

**CITY OF NEWPORT BEACH
CITY COUNCIL FINANCE COMMITTEE
NOVEMBER 18, 2013 MEETING MINUTES**

1. CALL TO ORDER

The meeting was called to order at 4:00 p.m. in the Newport Coast Conference Room, Bay 2E, 100 Civic Center Drive, Newport Beach, California 92660.

2. ROLL CALL

Present: Council Member Mike Henn (Chair), Mayor Keith Curry and Council Member Tony Petros

Staff present: City Manager Dave Kiff, Deputy City Manager Terri Cassidy, Finance Director Dan Matusiewicz, Deputy Finance Director Steve Montano, Budget Manager Susan Giangrande and Administrative Coordinator Tammie Frederickson

Members of the public: Jim Mosher, Carl Cassidy

3. PUBLIC COMMENTS

Mr. Jim Mosher inquired on the status of the Finance Committee work plan for the coming year; commented on possible public interest in the two reports posted by Finance staff about development fees showing what fees have been collected and how the fees were used during the last fiscal year; and he expressed that he has no intention of pursuing an appeal to the courts on the alleged Brown Act violations which was the subject of the last Finance Committee meeting. He reminded the Committee that the City Attorney stated discussions with the majority of elected officials of a legislative body must take place only at noticed meetings and there are no exceptions.

Mr. Mosher commented on the trash contract and noted the financial decision whether or not to outsource was based on savings. He believed it was unfair to have placed the burden on the trash collectors of demonstrating that insourcing was economical and feasible. He questioned the accuracy of recycling figures provided by CR&R and noted some members of the public may feel misled by information from CR&R regarding sending green waste to the landfill. This is because that may not be possible in the future and would then require implementation of a more expensive program.

4. APPROVAL OF MINUTES

Mayor Curry instructed a correction to his statement on page 2 from "...a waste of taxpayer time and effort" to "...a waste of taxpayer money." Mayor Curry moved, Council Member Petros seconded to approve the minutes of the October 15, 2013, Finance Committee meeting with the above correction. The Committee voted all ayes to approve the minutes.

All documents distributed for this meeting are available in the
administration office of the Finance Department

5. CURRENT BUSINESS

A. Review of Public Employees Retirement System (PERS) Valuations

Finance Director Dan Matusiewicz reviewed a presentation on the June 30, 2012, CalPERS Actuarial Valuations used to determine the 2014-15 contribution rates for safety and miscellaneous employees. The slideshow illustrated pension fundamentals; pension risks; retirement contributions; historical components of pension funding; the relationship between investment return and pension cost; CalPERS historic investment returns; plan cost variables such as mortality, investment returns, industrial disability retirements and workforce size; and a CalPERS timeline of historical decisions that affected actuarial assumptions.

Mr. Matusiewicz reviewed the new CalPERS asset smoothing methodology which will impact contribution rates starting in fiscal year 2016 and will result in a better funded plan with more stability. The previous actuarial value approach for the determination of rates is being eliminated. The difference between the actuarial value basis and market value basis is \$88.9 million which will be added to the unfunded liability and phased into rates over 5 years. Council Member Henn questioned whether the smoothing of the \$88.9 million is readjusted every year during the 5-year period if the asset value changes. Mr. Matusiewicz responded that a successive trapezoid-shaped amortization base is added to the schedule each year. The amortization base can be positive or negative depending on whether there is a net actuarial gain or loss for the year.

Mr. Matusiewicz went on to discuss projected PERS rates and pension costs. He noted that under the old methodology the unfunded liability continued to creep upwards each year and he illustrated an analogy of a homeowner refinancing a 30-year mortgage every year. He stated that under the new methodology the unfunded liability over a period of time will look very different than the old methodology. Referring to the mortgage analogy, this smoothing methodology will result in truly paying down the mortgage instead of refinancing every year. Mayor Curry added that under the new methodology the unfunded liability gets recalculated every year and is affected by factors such as mortality rates and investment assumptions. Council Member Henn commented there will be new deficits created over time but it will be paid off at the end of the 30-year amortization period. Council Member Petros agreed that the City has taken a responsible approach with steps already made to reduce our costs but he believed the unfunded liability will never go away. He suggested that the Council should express support for the efforts San Jose Mayor Reed is undertaking on a potential pension reform ballot measure.

Mr. Matusiewicz spoke on the projected pension cost increases and noted in six years the employer contribution will increase \$10 million. Council Member Henn remarked we should find a way to message the good things the City is doing such as the advance payments that were made, the shift to a fully amortizing methodology the City elected ahead of CalPERS, the reductions in employment

levels, and the fact that employees are paying a portion of the employer costs. Mayor Curry commented that by the end of the next fiscal year, employees will have gone from paying \$0 to \$7 million a year in costs; that is substantial progress and there is the possibility of employees picking up a portion of the increased cost, particularly safety employees. Council Member Henn advised against using percentages in discussions and to stick with using dollar amounts.

