RECORD OF PROCEEDINGS

CHERRY CREEK VALLEY WATER AND SANITATION DISTRICT

REGULAR MEETING OF THE BOARD OF DIRECTORS

JANUARY 18, 2018

The regular meeting of the Board of Directors of the Cherry Creek Valley Water and Sanitation District was held at the District Offices, 2325 S. Wabash Street, Arapahoe County, Colorado, at 7:00 p.m. on January 18, 2018.

PRESENT
Paul Hanley – Chairman
Mark Lampert – Vice Chairman
William MacPhee – Secretary/Treasurer
Frederick Norman – Director
Bradley Rastall – Director

OTHERS PRESENT
John Warford – Manager
Lisa Glenn – Office Manager/Accountant
Chuck Buchanan – Maintenance Supervisor
Darryl Farrington – Semple, Farrington & Everall, P.C.
Eric Hein – Merrick & Company
Jonathan Fung – Bernstein
Walker Williams - Bernstein

Chairman Hanley called the meeting to order at 7:02 p.m.

The Board unanimously approved the agenda.

The first item on the agenda was the investment report from Mr. Fung and Mr. Walker with Bernstein. Mr. Fung started off summarizing the portfolio. The return for 2017 was 2.9% and a total return since inception of 27.6%. The credit quality of the portfolio contains mostly AAA and AA Bonds and the average coupon yield is just shy of 5%. The yield at Bernstein is stronger than the treasury portfolio the District has at Morgan Stanley and it's expected to continue. The Federal Reserve is expected to continue rate hikes in 2018, probably four rate increases compared to three last year. This expectation is due to strong local and global economies and the recent tax reform that's just been passed. Fed fund increases have a greater negative impact on shorter bonds than intermediate bonds. The District's portfolio at Bernstein is in the intermediate duration at four years. Rate increases also have a more negative impact on US

Treasuries than municipal bonds. Municipal bonds will also benefit from a lower expected supply with continued strong demand. In the tax reform there's a provision that is preventing or negating advanced refunding in municipal bonds. Municipal supply from that one aspect will drop by 16%. There was only a small decrease in the top marginal tax rate from 39.6% down to 37%, which means that high income earners will still have strong demand for the tax free nature of municipal bonds. Municipal interest was not capped. The short treasuries the District holds at Morgan Stanley will likely have a greater negative impact from interest rate increases and supply and demand since there is no lack of supply of US Treasuries. The District's total portfolio is only a quarter municipal bonds and three quarters in treasuries. Bernstein recommends moving more investments to municipal bonds.

Mr. Williams then took the lead. Interest rate increases can hurt the portfolio in the short term but over the long run if the bonds are held to maturity, the District will get its capital back. There is broad based economic growth around the world supporting the valuations in the fixed income and equity market. Economic growth is expected to sustain at about 3% GDP, continued improvement in unemployment and productivity. If inflations starts to get hot it could create an adverse position for the District's bond portfolio. Recently there have been high returns in the market and low volatility. Bernstein's forecast is more moderate returns in equities and fixed income at somewhere around 2% with higher swings of volatility. Active management, especially yield curve management, will be needed. Moving down in credit quality increases yield. Two percent is the target return in this environment of rising interest rates. Unemployment and inflation have been very low. If inflation increases the Fed has to contain inflation by raising rates. If inflation really takes off, the rate increases will be more aggressive which creates move negative returns for bonds. With the great numbers the economy is having now, it is surprising that inflation hasn't crept up, but it hasn't happened yet. Inflation may be coming. Another item that may cause volatility in the bond market is the difference between the Feds expectation of raising the Fed Funds Rate as compared to Market expectations. If inflation moves up, the market will need to adjust. Mr. Fung added that Bernstein feels that inflation should have been higher at this point. For the low unemployment that's been experienced, wage growth has not increased to the extent expected. At 4% unemployment, wage growth is typically north of 5% and right now it's sitting at around 3%. At some point employers will need to pay more and when that happens inflation will likely heat up. Positioning the portfolio for rising interest rates early takes the worry away from the timing of this event.

