

March 28, 2023

Ron Munds, General Manager
Los Osos Community Services District

Dear Mr. Munds,

It was a pleasure speaking with you yesterday. As we discussed, Wulff, Hansen & Co. has a U.S. Treasury Investment Program that may be of interest to the Los Osos Community Services District. More specifically, our investment program is referred to as a “laddered portfolio of U.S. Treasury securities”.

Like the District, most participants in our investment program previously deposited their money in the Local Agency Investment Fund (**LAIF**) and/or in bank accounts. LAIF, a pool of funds managed by the State Treasurer’s Office, is popular among cities, towns and special districts throughout California due to its low cost and convenience, and its emphasis on safety and liquidity. The advantage of depositing funds in LAIF and/or in bank accounts is that these deposits are very liquid, meaning local public agencies can easily access their funds, typically within just a few days. However, the drawbacks include:

- Local public agencies forgo the opportunity to potentially earn additional interest income, and
- Returns on short-term variable-rate deposit accounts such as LAIF and local bank accounts may be subject to a high degree of volatility, making it difficult to accurately budget annual interest income.

Interest Rates

Interest rates or ‘bond yields’ increased dramatically throughout 2022 and into early 2023, due to a sharp and persistent rise in the rate of inflation and due to the Federal Reserve Board’s ‘tight money’ policy of raising interest rates to combat inflation.

For example, the yield-to-maturity on a 3-month U.S. Treasury security is currently **4.80%** as compared to **0.59%** one year ago. Moreover, until this year the last time a 3-month Treasury security had a yield greater than 4.80% was **more than 15 years ago**.

Similarly, the difference between Treasury yields and the yield paid on deposits in LAIF has also increased over time. For example, on July 1, 2022 the yield on a 3-month Treasury exceeded the yield paid by LAIF by less than **1.00%**. Today the difference is almost **2.00%**.

As you can see from the graph below, the yields on short-term U.S. Treasury securities have surged since last year, whereas the yield paid on LAIF balances has increased by far less.

Timeline

The process of investing in a laddered portfolio of U.S. Treasury securities takes approximately three weeks to complete and includes the following steps:

- Week 1:** Retain Municipal Advisor and select Custodian Bank and Bidding Agent;
- Week 2:** Bidding Agent/RIA solicits competitive bids from eligible bidders;
- Week 3:** Winning bidder delivers portfolio of securities to Custodian Bank.

Statement Regarding Potential Conflict of Interest

Municipal Advisor's fees for the anticipated services are intended to be contingent on its delivery of services to the District. Because neither the District nor Municipal Advisor can control or influence market conditions, it is possible that there could be future periods in which Municipal Advisor's provision of such services (e.g., quarterly reviews and/or reinvestment reports) may not produce any quantifiable financial benefit to the District despite the District's obligation to pay for such services. In such a period Municipal Advisor would have an incentive to continue providing services despite the absence of immediate tangible benefit to the District. This conflict is mitigated by the fact that it is anticipated that Municipal Advisor's contract will allow the District to terminate its contract and the provision of services at any time upon thirty days' notice, thus eliminating its obligation to continue paying Municipal Advisor any ongoing quarterly fees if the District believes that it is no longer receiving benefits exceeding the amount of the fee.

Thank you for considering our proposal to provide municipal advisory services to the Los Osos Community Services District. We are available to discuss our proposal with you and answer any questions at your convenience, either in-person, by phone or via a Zoom meeting.

Very truly yours,

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