CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA

Newport Coast Conference Room, Bay 2E - 100 Civic Center Drive, Newport Beach, California 92660

July 21, 2014 - 4:00 PM

Finance Committee Members:	***Staff Members:***
Mike Henn, Council Member, Chair	Dave Kiff, City Manager
Keith Curry, Council Member	Dan Matusiewicz, Finance Director
Tony Petros, Council Member	Steve Montano, Deputy Finance Director

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(1) CALL MEETING TO ORDER

(2) ROLL CALL

(3) PUBLIC COMMENTS

Public comments are invited on agenda and non-agenda items generally considered to be within the subject matter jurisdiction of the Finance Committee. Speakers must limit comments to 3 minutes. Before speaking, we invite, but do not require, you to state your name for the record. The Finance Committee has the discretion to extend or shorten the speakers' time limit on agenda or non-agenda items, provided the time limit adjustment is applied equally to all speakers. As a courtesy, please turn cell phones off or set them in the silent mode.

(4) APPROVAL OF MINUTES

Minutes for the April 29, 2014 Finance Committee meeting

(5) CURRENT BUSINESS

A. Annual Investment Policy Review (F-1)

Staff will present the results of the annual review of the City's investment policy and seek approval and guidance from the Finance Committee regarding the scope, objectives, and standards that govern the City's investment portfolio. No revisions are proposed at this time.

B. Annual Investment Performance Review

Staff and/or one or more investment advisors will describe the performance of the City's investment portfolio.

C. Council Reserve Policy (F-2) Review

On March 24, 2014 and April 29, 2014, staff presented certain proposed revisions to Council Policy F-2. Staff will seek direction from the Finance Committee whether further revisions to Council Policy F-2 are desired.

D. CalPERS Unfunded Liability Review and Pension Primer

Staff will introduce a pension primer that describes the City's pension benefit plan and the City's efforts to manage its financial exposure to rising pension liabilities while at the same time maintaining its support for promised benefits. The primer is organized in an easy to understand question/answer format as a means to educate the public about this complex topic.

E. ERP Milestone Review

Staff will provide the Committee with a progress report on the Enterprise Resource Plan project to receive and file.

F. Review of Latest Post Employment Retiree Insurance Actuarial Valuation (AKA OPEB)

This agenda item is deferred due to our OPEB actuaries requesting additional time to complete their analysis. This item will be presented at the next Finance Committee meeting.

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

(7) ADJOURNMENT

This Finance Committee is subject to the Ralph M. Brown Act. Among other things, the Brown Act requires that the Finance Committee's agenda be posted at least seventy-two (72) hours in advance of each regular meeting and that the public be allowed to comment on agenda items before the Finance Committee and items not on the agenda but are within the subject matter jurisdiction of the Finance Committee. The Finance Committee may limit public comments to a reasonable amount of time, generally three (3) minutes per person.

It is the intention of the City of Newport Beach to comply with the Americans with Disabilities Act ("ADA") in all respects. If, as an attendee or a participant at this meeting, you will need special assistance beyond what is normally provided, the City of Newport Beach will attempt to accommodate you in every reasonable manner. If requested, this agenda will be made available in appropriate alternative formats to persons with a disability, as required by Section 202 of the Americans with Disabilities Act of 1990 (42 U.S.C. Sec. 12132), and the federal rules and regulations adopted in implementation thereof. Please contact the City Clerk's Office at least forty-eight (48) hours prior to the meeting to inform us of your particular needs and to determine if accommodation is feasible at (949) 644-3005 or cityclerk@newportbeachca.gov .

NEWPORT BEACH

ITEM TITLE: Minutes for the April 29, 2014 Finance Committee meeting

ATTACHMENTS:

Description

Draft Minutes April 29, 2014 Finance Committee Meeting

CITY OF NEWPORT BEACH
CITY COUNCIL FINANCE COMMITTEE
APRIL 29, 2014 MEETING MINUTES

1. CALL TO ORDER

The meeting was called to order at 4:02 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), Council Member Keith Curry and Council Member Tony Petros

Staff present: City Manager Dave Kiff, Deputy City Manager/Human Resources Director Terri Cassidy, Finance Director Dan Matusiewicz, Deputy Finance Director Steve Montano, Budget Manager Susan Giangrande, Accounting Manager Rukshana Virany, Assistant City Attorney Leonie Mulvihill, Acting Municipal Operations Department Director George Murdoch, and Administrative Coordinator Tammie Frederickson

Members of the public: Jim Mosher, Carl Cassidy, Larry Tucker

Outside entities: John Farnkopf and Sima Mostafaei from HF&H

3. PUBLIC COMMENTS

Mr. Jim Mosher made a comment pertaining to financial transparency related to the City's arts initiatives and the difficulty of identifying whether there was an RFP process for the selection of a park sculptures coordinator, whether a contract was let and where the funding is included in the budget. He also mentioned that obtaining employee compensation information on the City's website was not as readily accessible in comparison to the information available on the websites of other cities.

4. APPROVAL OF MINUTES

Council Member Curry moved, and Council Member Petros seconded the approval of the March 24, 2014, Finance Committee meeting minutes. The Committee voted all ayes to approve the minutes with the corrected erratum pointed out by Mr. Mosher.

5. CURRENT BUSINESS

A. Review of FY 2014-15 Proposed Budget

Finance Director Dan Matusiewicz previewed the budget presentation scheduled for the May 13, 2014, City Council Study Session. He stated the proposed budget is balanced with a surplus of $29,000 and he outlined items totaling $41 million in strategic savings comprised as Contingency Reserves. There was discussion on the timing for making a discretionary reduction of $1 million beyond what is required on the pension liability.

Council Member Curry questioned how much expenditures are increasing and noted confusion that total General Fund expenditures are reported as increasing 6.7% in the Performance Plan City Manager's Transmittal letter. City Manager Kiff agreed it is confusing as written since a comparison of operating expenditures would be different than total General Fund expenditures which include CIP expenditures and rebudgets from the prior year.

Council Member Curry raised a question on sales tax allocation and how the sales tax point of sale is determined for online sales. Mr. Matusiewicz indicated that he will research the State Board of Equalization interpretation.

Council Member Curry stated that to make it easy for the public to compare year over year, the presentation should identify the General Fund budget, CIP budget and the total budget for the City, including Enterprise Fund revenue.

Council Member Petros noted in the FFP Highlights section of the presentation that the amounts for West Newport Community Center and Lower Castaways Park should be identified as "design" to make it clear for the public to understand the amounts shown are not the total project cost.

Council Member Henn commented it is helpful in the presentation to show how the results of the current year budget revenues and expenditures compare with next fiscal year's proposed budget. City Manager Kiff clarified the comparison would be the current year amended budget which includes the mid-year budget amendment.

Mr. Mosher noted his perceived discrepancies in the budget detail. He also noted his confusion in reconciling what the Council approved in the adopted budget with the amended budget.

Mr. Cassidy thanked the Committee and staff for their work and their availability in providing answers to questions raised by the public.

B. FFPP Project Planning Review

Mr. Matusiewicz stated that some of the projects are in the planning stages and it is too early to develop cost estimates. Council Member Henn concurred it is premature to reflect some of the costs included in the analysis and significant expenditures for new projects or large project enhancements should not be reflected until the point of conceptual plan approval. Council Member Curry added the scope should be narrowed to a 30-year plan.

City Manager Kiff noted the FFPP is used as a long-range planning tool for funding and will be revised based on the Committee's direction.

C. Phase I Changes to Council Policies F-2 (Reserve Policy) and B-2 (Recreation Fees and Related Equipment Replacement Reserves)

The Committee directed staff to implement the revisions proposed as phase 1 to the Reserve Policy and bring the policy revisions to the full City Council for approval. A subsequent discussion is needed for the revisions proposed as phase 2 and should be brought back at a later date.

D. Quarterly Financial Review

The Committee members had no discussion on this item. It was designated as receive and file.

Mr. Mosher commented the public might have an interest in knowing the amount of property tax coming from residential properties that is received by the City.

E. ERP Milestone Review

The Committee members had no discussion on this item. It was designated as receive and file.

F. Review and consider the Proposed Recycled Water Rates and Structure

Acting Municipal Operations Department Director George Murdoch outlined a proposal to reduce the recycled (non-potable) water rate and revise the computation to a fixed fee based on the cost structure.

Mr. Murdoch confirmed that the decrease in recycled water rates will have no impact on potable water rates and that this reduced rate provides full cost recovery of the recycled water operation.

In response to a question raised by Mr. Mosher, Mr. Murdoch explained that revenues resulting from rates that were higher in prior years were used to rebuild pump station infrastructure.

The Committee concurred with the recommendation to bring the matter to the full City Council for approval.

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

No other items were discussed.

7. ADJOURNMENT

The Finance Committee adjourned at 5:45 p.m.

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

Attest:

Mike Henn, Chair Finance Committee Chair	Date

NEWPORT BEACH

ITEM TITLE: Annual Investment Policy Review (F-1)

ITEM SUMMARY: Staff will present the results of the annual review of the City's investment policy and seek approval and guidance from the Finance Committee regarding the scope, objectives, and standards that govern the City's investment portfolio. No revisions are proposed at this time.

ATTACHMENTS:

Description

5A - Annual Investment Policy Review and Update

CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA ITEM INFORMATION

Agenda Item No. 5A
July 21, 2014

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Dan Matusiewicz, Finance Director
(949) 644-3123 or Danm@newportbeachca.gov

SUBJECT: Annual Investment Policy Review and Update

RECOMMENDATION:

Receive and file or provide staff with policy direction related to the current investment policy.

DISCUSSION:

Consistent with Section K-2 of Council Policy F-1, Statement of Investment Policy (the Policy), the Finance Department has completed an annual review of the Policy to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.

Finance staff recently met with representatives from each of the City's financial investment advisory firms to solicit suggested changes to the Investment Policy. There is consensus among the advisors and the Finance Department that no changes are needed in order to achieve the City's overall objectives at this time.

Prepared by:	Submitted by:
/s/Cory Pearson	/s/Dan Matusiewicz
Cory Pearson	Dan Matusiewicz
Accountant	Finance Director

Attachment: Council Policy F-1, Statement of Investment Policy

STATEMENT OF INVESTMENT POLICY

PURPOSE:

The City Council has adopted this Investment Policy (the Policy) in order to establish the scope of the investment policy, investment objectives, standards of care, authorized investments, investment parameters, reporting, investment policy compliance and adoption, and the safekeeping and custody of assets.

This Policy is organized in the following sections:

A. SCOPE OF INVESTMENT POLICY

1. Pooling of Funds

All cash shall be pooled for investment purposes. The investment income derived from the pooled investment shall be allocated to the contributing funds, net of all banking and investing expenses, based upon the proportion of the respective average balances relative to the total pooled balance. Investment income shall be distributed to the individual funds not less than annually.

