

**CITY OF NEWPORT BEACH  
FINANCE COMMITTEE  
MAY 12, 2022 MEETING MINUTES**

**I. CALL MEETING TO ORDER**

The meeting was called to order at 3:00 p.m.

**II. ROLL CALL**

**PRESENT:** Chair Will O'Neill, Council Member Brad Avery, Committee Member William Collopy, Committee Member John Reed, Committee Member Nancy Scarbrough and Committee Member Joe Stapleton. Mayor Pro Tem Noah Blom arrived at 3:07 p.m.

**ABSENT:** None

**STAFF PRESENT:** City Manager Grace K. Leung, Finance Director/Treasurer Scott Catlett, Deputy Finance Director Michael Gomez, Administrative Specialist to the Finance Director Marlene Burns, Accounting Manager Trevor Power, Senior Budget Analyst Amber Haston, Purchasing And Contracts Administrator Sander Huang, Public Works Finance/Administrative Manager Theresa Schweitzer, Budget Manager Shelby Burguan, and IT Manager Avery Maglinti

**MEMBERS OF THE PUBLIC:** Charles Klobe and Jim Mosher

**OTHER ENTITIES:** Jayson Schmitt, Chandler Asset Management

**III. PUBLIC COMMENTS**

None

**IV. CONSENT CALENDAR**

**MINUTES OF APRIL 14, 2022**

**Recommended Action:**

Approve and file.

**MOTION:** Committee Member Reed moved to approve the minutes, as presented, seconded by Committee Member Collopy. The motion carried 6 ayes – 0 noes, (absent - Mayor Pro Tem Blom).

**V. CURRENT BUSINESS**

**A. REVIEW OF INVESTMENT PORTFOLIO STRATEGY AND BENCHMARK**

**Summary:**

Staff will provide the Committee with an overview of the City's current investment strategy and several possible alternatives to determine if a change in strategy is appropriate at this time.

**Recommended Action:**

Provide feedback to staff regarding changing investment strategies.

Finance Director/Treasurer Catlett introduced the item.

Jayson Schmitt, Chandler Asset Management, provided a presentation of the Investment and Portfolio Strategy and Benchmark to the Finance Committee. He explained the recent increase in interest rates provides the City with an opportunity to increase future earnings by transitioning to a longer strategy, which would also result in higher market value volatility for the City's investments. He advised the portfolio could transition over the next six months into the new strategy as investment mature.

Committee Member Collopy inquired if there was an additional High Yield Index beyond 1-5 Years. Mr. Schmitt advised there was, but it was outside of the City's Investment Policy and the limitations of the California Government Code of a maximum maturity of 5-years.

Mr. Schmitt presented a brief overview of historical yields. He believes inflation will abate in the coming months. He presented the four key elements of Chandler Asset Management's approach which are Portfolio Duration, Sector Allocation, Term Structure, and Security Selection, and included details for each element.

Finance Director/Treasurer Catlett requested Mr. Schmitt explain how total return is different from yield.

Mr. Schmitt explained yield on securities is the interest rate. He explained total return includes the interest and the impact of the prices of those securities at any point in time, which if held to maturity are not realized as actual gains or losses.

Committee Member Collopy inquired if the difference between yield and total return is the result of trades or mark to market. Mr. Schmitt clarified the difference is due to mark to market.

Mr. Schmitt presented a Benchmark Study for the period ending December 31, 2021. He advised the 1-5 Year Index would place 38% of the securities in the 3-5 year range, thus increasing the overall duration of the portfolio but also potentially increasing the opportunities there.

Finance Director/Treasurer Catlett emphasized the City holds its securities to maturity unless there is an opportunity to trade at a net gain. He noted the numbers presented would be paper losses and gains, which over time are meaningless to the City because the City's liquid cash is invested in a different portfolio that is more liquid.

Committee Member Collopy inquired if the City is prohibited from trading securities prior to maturity and could be at a disadvantage if interest rates drop quickly. Mr. Schmitt clarified the City is not prohibited from trading securities prior to maturity if it makes sense to do so and provided an example of such a trade.

