CITY OF NEWPORT BEACH
FINANCE COMMITTEE
NOVEMBER 4, 2021 MEETING MINUTES

I. CALL MEETING TO ORDER

The meeting was called to order at 3:00 p.m. in the Civic Center Crystal Cove Conference Room, Bay 2D, 100 Civic Center Drive, Newport Beach, California 92660.

II. ROLL CALL

PRESENT: Chair Will O'Neill, Committee Member Brad Avery (arrived at 3:22 p.m.), Committee Member Noah Blom, Committee Member William Collopy, Committee Member John Reed, Committee Member Nancy Scarbrough, and Committee Member Joe Stapleton

ABSENT: None

STAFF PRESENT: City Manager Grace K. Leung, Finance Director/Treasurer Scott Catlett, Deputy Director/Finance Steve Montano, Administrative Manager Mary Locey, Administrative Specialist to the Finance Director Marlene Burns, Budget Manager Shannon Espinoza, Public Works Finance/Administrative Manager Theresa Schweitzer, Senior Budget Analyst Amber Haston, and Revenue Auditor Antonio Velasco

MEMBERS OF THE PUBLIC: Laura Curran, Charles Klobe, and Jim Mosher

OTHER ENTITIES: Gary Sherwin and Lily Pearson (Visit Newport Beach)

Debbie Snavely (General Manager Newport Beach Marriott Hotel & Spa, Visit Newport Beach Chairperson, Permanent Member), Homer Bludau (Visit Newport Beach Vice Chairperson), and Sharon Wood (Visit Newport Beach Board of Directors, City Appointee Member at Large)

III. PUBLIC COMMENTS

None

IV. CONSENT CALENDAR

MINUTES OF OCTOBER 14, 2021
Recommended Action:
Approve and file.

Chair O'Neill called for public comments and hearing none, closed public comments.

MOTION: Committee Member Stapleton moved to approve the minutes, as amended, seconded by Committee Member Scarbrough. The motion carried 5 ayes, 0 noes, 1 abstention (Committee Member Collopy), 1 absence (Mayor Avery)

V. CURRENT BUSINESS

A. Overview of Historical Funding Provided to Visit Newport Beach

Summary:

Staff will provide the Committee with historical information on the transient occupancy tax revenues generated in the City, as well as the portion passed through to Visit Newport Beach, to inform a discussion regarding the resources currently allocated to tourism marketing. Representatives from Visit Newport Beach will also be present to discuss the ways in which these resources are allocated in their budget to various categories of expenditures.

Recommended Action:

Receive and file.

Finance Director/Treasurer Scott Catlett introduced the item. He reported 18% of Transient Occupancy Tax (TOT) is transmitted to Visit Newport Beach (VNB), which comes out of the 10% rate that is charged on hotel stays. He advised there has been healthy growth in the City's TOT. He reported that Short Term Rentals (STRs) make up approximately 30% of the overall revenue and have had a very strong growth rate. He explained the Tourism Business Improvement District (TBID) is a separate assessment of 3% of revenue on a subset of the hotels, which provides an additional revenue source for different programming that VNB undertakes.

Debbie Snavely, Board Chair for VNB, reported the VNB's Board of Directors consists of 24 members, including hotel general managers, representatives from other tourism-based businesses in Newport Beach, and City staff and appointees. She advised the Marketing Committee is comprised of all of the Directors of Sales and Marketing from area hotels and the TBID Board is comprised of all the General Managers from the member hotels. She noted these groups help set the stage for how VNB will sell the hotels and market the City as a destination. She advised Newport Beach is completely different from other markets because there is one marketing voice. She explained the TBID Board members have sales and marketing teams on property that focus on property sales and bringing the big groups and leisure to Newport Beach. However, she advised VNB also helps sell the destination because many groups are just as interested in the destination as they are in the hotels. She noted Newport Beach differentiates itself by keeping visitors in the City through cross-selling hotels, which keeps the money and revenue in the City.

Gary Sherwin, President and CEO of VNB, reported VNB is aligned with the private sector and working within the hospitality community to address what they see as the most important business segments that VNB needs to address to generate as much hotel occupancy and drive as many high-quality visitors to Newport Beach as possible. He noted VNB sees itself as the economic development entity for the City to help drive revenue into the community. He advised while TOT plays a significant role, it aligns with sales tax generated from visitors coming into town, staying in hotels, shopping, and purchasing items.

Mr. Sherwin reported VNB's philosophy is the belief in a public-private partnership as reflected in their funding. He reported TOT revenues were good for 2019 and 2020 but dropped dramatically in 2021 due to the pandemic, which caused hotel closures and disruption in local and international business travel. He noted that group meetings and conventions are what sustain the hotels economically. He advised in 2009 the hotels came together to form the TBID and explained 100% of the TBID money is allocated towards meetings and conventions. He emphasized that approximately 60% of the City's large hotels are meeting dependent. He explained VNB needs to be aggressively going after that market and noted they have already seen a phenomenal Return on Investment (ROI).