2. Funds Included in the Policy

The provisions of this Policy shall apply to all financial assets of the City as accounted for in the City's Comprehensive Annual Financial Report, including;

a) General Fund
b) Special Revenue Funds
c) Capital Project Funds
d) Enterprise Funds
e) Internal Service Funds
f) Trust and Agency Funds
g) Permanent Endowment Funds
h) Any new fund created unless specifically exempted

If the City invests funds on behalf of another agency and, if that agency does not have its own investment policy, this Policy shall govern the agency's investments.

3. Funds Excluded from this Policy

Bond Proceeds - Investment of bond proceeds will be made in accordance with applicable bond indentures.

B. INVESTMENT OBJECTIVES

The City's funds shall be invested in accordance with all applicable City policies and codes, State statutes, and Federal regulations, and in a manner designed to accomplish the following objectives, which are listed in priority order:

1. Safety

Preservation of principal is the foremost objective of the investment program. Investments of the City shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. The objective shall be to mitigate credit risk and interest rate risk. To attain this objective, the City shall diversify its investments by investing funds among several financial institutions and a variety of securities offering independent returns.

a) Credit Risk

The City shall minimize credit risk, the risk of loss due to the failure of the security issuer or backer, by:

§ Limiting investments in securities that have higher credit risks, pre-qualifying the financial institutions, broker/dealers, intermediaries, and advisors with which the City will do business

§ Diversifying the investment portfolio so as to minimize the impact any one industry/investment class can have on the portfolio

b) Interest Rate Risk

To minimize the negative impact of material changes in the market value of securities in the portfolio, the City shall:

§ Structure the investment portfolio so that securities mature concurrent with cash needs to meet anticipated demands, thereby avoiding the need to sell securities on the open market prior to maturity

§ Invest in securities of varying maturities

2. Liquidity

The City's investment portfolio shall remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated without requiring a sale of securities. Since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets. A portion of the portfolio also may be placed in money market mutual funds or LAIF which offer same-day liquidity for short-term funds.

3. Yield

The City's investment portfolio shall be designed with the objective of attaining a benchmark rate of return throughout budgetary and economic cycles, commensurate with the City's investment risk constraints and the liquidity characteristics of the portfolio. Return on investment is of secondary importance compared to the safety and liquidity objectives described above. The core of investments is limited to relatively low risk securities in anticipation of earning a fair return relative to the risk being assumed.

C. STANDARDS OF CARE

1. Prudence

The standard of prudence to be used for managing the City's investment program is California Government Code Section 53600.3, the prudent investor standard, which states that "when investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency."

The City's overall investment program shall be designed and managed with a degree of professionalism that is worthy of the public trust. The City recognizes that no investment is totally without risk and that the investment activities of the City are a matter of public record. Accordingly, the City recognizes that occasional measured losses may occur in a diversified portfolio and shall be considered within the context of the overall portfolio's return, provided that adequate diversification has been implemented and that the sale of a security is in the best long-term interest of the City.

The Finance Director and authorized investment personnel acting in accordance with established procedures and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided that deviations from expectations are reported in a timely fashion to the City Council and appropriate action is taken to control adverse developments.

2. Ethics and Conflicts of Interest
Elected officials and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the City's investment program or could impair or create the appearance of an impairment of their ability to make impartial investment decisions. Employees and investment officials shall subordinate their personal investment transactions to those of the City. In addition, City Council members, the City Manager, and the Finance Director shall file a Statement of Economic Interests each year as required by California Government Code Section 87203 and regulations of the Fair Political Practices Commission.

3. Delegation of Authority
Authority to manage the City's investment program is derived from the Charter of the City of Newport Beach section 605 (j). The Finance Director

shall assume the title of and act as City Treasurer and with the approval of the City Manager appoint deputies annually as necessary to act under the provisions of any law requiring or permitting action by the City Treasurer. The Finance Director may then delegate the authority to conduct investment transactions and to manage the operation of the investment portfolio to other specifically authorized staff members. No person may engage in an investment transaction except as expressly provided under the terms of this Policy.

The City may engage the support services of outside investment advisors with respect to its investment program, so long as it can be demonstrated that these services produce a net financial advantage or necessary financial protection of the City's financial resources. Such companies must be registered under the Investment Advisors Act of 1940, be well-established and exceptionally reputable. Members of the staff of such companies who will have primary responsibility for managing the City's investments must have a working familiarity with the special requirements and constraints of investing municipal funds in general and this City's funds in particular. These firms must insure that the portion of the portfolio under their management complies with various concentration and other constraints specified herein, and contractually agree to conform to all provisions of governing law and the collateralization and other requirements of this Policy. Selection and retention of broker/dealers by investment advisors shall be at their sole discretion and dependent upon selection and retention criteria as stated in the Uniform Application for Investment Advisor Registration and related Amendments (SEC Form ADV 2A).

4. Internal Controls

The Finance Director is responsible for establishing and maintaining a system of internal controls. The internal controls shall be designed to prevent losses of public funds arising from fraud, employee error, and misrepresentation by third parties, unanticipated changes in financial markets, or imprudent action by City employees and officers. The internal structure shall be designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

D. BANKING SERVICES

Banking services for the City shall be provided by FDIC insured banks approved to provide depository and other banking services. To be eligible, a bank shall qualify as a depository of public funds in the State of California as defined in California Government Code Section 53630.5 and shall secure deposits in excess of FDIC insurance coverage in accordance with California Government Code Section 53652.

E. BROKER/DEALERS

In the event that an investment advisor is not used to purchase securities, the City will select broker/dealers on the basis of their expertise in public cash management and their ability to provide service to the City's account.

Each approved broker/dealer must possess an authorizing certificate from the California Commissioner of Corporations as required by Section 25210 of the California Corporations Code.

To be eligible, a firm must meet at least one of the following criteria:

1. Be recognized as Primary Dealers by the Federal Reserve Bank of New York or have a primary dealer within their holding company structure, or
2. Report voluntarily to the Federal Reserve Bank of New York, or
3. Qualify under Securities and Exchange Commission (SEC) Rule 15c3-1 (Uniform Net Capital Rule).

F. SAFEKEEPING AND CUSTODY OF ASSETS

The Finance Director shall select one or more banks to provide safekeeping and custodial services for the City. A Safekeeping Agreement approved by the City shall be executed with each custodian bank prior to utilizing that bank's safekeeping services.

Custodian banks will be selected on the basis of their ability to provide services for the City's account and the competitive pricing of their safekeeping related services.

The purchase and sale of securities and repurchase agreement transactions shall be settled on a delivery versus payment basis. All securities shall be perfected in the name of the City. Sufficient evidence to title shall be consistent with modern investment, banking and commercial practices.

All investment securities, except non-negotiable Certificates of Deposit, Money Market Funds and local government investment pools, purchased by the City will be delivered by book entry and will be held in third-party safekeeping by a City approved custodian bank, its correspondent bank or its Depository Trust Company (DTC) participant account.

All Fed wireable book entry securities owned by the City shall be held in the Federal Reserve system in a customer account for the custodian bank which will name the City as "customer."

All DTC eligible securities shall be held in the custodian bank's DTC participant account and the custodian bank shall provide evidence that the securities are held for the City as "customer."

G. AUTHORIZED INVESTMENTS

All investments and deposits of the City shall be made in accordance with California Government Code Sections 16429.1, 53600-53609 and 53630-53686. Any revisions or extensions of these code sections will be assumed to be part of this Policy immediately upon being enacted. The City has further restricted the eligible types of securities and transactions. The foregoing list of authorized securities and transactions shall be strictly interpreted. Any deviation from this list must be pre-approved by resolution of the City Council. In the event an apparent discrepancy is found between this Policy and the Government Code, the more restrictive parameter(s) will take precedence.

1. Investments Specifically Permitted

a) United States Treasury bills, notes, or bonds with a final maturity not exceeding five years from the date of trade settlement. There is no limitation as to the percentage of the City's portfolio that may be invested in this category.

b) Federal Instrumentality (government-sponsored enterprise) debentures, discount notes, callable and step-up securities, with a final maturity not exceeding five years from the date of trade settlement. There is no limitation as to the percentage of the portfolio that can be invested in this category.

c) Federal Agency Obligations for which the full faith and credit of the United States are pledged for the payment of principal and interest and which have a final maturity not exceeding five years from the date of trade settlement. There is no limitation as to the percentage of the portfolio that can be invested in this category.

d) Mortgage-backed Securities, Collateralized Mortgage Obligation (CMO) and Asset-backed Securities limited to mortgage-backed pass-through securities issued by a US government agency, or consumer receivable pass-through certificates or bonds with a final maturity not exceeding five years from the date of trade settlement. Securities eligible for investment under this subdivision shall be issued by an issuer whose debt is rated at least "A" or the equivalent by a Nationally Recognized Statistical Rating Organization (NRSRO). The security itself shall be rated at least "AAA" or the equivalent by an NRSRO. No more than five percent (5%) of the City's total portfolio shall be invested in any one issuer of mortgage-backed and asset-backed securities listed above, and the aggregate investment in mortgage-backed and asset-backed securities shall not exceed twenty percent (20%) of the City's total portfolio.

e) <u>Medium-Term Notes</u> issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States, with a final maturity not exceeding five years from the date of trade settlement, and rated at least "A" or the equivalent by an NRSRO. No more than five percent (5%) of the City's total portfolio shall be invested in any one issuer of medium-term notes, and the aggregate investment in medium-term notes shall not exceed thirty percent (30%) of the City's total portfolio.

f) <u>Municipal Bonds:</u> including bonds issued by the City of Newport Beach, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the City or by a department, board, agency, or authority of the City.

State of California registered warrants or treasury notes or bonds, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the state or by a department, board, agency, or authority of the state.

Registered treasury notes or bonds of any of the other 49 states in addition to California, including bonds payable solely out of the revenues from a revenue producing property owned, controlled, or operated by a state or by a department, board, agency, or authority of any of the other 49 states, in addition to California.

Bonds, notes, warrants, or other evidences of indebtedness of a local agency within California, including bonds payable solely out of the revenues from a revenue-producing property owned, controlled, or operated by the local agency, or by a department, board, agency, or authority of the local agency.