Finance Director/Treasurer Catlett explained the City would only make a trade if there was a positive gain to be had.

Committee Member Collopy inquired if Chandler Asset Management decides when it makes sense to trade a security prior to maturity. Mr. Schmitt advised they have discretion over the portfolio but are in constant communication with Finance Director/Treasurer Catlett and his staff.

Committee Member Scarborough inquired how often buying and selling occurs. Mr. Schmitt advised that it occurs infrequently when opportunities arise. He noted it would often be triggered by new issue securities and provided an example.

Mr. Schmitt continued with the presentation and advised the volatility of fixed income returns for short-term fixed income securities and portfolios is pretty low.

Finance Director/Treasurer Catlett advised there is also a budgetary impact to changing the strategy, which is that accounting rules require the City to book the total return paper losses on June 30 each year. The size of this accounting entry would be larger in years, such as this year, where interest rates are rising. However, he advised because interest income is such a small percentage of the General Fund Revenue it is not material.

Mr. Schmitt continued the presentation and provided a brief overview of the benchmark comparison. He advised March 2020 there was a huge increase due to the pandemic with interest rates coming down.

Committee Member Collopy noted the March 2020 increase was due to the market effect of the pandemic but as stated earlier, the mark to market effect does not apply to actual interest income because the City holds securities to maturity. Mr. Schmitt explained if comparisons were shown over a longer period, the total return starts to collapse on the average yield in the portfolio.

Committee Member Collopy requested to see the different actual yields if it is agreed to move to this proposed strategy.

Finance Director/Treasurer Catlett advised if the City was in the strategy being proposed today 10 years ago, it would have an additional \$5 million of investment income on hand.

Chair O'Neill inquired if the Finance Committee would like to continue with the remainder of the presentation as provided to staff. He inquired if there was additional information the Finance Committee would need to gather from the remainder of the report. Finance Director/Treasurer Catlett advised the remainder of the presentation was intended to be information and no feedback or discussion of the material is necessary.

Committee Member Collopy agreed with the recommendation to move to the long-term strategy.

Committee Member Stapleton noted it is remarkable to see where fixed income is going and believes the strategy makes sense.

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

Finance Director/Treasurer Catlett advised that hearing no objection from the Finance Committee, staff will move the City's managed investment portfolio to Chandler's Short-Term Bond (1-5 year) strategy.

The item was received and filed.

## **B. THIRD 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.

Budget Manager Shelby Burguan presented the 2021-22 Third Quarter Financial Report. She reported the adopted budget was \$234.1 million with third quarter projections at \$253.4 for a projected positive variance of \$19.2 million. She advised those primary variances were due to increased Property Tax, Sales Tax, Transient Occupancy Tax (TOT), and Property Transfer Tax.

Committee Member Stapleton requested clarification of why Property Tax grew by 3.6% over the prior year but 6.5% is being projected for next year.

Finance Director/Treasurer Catlett advised one of the main reasons for the increase is the City did not receive the full 2% Consumer Price Index (CPI) adjustment to the Proposition 13-limited assessed value of properties for the current fiscal year and the continued strength of the current real estate market.

Committee Member Collopy inquired why the City does not accrue the Property Tax that is owed since it knows it will be received. Finance Director/Treasurer Catlett explained there is no certainty when delinquent Property Taxes will be paid but confirmed the City does receive interest and penalties on delinquent payments.

Budget Manager Burguan reported staff met with the City's Sales Tax consultant and noted Sales Tax is now projected to be \$5.1 million higher than the projected budget mainly due to auto sales, brick and mortar retail receipts, and restaurant and hotels. She noted the growth is expected to slow down and next year's projected estimate is \$46.5 million.

Budget Manager Burguan reported staff analyzed TOT Revenue to date. She advised staff is holding to the projection provided in the second quarter report of \$25.6 million. She noted projections do not account for the reopening of VEA or the reopening of the Pendry. She advised next year's projected estimate is \$27.8 million. She presented TOT Revenue between hotel only and residential TOT Revenue. She advised hotel only TOT is trailing 2019 by 8.6%, but this has much to do with the two closed properties – VEA and the Pendry. She noted by excluding VEA and the Pendry, hotel-related TOT revenues are up 13.7% versus 2019. She advised Residential TOT is booming and is more than offsetting the lagging hotel TOT revenues with an 86.4% growth rate in the last 3 years.