Committee Member Collopy's inquired if any of the TOT is allocated for meetings and conventions. Mr. Sherwin explained TOT is not allocated for that use and is for leisure travel, brand building, international, and leisure-driven business. He noted VNB's marketing in Southern California, Phoenix, Arizona, and Las Vegas, Nevada was all funded through TOT.

In response to Committee Member Collopy's inquiry about VNB's operations due to their decreased budget, Mr. Sherwin advised they laid off a third of their 22 person workforce and cut a lot of the programming and stopped initiatives that were impacted by the pandemic. He advised they eliminated programming for international travel and noted their leisure dollars became much more targeted and regional in scope geared towards visitors who were driving into the area and willing to pay high room rates just to get out of the house. He also noted that regional travel artificially inflated the TOT and he referred to it as the Sugar High Summer. He noted it is not sustainable. He advised that meetings have not come back to any large degree this year but is seeing momentum for next year and noted VNB is relying on transient business.

Committee Member Collopy inquired if Ms. Snavely had worked with a TBID-like organization in other cities she has worked with and if TOT contributions were received. Ms. Snavely reported Costa Mesa did not provide TOT contributions, so marketing was funded through a TBID and noted, in that case, it was a privately funded TBID for marketing and sales to get business and be competitive to the outside areas. She explained it was not enough to compete against cities such as Huntington Beach or Newport Beach. She confirmed Anaheim has both a TOT contribution and a TBID. She explained that this funding is important for VNB to sell the destination.

Committee Member Collopy inquired if the City's TOT at 10% has made a difference in attracting business versus Anaheim or Huntington Beach who have significantly larger TOT's. Ms. Snavely explained that as long as she has been a hotel, no one has ever commented regarding TOT or TBID amounts. Mr. Sherwin advised many other cities have TOT rates of 16% or more. Ms. Snavely advised Newport Beach is very competitive against other cities because it is a destination rather than just a location for a meeting, and groups can also enjoy the destination.

Committee Member Blom noted the City has a tactical advantage because the bottom line is less expensive. Ms. Snavely explained businesses care what the room rate is but are not looking specifically at the taxes when making a decision. She explained for 90% of the groups that visit the City, the rooms are being paid for by the individual and not the company, so visitors base their decision on the room rate.

Mr. Sherwin noted when a meeting planner is looking at Newport Beach, they look at room rental costs and assistance in getting the food and beverage costs under control. He advised they are not concerned with the room rate unless the room has an extremely high taxation rate.

Committee Member Blom inquired if the hotel group decides on lessening room rates and food and beverage costs to win business or if they are being given marketing dollars to cover these incentives. Ms. Snavely advised that sometimes TBID funds are used for incentives such as discounts on food and beverage.

Committee Member Blom inquired if any of the percentage decrease in the room rate and/or food and beverage are given back to the hotel as an incentive to lower room rates. She confirmed the room rates discounts are not subsidized.

Committee Member Collopy noted the Fiscal Year 2021-22 adopted VNB TOT allocation in the City's budget was $4.2 million and was not in alignment with VNB's TOT revenue budget. Finance Director/Treasurer Catlett explained VNB develops its budget so it would not necessarily be in alignment with the City's budget. Ms. Snavely advised the titles in the slide labeled Total Annual Revenue for TOT and TBID were transposed which may also add to the confusion.

In response to Committee Member Collopy's inquiry, Mr. Sherwin confirmed VNB received $3 million in 2021 and not $3.7 million. Finance Director/Treasurer Catlett explained the numbers in the City's report are directly from the General Ledger. Lily Pearson, VNB Vice President of

Finance, added that VNB only books on the actual cash basis of what it receives so there will be a variance to the City's accrued revenues.

Committee Member Collopy inquired if VNB plans on hiring back employees and bringing back international programming. Mr. Sherwin advised all of their programming took a hit and noted VNB let two people go and furloughed three others. He reported the three furloughed employees have returned as of June 2021 and they are just beginning the process of filling the two vacant positions. He advised VNB's goal is to manage its resources carefully and conservatively. He explained a lot of VNB's work is labor-intensive and requires people to be in the office. He advised business travel-focused efforts are going to be coming back this month and they are hopeful they can restart international efforts in the spring. He noted while VNB does not spend a lot of money on international marketing, those visitors stay longer and spend more money in the City. He advised international visitors made up 16% of the overall visitation to the City pre-COVID.