In addition, these securities must be rated at least "A" or the equivalent by a NRSRO with maturities not exceeding five years from the date of trade settlement. No more than five percent (5%) of the City's total portfolio shall be invested in any one municipal issuer. In addition, the aggregate investment in municipal bonds may not exceed thirty percent (30%) of the portfolio.

g) Non-negotiable Certificates of Deposit and savings deposits with a maturity not exceeding two years from the date of trade settlement, in FDIC insured state or nationally chartered banks or savings banks that qualify as a depository of public funds in the State of California as defined in California Government Code Section 53630.5. Deposits exceeding the FDIC insured amount shall be secured pursuant to California Government Code Section 53652. No one issuer shall exceed more than five percent (5%) of the portfolio, and investment in negotiable and nonnegotiable certificates of deposit shall be limited to thirty percent (30%) of the portfolio combined.

h) Negotiable Certificates of Deposit only with a nationally or state-chartered bank, a savings association or a federal association (as defined by Section 5102 of the Financial Code), a state or federal credit union, or by a federally licensed or state-licensed branch of a foreign bank whose senior long-term debt is rated at least "A", or the equivalent, or short-term debt is rated at least "A-1" or the equivalent by an NRSRO and having assets in excess of $10 billion, so as to ensure security and a large, well-established secondary market. Ease of subsequent marketability should be further ascertained prior to initial investment by examining currently quoted bids by primary dealers and the acceptability of the issuer by these dealers. No one issuer shall exceed more than five percent (5%) of the portfolio, and maturity shall not exceed two years. Investment in negotiable and non-negotiable certificates of deposit shall be limited to thirty percent (30%) of the portfolio combined.

i) Prime Commercial Paper with a maturity not exceeding 270 days from the date of trade settlement that is rated "A-1", or the equivalent, by an NRSRO. The entity that issues the commercial paper shall meet all of the following conditions in either sub-paragraph i. or sub-paragraph ii. below:

i. The entity shall (1) be organized and operating in the United States as a general corporation, (2) have total assets in excess of $500,000,000 and (3) have debt other than commercial paper, if any, that is rated at least "A" or the equivalent by an NRSRO.

ii. The entity shall (1) be organized within the United States as a special purpose corporation, trust, or limited liability company, (2) have program wide credit enhancements, including, but not limited to, over collateralization, letters of credit or surety bond and (3) have commercial paper that is rated at least "A-1" or the equivalent, by an NRSRO.

iii. No more than five percent (5%) of the City's total portfolio shall be invested in the commercial paper of any one issuer, and the aggregate investment in commercial paper shall not exceed twenty five percent (25%) of the City's total portfolio.

j) <u>Eligible Banker's Acceptances</u> with a maturity not exceeding 180 days from the date of trade settlement, drawn on and accepted by a commercial bank whose senior long-term debt is rated at least "A" or the equivalent by an NRSRO at the time of purchase. Banker's Acceptances shall be rated at least "A-1", or the equivalent at the time of purchase by an NRSRO. If the bank has senior debt outstanding, it must be rated at least "A" or the equivalent by an NRSRO. The aggregate investment in banker's acceptances shall not exceed forty percent (40%) of the City's total portfolio, and no more than five percent (5%) of the City's total portfolio shall be invested in banker's acceptances of any one bank.

k) <u>Repurchase Agreements and Reverse Repurchase Agreements</u> with a final termination date not exceeding 30 days collateralized by U.S. Treasury obligations or Federal Instrumentality securities listed in items 1 and 2 above with the maturity of the collateral not exceeding ten years. For the purpose of this section, the term collateral shall mean purchased securities under the terms of the City's approved Master Repurchase Agreement. The purchased securities shall have a minimum market value including accrued interest of one hundred and two percent (102%) of the dollar value of the funds borrowed. Collateral shall be held in the City's custodian bank, as safekeeping agent, and the market value of the collateral securities shall be marked-to-the-market daily.

Repurchase Agreements and Reverse Repurchase Agreements shall be entered into only with broker/dealers and who are recognized as Primary Dealers with the Federal Reserve Bank of New York, or with firms that have a Primary Dealer within their holding company structure. Primary Dealers approved as Repurchase Agreement counterparties shall have a short-term credit rating of at least "A-1" or the equivalent and a long-term credit rating of at least "A" or the equivalent. Repurchase agreement counterparties shall execute a City approved Master Repurchase Agreement with the City. The Finance Director shall maintain a copy of the City's approved Master Repurchase Agreement and a list of the broker/dealers who have executed same.

In addition, the City must own assets for more than 30 days before they can be used as collateral for a reverse repurchase agreement. No more than ten percent (10%) of the portfolio can be involved in reverse repurchase agreements.

l) <u>State of California's Local Agency Investment Fund (LAIF)</u>, pursuant to California Government Code Section 16429.1.

m) <u>County Investment Funds:</u> Los Angeles County provides a service similar to LAIF for municipal and other government entities outside of Los Angeles County, including the City. Investment in this pool is intended to be used as a temporary repository for short-term funds used for liquidity purposes. The Finance Director shall maintain on file appropriate information concerning the county pool's current investment policies, practices, and performance, as well as its requirements for participation, including, but not limited to, limitations on deposits or withdrawals and the composition of the portfolio. At no time shall more than five percent (5%) of the City's total investment portfolio be placed in this pool.

n) <u>Money Market Funds</u> registered under the Investment Company Act of 1940 that (1) are "no-load" (meaning no commission or fee shall be charged on purchases or sales of shares); (2) have a constant net asset value per share of $1.00; (3) invest only in the securities and obligations authorized in the applicable California statutes and (4) have a rating of at least AAA or the equivalent by at least two NRSROs. The aggregate investment in money market funds shall not exceed twenty percent (20%) of the City's total portfolio and no more than ten percent (10%) of the City's total portfolio shall be invested in any one fund.

2. Investments Specifically Not Permitted

Any security type or structure not specifically approved by this policy is hereby prohibited. Security types, which are thereby prohibited include, but are not limited to: "exotic" derivative structures such as range notes, dual index notes, inverse floating rate notes, leveraged or de-leveraged floating rate notes, interest only strips that are derived from a pool of mortgages and any security that could result in zero interest accrual if held to maturity, or any other complex variable or structured note with an unusually high degree of volatility risk.

The City shall not invest funds with the Orange County Pool.

3. Exceptions to Prohibited and Restricted Investments

The City shall not be required to sell securities prohibited or restricted in this policy, or any future policies, or prohibited or restricted by new State regulations, if purchased prior to their prohibition and/or restriction. Insofar as these securities provided no notable credit risk to the City, holding of these securities until maturity is approved. At maturity or liquidation, such monies shall be reinvested as provided by this policy.

H. INVESTMENT PARAMETERS

1. Diversification

The City shall diversify its investments to avoid incurring unreasonable risks inherent in over-investing in specific instruments, individual financial institutions or maturities. As such, no more than five percent (5%) of the City's portfolio may be invested in the instruments of any one issuer, except governmental issuers, investment pools and Money Market Funds. This restriction does not apply to any type of Federal Instrumentality or Federal Agency Security listed in Sections G1 b and G1 c above. Nevertheless, the asset allocation in the investment portfolio should be flexible depending upon the outlook for the economy, the securities markets and the City's anticipated cash flow needs.

2. Maximum Maturities

To the extent possible, investments shall be matched with anticipated cash flow requirements and known future liabilities. The City will not invest in securities maturing more than five years from the date of trade settlement, unless the City Council has by resolution granted authority to make such an investment at least three months prior to the date of investment.

3. Credit Quality

The City shall not purchase any security rated "A1" and / or "A+" or below if that security has been placed on "credit watch" for a possible downgrade by an NRSRO.

Each investment manager will monitor the credit quality of the securities in their respective portfolio. In the event a security held by the City is the subject of a rating downgrade which brings it below accepted minimums specified herein, or the security is placed on negative credit watch, where downgrade could result in a rate drop below acceptable levels, the investment advisor who purchased the security will immediately notify the Finance Director. The City shall not be required to immediately sell such securities. The course of action to be followed will then be decided on a case by case basis, considering such factors as the reason for the rate drop, prognosis for recovery or further drop, and market price of the security. The City Council will be advised of the situation and intended course of action.

4. Competitive Transactions

Investment advisors shall make best effort to price investment transactions on a competitive basis with broker/dealers selected consistent with their practices disclosed in form ADV 2A filed with the SEC. Where possible, at least three broker/dealers shall be contacted for each transaction and their bid or offering prices shall be recorded. If there is no other readily available competitive offering, the investment advisor shall make their best efforts to document quotations for comparable or alternative securities. If qualitative characteristics of a transaction, including, but not limited to, complexity of the transaction, or sector expertise of the broker, prevent a competitive selection process, investment advisors shall use brokerage selection practices as described above.

I. PORTFOLIO PERFORMANCE

The investment portfolio shall be designed to attain a market rate of return throughout budgetary and economic cycles, taking into account prevailing market conditions, risk constraints for eligible securities, and cash flow requirements. The performance of the City's investments shall be compared to the total return of a benchmark that most closely corresponds to the portfolio's duration, universe of allowable securities, risk profile, and other relevant characteristics. When comparing the performance of the City's portfolio, its rate of return will be computed consistent with Global Investment Performance Standards (GIPS).

J. REPORTING

Monthly, the Finance Director shall produce a treasury report of the investment portfolio balances, transactions, risk characteristics, earnings, and performance results of the City's investment portfolio available to City Council and the public on the City's Website. The report shall include the following information:

1. Investment type, issuer, date of maturity, par value and dollar amount invested in all securities, and investments and monies held by the City;
2. A description of the funds, investments and programs;
3. A market value as of the date of the report (or the most recent valuation as to assets not valued monthly) and the source of the valuation;
4. A statement of compliance with this Policy or an explanation for non-compliance

K. INVESTMENT POLICY COMPLIANCE AND ADOPTION

1. Compliance
Any deviation from the policy shall be reported to Finance Committee as soon as practical, but no later than the next scheduled Finance Committee meeting. Upon recommendation of the Finance Committee, the Finance Director shall review deviations from policy with the City Council.

2. Adoption
The Finance Director shall review the Investment Policy with the Finance Committee at least annually to ensure its consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends.

The Finance Director shall review the Investment Policy with City Council at a public meeting if there are changes recommended to the Investment Policy.

This Policy was endorsed and adopted by the City Council of the City of Newport Beach on October 9, 2012. It replaces any previous investment policy or investment procedures of the City.