Budget Manager Burguan presented the historical General Fund Revenue trendline. She noted revenues are exceeding pre-pandemic projections for the first time in this quarter's projection. She presented all other General Fund revenues are projected to exceed the adopted budget by \$6.4 million or 12.1%.

Budget Manager Burguan presented the projected General Fund expenditures and noted is the revised budget is now \$12 million higher than the adopted budget and explained the reasons. She advised third quarter projections are \$233.3 million and noted savings are likely to increase. She reported the current projection is to end the year with a \$17.9 million surplus. She advised staff will continue to monitor inflation trends, consumer spending, and the financial markets for signs of slowing economic growth.

Finance Director/Treasurer Catlett discussed an increase to the projected amount of the Tideland's Operating Fund subsidy from the General Fund resulting from a revised analysis of the impact of the Capital Improvement Program on the Tideland's Operating Fund. He noted a similar adjustment has been made in the budget for the upcoming fiscal year. He reported the Tideland's Operating Fund will need a higher than budgeted subsidy of \$1.5 million as a result of this adjustment.

Finance Director/Treasurer Catlett returned to the earlier discussion of the total return on the City's investment portfolio and reiterated that due to Governmental Accounting Standards Board (GASB) requirements, the paper losses due to the market value of the portfolio have to be booked as though they will occur. He explained the \$17.9 million projected surplus does not take into account the impact this may have. He advised that the number would fluctuate between now and June 30 depending on the movement of the financial markets.

Committee Member Collopy advised there needs to be a way to look at the net effect and inquired how it can be displayed when analyzing the year-end surplus. Finance Director/Treasurer Catlett advised he will need to work with his staff to see if there is a way to display it as suggested that would not present problems for the presentation of the contingency reserve in the Annual Comprehensive Financial Report.

Committee Member Collopy recommended ignoring the \$2.9 million total return-related adjustment, taking the net effect and putting it into the reserve. Finance Director/Treasurer Catlett advised he will look into the matter further.

Committee Member Collopy noted the financial statements will show the loss, but the budget should not be impacted. Chair O'Neill advised the Finance Committee will look at the timing in the future.

Committee Member Scarbrough inquired if this was a typical amount. Finance Director/Treasurer Catlett advised the amount is usually much smaller and this is an outlier.

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

The item was received and filed.

#### **C. FOLLOW-UP DISCUSSION OF PROPOSED FISCAL YEAR 2022-23 BUDGET**

##### **Summary:**

Staff will provide the Committee with a copy of the Fiscal Year 2022-23 proposed budget document. Should the Committee wish to continue April's discussion of the Fiscal Year 2022-23 budget, this is also an opportunity to do so.

##### **Recommended Action:**

Receive and file.

Finance Director/Treasurer Catlett provided a brief overview of additional information for the FY 2022-23 Proposed Budget. He advised staff has revised the process for forecasting the fund balance for the Tidelands Fund which will require an additional \$1.9 million transfer to the Tideland Fund for the projected FY 2022-23 subsidy.

Finance Director/Treasurer Catlett provided a brief overview of the remaining structural General Fund surplus, which is expected to be \$7.8 million. He advised that similar to the requirements of City Council Policy F-5 the structural surplus could be utilized to address additional City Council priorities in a manner comparable to the direction of the policy. He reported staff recommends prefunding the \$5 million typical year-end CalPERS Unfunded Accrued Liability (UAL) additional payment for FY 2021-22, allocating \$1 million to establish an initial fund balance for the Recreational Facilities Finance Plan, and setting aside \$1.8 million for FY 2023-24 CIP. He noted staff recommends allocating the full \$14.4 million projected FY 2021-22 year-end surplus to FY 2023-24 CIP projects and waiving the 50/50 requirement in City Council Policy F-5 as was done last fiscal year.