Mr. Walker said Bernstein drove returns in 2017 by going a little bit longer in duration as rates fell. They also shifted the credit rating from AAA to more AA bonds. In 2018 there will also be more AA positioning and bring in the duration to about four or five years. If there's ever an issue with the portfolio, Bernstein is actively managing it to fix any problems. For inflation, Bernstein recommends a Consumer Price Index (CPI) swap on top of the bonds. It is essentially and insurance policy against inflation. If inflation takes off the CPI swap pays off on top of the bonds. You only allocate a part of the portfolio to a bond inflation sleeve, typically less than ten percent of the portfolio. Mr. Farrington asked if the CPI swap is authorized by the investment statute the District must comply with and Mr. Fung said they will double check. Chairman Hanley said that if inflation does not occur, then you lose on the swap. He also said that if the bonds are held to maturity, the market rates don't really matter. There's generally cash in the Morgan Stanley portfolio that could be invested in treasuries and if they're held until maturity, the year to year losses don't matter. Mr. Fung stated that the bonds generally earn a higher rate than treasuries. There's not a negative trade off here. If the District invests more in municipal bonds and rates don't rise, you're still getting the higher income yields than in cash or short treasuries. If rates do rise, you still get the higher income with more buffer and protection from rising interest rates than US Treasuries. The only thing that could happen is if municipalities have a tough road from a financial standpoint but Bernstein does not see that in a growing economy. Municipal revenues are up and stronger than they've ever been. At some point the Fed has to start liquidating their balance sheet and a lot of those are treasuries. Quantitative easing is still going on because whenever the treasuries on the Fed balance sheet mature, they buy new ones. One way for them to slow play it is to just stop buying treasuries. The Fed being a net seller creates a slower demand and more supply. Chairman Hanley said to put investments on the agenda for next month. The Board thanked Mr. Fung and Mr. Walker for the report and they left the meeting at 7:40 p.m.

Next the Board unanimously approved the consent agenda approving the December 12, 2017 minutes, the December 20, 2017 minutes, the December 2017 financial report, and December 2017 payment of bills.

Chairman Hanley opened the meeting for public comment at 7:42 p.m. There were no members of the public present, therefore the public comment period was closed at 7:42 p.m.

The Board unanimously adopted the 2018 Board meeting schedule and unanimously approved resolution 2018-0118-1 listing the official posting places for notices at the District office, the Eloise May Library, the South Metro Cunningham Fire Authority Administration Offices at 2015 S. Dayton St., and Arapahoe County. It was noted that per the adopted schedule the Board meetings will be held on the third Thursday of each month at 7:00 p.m.

MINUTES OF THE REGULAR MEETING OF THE BOARD OF DIRECTORS OF THE CHERRY CREEK VALLEY WATER AND SANITATION DISTRICT OF JANUARY 18, 2018, CONTINUED

The Engineering Report from Mr. Hein included the following topics:

- Developer Project Updates – Iliff Avenue Townhomes, Dayton Street Townhomes, Hunter's Run Fireline, Sky Mark Apartments, and Eloise May Library.
- Water Line Replacement Costs – Mr. Hein assisted with estimating waterline replacement costs for the next decade for various asset life scenarios. This will be discussed during the Manager's Report.

The following items were discussed during Mr. Farrington's Legal Report:

- At the last Board meeting a question had arisen concerning the District's right to utilize land and facilities within the Cherry Creek Country Club (CCCC) for District water system purposes. The last sentence of paragraph 2 of the District's agreement with CCCC (titled Water Rights License and Easement in Gross) gives the District the right to use CCCC existing water facilities provided there is no adverse impact on CCCC, and the District pays the costs associated with its use. It has been assumed this means that if the District wants to use any of the water in the golf course storage vessels for District purposes unrelated to CCCC (i.e., irrigation or augmentation other than the golf course) the District would pay a share of facility operating costs in proportion to the District's use of the water made available through the particular facility. Paragraph 6 grants the District an easement for water activities and facilities on the CCCC property, as long as those activities or facilities do not unreasonably interfere with the golf course. Unlike the reference in paragraph 2, the focus of paragraph 6 is the ability of the District to construct new facilities and structures of its own within the CCCC property.
- As a public entity it is legally feasible for the District to establish a solar garden on District property. Mr. Warford asked if the Board would be interested in subscribing to a solar garden not on District property. Director MacPhee agreed that this would be a good option. The Board would like Mr. Warford to also pursue a third-party operator for a solar garden on the District's property. Mr. Warford would like to use the flood plain area for a solar garden on the District's property if the District could build in this area.

Next on the agenda was the Manager's report from Mr. Warford:

- Chairman Hanley went through each of the four models Ehler's prepared for the Board's review. All models use 3.5% for investment returns and $4,400,000 in sewer replacements for the projected period. One set uses $4,000,000 for water replacements over the forecasted period and the other set uses $8,000,000 for water replacements that was used in the 12/8/17 model. Each water replacement scenario has two variables: 1) pass through of all water and sewer increases to customers from Denver Water and Metro

Wastewater at 3% for water and 8.3% for sewer, 2) Ehlers recommended rate increases to customers. Mr. Warford feels it is prudent to use a conservative model for future planning. Mr. Hein from Merrick prepared an analysis showing how the value of the replacement of water assets over the next 10 years can change based on decreasing the useful lives of those assets. Decreasing the useful lives from 90 years for ductile iron and 80 years for cast iron down to 65 years for ductile and 55 years for cast (55 years being the age of the water lines in the Huntington subdivision being replaced currently) shows that $15.8M dollars in water assets would need replacement in the next ten years as compared to $2.7M with the original lives. Thus Mr. Warford's estimate of $8M in water replacements over the next ten years is fairly accurate. Chairman Hanley stated that keeping the reserves where they are results in reducing rates to future customers. The District already has some of the lowest rates in the metro area and the gap in rates between the District and other Districts will grow larger since other Districts will need to raise rates to fund their replacement costs. The question is how much should current customers versus future customers benefit? Director Lampert said the District historically passes through increases from Denver Water and Metro Wastewater nearly every year to customers.