Adopted – April 6, 1959
Amended – November 9, 1970
Amended – February 11, 1974
Amended – February 9, 1981
Amended – October 27, 1986
Rewritten – October 22, 1990
Amended – January 28, 1991

Amended - January 24, 1994
Amended - January 9, 1995
Amended - April 22, 1996
Corrected - January 27, 1997
Amended - February 24, 1997
Amended - May 26, 1998
Reaffirmed - March 22, 1999
Reaffirmed - March 14, 2000
Amended & Reaffirmed - May 8, 2001
Amended & Reaffirmed - April 23, 2002
Amended & Reaffirmed - April 8, 2003
Amended & Reaffirmed - April 13, 2004
Amended & Reaffirmed - September 13, 2005
Amended - August 11, 2009
Amended & Reaffirmed - August 10, 2010
Amended & Reaffirmed - September 28, 2010
Reaffirmed - June 28, 2011
Amended & Reaffirmed - October 9, 2012
Amended - August 13, 2013

NEWPORT BEACH

ITEM TITLE: Annual Investment Performance Review

ITEM SUMMARY: Staff and/or one or more investment advisors will describe the performance of the City's investment portfolio.

ATTACHMENTS:

Description

5B - Annual Investment Performance Review

CITY OF NEWPORT BEACH
FINANCE COMMITTEE STAFF REPORT

Agenda Item No. 5B
July 21, 2014

TO: HONORABLE CHAIR AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Dan Matusiewicz, Finance Director
(949) 644-3123 or Danm@newportbeachca.gov

SUBJECT: ANNUAL INVESTMENT PORTFOLIO PERFORMANCE REVIEW

ABSTRACT:

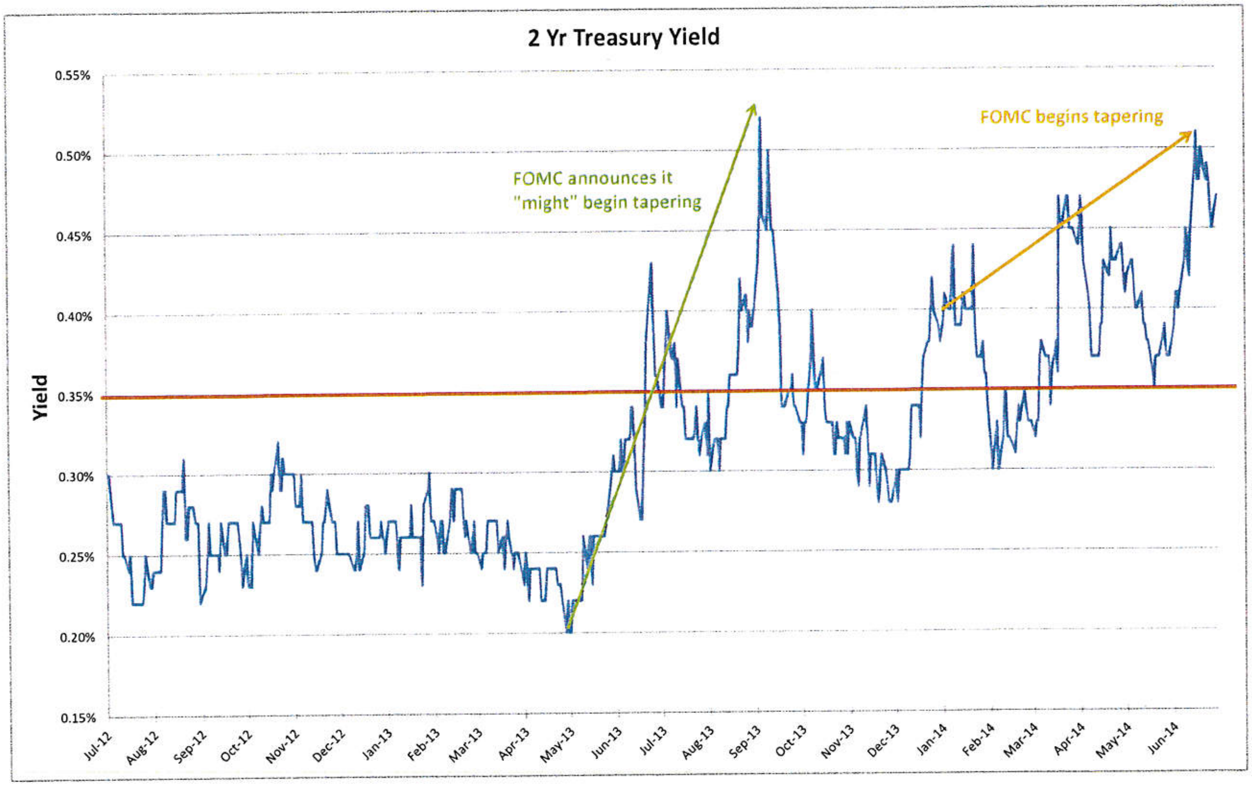
The purpose of this report is to summarize the performance of the City's investment portfolios relative to the City's investment objectives and pertinent performance benchmarks.

Yields have been somewhat volatile, as investors reacted to geopolitical tensions by making less risky investments thereby driving rates down. Additionally, the Federal Reserve started the tapering of its quantitative easing bond purchasing program putting an upward pressure on long-term rates. Further interest rate volatility was likely driven by a temporary deceleration in the economy caused partially by severe winter weather and the subsequent rebound in activity in the spring months. Overall, we believe the economy continues to be on a slow growth trajectory driven by modest ongoing improvement in the labor market. This combination of opposing influences has increased the volatility of interest rates over the most recent year.

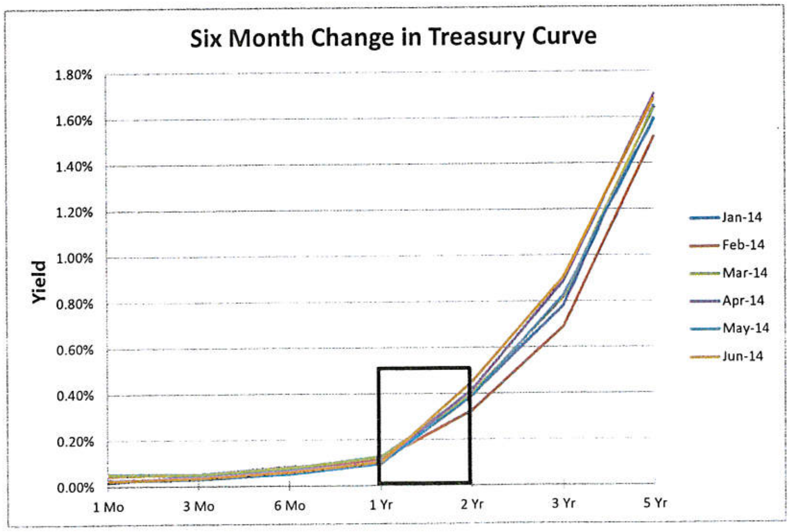
Throughout the fiscal year, the City's medium-term portfolio's annual average total return rose from 0.21% to 1.15%, while the benchmark's total return rose from 0.66% to 1.03%. This is attributable to an improving economy and increasing interest rates. While "total return" reflects the change in market value and the portfolio's income, the portfolio's yield if held to maturity, is currently 0.73% (at cost). If the rising interest environment is sustained, the prospect of higher future portfolio yields will return as new securities are purchased. However, if interest rates rise too quickly, the portfolio's total returns will become negative as the change in market value will outweigh the increased portfolio income.

BOND MARKET OVERVIEW:

In the past fiscal year, the Federal Open Market Committee (FOMC) made some changes to its forward guidance on monetary policy. Rather than pointing to 6.5% unemployment as a trigger point for policy change, the Federal Reserve is now using more qualitative language and indicated that it will instead be focused on targeting "maximum employment." The Chairwoman noted that the employment market, despite its improving unemployment rate, still has significant "slack." As the second part of its dual mandate, the FOMC will continue to target a long-run inflation goal of 2%. Due to recent improvements in economic data, the FOMC began reducing its bond-buying program by $10 billion a month in January and recently signaled that it will be ending it altogether by October 2014. The quantitative easing program was designed to keep long-term rates at record lows, and as a result of this tapering, the yield on two-year treasury notes has increased slightly over this past fiscal year from 0.36% to 0.47%. However, treasury yields remain low relative to long-term historical averages.



Despite the Federal Reserve putting upward pressure on long-term yields driven by the unwinding of quantitative easing, the two-year Treasury note yield improved only slightly in recent months. This is a result of the Federal Reserve's ultra-low overnight funds rate, which controls the shorter end of the yield curve.

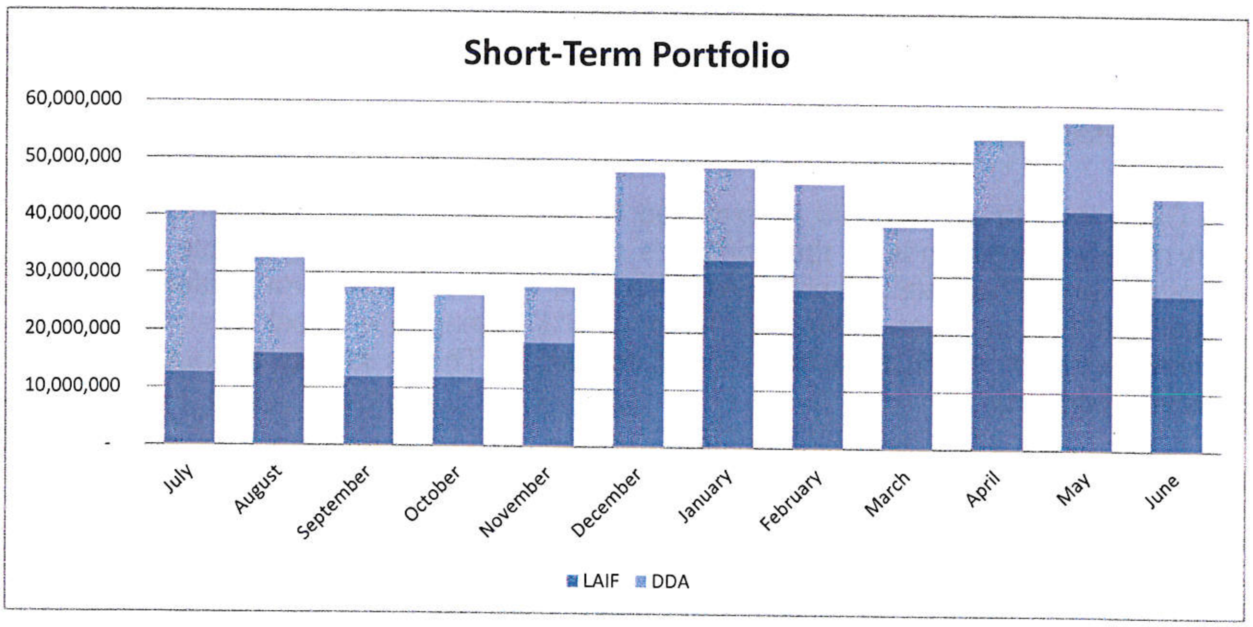


PORTFOLIO OVERVIEW:

Guided by Council Policy F-1 and constrained by state law, the City's core investment objectives are to provide safety of the invested principal by maintaining a well-diversified, high quality portfolio of liquid assets while earning a market rate of return commensurate with the City's conservative risk profile. California State Code Section 53600.5 mandates that the City Treasurer shall follow three objectives when investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds. The primary objective of the City Treasurer shall be to safeguard the principal of the funds under its control. The secondary objective shall be to meet the liquidity needs of the City. The third objective shall be to achieve a return on the funds under his or her control.

