

**CITY OF NEWPORT BEACH
FINANCE COMMITTEE
APRIL 14, 2022 MEETING MINUTES**

I. CALL MEETING TO ORDER

The meeting was called to order at 3:00 p.m., in the Civic Center Community Room.

II. ROLL CALL

PRESENT: Chair Will O'Neill, Mayor Pro Tem Noah Blom, Council Member Brad Avery, 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, Administrative Specialist to the Finance Director Marlene Burns, Utilities Director Mark Vukojevic, Public Works Director David Webb, Community Development Director Seimone Jurjis, Fire Administrative Manager Mary Locey, Management Assistant Lili Melero, Senior Budget Analyst Amber Haston, Purchasing And Contracts Administrator Sander Huang, Public Works Finance/Administrative Manager Theresa Schweitzer, and Budget Manager Shelby Burguan

MEMBERS OF THE PUBLIC: Charles Klobe and Jim Mosher

III. PUBLIC COMMENTS

Jim Mosher reported he reviewed the changes to the fee schedule and subsidy policies that were presented to the City Council. He noted staff had recommended refunding appeal fees if the applicant was successful but noted there was some reluctance to extend that to Planning Division until the matter could be studied. He explained the cost of studying the fees is probably greater than the amount of money in question. He reported there were 17 appeals in the last 12 years with four of them being in the last year. He believes there may be the possibility of one refund per year and encouraged the Finance Committee to keep that in mind.

Chair O'Neill recommended City Manager Grace Leung agendaize the item for the Planning Commission to review as a matter of policy.

IV. CONSENT CALENDAR

MINUTES OF MARCH 10, 2022

Recommended Action:

Approve and file.

Jim Mosher suggested minor changes to the minutes.

MOTION: Committee Member Collopy moved to approve the minutes, as amended, seconded by Committee Member Stapleton. The motion carried 7 ayes – 0 noes.

V. CURRENT BUSINESS

A. PROPOSED FISCAL YEAR 2022-23 BUDGET OVERVIEW

Summary:

Staff will provide the Committee with an overview of the expenditure budget for Fiscal Year 2022-23 that will be presented to the City Council in May.

Recommended Action:

Receive and file.

Finance Director/Treasurer Catlett provided a brief overview of the guiding principles of the budget, additional areas of focus for this year, and the budget development timeline.

Budget Manager Shelby Burguan provided a brief status update on the current year's budget. She advised a \$15.9 million increase in projected revenue and noted that \$10 million came from Property Tax, Sales Tax, and Transient Occupancy Tax (TOT). She reported staff anticipates ending the year with \$15.2 million in Unrestricted Funds after the \$31 million appropriation by the City Council from the Fiscal Year 2020-21 Surplus. She advised staff will be returning next month to present the 3rd Quarter budget update to the Finance Committee and also anticipates an increase in the year-end projected surplus.

Budget Manager Burguan reported a 12.5% growth in the Fiscal Year 2022-23 proposed operating budget, primarily due to the Tidelands Fund presentation format change, the increase in proposed CalPERS UAL payment to \$40 million, the higher Internal Service Fund charges based on a recent project to review rates, and adjustments to Police Department and Fire Department overtime budgets. Finance Director/Treasurer Catlett clarified there will be no additional overtime spending and noted this is simply an accounting change. Budget Manager Burguan explained the increase also includes an additional \$5 million CalPERS UAL payment, a possibility that was discussed at the City Council's January Planning Session.

Budget Manager Burguan provided a brief overview of Fiscal Year 2022-23 expenditures by fund. She reported growth in the General Fund was 8.1% and Wastewater Fund growth was 23.4%. She noted the Wastewater Fund growth was due to the improved insurance Internal Service Fund (ISF) allocation methodology and updated administrative charge calculations that better apportion costs between the Water and Wastewater Funds.

Utilities Director Mark Vukojevic provided a brief overview of the anticipated impact of ongoing inflation on the City's Water and Wastewater Funds. He explained that capital & maintenance projects and materials have been greatly impacted by inflation. He advised higher inflation is manageable in the short-term, especially if it stabilizes, but sustained higher inflation or a prolonged drought could lead to future rate implications.

Chair O'Neill inquired about the definition of a prolonged drought. Utilities Director Vukojevic advised it is a drought that lasts longer than 1.5 years. He noted the drought would require the City to cut back more than 15% of its water usage. He explained that the impact of not responding to prolonged inflation through an upward rate adjustment would be future reductions in capital spending, reduced reserves, and a more dramatic rate increase in future years. He provided a brief overview of the concept of pass-thru rates for water supply costs and detailed how other cities are utilizing them. City Manager Leung confirmed a Wastewater Rate Study will be conducted next year. Utilities Director Vukojevic advised the rates for wastewater will increase by 2% in January.