Mr. Sherwin explained TOT is not always collected because in some cases, international visitors will stay more than 30 days and leave a large economic footprint in terms of what they spend in the City.

Committee Member Collopy inquired if VNB is anticipating a return to normal for meetings and conventions in terms of pandemic protocols. Mr. Sherwin anticipates meetings and conventions being a little bit different. He explained hybrid meetings are going to be a reality for some time until people get comfortable with traveling again. He advised the groups being booked in 2022 are smaller in size.

Committee Member Collopy inquired how the TBID fees are determined. Mr. Sherwin explained every guest pays 3% to TBID in their room rate. Ms. Snavely confirmed guests at her hotel are effectively paying a 13% TOT which is still lower than many of the big cities.

Mr. Sherwin presented VNB's annual Marketing Plan and advised it is first developed with the staff and then through the Marketing Committee. He advised it includes programs, budgets, metrics, and goals. He reported it is approved by the Board of Directors and then submitted to the City for approval. He explained they run on a two-year marketing plan cycle and produce a supplement if there are changes to the plan.

Committee Member Collopy inquired if City staff reviews the Marketing Plan. Chair O'Neill advised the Marketing Plan is a receive and file document. He advised City Council gives opinions, but the staff does not. He advised the City Council appointed Sharon Wood to the VNB Board and Finance Director/Treasurer Catlett also sits on the Board. VNB Board Vice Chair Homer Bludau explained the VNB Marketing Committee is made up of sales and marketing representatives of the local hotels, businesses, and restaurants around the City.

Committee Member Blom inquired if there were any Short Term Rental (STR) operators on the board. Mr. Sherwin reported there are no STR operators on the board now and it depends on if there is an open seat and if someone is willing to serve. He noted Craig Bately from Burr White Realty has been on and off the board for years. He advised every hotel representation on the board has a permanent seat, while the remainder of the seats are open and have three-year terms which can be renewed for an additional three years. He confirmed STR operators are very involved and are an important part of the City's hospitality lodging mix. He noted VNB sees STRs as a continuing growth segment and advised VNB will gladly support including legitimate operators in their lodging package. He acknowledged that Airbnb does not always play by the rules and pay the taxes so VNB will not promote them unless they have an agreement with the City that they will pay their taxes and adhere to zoning laws.

Committee Member Blom noted the City should promote good STR operators but would need them on the board and Marketing Committee to help identify good operators. He advised it is important as a marketing wing for the City to have a focus on STRs so the City is seen as a luxury city for STRs and not a party city. He believes VNB is light on promoting the luxury side of Newport Beach and feels that the STR market has a lack of representation on the board. Mr. Sherwin advised if there is a legitimate STR operator who wants to join the marketing committee VNB is happy to have them.

Mr. Sherwin reported there has been a slow recovery of meetings and conventions and had it not been for the delta variant, he believes the City would be ahead of pace right now. He explained there were challenges in obtaining reopening guidelines from the Governor's Office to allow VNB to book conventions and meetings, which caused some business to be lost to other states and set the City back in its recovery. He reported VNB has started to build back a base of business and noted it will be a slow effort although it is building momentum. He believes the momentum will be reflected in the next year.

Mr. Sherwin reported renovations at the Marriott will be a major game changer and will elevate the City to a new luxury tier along with whatever happens with the Fashion Island Hotel. He advised Newport Beach has always been an aspirational luxury destination and sees the City being elevated to an entirely new level similar to Cannes, France. He explained the Marriott will have fewer rooms but will generate more TOT because it will have a higher room rate. He noted VNB is looking for the right kind of visitor who will pay the right room rate and have the maximum impact on the City. He noted the mix of shops at Fashion Island is in alignment with this new luxury mentality and product and predicted a very transformational 3 to 4 years in Newport Beach's hospitality industry. He advised before the Resort at Pelican Hill came on board in 2008 there was no luxury tier product in the area and noted other hotels in the area have started to up their game. He explained that also means VNB will need to go after different segments of business including incentive business and international business.

Mr. Sherwin reported TOT is off the charts right now, but he explained that tourism needs conventions, international travel, incentive travel, and corporate business travel to function well and have a healthy tourism economy. He noted only a few segments are doing well right now. He does not believe the City is past the difficult period but believes a lot of progress has been made. He advised the immediate goals are to stabilize all of these different markets moving into the luxury tier area and assist hotels with repositioning their products. He reported VNB also helps with strategy and noted they helped the Marriott, the Lido House, and the Balboa Bay Resort with their branding.

Mr. Sherwin reported VNB is increasing outreach to media planners and dealing with issues such as the recent oil spill. He advised they developed a partnership with Laguna Beach and Huntington Beach after the oil spill and created a crisis communications platform. He noted the national media hurt the City by reporting incorrect spill numbers and advised VNB helped control that.