Chair O'Neill indicated the City will see substantial revenue increases and this will be the first time the City is budgeting over \$400 million across all funds. He inquired about the sizable increase in residential TOT payments and inquired if that was only being seen in Newport Beach. Finance Director/Treasurer Catlett confirmed the increase does appear to be unique in Newport Beach. Chair O'Neill noted that \$6 million is the highest the City has ever received for residential TOT.

Chair O'Neill inquired about the Recycling Fee increase from \$1.3 million to \$2.3 million. Finance Director/Treasurer Catlett confirmed that this was due to the recent rate increase and expansion of the fee to Newport Coast.

Chair O'Neill inquired about Fines and Penalties of \$3.8 million. Finance Director/Treasurer Catlett indicated that this was primarily parking fines but includes other items.

Chair O'Neill requested clarification regarding the \$2.3 million for the Orange County Transportation Authority (OCTA) Bicycle Funding Program. Public Works

Finance/Administrative Manager Theresa Schweitzer clarified it is grant funds for the Superior Avenue Pedestrian/Bicycle Bridge and Parking Lot Project.

Chair O'Neill requested clarification regarding the \$7.9 million for Private Donations and Contributions. Finance Director/Treasurer Catlett clarified it is for the Junior Lifeguard Building and the Library Lecture Hall.

Committee Member Collopy inquired about the funding for the Superior Avenue Pedestrian/Bicycle Bridge. Finance Director/Treasurer Catlett clarified it is a discretionary grant that was awarded to fund part of the construction of the bridge. Mayor Pro Tem Blom noted the offer from OCTA was that the City could implement a bicycle lane or utilize it for a crossing. He noted the City chose the latter.

Committee Member Collopy inquired if the payment to Visit Newport Beach was based on last year's actual TOT or projected TOT. Finance Director/Treasurer Catlett clarified it is based on actual TOT revenues received. He explained the growth for next year is anticipated to be in the 3% to 5% range.

City Manager Grace Leung reported the Superior Avenue Pedestrian/Bicycle Bridge and Parking Lot Project has a total cost of \$12.9 million.

Chair O'Neill explained when looking at the budget for the General Fund of the City, it includes a sizable discretionary payment towards the City's UAL. He noted the City aggressively tries to pay down its UAL. He reminded residents that the Police budget remains under 30% of the City's General Fund and the Fire budget remains under 25% of the General Fund even with all the UAL discretionary payments.

Committee Member Collopy inquired if the labor negotiations were recently concluded. Finance Director/Treasurer Catlett confirmed they recently concluded and that the related fiscal impacts have been included in the proposed budget.

Chair O'Neill inquired if \$18.3 million is the anticipated surplus fund balance. Finance Director/Treasurer Catlett confirmed that is what the number represents, but that it differs from the third quarter projection because it does not take into account current year budget savings or the latest revenue information.

Chair O'Neill inquired about the Environmental Liability Fund of \$8.9 million. Finance Director/Treasurer Catlett advised that is mainly kept in reserve for the maintenance of the cap and related facilities for the landfill at the western end of the City. Chair O'Neill requested Utilities Director Mark Vukojevic provide an update to the Finance Committee as to what the anticipated uses are for the \$8.9 million.

Committee Member Scarbrough inquired about the PEG Fees Fund. Finance Director/Treasurer Catlett explained it is a 1% surcharge of franchise fees on cable operators and is set aside for CIP-related expenditures related to government access television and other types of programming and systems for broadcasting official City meetings.

Chair O'Neill inquired about the General Liability Reserve Fund expenditures of \$6.9 million. Finance Director/Treasurer Catlett clarified that this amount includes excess insurance premium payments, settlements, and legal fees. Chair O'Neill requested staff provide additional information on this.

Chair O'Neill agreed with using the structural surplus to prefund \$5 million towards CalPERS Unfunded Accrued Liability (UAL) and allocating \$1 million to establish an initial fund balance for the Recreational Facilities Finance Plan. He advised his preference would be to use the \$1.8 million for FY 2023-24 CIP for the Balboa Island Drainage Project. He advised he does

not see the need to recommend to the City Council how to spend the \$14.4 million at this time and would like to wait for the final year-end surplus to be calculated.