Committee Member Collopy inquired if an assumed rate of inflation was baked into the rates since 2019. Utilities Director Vukojevic confirmed they were baked into the rates. Committee Member Collopy recommended accelerating the next rate study by one year.

Budget Manager Burguan provided a brief overview of the Capital Improvement Program (CIP) Budget over the last five years and noted the proposed CIP for Fiscal Year 2022-23 is \$71 million.

Budget Manager Burguan provided a brief overview of the General Fund Budget and reported General Fund Revenues are projected to surpass staff expectations and pre-pandemic projections. She advised the City's Sales Tax consultant has projected an increase of \$1.2 million in Sales Tax. She reported Salaries and Benefits are the largest General Expenditure at \$163.4 million.

Finance Director/Treasurer Catlett provided an overview of the staff's efforts to enhance budgeting accuracy.

Chair O'Neill inquired why the City has seen significant revenue and expenditure growth year after year considering it has not increased the Transient Occupancy Tax (TOT), Sales Tax, or Property Tax rates as many other jurisdictions have. Finance Director/Treasurer Catlett explained that a good portion of the expenditure growth in excess of other jurisdictions is due to the City's significant increased contribution to CalPERS to pay down the City's UAL. He noted he believes revenue is growing at an accelerated rate due to significantly increased coastal property values, an uptick in business activity combined with the City's role as a regional retail center, and an increase in the prevalence of short-term rentals and higher occupancy and rates for both short-term rentals and hotels.

Council Member Avery noted this is a housing market that has historically not been seen and the City is a safe place to invest when buying a home.

Finance Director/Treasurer Catlett noted the City was able to taper the use of discretionary funds during the pandemic, which provided flexibility to avoid any service level reductions.

Council Member Avery inquired about the risk of a downturn impacting property tax revenues. Finance Director/Treasurer Catlett noted that due to the growth seen from reassessed properties, even if sales decline these often significant reassessments result in rising property tax revenues.

Committee Member Scarbrough inquired if the City is tracking Sales Tax revenue trends due to increasing inflation. Finance Director/Treasurer Catlett advised staff meets quarterly with its Sales Tax consultant and the impact of inflation has been a topic of conversation at the most recent meetings.

Committee Member Collopy noted the City has a robust increase in expenditures. Finance Director/Treasurer Catlett explained the operating budget growth is primarily driven by the proposed increased UAL payment, increased transfers to ISFs, removal of the vacancy factor, and budget accuracy-related adjustments that will be discussed in more detail later in the presentation.

Committee Member Collopy noted there was \$4.4 million in expenditure savings and advised it should be a City Council decision to budget to full employment or probable employment.

Chair O'Neill advised City Council has been working through that policy since 2015 and noted when the budget is tight the City Council can budget towards probable employment and budget to full employment when the budget is full.

Finance Director/Treasurer Catlett clarified the \$4.4 million in expenditure savings includes \$2.4 million in salary savings, \$2.1 million in contracts, and the remainder in miscellaneous expenditures. He clarified the only new spending included in the budget is for the Program Enhancements and the Be Well OC contract continuation. He presented an overview of

General Fund Expenditures by Department and General Fund Transfers. He highlighted the addition of the Tidelands subsidy transfer per a recent Finance Committee discussion and the transfer to the Fire Equipment Fund for a program enhancement.

Finance Director/Treasurer Catlett provided a brief overview of the General Fund Internal Service Fund Charges and explained the insurance charges are increasing due to increasing excess insurance premiums and the elimination of the fund balance drawdown included in last fiscal year's budget. He reported the budget as proposed has a \$9.7 million structural surplus. He advised the current year's projected surplus of \$15.8 million will need to be partially allocated to maintain the contingency reserve at 25%. In response to Committee Member Collopy's inquiry, he explained how the surplus funds accumulated from fiscal year to fiscal year. He advised that any surplus funds would be allocated to neighborhood enhancements and paying down long-term obligations as per Council Policy F-5. He noted that \$8.6 million could be used to fully fund the remaining components of the Balboa Island drainage project or \$5.7 million could be used to eliminate the City's unfunded Other Post-Employment Benefits (OPEB) liability. He noted the City Council would determine how to spend the funds.