Mr. Sherwin reported VNB conducts leisure-oriented campaigns, which are measured by a third-party company that measures incremental trips, the associated room nights, and the economic impact of those leisure room nights. He explained there is a company called Adara that can track cell phones and determine whether or not a hotel was booked, or a person traveled to Newport Beach.

Committee Member Collopy inquired how an incremental trip is measured by these third-party companies. Mr. Sherwin advised that third-party companies could determine the flow based on the time of year and what the hotel would normally get in addition to being able to measure based on the additional messaging in the marketplace and how people are responding. He explained in addition to mass marketing VNB can provide targeted messages about Newport Beach based on what the individual likes and if their cell phone is coming to the city. He clarified VNB spends part of its budget on targeted marketing.

Committee Member Collopy inquired if the Resort at Pelican Hill is included in the statistics. Mr. Sherwin confirmed they are included and clarified they have representation on the board of directors and the executive committee but are not part of the TBID.

Chair O'Neill explained everyone who rents below 30 days is part of the TOT and advised VNB is the entity that receives the money from TOT.

Mr. Sherwin explained VNB was created as an independent 501(c)6 in 1989 and at the time was known as the Newport Beach Conference and Visitor's Bureau, which promoted leisure business in the city. He advised in 2011 they were approached by the City to come up with a more holistic way of being able to become a city-wide integrated marketing arm. He reported the City Manager at the time asked if they would be interested in running Newport Beach TV. He explained they did not want to complicate the contract they had with the City on the VNB side, so the board created an umbrella organization called Newport Beach and Company that serves as the City's marketing agency.

Mr. Sherwin explained Visit Newport Beach has a leisure side which is TOT and then there is TBID to focus on meetings and conventions. Committee Member Blom noted it is important to remember TBID is voluntary. Mr. Sherwin explained the Resort at Pelican Hill is included in the statistics because this is a leisure-oriented campaign, not meetings and conventions.

Chair O'Neill explained there are only 9 hotels in the TBID, and they have opted to voluntarily add 3% on top of TOT. Mr. Snavely explained if a visitor was staying at the Resort at Pelican Hill, they would pay 10%, not 13% since they do not participate in TBID.

Mr. Sherwin explained, for example, that VNB's salespeople will meet with Apple to bring a meeting into Newport Beach. He advised Apple will meet with the meeting planner at Apple to determine what their interests are and then VNB brings that person to town for a site inspection and then works with a hotel of their choice to develop a contract. He advised sometimes a client needs help making sure this is the right destination by getting them on the harbor or putting in a small amount of money to help host the opening reception which is funded by TBID. He explained a form then goes to the hotel to track the rooms and food and beverage. He advised the hotel revenue is what the hotels report to VNB based on those numbers. He noted they use an industrywide calculator to develop the overall economic impact. He confirmed it is all driven and signed off on by the hotels and is 100% TBID.

Chair O'Neill inquired how the Fiscal Year 2021 actual is $1.7 million when the hotel revenue is $5 million. Ms. Snavely explained the amount includes the 3% TBID on rooms plus catering. Mr. Sherwin explained the $1.7 million is not for the same year. He advised VNB books meetings years out so there is not a correlation between the timing of the revenue received and the booking. Finance Director/Treasurer Catlett clarified the TBID is also being assessed on every room night regardless of purpose, which was confirmed by Ms. Snavely.

Committee Member Collopy inquired if VNB receives any funding from the Chamber of Commerce. Mr. Sherwin advised in addition to TOT and TBID, the Chamber of Commerce provides $25,000 per year to market the boat parade. He confirmed VNB has a contract with the City for Newport Beach TV for $200,000.

Committee Member Collopy expressed concern that the TOT is too low at 10%. Mr. Sherwin explained the City is keeping 82% of the money collected by the hotels from the taxpayers paying the TOT. He clarified for Committee Member Collopy that VNB collects 18% of the 10% TOT and the City collects 82% of the 10% TOT collected.

Committee Member Collopy acknowledged that 82% is coming back to the City but 18% is being used to fund marketing. Ms. Snavely advised it is used to generate more TOT for the City.

Committee Member Collopy inquired how the City rationalizes and whether it fully understands the marketing dollars it is spending. He advised it is the City Council's responsibility to understand that and make the right decision. He noted the 10% TOT does not entice or discourage visitors one way or another and neither does the 3% TBID. Ms. Snavely advised the 3% TBID does not discourage visitors but brings them in since VNB is selling a destination.