Mr. Matusiewicz noted in terms of the unfunded liability, the City was fully funded in 2007 on a market value basis. He commented that 60% of the pension benefit obligation is associated with separated employees and 40% is associated with active members. Mayor Curry remarked the footnote on that slide should be corrected because it was not in sync with the percentages shown in the pie chart.

More actuarial changes on the horizon will likely impact 2015-16 rates, including a possible 0.25% reduction to the discount rate, a new experience study looking at mortality and disability retirement assumptions, a review of the investments strategy and GASB Statement No. 68 requirement to report unfunded pension liability on the balance sheet. This reporting requirement will not change our means of funding the pension liability.

As previously noted by members of the Finance Committee, the latest actuarial valuation does not reflect steps taken by the City Council toward pension reform. Council Member Henn insisted that it is important to find a way to express the fact in dollars. It is important to reflect the fiscal impact of decisions that have a substantive benefit in reducing the liability beyond what it otherwise would have been. Mr. Matusiewicz concluded the presentation with his recommendations to continue with maintaining reasonable employee contributions, seeking opportunities for staffing efficiencies to keep payroll in check, and consider the use of reserves to accelerate payments on the unfunded liability so as to avoid the interest that accrues to the City from the liability. Mayor Curry further recommended an increase to employee contributions, especially safety employees. He added another key element is to constrain compensation growth. Council Member Henn commented that as contract negotiations begin it is important in terms of policy direction to understand compensation distinctions and how to control payroll cost growth. Deputy City Manager Terri Cassidy noted that some agencies have made a policy decision to only hire new hires as opposed to laterals. City Manager Kiff remarked that would result in possibly replacing top executives with someone from the private sector who has never been in PERS but it is something for the Council to consider.

Council Member Henn stated the recommendations are not ready to go forward and that Council needs to have a thoughtful discussion about the recommendations and establish the policy direction Council wants to take. He directed staff to bring back an expanded list of aggressive policy options and include a dollar value expressed for the steps already taken toward reducing the cost through negotiated increases in employee contributions. Mayor Curry

added it should be explained that the \$89 million increase in the liability is the result of CalPERS changing the assumptions and calculations in a way that states the number in a much different way than it was a year ago.

Mr. Mosher commented it would be useful to the public to understand how the various formulas work for calculating employee pensions. Mr. Kiff remarked the CalPERS website provides information on pension formulas.

B. Quarterly Financial Review Q4 FY 2012-13 and Q1 FY 2013-14

Deputy Finance Director Steve Montano went over the financial results for the fourth quarter of fiscal year 2012-13, the period between April 1 and June 30. Newport Beach continues to be a prosperous and financially secure municipality due to the strong underlying tax base, strong governance and disciplined fiscal decisions. He reviewed the "Top 3" revenue sources which are property tax, sales tax and transient occupancy tax (TOT), and he reported increases higher from the prior fiscal year for each of the three sources. In response to Council Member Petros' question regarding why the sales tax year-to-date actual is lower than the amended budget, Mr. Matusiewicz explained the State Board of Equalization made a large adjustment for some funds that were misallocated to the City.

Mr. Montano concluded that overall in FY 2013-13, the net increase to the City's General Fund reserve was \$2.6 million. Council Member Henn asserted there was a positive \$7.4 million revenue variance and a \$5 million positive expenditure variance, which amounts to a \$12.4 million positive variance on an operating basis. He pointed out the policy decision made to transfer \$11.6 million out of the General Fund to reserves. Mayor Curry commented it is important to get the message out that the \$12.4 million operating variance was achieved through reduced expenditures and higher revenue growth to finish the fiscal year with a budget surplus over the adopted budget. Putting the number in perspective, Mayor Curry stated the surplus is 150% higher than the \$8 million debt service cost for City Hall, or from another perspective the surplus would cover six years of the \$2 million yearly pension cost increase. He emphasized the City continues to be in strong shape and will continue stringent efforts to reduce pension liability costs.

Council Member Henn remarked that achieving the budget surplus is a mark of distinction to those who operate the City and a view of the operating performance should be isolated and highlighted.

