

**CITY OF NEWPORT BEACH
FINANCE COMMITTEE
June 27, 2019 MEETING MINUTES**

I. CALL MEETING TO ORDER

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

II. ROLL CALL

PRESENT: Chair/Mayor Pro Tem Will O'Neill, Mayor Diane Dixon (3:03 p.m.), Council Member Joy Brenner, Committee Member William Collopy, Committee Member John Reed, Committee Member Joe Stapleton, Committee Member Larry Tucker

STAFF PRESENT: City Manager Grace K. Leung, Finance Director/Treasurer Dan Matusiewicz, Deputy Director/Finance Steve Montano, Utilities Director Mark Vukojevic, Budget Manager Susan Giangrande, Water Conservation Coordinator Shane Burckle, Assistant City Engineer Michael Sinacori, Field Superintendent II Steffen Catron, Administrative Specialist to the Finance Director Marlene Burns, and Senior Management Analyst Joshua Rosenbaum

MEMBERS OF THE PUBLIC: Jim Mosher

OTHER ENTITIES: Sanjay Gaur and Khanh Phan of Raftelis Financial Consultants, Inc., Khanh Phan, Raftelis Financial Consultants, Inc.

III. PUBLIC COMMENTS

Chair O'Neill opened public comments.

Jim Mosher referenced comments he made in a previous meeting regarding a discrepancy in the budget relative to how much is being budgeted to be paid to Council Members and since then he has been informed that the correct amount has been paid, according to the City Charter. Additionally, he commented on the rate paid to the Mayor (50 percent above what other Council Members receive) and noted that it complied with a previous Charter amendment. In addition, he reported the term of several Committee Members will expire soon and asked about the status of making new appointments, as last year, appointments were made before terms expire.

It was noted appointments would be made during City Council's meeting on July 9, 2019.

IV. CONSENT CALENDAR

A. MINUTES OF MAY 30, 2019

Recommended Action:
Approve and file.

MOTION: Committee Member Stapleton moved, and Committee Member Tucker seconded, to approve the minutes. The motion carried, with 5 ayes – 0 noes, 2 abstentions (Brenner and Collopy).

V. CURRENT BUSINESS

A. 2019 WATER RATE STUDY

Summary:

The Utilities Department retained the consulting services of Raftelis Financial Consultants Inc. to prepare the 2019 Water Rate Study. The previous water rate study was completed in 2009 and the last rate increase for water users was in 2014. The purpose of this presentation is to review the preliminary results of the draft water rate study, receive input, and seek the Committee's direction to move the item to City Council for discussion and approval.

Recommended Action:

- a) Review the water enterprise fund financial analysis and 2019 Draft Water Rate Study information and provide input to staff; and
- b) Forward the item to City Council for discussion and consideration.

Director/Treasurer Dan Matusiewicz introduced Sanjay Gaur, Vice President and Khanh Phan, Senior Consultant with Raftelis Financial Consultants, Inc.

Chair O'Neill presented a brief overview of the item addressing the City's various funds; noting this is an enterprise fund and all revenue needs to go through an offset on expenses and that increases in water rates, must go through a Proposition 218 analysis.

Sanjay Gaur, Vice President, Raftelis Financial Consultants, Inc., addressed the rate-study framework and prior meetings with Council Members and Committee Members noting direction is needed relative to Reserve policies and how much revenue the City would want to collect on fixed and variable components. He commented on the process, addressing customer impacts and developing an administrative record. Mr. Gaur provided background including the most-recent drought, dealing with droughts in the future and presented several approaches including increasing fixed costs to reflect fixed revenues, establishing a rate-stabilization fund, or implementing a dropped rate. He explained pros and cons for each approach and recommended establishing a rate-stabilization fund and considering fixed costs/fixed revenue policies. In addition, he discussed droughts and how to allocate water during drought conditions; explained lessons learned noting penalties help people cut down on their water use and some form of penalties will be needed in the next drought and commented on assessing penalties. Another approach would be to use a water budget framework and Mr. Gaur discussed the process including setting benchmark standards.

Committee Member Tucker asked whether that is something Council will be voting on and Utilities Director Mark Vukojevic reported the penalty assessment is not a Proposition 218 item but rather has more to do with Code Enforcement. He noted the timing has not yet been set but it will be an independent and parallel Council consideration.

Chair O'Neill added it is an alternative to having a drought rate.

Committee Member Tucker noted, at this point, that the discussion is about using penalties as an alternative but that the manner in which to penalize has not been decided.

Committee Member Collopy added that there has been no decision on the basis for the drought rate and in response to his inquiry; Utilities Director Mark Vukojevic stated input is needed at this point, but staff does not want to confuse the issue with too many decisions. Direction is needed in terms of either building a drought rate into the model or implementing Code Enforcement drought penalties.

Brief discussion followed regarding avoiding public confusion.

Mr. Gaur discussed the need for a reserve to deal with cash flow risks and risks of future droughts and noted clean water, pressurizing water and transporting is costly; and maintaining the water infrastructure has costs as well. He addressed various types of reserves including operational, CIP and rate stabilization.

Committee Member Collopy asked about the CIP and in response to his question, Utilities Director Mark Vukojevic reported that the City's CIP has averaged about \$5 million per year and that it is increasing to \$7.2 million. It was noted that the latter is the set-aside amount for future construction, not the actual dollars being expended.

Mr. Gaur continued with the presentation addressing the three types of reserves recommended.

Committee Member Collopy clarified it is a revenue loss reserve in the event of a drought.