Short-Term Portfolio

The City uses a combination of demand deposit accounts (DDA) and the Local Agency Investment Fund (LAIF) in its short-term portfolio to provide sufficient liquidity to meet its operating requirements. The average investment life of the LAIF fund is approximately 232 days. The average effective yield is 0.23%. Recent liquidity needs related to capital improvement projects identified in the Facilities Financial Planning Program, have caused the City to keep larger short-term balances than before.



The chart above indicates a short-term portfolio balance of just under $44 million as of June 30, 2014.

Medium-Term Portfolio

Funds that are unlikely to be spent in the near future are kept in a medium-term portfolio consisting of over $154 million that is actively managed by three individual investment advisors in accordance with all applicable City policies and codes, State statutes, and Federal regulations.

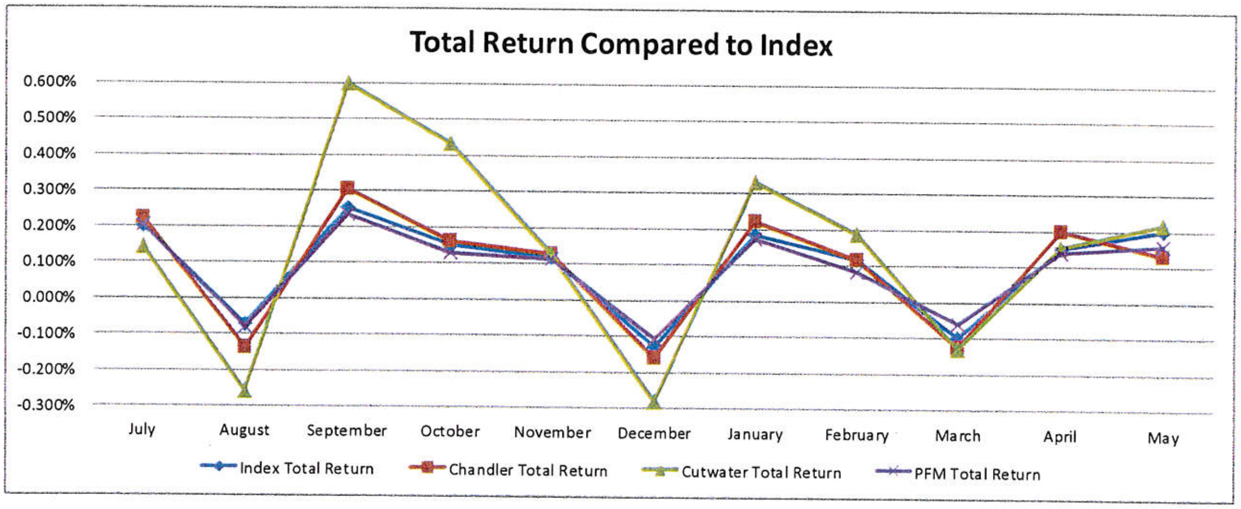
The City's entire investment portfolio of over $211 million as of June 30, 2014 is summarized as follows:

CITY OF
Newport Beach

TREASURER'S REPORT
For the Month Ended
June 30, 2014

Portfolios	Amortized Cost	Unrealized Gains/(Loss)	Fair Value	Accrued Interest	Market Value	% Total	YTM @ Cost	YTM @ Market	Notes
Operating Portfolios									
Short-term Portfolio									
Demand Deposit Accounts	$ 16,951,378	$ -	$ 16,951,378	$ -	$ 16,951,378	8.54%	0.54%	0.54%	(1)
Local Agency Investment Fund	27,015,318	-	27,015,318	-	27,015,318	13.60%	0.24%	0.24%	(2)
Medium-term Portfolio									
Cash Equivalents	1,879,258	-	1,879,258	-	1,879,258	0.95%	0.01%	0.01%	
Marketable Securities	152,004,600	189,521	152,194,122	549,367	152,743,489	76.91%	0.74%	0.61%	
TOTAL OPERATING FUNDS	**$ 197,850,554**	**$ 189,521**	**$ 198,040,075**	**$549,367**	**$ 198,589,442**	**100.00%**			
Bond Fund Portfolios									
2010 Civic Center COPs	$ 7,901,395	$ -	$ 7,901,395	$ -	$ 7,901,395	59.81%	0.01%	0.01%	
Assessment Districts	2,213,432	-	2,213,432	-	2,213,432	16.75%	0.01%	0.01%	
Special Improvement Districts	3,096,852	-	3,096,852	-	3,096,852	23.44%	0.01%	0.01%	
TOTAL BOND FUNDS WITH FISCAL AGENT	**$ 13,211,679**	**$ -**	**$ 13,211,679**	**$ -**	**$ 13,211,679**	**100.00%**			
TOTAL CASH & INVESTMENTS	**$ 211,062,233**	**$ 189,521**	**$ 211,251,754**	**$ 549,367**	**$ 211,801,121**				

The City's investment portfolio is expected to generate a return of a benchmark that most closely corresponds to the portfolio's duration, universe of allowable securities, risk profile and other relevant characteristics. The City's medium-term portfolio average annual total return rose from 0.21% to 1.15% during the fiscal year, while the benchmark's total return rose from 0.66% to 1.03%. This is largely attributable to an improving economy.



Although all investments contain an el ement of risk, the City's Investment Policy is designed to limit exposure to risk. Each of the three professional investment advisors has unique strategies to minimize risk and take positions on key variables within the constraints of the City's Investment Policy. The total return performance of each advisor is shown on a monthly and annual basis in the table below.

City of Newport Beach Medium-Term Portfolio									
	Medium-Term			Chandler		Cutwater		PFM	
Month	Market Value	Duration	Total Return	Duration	Total Return	Duration	Total Return	Duration	Total Return
July	159,180,184	1.863	0.189%	1.639	0.222%	2.317	0.141%	1.634	0.202%
August	157,327,532	1.932	-0.158%	1.656	-0.136%	2.393	-0.257%	1.739	-0.081%
September	156,139,457	1.876	0.379%	1.673	0.305%	2.283	0.598%	1.668	0.232%
October	153,282,469	1.872	0.242%	1.753	0.160%	2.089	0.433%	1.763	0.128%
November	153,456,929	1.841	0.121%	1.724	0.125%	2.041	0.128%	1.748	0.110%
December	153,137,644	1.830	-0.183%	1.750	-0.160%	2.037	-0.280%	1.695	-0.106%
January	153,514,548	1.743	0.241%	1.728	0.220%	1.931	0.331%	1.568	0.172%
February	153,715,756	1.715	0.128%	1.739	0.114%	1.648	0.187%	1.758	0.082%
March	153,715,756	1.810	-0.105%	1.860	-0.127%	1.839	-0.128%	1.735	-0.063%
April	153,949,078	1.745	0.162%	1.802	0.199%	1.759	0.152%	1.679	0.139%
May	154,162,289	1.723	0.169%	1.725	0.130%	1.755	0.216%	1.690	0.158%
June	154,073,379	1.751	-0.035%	1.642	-0.033%	1.891	-0.047%	1.711	-0.027%
Fiscal Year	**154,637,918**	**1.808**	**1.150%**	**1.72**	**1.019%**	**2.00**	**1.474%**	**1.70**	**0.946%**

Throughout the fiscal year, the City's medium-term portfolio has historically fell between the 1-3 Year Treasury index and 1 -3 Year Government/Corporate AAA-A Rated benchmarks as indicated in the table below.

Total Rate of Return As of 06/30/2014	Current Month	Latest 3 Months	Annualized 1 Yr	3 Yrs	5 Yrs	10 Yrs
Chandler	-0.033%	0.297%	1.024%	0.922%	1.590%	3.040%
Cutwater	-0.047%	0.322%	1.480%	0.819%	1.160%	2.840%
PFM	-0.027%	0.270%	0.950%	0.898%	1.490%	2.990%
1-3 Yr Treasury	-0.040%	0.270%	0.760%	0.630%	1.180%	2.620%
1-3 Gov/Corp A or Above	-0.036%	0.313%	1.028%	0.916%	1.570%	2.830%

A more robust summary of portfolio characteristics and performance by each investment advisor is summarized and attached for your review.

Prepared by:

/s/Cory Pearson
Cory Pearson
Accountant

Submitted by:

/s/Dan Matusiewicz
Dan Matusiewicz
Finance Director

Attachments: FY 2013-14 Summary of Medium-Term Investment Portfolio Characteristics

Medium-Term Investment Portfolio Characteristics

Average FY2013-14

Summary*	Chandler	Cutwater	PFM	1-3 Yr Gov/Corp AAA-A
Cash	1,435,288	109,750	334,221	N/A
Fixed Income	46,944,781	53,020,189	52,778,519	N/A
Duration	1.642	1.891	1.711	1.930
Weighted Avg Life	1.658	1.885	1.897	N/A
Weighted Avg Maturity	1.789	2.056	1.938	1.982
Weighted Avg Eff Maturity	1.658	1.885	1.897	1.982
Avg Credit Rating	AA/Aa2/AA	AA-/Aa3/AA-	AA-/Aa3/AA-	AAA
Yield to Maturity @ Market	0.513%	0.728%	0.548%	0.545%
Yield to Maturity @ Cost	0.870%	0.737%	0.605%	N/A
* as of 06/30/13				

Duration Allocation	Chandler	Cutwater	PFM	1-3 Yr Gov/Corp AAA-A
0.00 - 0.25	21.66%	31.77%	12.24%	0.17%
0.25 - 0.50	4.30%	1.73%	2.84%	0.06%
0.50 - 0.75	10.44%	7.13%	1.27%	0.20%
0.75 - 1.00	6.33%	0.00%	12.84%	4.18%
1.00 - 2.00	31.95%	13.27%	46.91%	53.68%
2.00 - 3.00	18.79%	31.56%	23.60%	41.72%
3.00 - 4.00	6.54%	14.54%	0.30%	0.00%
4.00 - 5.00	0.00%	0.00%	0.00%	0.00%
Total %	100.0%	100.0%	100.0%	100.0%

Security Type Allocation	Chandler	Cutwater	PFM	1-3 Yr Gov/Corp AAA-A
Agency	48.67%	58.04%	25.46%	13.24%
Asset-Backed Security	4.34%	0.00%	0.00%	0.00%
Cash	0.13%	0.27%	0.09%	0.00%
Certificate of Deposit	0.00%	0.00%	6.20%	0.00%
Commercial Paper	1.03%	7.84%	3.92%	0.00%
Corporate Notes	24.85%	28.34%	18.62%	15.40%
MM Fund	1.13%	0.91%	1.05%	0.00%
Municipal Bonds	0.00%	0.00%	0.40%	0.00%
U.S. Government	19.86%	4.59%	44.27%	71.36%
Total %	100.0%	100.0%	100.0%	100.0%

Market Sector Allocation	Chandler	Cutwater	PFM	1-3 Yr Gov/Corp AAA-A
Agency	48.67%	58.04%	25.46%	13.24%
Asset Backed	4.34%	0.00%	0.00%	0.00%
Cash	0.00%	0.00%	0.00%	0.00%
Financial	12.08%	27.04%	20.87%	8.83%
Government	19.86%	4.59%	44.27%	71.36%
Industrial	12.80%	10.33%	9.01%	5.96%
Municipal	0.00%	0.00%	0.40%	0.24%
Utility	2.25%	0.00%	0.00%	0.38%
Total %	100.0%	100.0%	100.0%	100.0%

NEWPORT BEACH

ITEM TITLE: Council Reserve Policy (F-2) Review

ITEM SUMMARY: On March 24, 2014 and April 29, 2014, staff presented certain proposed revisions to Council Policy F-2. Staff will seek direction from the Finance Committee whether further revisions to Council Policy F-2 are desired.