Mr. Sherwin referenced a case where the Mayor of San Diego shut down marketing for the City for the better part of a year and in turn, they lost meetings, conventions, and their leisure business. He reported Sea World and the San Diego Zoo had to step up to supplement it because they were losing business because other destinations were asking for the customer's business. He argued the City needs to sell itself and simply cannot rest on its laurels. He explained every major city across the United States is going after the same visitors.

Committee Member Scarbrough inquired which local cities have an organization similar to VNB. Mr. Sherwin reported Huntington Beach, Santa Monica, Irvine, Santa Ana, and Costa Mesa all have similar organizations. He advised most organizations are set up with TBID, TOT, or a combination of the two.

Committee Member Collopy inquired if the City has a contract with VNB. Mr. Sherwin confirmed VNB has a five-year contract through 2024. He advised the TOT percentage varies depending on the community and the need.

Mr. Bludau noted there is a real disadvantage in Newport Beach that it does not have a convention center. He referenced a statistic from eight years prior that listed Newport Beach as number 48 of the top 50 cities in the United States as far as the number of group rooms. He noted that was quite an accomplishment given the City does not have a convention center.

Ms. Snavely reported before the TBID, VNB was doing over 9,000 group rooms and in 2019 did 110,000 group rooms. She noted it is a huge ROI for hotels to invest 3% in the TBID.

Mr. Sherwin reported the 2014 Bowl Championship Series (BCS) impacted every hotel in the City and was the largest single piece of business VNB ever had and that was in direct competition with Los Angeles.

Chair O'Neill opened public comments.

Charles Klobe inquired about raising the TOT a couple of percent and using that money to fund Code Enforcement for STRs, Police, and City staff to audit STRs to increase the income to Newport Beach and Company as they would get 18% of a larger number.

Jim Mosher reported he has a philosophical concern about the government being involved in private marketing efforts at all. He noted this concern derives from the kind of naive idea when the government collects taxes and TOT, it should be distributed equitably and in alignment with some kind of publicly debated and decided upon rules. He advised in this case taxes are being collected and being very opaquely distributed.

Mr. Mosher expressed concern that the Resort at Pelican Hills has a big say in how TOT money is being spent. He advised he does not know the rule that gives them a bigger voice than STR owners or anybody else. He also noted he is not surprised but concerned that part of the 18% is being used tonight to throw a private party and advised the City Manager could not use any part of the 82% of the 10% to throw a party for private partners and believes it is an odd use of government-collected taxes. He inquired if the Finance Committee should recommend the City divert some of its General Fund money into this marketing effort and pay off some of its unfunded pension liabilities or other liabilities as it seems like a money-making machine and since the City receives such a large ROI for what it puts into VNB. He inquired why the Finance Committee is not recommending the City divert some of the City's sales tax revenue into hiring a marketing firm to promote other kinds of businesses in Newport Beach such as auto sales. He noted he has philosophical, logical, and financial concerns.

Laura Curran reported she has followed VNB over the years and noted the report lists the budget amounts and the expenditures, but the public does not always get a lot of color on the marketing, what the actual types of expenditures were, and how the ROI relates. She requested to see more detail in future reports. She advised this report is the Fiscal Year 2019 Actual being compared to the Fiscal Year 2022 budget and noted it should probably include the 2020 budget and 2021 budget. She noted there will be anomalies due to the pandemic, but the public will still want to see the trends.

Ms. Curran advised the net number for Fiscal Year 2022 is break even and that is after $188,000 in carry-over from the cash reserves. She noted in the past there was a $200,000 surplus and for this year there is a $200,000 deficit before the cash carryover. She inquired if this was going to be an ongoing part of the budget. She encouraged having the STR owners in the mix and holding them accountable for having high-quality programs and outreach. She recommended taking some of the money they would bring in and using it for amenities that benefit the entire visitor-serving community.

Chair O'Neill closed public comments.

The item was received and filed.

B. CALPERS UPDATE

Summary:

Staff will provide the Committee with an overview of the data from the latest actuarial reports from CalPERS as well as their impact on prior projections of the paydown of the City's unfunded pension liability.

Recommended Action:

Receive and file.

Finance Director/Treasurer Catlett reported CalPERS had quite a bit more in assets than last year and advised their funded status across the whole plan went from 71% to 82%. He advised that is a huge jump in one year but is reflective of that 21.3% return CalPERS got this year, which is the best that they have done in quite a while. He advised CalPERS received a 36% return on their stock investments versus 43% on private equity. He noted a 21% net return on investments was a very good number. He advised this is almost CalPERS' best year ever although they underperformed the last two years.

Committee Member Collopy inquired if CalPERS was underwater on private equity. Finance Director/Treasurer Catlett clarified they were under their benchmark. He explained CalPERS has a benchmark they use as an index they construct themselves of what they think private equity should do and it did not do as well as they thought it would. He further explained if looking at the Standard and Poor's (S&P) 500, CalPERS underperformed it at 36% but they constructed their index for public equity and deducted out classifications of assets the board requested they divest from cigarette makers, as an example.