Committee Member Scarbrough advised there was at one point money in the budget for a capital improvement project at the Community Center in West Newport. She inquired if other items were removed from the budget due to the pandemic and never added back again. Finance Director/Treasurer Catlett believes on the project may have been included in a presentation by Director of Public Works David Webb regarding projects deferred during the pandemic, but noted if so, the funding was not deleted but deferred.

Committee Member Collopy noted the total UAL contribution would be \$45 million inclusive of the additional \$5 million. He inquired if Chair O'Neill remembered the discussion from four years ago when the Finance Committee was looking to scrape together \$31 million. Chair O'Neill noted he is unsure if the City can remain on this road over the next few years given the possibility of a recession. He noted he would be shocked if CalPERS hits its benchmark of 6.8% this year.

Finance Director/Treasurer Catlett reported the UAL would be fully funded in 2027-28 under current assumptions with future payments of \$45 million per year. Chair O'Neill advised there will be a year when a future City Council will have an additional \$45 million to spend. Finance Director/Treasurer Catlett cautioned the payoff may extend to 2029/30 or beyond if the current market downturn is not reversed within the next 60 days.

Committee Member Collopy noted that during a recession the biggest impact on the City would be Sales Tax. He inquired if the City's Sales Tax consultants are sophisticated enough to project Sales Tax in future years. Finance Director/Treasurer Catlett explained their current view is there are no signs of an imminent recession. He explained the City would need to look at this again throughout next fiscal year and reevaluate the projection as new information becomes available. He noted staff will be looking at the risks of recession as part of the annual update to the long-range financial forecast. He advised a large part of the budget is discretionary and the City can react appropriately at any time if spending reductions are required.

Mayor Pro Tem Blom opined that the increased consumer spending in the City has been more on the luxury goods and travel side. He therefore does not see a recession as likely impacting the City to the degree it might other cities, even if TOT is decreased due to a reduction in visitors.

Committee Member Collopy inquired if the City was current on Uptown Newport Development Fees. Finance Director/Treasurer Catlett advised he was unaware of any delinquencies. Mayor Pro Tem Blom concurred and indicated that any prior issues had been resolved.

Committee Member Reed inquired about the Donations and Contributions on Page 21. Finance Director/Treasurer Catlett confirmed this amount was for the previously discussed capital projects.

Chair O'Neill called for public comments.

Mr. Mosher noted the agenda denotes the Finance Committee was provided with a paper copy of the budget. He advised residents may become interested in the budget book if they are notified that it has been posted. He confirmed it is included in the agenda, but most residents will not be able to find it. He advised the paper version is full of tabs and the PDF version that residents review at home also has electronic tabs. He was pleased to see the Chair's recommendation restored a breakdown of employees for each department. He noted that information was not available for the City Manager Department. He noted he was pleased to see the Chair inquire about line items like a previous Chair of the Finance Committee. He inquired about the \$7.9 million for Private Donations and Contributions and noted it has not

been a City practice to anticipate donations. He inquired if there was a change in the anticipated donations practice.

Chair O'Neill closed public comments.

Chair O'Neill agreed an announcement should be made on the splash page on the City's website regarding the availability of the budget document. He inquired if there were electronic tabs as recommended. Budget Manager Burguan advised the PDF has a clickable Table of Contents. She advised it is not visible by default. Finance Director/Treasurer Catlett suggested the Table of Contents display by default when the file opens.

Committee Member Collopy advised the first time he looked through the budget he spent several hours asking questions of the then Finance Director. He does not believe it will be worthwhile to go over that level of detail with the Finance Committee.

City Manager Leung clarified that Private Donations and Contributions are listed because the City has contracts with those entities and there is therefore some certainty as to the receipt of the funds.

Chair O'Neill advised the Finance Committee needs a consensus on a recommendation to the City Council.

Chair O'Neill expressed support for the full staff recommendation.