ATTACHMENTS:

Description

5C - Council Reserve Policy (F-2) Review

CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA ITEM INFORMATION

Agenda Item No. 5C
July 21, 2014

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Dan Matusiewicz, Finance Director
(949) 644-3123, DanM@newportbeachca.gov

SUBJECT: Council Reserve Policy (F-2) Review

RECOMMENDATION:

Direct staff on whether or not to propose revisions to the Newport Beach Municipal Code to eliminate revenue set-aside requirements for Neighborhood Enhancement Area A (West Newport); Neighborhood Enhancement Area B (Newport Peninsula); Off Street Parking; and Public, Educational and Government Access (PEG) Fees. Based on the Committee's guidance, staff will bring a more formalized policy recommendation to the City Council for consideration.

DISCUSSION:

At the March 24, 2014, and April 29, 2014, Finance Committee meetings, staff and the Committee reviewed City Council Policy F-2 (Reserve Policy) and proceeded with a plan to change the Reserve Policy in two phases. Phase I changes were simple to enact via a Council resolution. These revisions largely eliminated various equipment related revenue set-asides that could be more efficiently managed in our equipment replacement fund. These policy changes were submitted to and adopted by the City Council on June 10, 2014.

At the March 24, 2014 Finance Committee meeting, staff indicated that revenue set-asides may no longer be the best means to allocate revenue resources in support of various City programs. As a second phase to Policy F-2 changes, staff recommended the incorporation of a master replacement/improvement funding plan for equipment and capital project needs in lieu of revenue set-asides. Staff's recommendations would result in the sunsetting of parking revenue set-asides for Neighborhood Enhancement areas A & B; Off-Street Parking; and Public, Educational and Government Access (PEG) revenue restrictions. Additionally these changes would require an amendment to the City's Municipal Code, are more complex than Phase I changes, and would require additional time.

At the April 29, 2014 Finance Committee meeting, Chair Henn requested more information on the Phase II changes under consideration. Community Development Director Kim Brandt and I met with Chair Henn to discuss the concept in more detail. We discussed the potential sunsetting of the Off-Street Parking reserve, the Neighborhood Enhancement Areas A & B reserves, and the potential creation of a Neighborhood Enhancement Fund that would function in a manner similar to the Facilities Financial Planning Reserve fund. Under this funding model, project prioritization and funding are driven by project need rather than geographically-based revenues.

Chair Henn favored the sunsetting of the current parking reserves with the potential of parking management district(s) being formed in the future. He recommended that the City not pursue the creation of a new Neighborhood Enhancement Fund under the rationale that parking management districts may be a better solution.

We did not discuss the Public, Educational and Government Access (PEG) revenues derived from cable franchise fees but we recommend that staff research the laws related to PEG fees derived from cable franchise revenues to determine whether there is any ongoing financial benefit of restricting a portion of cable franchise revenues for PEG purposes or whether this requirement should be eliminated, if possible.

If the Finance Committee feels these proposals have merit, please direct staff to review the Municipal Code and related laws with the intent to rescind portions of the Municipal Code that restrict the use of parking revenues and cable franchise revenues. Based on the Committee's guidance, staff will bring a more formalized policy recommendation to the City Council for consideration.

Prepared and submitted by:

/s/Dan Matusiewicz

Dan Matusiewicz
Finance Director

NEWPORT BEACH

ITEM TITLE: CalPERS Unfunded Liability Review and Pension Primer

ITEM SUMMARY: Staff will introduce a pension primer that describes the City's pension benefit plan and the City's efforts to manage its financial exposure to rising pension liabilities while at the same time maintaining its support for promised benefits. The primer is organized in an easy to understand question/answer format as a means to educate the public about this complex topic.

ATTACHMENTS:

Description

5D - CalPERS Unfunded Liability Review and Pension Primer

City of Newport Beach

July 2014

PENSION PRIMER

INSIDE THIS PRIMER

WHAT YOU'LL LEARN

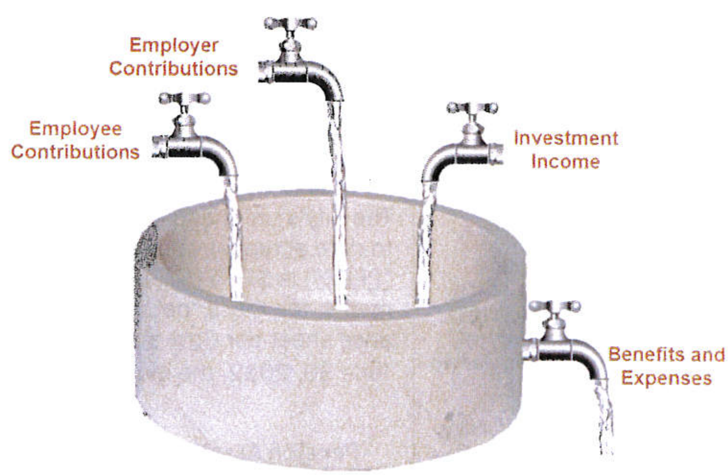
This Pension Primer will help you better understand how defined benefit pension programs in California work, and will tell you more about Newport Beach's pension program and its problems. We will show you our funding status, which in July 2014 reflects a market date of June 30, 2012—a full two years prior. We also write about solutions—solutions already implemented, and more that could come if the law allowed it. You'll learn common terms and that pension law is rather complex, and limiting. A number of tools are at our disposal to continue to address our liabilities, but those tools come with their own challenges.

FREQUENTLY ASKED QUESTIONS

How are pension costs determined?

Employers must compensate employees for their service. Typically, public employee compensation combines three distinct elements, including salaries and wages, benefits provided during active service (for example, health care for active employees), and benefits provided following the completion of active service (retirement income and in some cases health care). Local government pensions are pre-funded, as opposed to pay-as-you-go retirement systems like Social Security. In pay-as-you-go systems, contributions from current employees are used to pay benefits for current retirees. In pre-funded systems, the employer and employee make contributions into a pension trust each year, over the course of an employee's working life. That money is invested and earnings on these funds are re-invested. By the time the employee reaches retirement, the accumulated assets in the trust are available to pay benefits. The objective of course, is to accumulate sufficient assets to pay the benefits over the remainder of the employee's life. To meet this objective, a pension plan should receive contributions in accordance with an actuarially based funding policy. The actuarially determined pension funding plan determines exactly how much the employer and employee should contribute each year to ensure that the benefits being earned will be securely funded in a systematic fashion.

Funding a Pension Plan



What is the City's pension benefit plan and how is it administered?

The City contributes to the California Public Employees Retirement System (CalPERS or "PERS"), an agent multiple-employer public employee defined benefit pension plan. PERS acts as a common investment and administrative agent for participating public entities within the State of California and provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. In a defined benefit plan, an employer promises future benefit payments based on an agreed-upon formula (for example, 2.5 percent of salary x the number of years of service = amount of pension payments) during retirement (See Benefit Formula in the Glossary of Terms).

PERS Asset Allocation

What is the City's pension funding policy?

In July 2011, the City Council passed Resolution No. 2011-55 establishing a Compensation Philosophy which included a goal that employees share 50/50 in the total cost of retirement benefits, which was the guiding principle in the 2012 and all subsequent labor negotiations. The labor contracts adopted since 2012 provide for employees paying the full member contribution, create lower benefit tiers for new employees, eliminate the Employer Paid Member Contribution (EPMC) for all but one unit, and for all but three of the labor contracts, employees are also paying a portion of the employer contribution. Through negotiations, the City and its collective bargaining groups have worked collaboratively toward a solution that would help to relieve the City's growing pension burden. The City and its bargaining units also agreed to implement second tier (lower) retirement benefit formulas for future employees (2%@60 for Miscellaneous, 2%@50 for Fire and Lifeguards, and 3%@55 for Police), and changed the single highest year calculation to the highest three years for determining the actual pension benefit amount. These second tier benefits were negotiated in advance of adoption of the Public Employees Pension Reform Act (PEPRA), creating an "intermediate tier," and ensuring that new employees, including those now deemed "classic" by PERS, will be hired under a lower benefit formula.

How much has the City set-aside (assets) for employee pensions and how much does it owe (liability)?

The City's unfunded liability (UL) as of June 30, 2012 (the "date of value" for our most up to date actuarial valuation from the California Public Employees Retirement System or "PERS") is $275 million on a market value basis. Starting in the 2014-15 financial statements, the City's "net pension liability" must be posted to the City's Government-wide balance sheet per Governmental Accounting Standards Board (GASB) Statement 68. As of June 30, 2012, the market value of the City's pension assets and liabilities is as follows:

Pension Assets and Liabilities

City of Newport Beach PERS Plan	June 30, 2011	June 30, 2012
Funded Portion of Plan (Market Value Basis)	$467,000,000	$452,000,000
Unfunded Portion of Plan (Market Value Basis)	$226,000,000	$275,000,000 *

Pension Facts:

- ⇒ The Percent of the normal retirement cost being paid by Newport Beach employees is now 51%. That now exceeds where Governor Brown wanted all cities to be by 2018.
- ⇒ City employees will be funding a record $7.4 million of the City's pension costs through payroll deductions.
- ⇒ The FY 14-15 budget provides for a $13.7 million payment towards the unfunded pension liability.