Committee Member Collopy inquired if CalPERS is using mark-to-market (MTM) on those treasuries. Finance Director/Treasurer Catlett advised interest rates were changing during this time so whatever the rates were for the securities they already held would vary from the market rates as the interest rate environment changed.

Finance Director/Treasurer Catlett presented CalPERS historical investment returns and noted the discount rate has been going down because they consistently reduced their assumption about their investment earnings over the last 10 or 12 years. He reported the CalPERS Risk Mitigation Policy was triggered as of June 30 and it says that if returns exceed 7% then it triggers an adjustment to the discount rate. He explained it creates an element of de-risking but results in higher contribution rates for the City.

Committee Member Collopy inquired if the discount rate itself triggers a change in investment mix or is a policy change required. Finance Director/Treasurer Catlett explained if CalPERS did not have their Asset Liability Management process going on in parallel, it would have triggered the investment people at CalPERS to change their mix to earn 6.8% versus 7%. He noted by July 2022, CalPERS would have had to remix the portfolio to earn a lower rate. He explained the thought process is to use part of the big gain to achieve a lower risk in the long term.

Committee Member Stapleton inquired if the City's CalPERS funds are split 70% equities and 30% fixed income, including private equity and public securities. Finance Director/Treasurer Catlett clarified it is about 50% public equities with the balance of the 70% including private equity and real estate assets.

Committee Member Avery inquired if CalPERS is on the right track with this philosophy on risk mitigation. Finance Director/Treasurer Catlett advised CalPERS was under a lot of pressure to avoid big swings in rates and noted there is logic to it. He referenced Committee Member Collopy's previous remarks that they have had a big windfall and are ignoring part of it.

Finance Director/Treasurer Catlett reported what is happening in parallel right now is that every four years CalPERS looks at that discount rate. He advised that even with the current asset mix, CalPERS is advising they can only earn 6.2% so to achieve 6.8% they need to change their mix of assets. He advised if CalPERS does nothing then they will have to lower the discount rate to 6.2% next year and the City will have another actuarial loss.

In response to Committee Member Collopy's inquiry, Finance Director/Treasurer Catlett clarified CalPERS by policy only does this process every four years and it is separate from the Risk Mitigation Policy process and is CalPERS' normal periodic review of the discount rate.

Committee Member Collopy inquired if CalPERS intends to change the discount rate to 6.6% next year or is it 6.8% for the next four years. Finance Director/Treasurer Catlett explained the 6.8% trigger is outside of the four-year cycle and is a separate policy effective immediately. He noted the four-year study is ongoing and will be decided by the end of this fiscal year but believes they will stay at 6.8% or initiate a further reduction.

Chair O'Neill reported when he met with CalPERS at a stakeholder meeting in 2019, he was pressing them hard on this issue and told them they were not being realistic and needed to lower the discount rate. He advised their reply was if they did that, they would bankrupt cities. He advised CalPERS could reduce the discount rate down to 6% and the normal cost is going to skyrocket on a bunch of cities as well as the unfunded pension liability. He noted the City could absorb it, but other cities would get crushed, and Anaheim would be bankrupt, probably.

Finance Director/Treasurer Catlett reported the CalPERS board has taken 6.2% off the table and advised they are not willing to go below 6.5% assuming they stick with what they said at their first discussion of the topic. He advised they are looking to increase the private equity allocation and perhaps leveraging a portion of the portfolio by borrowing money and reinvesting it to earn higher rates of return.

Finance Director/Treasurer Catlett reported CalPERS conducted an experience study that looked at all of the other actuarial factors besides the investment return. He advised there is no big impact from that this time around.

Finance Director/Treasurer Catlett advised CalPERS has made some preliminary comments about a willingness to have different portfolio options for cities that are well funded. He explained it is not really on the table yet and is unsure if it will get legs.

Finance Director/Treasurer Catlett reported he expects the normal cost to go up because of the discount rate reduction and the minor changes from the experience study. He advised these were probably going to be small increases and manageable. He noted half of the costs are being passed on to Public Employees' Pension Reform Act (PEPRA) employees.

Finance Director/Treasurer Catlett presented the blended normal cost, which is the rate the City is paying for all of its employees. He advised it is trending downward over time as the number of PEPRA employees increases.