Committee Member Collopy expressed support for the full staff recommendation. He inquired why it is called a structural surplus. Finance Director/Treasurer Catlett explained it is to reflect that the surplus is not the result of one-time revenues and is therefore anticipated to recur in future fiscal years absent allocation to recurring expenditures.

Council Member Avery inquired if the \$14.4 million shown for the year-end surplus is locked in. Finance Director/Treasurer Catlett explained it is staff's current best projection and that final year-end results will come to the Finance Committee in September, then to the City Council in October to determine the allocation of the funds. He noted that after the City Council allocates the funds, Public Works Director David Webb would provide recommendations for using the funds as part of the fiscal year 2023-24 budget process.

Chair O'Neill noted it could be used for anything since it is General Fund and would like to see how things look in October.

Mayor Pro Tem Blom expressed support for using the \$7.8 million now.

The item was received and filed.

#### **D. INTERNAL AUDIT PROGRAM UPDATE**

**Summary:**

Bi-monthly progress update on the internal audit program

**Recommended Action:**

Receive and file.

Finance Director/Treasurer Catlett introduced the item.

Deputy Finance Director Michael Gomez provided a brief overview of the City's Internal Audit Program. He reported Procurement Policies, Cash Handling, Information Technology, Inventory Management, and Fiscal Policies have all been reviewed. He advised Accounts Payable Disbursements, Payroll, Fixed Asset Management, and Police Property and Evidence will be reviewed in the next fiscal year. He advised staff released a Request for Proposals



(RFP) to complete the remaining audits. He anticipates the contracts to be awarded in June. He provided a brief overview of the implementation of the previous five audit report findings and provided a status update on each topic. He advised the staff is drafting policies for Procurement and Cash Management. He reported that 14 other fiscal policies were identified as medium to low risk. He advised the highest priority policies will be reviewed or drafted within 12 months and the remaining policies are anticipated to be addressed within 24 months.

Finance Director/Treasurer Catlett advised Moss Adams completed their policy review and identified gaps. He explained there were items identified that did not have policies in addition to revisions to existing policies. Policies ultimately requiring City Council approval will be coming forward to the Finance Committee for review prior to the Council's review.

Deputy Finance Director Gomez advised staff is working on a schedule to complete the policies. He anticipates the Procurement and Cash Management Policies will be completed by the end of the summer with the Inventory Policy soon thereafter.

Chair O'Neill recommended staff contemplate if these will be Council Policies or Administrative Policies.

Council Member Avery inquired if staff ever conducted surprise cash audits. Finance Director/Treasurer Catlett advised this is not being conducted today but can be investigated.

Chair O'Neill called for public comments.

Mr. Mosher noted that some of the policies will become Council Policies, and some will become internal Administrative Policies. He inquired if any of the policies will remain confidential and if they will be presented to the City Council at a public meeting.

Chair O'Neill closed public comments.

Finance Director/Treasurer Catlett deferred to the Finance Committee as to whether the Committee would wish to review proposed changes or additions to the City's Administrative Policies. He noted he is looking to evaluate the recommendations of the auditors to determine which policies are appropriately Council Policies versus those that are better suited to be internal Administrative Policies reviewed and approved by staff. He advised he can bring the Administrative Policies to the Finance Committee if there is an interest in reviewing them.

The item was received and filed.

#### **E. 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 Special Joint Meeting of the City Council and Finance Committee will take place on May 24, 2022. He announced the Finance Committee will meet on May 26, 2022, to discuss the Financial Statement Auditor's Communication with the Finance Committee and the Finance Committee's recommendation to the City Council for the Fiscal Year 2022-23 Budget.

Committee Member Collopy suggested eliminating May 26, 2022, meeting. Chair O'Neill advised it would not be possible as something may come out of the Joint Meeting that may need to be addressed.

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 4:40 p.m. to the next regular meeting of the Finance Committee.

The agenda for the Regular Meeting was posted on May 5, 2022, at 6:33 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:

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Will O'Neill, Chair  
Finance Committee

\_\_\_\_\_  
Date