The City's annual payments to PERS to fund the Normal Cost of pensions and the Unfunded Liability have risen significantly over time, as has the amount contributed to the Plan by City employees:

Annual PERS Cost

Annual Payment to PERS	FY 11-12	FY 12-13	FY 13-14	FY 14-15 (est)
by City	$18,000,000	$18,150,000	$19,440,000	$20,000,000
by Employees	$3,550,000	$4,700,000	$6,060,000	$7,400,000
Total Payments	$21,550,000	$22,850,000	$25,500,000	$27,400,000

How does Newport Beach's unfunded liability compare to other cities?

A great question! But we don't actually know— and no one else seems to, either. But many like to speculate about it. It's nearly impossible to compare cities' pension liability on an apples-to-apples basis. Cities that provide a lot of services on their own (without contracting with other agencies) will have the liability show up clearly—like us. But cities that contract with the Sheriff's Department for police services, or that have the OC Fire Authority providing Fire/EMS, can have those employees' pension costs off of their books (not nefariously, of course). We just know that ours needs to be addressed, and we're addressing it.

What caused the jump in unfunded liability?

At least three major things:

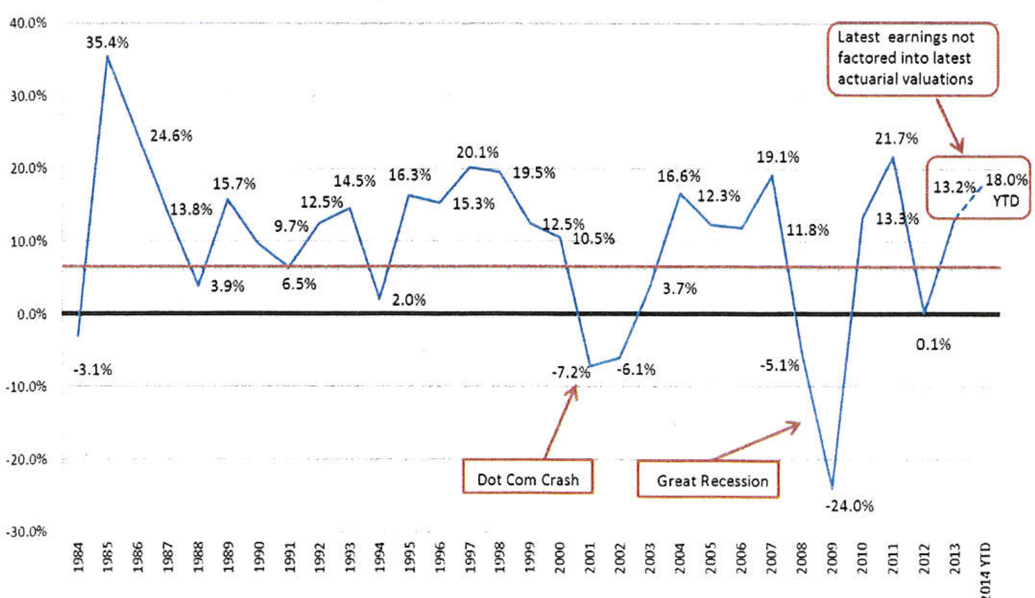
1) Especially in 2008-2010, investment returns fell well short of expectations (see chart below). In part because of this, PERS last year revised the investments earnings or "discount rate" down from 7.75% to 7.5%. Both the CalPERS action and the markets' actions increased the unfunded liability, but painted a truer picture of it.

2) When market returns were high in the early 2000s, many public entities including Newport Beach, increased pension benefits. The increases were retroactive, meaning that a new higher benefit applied to all of an employee's years of service with the City.

3) Studies are showing that people have retired earlier (in some cases due to industrial disability) and retirees are living longer than expected.

In 2013, CalPERS made administrative changes (good ones) that asks cities to pay more money faster to improve the unfunded liability more quickly.

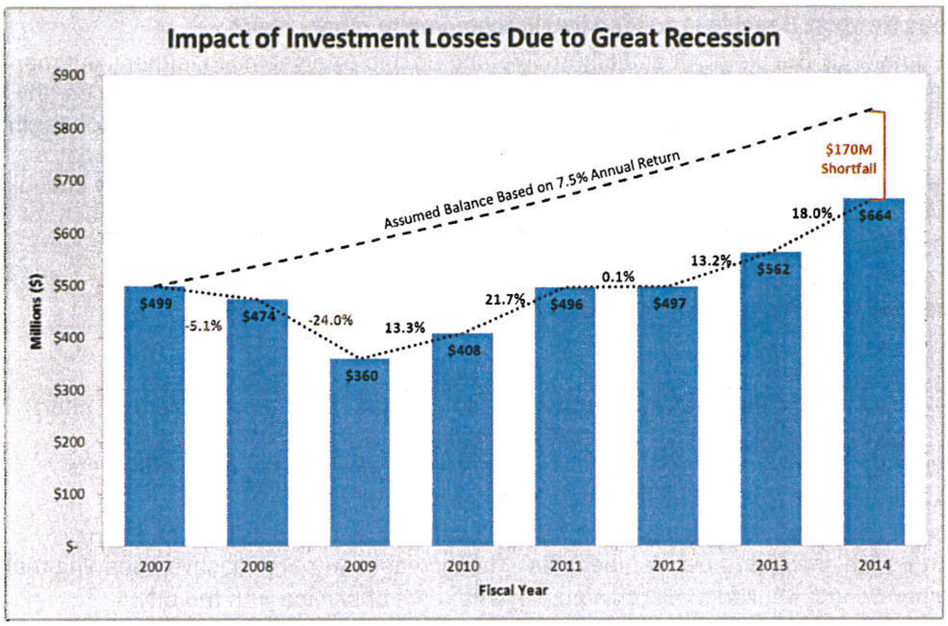
CalPERS Historic Investment Returns



Investment earnings affect how much of future benefit payments can be funded by investment income rather than by contributions. If lower investment earnings occur, future contributions must increase to make up the expected difference. As can be seen from the chart to the left, the significant drop in the PERS investment returns from 2008 to 2009 means that current assets well underperformed during the actuarial period. The decrease in funded status is largely due to the low investment returns booked in 2009 and 2012.

Haven't we regained the investment losses incurred during the Great Recession?

No, and we're not too close. While the equities markets have made an impressive comeback, now above the levels in 2007, they still fall short of the where investment balances would have been had they continued to grow 7.5% annually since 2007. The chart shows that our assumed balance of funds at CalPERS still falls below where a 7.5% annual rate of return would have brought it had there not been a market collapse starting in 2008. Please note that the chart below is for illustrative purposes only. It does not fully reflect what the plan assets and unfunded liability is or was (as the plan assets and unfunded liability are affected by factors besides market changes such as plan contributions, benefit distributions, and actuarial assumptions).



Can pension benefits be further reduced?

Most legal experts say that pension benefits are a protected contractual agreement under California's Constitution, and that prohibits employers from reducing benefits for current employees (either retrospectively or prospectively) except for having the employees pay more towards pension costs. For new hires, less-generous benefit tiers have reduced benefits from the day an employee starts work.

Can the City terminate the Pension Plan altogether?

Yes, but plan termination costs are astronomical.

Why not move all employees into a defined contribution (401k) Plan?

It's not allowed by state law right now. The City can only offer retirement benefits that PERS itself allows us to offer. The City does have a 401k-style plan for part-time employees who are generally outside of the PERS system. All full-time employees MUST be placed in the PERS system and offered a defined benefit pension as the law stands today.

What has the City done to address the unfunded liability and to lower pension costs to the taxpayer?

- Established two new lower benefit tiers (one for employees who transfer here from other agencies and one for employees brand new to the PERS system).

- Negotiated to eliminate the Employer-Paid Member Contribution (EPMC). This practice previously allowed cities to pay both the City's expected contribution to PERS and the contribution that PERS indicates that employees (the "members") should pay.
- Employees contribute up to 43% of the total cost of their pensions. Most employees pay between 16.8% and 40.65%. Each increase must be negotiated under California law, and equates to between 9% and 12.8% of their salary being deducted and going to PERS. Most employee contributions in Newport Beach in 2014 exceed Governor Brown's employee contribution goals for 2018.
- Reduced the overall amount of staff at the City (from 833 full-time positions in FY 2009-10 to 727 in the FY 2014-15 budget). This does not affect the unfunded liability but it can stop additional liability from accruing.
- Adopted a Fixed Amortization Schedule to Eliminate the Unfunded Liability (referred to as a "Fresh Start"). Simply put, this means that the City will invest more dollars earlier to fully fund the unfunded portion of the pension plan by a date certain. For the plan that covers non-safety employees, that date is 21 years from now. For the safety plan, it's 25 years from now. Increased contributions related to Council's decision to implement the Fresh Start are anticipated to be $72.2 million over 30 years while reducing the unfunded liability by approximately $185.7 million and avoiding $113 million in increased interest.

Why not pay down more of the liability now, and do it faster?

That can be a great choice, but it should be done carefully. If you place a lot of money into the PERS account at the high end of a bull market, we risk losing some of the benefit of those dollars should the market fall. Arguably, the best way to invest more cash now is a bit more methodically, such as the Fresh Start method we are using now where additional contributions are invested on a dollar-cost-average basis, an accepted method of mitigating market risk.

Using cash now to pay off the UL also has an opportunity cost. What services, programs, facilities, or beautification might the community desire now that would be foregone? And does paying more now negate the current partnership between the City and its employees, where the employees pay a growing share of the annual payments?

What does pension liability per capita tell me?

When someone uses pension liability per resident, they leave information out. Pension costs are paid by employees (as noted) as well as residents, visitors, and businesses. Every visitor who uses a parking lot, eats at a restaurant, or stays at a hotel contributes to the overall tax base, and thus the pension payments. The employees themselves are paying nearly a quarter of the annual cost. So to us, pension liability per capita is a rather useless metric.

What more can be done to address this significant concern?

Today, Newport Beach has done all that we know the law allows in terms of pension reform, and done so primarily through civil negotiations. Imposition of more significant contributions or pay reductions on City staff has consequences in terms of attracting and retaining good staff. Outsourcing can help, but it doesn't remove the vested pension rights of a city employee who might be replaced by a private provider. A 401k-style plan for new hires is a possible next step, but PERS and the Legislature need to allow us to do that. If you have other ideas we've missed, please feel free to suggest them.