Chair O'Neill noted this is General Fund money that can be used on anything and advised the City has never had this option before.

Committee Member Scarbrough recommended using the funds towards affordable housing to get the State off of the City's back.

Committee Member Collopy recommended reducing taxes. Chair O'Neill advised the City Council cannot reduce Property or Sales Taxes because the City does not currently have any add-on taxes above the minimum rate set by the State.

Committee Member Collopy suggested a moratorium on the new recycling fee for residents. Chair O'Neill recommended the Finance Committee go through the budget and identify targeted revenue reductions that may benefit residents.

Committee Member Reed encouraged the Finance Committee to set aside the CIP funding until construction materials are less expensive. Chair O'Neill concurred. Mayor Pro Tem Blom noted this is not the time to spend and there will be long-term costs.

Finance Director/Treasurer Catlett provided a brief overview of program enhancements and staffing changes. He advised this includes funding the Police Department body-worn camera program, taser replacement program, enhanced internal service fund allocations, and one additional Community Services Officer position. He noted that \$1 million will be used for addressing homelessness.

Finance Director/Treasurer Catlett provided a brief overview of Capital purchases and other material miscellaneous enhancements recommended by staff.

Committee Member Scarbrough inquired how surplus vehicles are determined. Finance Director/Treasurer Catlett explained the process.

Finance Director/Treasurer Catlett provided a brief overview of changes in full-time staffing from 2009 through 2020. He advised total staffing levels, including part-time employees, in the City remain 7.4% below the 15-year peak in 2009. He explained some part-time employees become eligible for CalPERS membership but are not eligible for the same benefits as full-time employees, which then creates recruitment and retention challenges. He advised staff is proposing a limited program to convert part-time positions to full-time positions and provided a list of those positions.

City Manager Leung explained the current labor market is very challenging and competitive. She noted there are currently 50 open recruitments. She explained some of the positions have

become a training ground where the staff member can get trained and move to another agency full-time which is creating challenges.

Committee Member Stapleton inquired if any full-time staff was being added to the Harbor Department. City Manager Leung advised the Harbormaster has asked for additional positions and noted a staffing study was being conducted to determine what makes sense for the long term.

Committee Member Reed inquired what the cost is to the City of staff members who are leaving after being trained. City Manager Leung advised she has not quantified those numbers.

Community Development Director Seimone Jurjis explained they are struggling with the talent pool. He noted training for an Inspector requires over one year.

Mayor Pro Tem Blom noted the current goal is employee retention.

Committee Member Collopy inquired if 50 vacancies mean the City is understaffed by 50 positions. City Manager Leung concurred and noted the City has average recruitment for 30 positions at any given time.

Finance Director/Treasurer Catlett provided a brief overview of proposed additional staffing, new positions, and reclassifications. He advised the program enhancements total \$4.2 million of which \$4.1 million is from the General Fund.

Finance Director/Treasurer Catlett provided a brief update on the City's Unfunded Pension Liability. He reported the 21.3% investment return in Fiscal Year 2020-21 has significantly reduced the City's unfunded liability. He noted the City is approaching 50% of employees being covered by the Public Employees' Pension Reform Act (PEPRA) pension formulas, which has also been helpful. He explained the Finance Committee endorsed a \$35 million base contribution to the unfunded liability. He advised that given the City's recent revenue growth, staff recommends maintaining a \$40 million per year payment from the baseline budget until the unfunded liability is eliminated. He noted this change would fully fund the liability in 2029, or 2028 if the payment was increased to \$45 million through continued allocations of \$5 million from year-end surplus.

Committee Member Collopy noted a 6.8% discount rate is aggressive after the 21.3% investment return. He also noted it is not an additional \$5 million at the end of 2023 but an additional \$10 million due to City Council policy because a \$20 million surplus is anticipated.

Finance Director/Treasurer Catlett advised last year the City Council waived the surplus utilization policy and allocated additional funds to the Facilities Financial Plan (FFP) in lieu of an additional contribution to CalPERS.

Chair O'Neill noted a \$20 million surplus assumes the City Council will not allocate the \$9.7 million. He referenced some projects that could be accelerated. He believes the City Council will allocate the \$9.7 million.

Committee Member Collopy recommended the Finance Committee keep in mind that the largest capital expense for the City in the future is the police station. He recommended using some of the surplus funds to fund that expense.

Finance Director/Treasurer Catlett advised the police station is fully funded in the FFP but could be impacted by inflation. Chair O'Neill confirmed the City is looking to buy a parcel for the police station.