In response to a question raised by Mayor Curry, Mr. Montano replied the aggregate total reserves, which include discretionary and committed reserves, total \$130 million. Mr. Matusiewicz noted the Facilities Reserve currently includes committed money that has not yet been set aside for a couple of capital projects, namely Marina Park and Sunset Ridge. Council Member Henn asked staff to find a consistent methodology for expressing the amount of available reserves. Mayor Curry declared the City's reserves are at their highest level in the 108 year history of the City. He stated it is important for the taxpayers to know that in terms of how we're being good stewards of the City finances. Council Member Petros pointed out that for policy making, it is vitally important to report

consistently and correctly the reserve amount and how you arrive at that amount.

Mr. Montano went on to report on the first quarter for fiscal year 2014-15, the period between July 1 and September 30. As is typically the case, much of the revenue lags during the first quarter, such as property tax and sales tax. He noted the TOT which reflects 26% of revenue covers the summer months. Council Member Petros questioned whether the housing market is keeping pace with the fourth quarter as reported. Mr. Montano responded it is too early to offer any projected increase over what was conservatively budgeted.

In response to a question raised by Council Member Petros, Mr. Kiff said the information on CalPERS was included in the draft Quarterly Financial Report because PERS released the actuarial reports and this is an opportunity to help educate the public on the issue. Council Member Henn expressed that the CalPERS discussion is not relevant to the financial report and the conclusion for the first quarter should be a positive indication that the budget is on track. Mr. Henn preferred a separate PERS primer document that addresses some of the pension issues.

Mr. Mosher inquired about the charts and suggested a revision for clarification to the column heading "Percent of 2012/13 Budget Realized." He also questioned whether the Top 3 components are consistent with the Performance Plan that shows a large amount of funds coming from fees for services yet there is no mention of these funds or the tidelands fund in the financial report. Mr. Matusiewicz responded that this is the first year a separate tidelands report was published to address issues raised by the State Lands Commission. Agreement was expressed to include some verbiage in the quarterly financial report on the expanded tidelands financial report.

C. Budget Process Strategy and Roadmap

Budget Manager Susan Giangrande discussed the fiscal year 2014-15 budget process. The budget will be compiled using new budgeting software technology that will bring more structure and efficiency to the budgeting process. Ms. Giangrande spoke about the improved reporting and expanded capability features of the software, City Vision. She reviewed highlights and a timeline for the new Enterprise Resource Planning (ERP) program selection and implementation process with modules phased in over time through mid-2017.

Ms. Giangrande gave an overview of the 2014-15 budget calendar. Council Member Petros stated that during the budget review process, he is interested in addressing staffing and project management oversight which appears to constrain the capacity to execute capital projects.

Council Member Henn commented the revenue assumptions included in the roadmap are conservative and the Committee Members did not express any concerns with the conservative nature of the assumptions. The discussion moved on to expenditures wherein Mr. Kiff suggested that at the January Council goal

setting session there could be further discussion on the Council priorities for completing capital projects faster. He commented that operationally the next year will include changes to trash collection service, a consultant's study on fire and emergency medical services that may result in a change, the class and compensation study as well as the new ERP will result in operational changes, and maintenance and operation of higher technology buildings including OASIS and the Civic Center.

Mr. Kiff spoke on citizen engagement in the budget process and said he is open to suggestions on how to achieve a dialogue with the public to help them better understand various aspects of putting together the City's budget.

Mr. Cassidy encouraged promoting the work of this Committee to members of the public. He stated his belief that the public would benefit from the opportunity to listen to the discussion and interaction with staff. Mr. Cassidy thanked the Committee Members and staff for breaking down the information and he requested there always be monthly meetings of the Finance Committee.

Mr. Mosher asked about how performance based budgeting fits in with the changes to the new budgeting software and the ERP. Council Member Henn explained performance based budgeting does not automatically tie in to a new ERP system. He stated the ERP will help facilitate steps towards performance based budgeting which he articulated as activities of the City defined and prioritized through its programs and an assignment of revenues and costs associated with the programs. The City Vision software is an enhanced reporting tool that is revenue and expenditure oriented.

Ms. Giangrande commented that one new feature of City Vision will be the ability to report the full pension obligation and employee contribution in the fiscal year 2014-15 detail budget.

On the topic of citizen engagement, Mr. Mosher commented it is disappointing in many areas and we have a long way to go to get the public actively engaged in financial matters.

6. FINANCE COMMITTEE ANNOUNCEMENTS OR MATTERS WHICH MEMBERS WOULD LIKE PLACED ON A FUTURE AGENDA FOR DISCUSSION, ACTION OR REPORT (NON-DISCUSSION ITEM)

Council Member Henn directed staff to return with a pension summary and a 2014 work plan.

7. ADJOURNMENT

The Finance Committee adjourned at 5:54 p.m.

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

Attest:



Mike Henn, Chair
Finance Committee Chair

Date

All documents distributed for this meeting are available in the
administration office of the Finance Department