Finance Director/Treasurer Catlett reported the City receives separate valuation reports for the miscellaneous and safety plans. He advised the Fiscal Year 2019-20 investment return was 4.7% and underperformed the 7.0% target. He explained the unfunded liability went up, but the funded percentage also went up. He noted the City implemented fresh starts in 2013 and 2018 with 20-year amortizations. He reported Newport Beach is one of two cities whose funded percentage went up and noted the other city is Irvine. He advised they also made extra payments towards unfunded liabilities but suspended the plan during the pandemic.

Committee Member Collopy inquired which cities in California are fully funded. Finance Director/Treasurer Catlett did not have the information available on which California cities may be fully funded. Chair O'Neill advised there is a chance that Transportation Corridor Agencies (TCA) is fully funded.

Finance Director/Treasurer Catlett reported the 21.3% return and risk mitigation policy discount rate change will be reflected in the June 30, 2021, valuation reports to be received in August 2022. He cautioned that investment earnings can be volatile and should not assume that this is the way the world is going to stay. He advised CalPERS has the Asset Liability Management (ALM) process underway and could drop the discount rate to 6.5% and noted the experience study will have a small effect on rates coming up soon.

Finance Director/Treasurer Catlett presented the Orange County CalPERS Plans Funded Status and advised the Miscellaneous Non-Pooled plans are almost 90% funded with the Safety Non-Pooled at approximately 82% funded. He explained pooled means agencies that are so small they pool their liabilities together.

Finance Director/Treasurer Catlett reported in November 2019, the Finance Committee endorsed City staff's recommendation to anticipate a future drop in the discount rate. He advised $35 million per year has been in the base budget for several years now and an additional $5 million has been added for the last two years. He advised the City Council endorsed this strategy for the Fiscal Year 2020-21 budget with a plan to revisit the plan's adequacy and approach each year.

Finance Director/Treasurer Catlett presented the roll-forward of valuations to June 30, 2021. He noted this is just a roll-forward of the investment gain and other things going on with the actuarial changes are not included in the numbers and advised the number in the next valuation will be different. He advised this is a reasonably good tracking point to see where the City is a year forward from the valuation that was received and is a reflection of that 21% investment return. He reported the modeling was also done with the 6.8% discount rate going forward.

Committee Member Collopy noted the prior chart said the City is committed to $5 million per year for the next three years. Finance Director/Treasurer Catlett clarified the City Council has said they will revisit that every year and decide on an annual basis. He reported the City would be able to pay off the unfunded liability in 2029 using the base payment plan. He advised if the payments were $40 million per year, the City would be able to pay off the unfunded liability in 2028 and would save $8 million off of those payments in the future in interest costs.

Committee Member Collopy inquired what the valuation requires the City to pay. Finance Director/Treasurer Catlett believes the valuation requires the City to pay $30 million per year.

He explained as the City pays the extra money each year the minimum required contribution decreases. He noted in those last years the minimum contribution is approximately $10 million.

Committee Member Collopy commended the Finance Committee for its brilliant move.

Finance Director/Treasurer Catlett reminded the Finance Committee that projections can change. He reported two years ago staff shared a projection with the Finance Committee of a 2034 payoff date for the unfunded liability and noted staff shared a projection of 2036 last year due to underperformance of the portfolio. He hopes it will continue to be comparable to the current projection next year but cautioned things can change. He outlined a variety of factors that could change the projection. He recommends continuing with the strategy the Finance Committee endorsed in 2019 which will keep the City on target to pay down the unfunded liability in Fiscal Year 2028-29. He noted the City will investigate another fresh start after the ALM process to determine if it makes sense and will bring that back to the Finance Committee as part of next year's conversations.

Chair O'Neill opened public comments.

Laura Curran inquired why CalPERS continues to have an Interim Chief Investment Officer. Finance Director/Treasurer Catlett commented that it likely does not pay as well as doing the same work for a firm in New York, but beyond that has no insight.

Chair O'Neill closed public comments.

Chair O'Neill noted the Finance Committee and staff are not rosy when it comes to assuming CalPERS will continue to even hit 6.8% which is another reason the City will continue to make the additional discretionary payments because that $35 million only takes into account past unfunded liabilities. He noted any additional amount above that is the City's hedge against believing CalPERS is not going to be able to hit their anticipated amounts.

Committee Member Scarbrough inquired how CalPERS would treat other cities if they had to file for bankruptcy and would it impact the City. Finance Director/Treasurer Catlett advised he does not think it would impact the City and noted San Bernardino was a good test case for that scenario. He explained CalPERS advised San Bernardino if they did not pay the result would be impaired pensions for its retirees.

Chair O'Neill explained any city that tries to get out of CalPERS would pay a 1% to 2% discount rate that balloons the amount owed to CalPERS by a staggering amount. His understanding is that the only liability that did not get cut in the San Bernardino bankruptcy was the CalPERS obligation.