Chairman Hanley stated that the District could set up a separate fund in the financial statements for water and sewer asset replacements. The Board would also adopt a policy of how this fund is operated. The balance of the fund could be evaluated every year to determine the balance needed for projected replacements. Mr. Farrington said special districts are not required to use fund accounting but may do so. He also stated that monies can be transferred between funds without having to do a budget amendment. A budget amendment is required only if the appropriations are increased. The separate funds do not need to have separate bank accounts, just separated on the financial statements. The Board will discuss this further next month and decide if this is possibly a direction they'd like to take.

The Board approved the budget last month but did not approve rates at that time. Notice that the Board would consider rates at its January meeting has been posted on the District's website for at least thirty days as required by law. Mr. Warford said Denver Water is still looking at adding phosphorus to water to help with corrosion of water lines which will be something Metro Wastewater will have to remove from the wastewater which will probably increase the cost of sewer treatment to the District. Director Lampert stated that Ehlers scenario four with their rate proposals with ending cash and investments at about the same level as they are today, which may not be a beneficial position for the District. Chairman Hanley said the total net assets increased by about $16M in capital improvements during that time. Director Lampert said the investments are over $35M now and he's looking at reducing rates to bring down the District's investment balance. Chairman Hanley asked if rate reductions should be passed along now or in future years. He doesn't see the point in keeping funds now for rate reductions for future customers. Mr. Warford said to keep in mind that the District is close to build out and tap fees won't be a source of revenue in the future. Administrative and replacements costs are going to increase. Director Lampert said that redevelopment tap fees would be a revenue source later. The Board compared the budget that was adopted last month that had excess revenues over expenditures of $(224,000) that passed through a 2% water rate increase and 8.3% sewer rate increase to customers. Mrs. Glenn prepared another draft budget showing Ehlers recommended rate increases of 3.5% for water and 0% for sewer. Excess revenues over expenditures for this draft was $(356,000). Director Norman made a motion to pass through half of Ehler's projected water increase of 1.75%, and the full sewer increase from Metro Wastewater of 8.3%. Director Lampert seconded the motion. Chairman Hanley said he voted in favor of the motion but said it was not enough of a reduction of the pass through to customers. The Board unanimously passed the motion as stated by Director Norman.

- The final two Board members signed the authorization to allow Mrs. Glenn to sign checks for the District's checking accounts at Wells Fargo.
- Mr. Warford and Mrs. Glenn met with Bruce Lytle of Lytle Water Solutions and Matt Poznanovic with Petrock & Fendel to discuss using the Arapahoe aquifer water for the County's Club's irrigation/augmentation use. Mr. Poznanovic and Mr. Lytle verified that the District's augmentation plan allows the water to be used in this fashion. Mr. Lytle is verifying the location, depth and size of each of three wells available for the District's use. The wells have not been used for a long period of time and will need to be rehabilitated. Mr. Warford is in the process on getting bids for the boring and installing pipe over to the Country Club ponds. Mr. Warford will work on getting bids for rehabbing the wells also. An analysis will be done to determine if the program would be beneficial to the District and the Country Club. The Board agreed to go ahead with the economic analysis of this project.
- District Goals – continue to fund the reservoir project, utilize the District's Arapahoe aquifer water rights, create an education program with the District owned house next

door to the District office, develop a solar concept for the benefit of District customers and the District, develop a park concept in conjunction with the education program. Chairman Hanley said most of these goals were discussed tonight and will be discussed further at future meetings.

- Succession Plan – the Board had no questions or comments regarding the District's succession plan. Mr. Warford said the plan could take a minimum of two years to complete depending on how things go.

As discussed at the regular December Board meeting, Chairman Hanley sent a letter via email to Arapahoe County Commission Nancy Jackson and copied various others at the County. The letter stated the District's disappointment with County cooperation on the Iliff corridor landscaping project. In return, Commissioner Jackson replied with their regret as well. There were no additional comments from the Board.

There being no other business to discuss, the Board unanimously voted to adjourn. Chairman Hanley declared the meeting adjourned at 9:01 p.m.

READ AND APPROVED ____________________ DATED 2-15-18