Mr. Cain reported that staff would bring the revised Investment Policy before the Board tomorrow night for adoption. President Fiore thanked Mr. Pirokowski for his participation in the meeting.

Financial Policies

Mr. Cain reported that staff is bringing this matter to the Board to address some discussion items from the past relating to the budget and appropriations during the year and to begin to put in writing the overall financial policies of the District. He reported that some of the policies, such as the Reserve Policy, have more detailed adopted policies behind them. Mr. Cain reported that the day-to-day guidelines and procedures developed to implement the policies are to be defined by the General Manager and staff.

Director Lizotte directed the Board’s attention to the paragraph on Risk Management and asked what the District’s liability is if some of the agencies in the District’s CalPERS pool are unfunded and if staff is looking into this. Mr. Cain explained that the Risk Management paragraph indicates that the District wants to be proactive in communicating its concerns to CalPERS regarding what is important for the District and for the pool. Further discussion ensued and President Fiore asked Mr. Cain and Ms. Desai to contact CalPERS and get an answer to Director Lizotte’s question.

Director McKenney commented that staff does a CIP update every year even though the budget is done every two years and asked if this creates any problems. Ms. Desai explained that

staff does an O&M budget every two years and the CIP budget is done each year. The Directors continued their review of the Financial Policies and provided staff with their comments and suggested revisions. President Fiore asked if the Financial Policies document is on the agenda for the Board meeting and Mr. Cain reported that it is not, and was a discussion item for this month. He reported he would incorporate the Board's input and bring a revised document to the Board for discussion in February. Director Probolsky commented that although the Board is very comfortable with Mr. Cain, Dr. Gumerman, and staff, it would be good for Mr. Cain to read the Financial Policies with the eye of a new General Manager or new Finance Director who has no history of the District.

Mayer Hoffman McCann Letter

Mr. Cain reported that he provided the Board with copies of a letter to the District from Mayer Hoffman McCann regarding the quality control review report on Mayer Hoffman McCann done by the California State Controller's Office and notifying the District that Mayer Hoffman McCann has engaged the CPA firm of Carr Riggs & Ingram, LLC to perform a peer review of the quality of its audit practice. He recommended that the Board not make any decisions on whether to retain Mayer Hoffman McCann as the District's Auditor until the peer review has been completed. Mr. Cain reported that Ms. Jennifer Farr, who has performed the District's audit on behalf of Mayer Hoffman McCann for the last four years, is present to answer the Board's questions.

Ms. Farr commented that it is appropriate for the District to be concerned and the Board is doing the right thing by obtaining all of the information before making a decision about Mayer Hoffman McCann's audit contract with the District. She commented that Mayer Hoffman feels that the report by the State Controller's Office mischaracterized the quality of work Mayer Hoffman did, that the findings in the report do not support its conclusions, and that it was perhaps more of a political document than an accurate review of the quality of Mayer Hoffman's work.

Ms. Farr reported that Mayer Hoffman considers the firm it has commissioned to do the peer review to be the most respected firm doing quality reviews. Ms. Farr explained the extent of the peer review that would be done and answered the Board's questions. She asked that the Board defer making a decision about continuing to work with Mayer Hoffman until February
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when Carr Riggs & Ingram's report has been completed, at which time the Board will have the peer review and the report from the State Controller's Office to review. President Fiore thanked Ms. Farr for coming to the meeting.

Review Financial Statements for the Period Ended December 31, 2010

Ms. Desai reviewed the Investment Activity Summary for the period of 12/1/10 through 12/31/10. She commented that the District has an \$11.8 million balance in LAIF because the District received the December installment of property tax revenue in the amount of \$8 million. Ms. Desai reported that a portion of the funds will be used to pay debt service in February and March and the remainder will be invested.

Ms. Desai directed the Board's attention to the Restricted Trust Accounts and noted that the 1993 COPs trust reserves balance of \$394,000 was refunded to the District in January. She explained that when the District originally obtained the CIEDB loan CIEDB did not know what mechanisms to use to attach a covenant of a reserve and added its reserve requirements to the 1993 COPs, and the reserve amount has now been refunded.

Ms. Desai reported that the 2010 COPs Trust Reserves balance of \$10.4 million is related to the refunding of the 1993 COPs issuance; therefore, for all intents and purposes the 1993 COPs are defeased but the bonds will not be callable until March and September. She reported that approximately \$7 million of the \$10.4 million will be paid off in March and \$1.6 million will be paid off in September.

Ms. Desai reviewed the Budget Comparison for the six months ending December 31, 2010. She reported that there are two things not included in the Budget Comparison that were approved last month; the additional appropriation of \$132,000 for the EOC Feeder and the additional appropriations for SOCWA. Ms. Desai reported that these two items will be on the January report. She reported that the expenses are in line with the budget. Director Lizotte asked why there is a difference between the adopted budget and the adjusted budget and Ms. Desai reported that the District has expended the Contingency Line Item. Further discussion ensued and Ms. Desai and Mr. Cain answered the Board members' questions.

Ms. Desai reviewed the Comparative Income Statement for the year-to-date ending December 31, 2010. She reported that water sales are up 6% and recycled water sales are 6% lower than last year. Ms. Desai reported that this is attributable to conservation and the amount of

rain we have had. She reviewed footnote No. 10 regarding the amortization of bond issuance costs and answered the Board's questions regarding the Comparative Income Statement.

Ms. Desai reviewed the Budget vs. Actual Report for the six-month period ending December 31, 2010. She reported that she revised Pages 4 and 5 to separate out the General Fund and the Capital Improvement Funds to give the Board more of a cash-flow scenario for the General Fund by showing the beginning fund balance and the sources and uses, which are typically shown in the Budget vs. Actual report. Ms. Desai noted that she added a Projected Fund Balance in General Fund line item and explained that the balances for the General Fund would tie into the 10-year cash flow at year end. She continued her review of the Budget vs. Actual Report and answered the Board members' questions. Ms. Desai reported that Page 5 of the Budget vs. Actual Report – Capital Improvement Program is broken out into the three funds; R&R, Water Supply Reliability, and Planning & Construction. She reviewed Page 5 and answered the Board members' questions.

Ms. Desai reviewed the Summary of Disbursements for the month of December 2010, which staff will ask the Board to receive and file at the Board meeting on Thursday.

INFORMATION ITEMS

ISDOC Election

Dr. Gumerman reported that he distributed to the Board information on the Independent Special Districts of Orange County (ISDOC) election. He reported that this matter is an action item under the General Manager's Report at the Board meeting tomorrow night and he thought the Board might want to review the qualifications of the candidates.

ADJOURNMENT

THEREAFTER, UPON A MOTION DULY MADE AND SECONDED, THE MEETING WAS ADJOURNED AT 10:40 A.M.

Respectfully submitted,

Frani Bailey
Recording Secretary