Committee Member Collopy inquired if CalPERS could put covenants on a city that files bankruptcy. Finance Director/Treasurer Catlett explained CalPERS was treated like any other creditor in the bankruptcy process, but the reason San Bernardino treated them favorably as a creditor was the squeeze CalPERS was going to put on their retirees and employees if they withheld their payments.

Chair O'Neill noted every city that went bankrupt in the last decade or two had pension obligation bonds.

The item was received and filed.

C. FIRST QUARTER BUDGET UPDATE

Summary:
Staff will provide a presentation regarding the year-to-date and projected Fiscal Year 2021-22 budget performance.

Recommended Action:

Receive and file.

Finance Director/Treasurer Catlett reported the budget was adopted with projected revenue of $234 million and City staff is now projecting $238 million. He advised the biggest change in the big three revenues would be property tax, which is due to the higher than originally assumed assessed valuation. He reported the City's consultants are seeing positive trends in sales tax and noted there will likely be an increase to the revenue projection in the second quarter. He believes it is safe to say the City can hit its TOT number in the budget and it is just a question of to what degree the projection is increased later in the fiscal year. He noted there are no assumptions in the budget that the Fashion Island Hotel will be opening.

At 4:53 p.m., Committee Member Avery left the Finance Committee meeting.

Finance Director/Treasurer Catlett believes there will be positive news about revenue in the second quarter although he advised the City is tracking below where it was in the pre-pandemic projections. He reported a positive expense adjustment and revenue adjustment for recreation classes and facility rentals and noted they are back strongly. He reported a couple of minor adjustments to the City's intergovernmental revenues. He advised expenses are tracking higher than the revised budget because of the offset to those recreation classes, which has revenue associated, as well as some expenditure that are being reimbursed by those intergovernmental revenues.

Committee Member Collopy noted the biggest single variance in expenses is Salaries and Wages. Finance Director/Treasurer Catlett advised that is the $5 million pension payment added to the budget from prior year budget surplus and that there is also $3.1 million of carryover expenditures that were added to the budget and funded from prior year revenues.

Finance Director/Treasurer Catlett reported on General Fund Sources and Uses and noted there is an increase in transfers out that reflects the use of prior year surplus for the Facilities Financial Plan (FFP) and the Capital Improvement Program (CIP) that the City Council approved at their last meeting. He noted staff is projecting a $1.1 million surplus on June 30, 2022, which will hopefully increase as the year progresses.

Chair O'Neill called for public comments and hearing none, closed public comments.

The item was received and filed.

D. LONG RANGE FINANCIAL FORECAST (LRFF) UPDATE
Summary:
Staff will brief the Committee regarding the results of the updated LRFF analysis.
Recommended Action:
Receive and file.

Deputy Director/Finance Steve Montano announced his retirement effective December 3, 2021.

Committee Member Collopy thanked Deputy Director/Finance Montano for doing a great job and noted his contributions have been invaluable.

The item was continued to the January 13, 2022, meeting of the Finance Committee.

E. INTERNAL AUDIT PROGRAM UPDATE
Summary:
Bi-monthly progress update on the internal audit program.
Recommended Action:
Receive and file.

Finance Director/Treasurer Catlett reported that there were no updates to share regarding the internal audit program and that audit reports would be presented to the Committee on January 13, 2022.

F. WORK PLAN REVIEW

Summary:
Staff and Finance Committee to review the proposed work plan and identify matters that members would like placed on a future Agenda for discussion, action, or report.

Recommended Action:
Receive and file.

Chair O’Neill reported the Finance Committee will be talking through the financial statement audit results and related communications. He advised the external auditors will be in attendance to discuss the results for Fiscal Year 2020-21. He noted the committee will also be reviewing internal audit program reports, talking about the Tidelands Fund Budget presentation, and reviewing the long-range financial forecast update. He reported budget season will then be underway. He advised the fee study will be reviewed later in the year and noted the Committee will be talking through the FFP and CIP to ensure there is funding necessary over the next few years. He advised an internal services fund update, budget update, and revenue projection discussion will also be conducted.

In response to Committee Member Collopy's inquiry, Chair O'Neill reported the Tideland Funds discussion will take place of one of the department deep dives. Committee Member Collopy recommended next doing a deep dive into the Police Department.

Chair O’Neill called for public comments and hearing none, closed public comments.

The item was received and filed.

VI. ADJOURNMENT

The Finance Committee adjourned at 5:02 p.m. to the next regular meeting of the Finance Committee.

The agenda for the Regular Meeting was posted on October 29, 2021, at 12:40 p.m., in the binder and on the City Hall Electronic Board located in the entrance of the Council Chambers at 100 Civic Center Drive.

Attest:

______________________________ ____________________
Will O’Neill, Chair Date
Finance Committee