Committee Member Scarbrough suggested the Finance Committee keep in mind that they do not know how affordable housing changes such as Accessory Dwelling Units and Senate Bill 9 will impact the City.

Finance Director/Treasurer Catlett reported the General Fund budget is balanced with increased accuracy and results in a \$9.7 million surplus.

Committee Member Scarbrough inquired if there has been any discussion of a program from CalPERS to assist jurisdictions with reducing their UALs. Finance Director/Treasurer Catlett advised he had not heard of such a program but believes that if such a program is created there would likely be some socio-economic criteria for which agencies would be eligible for that program that would likely result in the City not being eligible for participation.

Chair O'Neill opened public comments.

Charles Klobe inquired about the 31% increase in expenditures for the City Manager's Office and the 8.2% for the City Council. Finance Director/Treasurer Catlett explained the City Manager increase is for Be Well OC program and the City Council is for the ISF charges.

Mr. Mosher inquired if the fire station's early warning system includes an early warning earthquake system. He expressed surprise that vehicles are being auctioned as soon as they reach the end of their useful life and thought they would be assessed at the end of their useful life. He asked for clarification if the Be Well OC program is funded by a grant program and inquired about the anticipated time the budget book will be posted on the City's website.

Chair O'Neill closed public comments.

Finance Director/Treasurer Catlett confirmed the City Council increase was due to the increase in ISF charges.

Chair O'Neill clarified the Fire Department did not move forward with the early warning earthquake system.

Finance Director/Treasurer Catlett clarified vehicles are kept longer if they are not used regularly and noted there are vehicles in the fleet that are five years beyond their useful life date. He confirmed the City did receive some grant funding for the Be Well OC Program but clarified that \$400,000 to \$500,000 was from the General Fund. He explained the City will fund 100% of the cost moving forward from the General Fund. He advised the budget book will be made available on the City's website at the same time it is provided to the Finance Committee.

Committee Member Collopy requested the Finance Committee receive their budget book before the May 12 meeting for review.

The item was received and filed.

B. OPEB ACTUARIAL VALUATION REPORT UPDATE

Summary:

Staff will provide the Committee with an overview of the latest actuarial valuation report prepared by the City's actuary.

Recommended Action:

Receive and file.

Finance Director/Treasurer Catlett presented the OPEB Actuarial Valuation Report Update to the Finance Committee. He explained there is no requirement to pre-fund long-term OPEB costs, but the City has voluntarily chosen to do so as is a best practice under sound financial management principles. He advised City Council Reserve Policy F-2 includes a requirement to pre-fund the explicit portion of the Actuarial Accrued Liability (AAL) over a 20-year amortization

period or less. He provided a brief recap of the January 2020 Finance Committee discussion where the staff recommendation was to lower the discount rate from 6.5% to 5.5%

Finance Director/Treasurer Catlett reported the California Employers' Retiree Benefit Trust (CERBT) Strategy 1 earned returns of 27.43% in Fiscal Year 2020-21. He provided a brief overview of the OPEB Benefit Plan.

Committee Member Collopy inquired if the discount rate was 5.5%. Finance Director/Treasurer Catlett explained the rate recommended by the City's actuary and utilized to calculate the unfunded liability is 6.5%, but the rate was artificially reduced to 5.5% for purposes of calculating the required contribution. Staff is recommending it go back to 6.5% for funding purposes.

Finance Director/Treasurer Catlett provided a brief overview of the CERBT program including an overview of the historical performance of the City's Trust Account.

Committee Member Collopy inquired if the City could contribute a larger amount to OPEB in a single year than what is recommended by the actuary. Finance Director/Treasurer Catlett confirmed the City can contribute as much as it would like, and the City Council could choose to eliminate the unfunded liability at any time.

Finance Director/Treasurer Catlett reported the Actuarially Determined Contribution (ADC) is increasing by 5.7% or \$235,000. He presented a projection of the future amortization of the unfunded liability and noted the City's actuary projects that the unfunded OPEB liability will be eliminated by Fiscal Year 2028-29. He explained staff's recommendation is to put the discount rate back to 6.5% and to consider contributions from surplus funds under City Council Policy F-5 to eliminate the liability.