Mr. Gaur recommended \$2.7 million as the revenue loss reserve and explained the reserve policy in terms of rate stabilization. In addition, he reported that the Council reserve policy talks about a capital reserve, but it is currently undefined. He proposed defining the capital reserve at 75 percent of the five-year CIP, or \$17 million.

Committee Member Collopy asked why the revenue loss reserve has to be inflationary and it was noted it is because the cost associated with purchasing the water will be increasing.

Mr. Gaur presented details of the financial model, commented on challenges in purchasing water on importing systems and noted the need for some type of revenue adjustment to address those challenges.

Committee Member Tucker asked for clarification of Slide 12 and Utilities Director Vukojevic explained it tracks the annual operating costs without capital spending. He added that the slide would be modified to show the whole picture including capital costs.

Mr. Gaur recommended doing a 7.5 percent increase in revenues for the next five years and although reserves will be going down, the City would continue to be above the target. He added that they are looking at a five-year rate adjustment.

In response to Committee Member Tucker's comment on the City spending another \$14 million of the reserves during those first five years to get down to the target. Committee Member Tucker stated that there is a backlog of projects worth \$13 million and that in order to land at the projected target reserves the City also needed to increase 7.5 percent in revenues. He stated it would be important to prepare a schedule that shows those increases are pass-through increases. Committee Member Tucker opined it would be helpful to account for what part of the 7.5 percent per annum for five years is because of the schedule.

Discussion followed regarding whether the Committee is comfortable with the 7.5 percent, the recommended reserve levels, capital costs and fixed and variable costs.

Utilities Director Vukojevic addressed another rate structure, which consists of building a pass-through into the actual rate, but noted staff is not recommending it. He opined it is better to calculate the math, upfront and show the actual rates.

Assistant City Engineer Michael Sinacori interjected that it has been five years since the last rate increase and in response to his question, it was noted that with Proposition 218, a pass-through could only be five years.

Mr. Gaur addressed the cost structure, different types of meters and rate options including maintaining a 31 percent fixed versus variable cost or do a slight increase to 34 percent.

Chair O'Neill explained that if the fixed rate is increased, substantially, people who care about the environment become upset as it takes away the incentive of people to reduce their water consumption.

Mr. Gaur recommended removing \$1.00 per month per unit charged for multi-family meters and commented on justifying rates, the compounding effect and various scenarios of fiscal impacts.

Chair O'Neill indicated the City has to get to a point where there is a higher fixed rate (34 percent) and noted the need for public outreach to explain it in an articulate way. He added costs are going up and the City needs to be able to provide clean water in a way that revenue balances with expenses. He recommended adoption of Option 2 at 34 percent.

Committee Member Tucker agreed with Chair O'Neill.

Committee Member Brenner asked how a "safe" reserve could be determined. Utilities Director Vukojevic stated that the City is well above its reserve policy, currently, but it is depleting, rapidly and he explained how the new reserve amount is determined using the analogy of having a water reservoir. Having reserves allows stability, going forward.

Chair O'Neill stated the target is being increased to 17 percent from 12.5 percent as a finance policy approved by Council. The goal is 17 percent but it is anticipated that after five years, it will be at 22 percent.

Discussion followed regarding 2009 rate increases and spending on the CIP side.

Utilities Director Vukojevic reported staff would go back and develop a history of how the 34 percent was generated.

Committee Member Tucker added he would be more inclined to focus on where the money will go from \$31 million to a target of \$17 million, the need for rate increases in the future and a starting point could determine where the money is needed and where the excess reserve will go.

Chair O'Neill opened public comments.

Jim Mosher commented on the \$2.7 million revenue loss reserve, based on a 30 percent drop in revenues and asked whether the drop is for one year rather than five and staff confirmed it would be 30 percent over one year or 10 percent over three years. Additionally, he stated in a Proposition 218, the City is supposed to charge the cost of providing service and suggested the City will charge more than what it costs to provide the service. He questioned how building up a reserve squares with the Prop 218 idea. He commented on fixed and variable costs and wondered if the term "fixed" is being used in two different senses, with respect to the water bill versus the water system.

Chair O'Neill reported that once the rate study is generated, the discussion about reserves and the analysis of Proposition 218 would be included. In terms of fixed costs on the expenses side and the revenues side, staff explained the water enterprise fund has 55 percent of its cost is fixed and the other 45 percent is variable. On the revenue side, there is a fixed cost of 31 percent and 69 percent variable. If they were made equal, there would be a significant impact to customers. Additionally, it was noted that Proposition 218 states there must be logic and rationality regarding rates.

Chair O'Neill closed public comments.

MOTION: Chair O'Neill moved, and Committee Member Collopy seconded, to forward the item to City Council for discussion and consideration and recommend to City Council that it adopt rate option 2. The motion carried, unanimously, with 7 ayes – 0 noes.

B. WORK PLAN REVIEW

Summary:

Staff will review with the Committee the agenda topics scheduled for the remainder of the calendar year.

Recommended Action:

Receive and file.

Chair O'Neill announced appointments for Committee Members will be made at the next City Council meeting and the Finance Committee will meet again in September, adding that notices will be sent. He thanked everyone for their service.

VI. FINANCE COMMITTEE ANNOUNCEMENTS ON MATTERS WHICH MEMBERS WOULD LIKE PLACED ON A FUTURE AGENDA FOR DISCUSSION, ACTION OR REPORT (NON-DISCUSSION ITEM) - None

VII. ADJOURNMENT

The Finance Committee adjourned at 4:14 p.m. to the next regular meeting of the Finance Committee.

Filed with these minutes are copies of all materials distributed at the meeting.

The agenda for the Regular Meeting was posted on June 21, 2019, at 12:45 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