City of Newport Beach Finance Department

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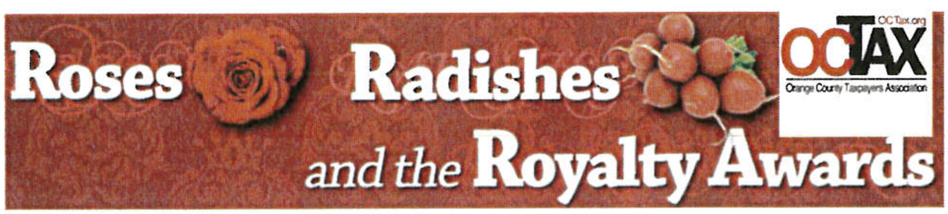
The City of Newport Beach Finance Department's primary purpose is to act as the chief financial steward over all public resources and to provide a wide variety of financial, technical and support functions generally encompassed by treasury, accounting, budget, long-term financial planning, auditing and revenue administration. The City places a high value on transparency and full disclosure in all matters concerning the City's financial position and results of operations. To this end, Finance strives to provide superior disclosure in all documents including but not limited to the City's Budget, Quarterly Financial Reports, Comprehensive Financial Report and compliance filings.

Newport Beach Wins Award for its Pension Reform Program

July 19, 2013—The City of Newport Beach (City) won a Rose Award for its pension reform program from the Orange County Taxpayers Association (OCTax). Rose Awards are given to individuals or organizations that have programs consistent with OCTax's mission that "Taxes and tax-supported programs must be fair, understandable, cost-effective and good for the economy." Winning programs must also show measurable results in terms of taxpayer benefit, tax savings, or government waste cutting.



Newport Beach faced its CalPERS pension problem head on, in advance of any pension reform regulations issued by the State. The City's efforts included the following major initiatives between May 2012 and May 2013:

Labor contracts were negotiated with nearly all bargaining units. They include significant increases in employee contributions toward retirement benefits.

The City adopted lower benefit formulae (second tier) for all groups, ensuring all new employees, including lateral "classic" members, are hired under a lower benefit factor. Not all cities were able to accomplish this – those who did not do so will see transfers from other PERS-member agencies come in at the oldest, most generous tier, but not here. For Newport Beach, the savings associated with adopting second-tier formulae will occur gradually.

The City Council elected not to phase-in expected CalPERS rate increases and instead opted to accelerate payment of the City's unfunded liability by amortizing payments on a fixed declining schedule, rather than a rolling 30-year amortization schedule. Paying over a fixed and shorter time period will help the City to potentially avoid $113 million of interest expense over the next 30 years.

Glossary of Terms

Actuary: A person professionally trained in the technical and mathematical aspects of insurance, pensions, and related fields. An actuary estimates how much money must be contributed to a pension fund each year in order to support the benefits that will become payable in the future.

Actuarial Assumptions: Assumptions made about certain events that will affect pension costs. Assumptions generally can be broken down into two categories: demographic and economic. Demographic assumptions include such things as: mortality, disability, and retirement rates. Economic assumptions include: investment return, salary growth, payroll growth, inflation rates, and health care inflation rates.

Actuarial Gains or Losses: Gain or loss arising from the difference between estimates and actual experience in the City's pension plan. Actuarial gains and losses are used when accounting for pension plans because of the need to make assumptions about the future rate of salary increases, the length of employee tenure, an appropriate discount rate for the plan obligations and the expected rate of return on plan assets

Actuarial Valuation: A mathematical analysis of the financial condition of a pension plan which requires making economic and demographic assumptions in order to estimate future liabilities. The assumptions are typically based on a mix of statistical studies and experienced judgment. An actuary prepares an actuarial valuation at least once every three years.

Amortization: This term refers to the process of reducing a recognized liability systematically by recognizing revenues or reducing a recognized asset systematically by recognizing expenses or costs.

Annual Required Contribution (ARC): The actuarially determined level of employer contributions that would be required on a sustained, ongoing basis to systematically fund the normal cost and to amortize, over a period not to exceed thirty years, the unfunded actuarial accrued liability

Assets: Employer contributions and accumulated earnings on the investment of these contributions to be used to pay retirement benefits to retired employees.

Assumed Rate of Return: An estimate of the annual rate of investment returns to be generated by the retirement fund. This amount is approved by the governing body of the retirement system, and the assumed rate of return has a significant impact on the actuary's estimate of the cost of funding a defined benefit pension plan. An assumed rate of return is also used by an actuary to determine the investment earnings on assets set aside in an irrevocable trust to prefund pension liabilities.

Benefit Formula: The formula used to determine the amount of a benefit that an eligible participant receives upon retirement. Each formula specifies a percentage rate based on the member's age at retirement, and either statute or a collective bargaining agreement specifies which formula will be applicable to an individual member. The retirement benefit calculation typically includes three factors: a percentage rate based on the age at retirement and benefit formula applicable to the member, the member's length of credited service, and the member's final compensation. Typically, retirement formulas are titled in such a way as to describe how a retirement benefit would be calculated, such as "2% at age 55." In this case, the retirement benefit for a member retiring at age 55 would be: 2% (the formula percentage) X years of service X average monthly pay rate.

California Public Employees' Retirement System (CalPERS): The retirement system established under the California Government Code (Section 20000 et seq.) for state employees, classified (non-teaching) school employees, and employees of California public agencies that contract with CalPERS for retirement coverage.

Defined Benefit (DB) Plan: A traditional pension. A plan designed to provide eligible participants with a specified lifetime benefit at retirement. The benefit is based upon the following three factors: a percentage rate based on the member's age at retirement and benefit formula applicable to the member, the member's length of credited service, and the member's final compensation. Defined benefit plans also typically provide disability and death benefits. The plans are funded by member contributions, employer contributions, and income earned from the investment of accumulated contributions.

Defined Contribution (DC) Plan: Like a 401k. A plan that provides an individual account for each participant. Benefits are based solely on (1) the actual amount contributed by the participant, as well as any employer contributions made on the participant's behalf, plus (2) any income, expenses, gains/losses, and forfeitures that may be allocated to the participant's account. The account value can increase or decrease due to stock market variations and the performance of chosen investment vehicles. The lump-sum value of the plan is available to the employee upon retirement for annual withdrawals as he or she deems appropriate, but total withdrawals cannot exceed the account balance.

Discount Rate: The rate at which the U.S. Federal Reserve will lend short-term funds. For pension accounting, this discount rate must reflect either the market rates currently applicable to settling the benefit obligation or the rates of return on high quality fixed income securities.

Fully Funded: A specific element of pension cost (for example, past service cost) is said to have been fully funded if the amount of the cost has been paid in full. A retirement plan is fully funded when the funded ratio equals 100% or greater.

Funded Plan: A plan whose benefit promises are backed by a fund of assets set aside and invested for the purpose of meeting the plan's liability for benefit payments as they arise.

Funding: The provision in advance for future benefit liabilities by setting aside money in a trust, which is separate from the employer's business, to finance the payment of pensions.

Funding Level: The relationship, usually expressed as a percentage, between the actuarial value of a plan's assets and its actuarial liability.

Funding Method: The approach used by an actuary in an actuarial valuation. A variety of methods can be used, but whatever method is employed should be adequately described in the valuation report.

GASB (Governmental Accounting Standards Board): Independent, non-governmental organization that establishes the accounting standards for state and local governmental entities. The standards of financial accounting and reporting are intended to provide concise, transparent, and understandable financial information.

Industrial Disability Retirement (IDR): Retirement that results from an injury or illness that prevents the employee from performing job duties. The cause of disability does not need to be related to their employment.

Liabilities: The obligations of a plan to pay amounts of money either immediately or in the future. Liabilities whose payment is dependent on unpredictable future events (such as the death of a member) are called "contingent liabilities."

Market Value of Assets: The price that would be received to sell an asset in an orderly transaction between market participants at the measurement date (sometimes referred to as fair value).

Normal Retirement Cost: A plan's normal cost represents the present value of benefits that have accrued on behalf of the members during the current plan year.

Unfunded Actuarial Accrued Liability (UAAL): The amount by which actuarial accrued liability exceeds the actuarial value of assets; or, in other words, the present value of benefits earned to date that are not covered by plan assets.

NEWPORT BEACH

ITEM TITLE: ERP Milestone Review

ITEM SUMMARY: Staff will provide the Committee with a progress report on the Enterprise Resource Plan project to receive and file.

ATTACHMENTS:

Description

5E - ERP Milestone Review

CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA ITEM INFORMATION

Agenda Item No. 5E
July 21, 2014

TO: HONORABLE CHAIRMAN AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
Dan Matusiewicz, Finance Director
(949) 644-3123, DanM@newportbeachca.gov

SUBJECT: Enterprise Resource Planning Software Implementation (ERP) Update

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BACKGROUND:

The purpose of this progress report is to inform the Finance Committee of the latest developments regarding the Enterprise Resource Planning (ERP) software implementation. An ERP is a business management software system that integrates all of the City's core functional requirements for financials, human capital management, citizen services, and revenues. The ERP implementation is scheduled to take between 25 and 30 months and will consist of 5 major phases.

PROGRESS:

Tyler Technologies (Tyler), the ERP software provider, lead staff through a project kick-off event on May 14-15. Tyler staff outlined the ERP project progression, reviewed roles and responsibilities, and informed staff of the necessary information for adequate project planning. We also took the opportunity during this event to unveil the ERP project name "eSAIL" and logo (see below) that was selected by the management team among 10 other staff designs.

Newport Beach eSAIL unity in purpose
ERP SYSTEM ADMINISTRATION and IMPLEMENTATION LINEUP

This important project must foster an environment of change in order to allow for the creation of more efficient and effective processes to support the City's mission and goals. With the many changes to the City's business processes that are expected, City staff must be prepared to adapt. To assist in this regard, representatives from Tyler provided representatives of the core implementation team an overview of several change management methodologies and a roadmap of future change management strategies that can be deployed. During the Change Management Kick-off on June 18-19, there was a particular emphasis on effective communication strategies that inform various stakeholders of the reasons for the change (why?), the benefits of successful implementation (what is in it for us, and you?) as well as the details of the change (when? where? who is involved?, etc.).

The installation of the Tyler software on City servers occurred on June 23. This rather large and complex software installation was assisted by a Tyler software technician who also provided the IT staff with training on installation procedures and how to maintain the new software system.

Over the summer, Finance and IT staff will be participating in Tyler-led Business Processing Consulting (BPC) sessions in anticipation of the financials Phase I go live date set for July 2015. The first such BPC session occurred July 15-17 to review the City's budgeting process. HR staff will begin a similar process after Phase II of the eSAIL project commences in January of 2015. The ultimate goal of these BPC sessions is to develop software configuration specifications in conformance with the City's business needs and in consideration of industry best business practices.

Prepared and submitted by:

/s/Steve Montano
Steve Montano
Deputy Finance Director