Finance Director/Treasurer Catlett provided a brief overview of explicit and implicit subsidies. He explained upon implementation of GASB Statement No. 75, the Governmental Accounting Standards Board required that the future value of the implicit subsidy be included in the City's OPEB liability. He indicated that the implicit subsidy is imbedded in the City's insurance rates for active employees and that it is unnecessary to prefund for these operating costs related to employees' current service. He advised staff's recommendation is to contribute toward the unfunded liability up to an amount equal to the total explicit liability, while leaving the implicit subsidy liability unfunded. He also advised the downside of leaving the \$8 million implicit subsidy liability unfunded is that this amount will remain on the City's balance sheet permanently.

Committee Member Collopy inquired why the \$8 million would remain on the City's balance sheet. Finance Director/Treasurer Catlett explained staff recommends funding to \$40 million not \$50 million. Since funding the additional portion of the liability would result in the need to routinely draw down funds from the trust to pay current costs for active employees' health insurance. He requested the Finance Committee's guidance on whether it is preferred to target funding at 100% of the explicit subsidy liability or 100% of the total OPEB liability. He explained that following City Council Policy F-2 would result in the implicit subsidy liability remaining on the City's statement of net position.

Finance Director/Treasurer Catlett summarized that staff recommends returning the discount rate from 5.5% to 6.5%, remaining in CERBT Strategy 1, based on the Finance Committee's feedback either setting the target funding level equal to the explicit subsidy liability or the total OPEB liability with an amendment to City Council Policy F-2, remitting the net \$525,000 balance on hand in the OPEB ISFs to CERBT as a one-time additional contribution, and returning to the Finance Committee annually with an OPEB Update.

Committee Member Collopy inquired if moving the discount rate from 5.5% to 6.5% impacts the numbers of years until full funding will be reached. Finance Director/Treasurer Catlett

assumes that is the case but will confirm with the Actuary. He further explained that the City Council under Policy F-5 may still contribute additional resources to the unfunded OPEB liability, which would reduce the time until full funding is reached.

Committee Member Collopy inquired if the City could do both.

Chair O'Neill noted the OPEB liability is not a large debt for the City because it is a closed system. He noted no one will understand OPEB. He noted the Finance Committee could recommend paying it off completely. He recommended keeping the course of moving the discount rate from 5.5% to 6.5%.

Finance Director/Treasurer Catlett provided a brief overview of current and proposed OPEB accounting. He advised the staff recommends remitting the \$500,000 to CERBT as a one-time additional contribution.

Chair O'Neil opened public comments.

Mr. Klobe recommended the City pay off OPEB and no longer spend time on it at the Finance Committee.

Chair O'Neill closed public comments.

Finance Director/Treasurer Catlett requested guidance from the Finance Committee that it makes sense to target funding the explicit liability only. The dais concurred.

The item was received and filed.

C. BUDGET AMENDMENTS FOR QUARTER ENDING MARCH 31, 2022

Summary:

Staff will report on the budget amendments from the prior quarter.

Recommended Action:

Receive and file.

Committee Member Collopy inquired about the rationale behind Budget Amendment Nos. 36 – 38. Finance Director/Treasurer Catlett explained the City has a long-standing policy of not presuming the results of negotiations with contracts and noted lump-sum payments were included in those agreements. He advised they were not included in the adopted budget as the Cost of Living Adjustment (COLA) amounts for the agreements were not known at the time.

Committee Member Scarbrough inquired why this item did not come up on the City Council's consent calendar. City Manager Leung explained the budget amendments are included in the approval of the labor contracts and are attached to the related staff reports.

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

The item was received and filed.

D. 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 meeting on May 12, 2022, will include a follow-up discussion on the budget and is also the date the Finance Committee will receive their budget books.

Finance Director/Treasurer Catlett explained there is a billing issue with Recycle Only bills and Sewer Only bills. He advised staff will be bringing forward an item to change the strategy to place those charges on the Property Tax roll.

City Manager Leung advised the City is spending a lot of money trying to collect the funds and it makes sense to move it to the Property Tax bill. The dais agreed it did not need to come to the Finance Committee.

Chair O'Neill advised the joint City Council-Finance Committee Study Session will be held on May 24, 2022, at 4:00 p.m. He noted the Finance Committee will meet on May 26, 2022, to make its final recommendation to the City Council on the budget.

Committee Member Collopy inquired if the City Council will be able to see budget data before May 24, 2022. Chair O'Neill advised the City Council will be able to review the proposed budget online. Committee Member Collopy recommended the Finance Committee make the City Council aware the budget book is available for review.

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 5:09 p.m. to the next regular meeting of the Finance Committee.

The agenda for the Regular Meeting was posted on April 8, 2022, at 4:18 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
Finance Committee

Date