

**CITY OF NEWPORT BEACH
CITY COUNCIL FINANCE COMMITTEE
MINUTES**

The Finance Committee met at 2:00 p.m. on Monday, July 26, 2010, in the Council Chambers, 3300 Newport Blvd., Newport Beach, California 92663.

I. ROLL CALL

Present: Mayor Keith Curry, Mayor Pro Tem Mike Henn (Chair) and Council Member Leslie Daigle

Staff present: City Manager Dave Kiff, Assistant City Manager Dana Smith Administrative Services Director Tracy McCraner, Interim Deputy Administrative Services Director Dan Matusiewicz, City Attorney David Hunt and Risk Manager Lauren Farley

Outside entities: Randy Palomba and Gay Eichhoff with Cutwater Asset Management; Ron Rakich, Ron Rakich & Associates

II. APPROVAL OF MINUTES

The minutes for the Finance Committee meeting of June 2, 2010, were approved as submitted.

III. PUBLIC COMMENTS

There were no public comments at this time.

IV. DISCUSSION/ACTION ITEMS

A. MONTHLY FINANCE COMMITTEE UPDATE

1. Fiscal Sustainability Planning

- a. Investment Portfolio Review with Cutwater Asset Management – Randy Palomba, Gay Eichhoff

Randy Palomba began his presentation speaking about the current economic situation. He said the Fed funds target rate remains at 0-25 basis points and it has been that way since December 2008. He commented on spread relationships and inflation numbers that have come down recently. He said June PPI is up 1.1 percent and June CPI

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is up 0.9 on a year over year basis. He said GDP is growing at about 2.7 percent in the first quarter and the Fed expects GDP will show about a 3.0 percent growth this year. Unemployment remains a big problem running at about 9.5 percent at the present time with 125,000 jobs lost in June. Retail sales fell for the second straight month in June and for all of 2009. The housing market remains on the weak side.

Mr. Palomba went on to speak about the return on the investment portfolio. He said over the past year the portfolio has returned on an amortized cost basis net of fees 3.02 percent; 39 basis points on a one-year Treasury note; 92 basis points on a two-year Treasury note; and the two-year Treasury note 12 month trailing at 1.0 percent. He said there's more fluctuation in the fair value basis which takes in all the components of amortized cost plus looks at the change in market value from period end to period end with a return of 2.47 percent. Deputy Administrative Services Director Matusiewicz noted that 2.25 percent was factored in next year's budget which might be overly optimistic. Mr. Palomba commented that negative returns on a total return basis will result when the bond market starts to unwind and interest rates rise. In response to a question raised by Mayor Pro Tem Henn, Mr. Palomba said the portfolio duration on a final basis is 1.8 years and on an effective basis is 0.9 years. He said the period started at \$18 million and most recently it was up to almost \$28 million with an average of \$23.8 million.

Reviewing the investment report for the month of June 2010, Mr. Palomba said the return for the month on an amortized cost basis was reported at 2.87 percent annualized return and a year-to date return of 2.89 percent on 219 days or 0.6 years for the duration of the portfolio. He pointed out the Treasury benchmarks with a two year return of 0.73 and a five year Treasury note on an amortized cost basis returning 2.0 percent for the month. He noted the portfolio had an unrealized capital gain of about \$430,000 at the end of June. He reviewed the fair value basis returns of 2.08 percent which include the change in market value. He pointed out the Treasury returns for the month were very strong and explained with the uncertainties in the market, investors are avoiding risk and going back into the Treasury market which is driving up the returns.

Mr. Palomba reviewed the diversification of securities in the portfolio which is 15 percent high grade corporates and 85 percent instrumentalities or U.S. agencies. The maturity distribution schedule of the securities held showed about 38 percent of the portfolio will come due in the next 90 days. Mr. Palomba spoke on some of the holdings details and pointed out the higher yields on holdings which were purchased in 2006-2008. He said the strategy changed to

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concentrate on putting more callable holdings into the portfolio because they are paying a higher rate of return. He noted all of the corporates in the portfolio will mature by November of 2010 and he is continuing to look for corporates that make sense for the portfolio.

He provided a rundown on the GASB 40 credit risk disclosure on the holdings and said they are not concerned about any of the credit risks in the portfolio. Mr. Palomba reviewed bank credit ratings and explained the rating components used to develop the peer group ranking. The presentation was concluded with a listing of the broker/dealers currently approved for City of Newport Beach use.

In response to a question raised by Mayor Pro Tem Henn, Mr. Palomba said the strategy right now is to maintain the duration in the portfolio with safety as the primary concern followed by liquidity necessary to respond to the cash flow needs of the City. Administrative Services Director McCraner noted there has been more volatility in the cash flow needs to cover Civic Center and OASIS construction costs before the bond issue. Mr. Matusiewicz commented on the lack of good short term options. He noted that City National is giving 1.1 percent on compensated balances which allows some liquidity. Mayor Curry commented that if we have accumulated short term cash, LAIF is a better option than Goldman Sachs.

b. Revisions to Council Policy F-1, Statement of Investment Policy

Mr. Matusiewicz reviewed proposed revisions to the investment policy, Council Policy F-1. He noted that Cutwater Asset Management staff reviewed the policy with a focus on the area outlining authorized investments. Mr. Matusiewicz said the City of Santa Barbara policy was used as a model for some of the revisions.

Mayor Curry commented that limiting investments to the safest types of securities would only permit treasuries and he instructed that language be revised. He pointed out an inconsistency needing to be corrected under interest rate risk that addresses limitations on securities to short term securities. Under delegation of authority, Mayor Curry said clarification is needed to confirm there is no conflict with State law provision 53607. Ms. McCraner said she will get the City Attorney's review on that issue.

Ms. McCraner said a consolidation of custodial banks and investment advisors is under consideration. Mayor Pro Tem Henn expressed his agreement with deleting the paragraph that states no more than 30 percent of the City's total investment portfolio may be placed in any one investment account.

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Mayor Pro Tem Henn questioned who is aggregating the portfolio in total to determine compliance with maximum allowable percentages in line with what the policy allows for the different investment categories. Mr. Matusiewicz replied that past practice has been a reliance on the individual constraints but he intends to implement a platform to show consolidated reporting with an aggregated total. He said to achieve that goal the first order of business is to consolidate the custodian banks from five individual banks.

In the policy section addressing authorized investments, Mr. Matusiewicz questioned whether to continue to allow mortgage-backed and asset-backed securities. Mr. Palomba explained the difference between the securities and the limit of AAA rating. He noted that although these securities are not precluded by the Government Code, many cities do not include this option. Mr. Palomba suggested keeping the option in the policy since it is a viable alternative and offers diversification at a higher yield. Mayor Pro Tem Henn agreed with leaving the option in the policy and confirmed that the maximum is 20 percent of the total portfolio.

Mayor Curry suggested formatting changes to the paragraphs addressing prime commercial paper. City Manager Kiff pointed out 10) and 11) should become a) and b) under paragraphs 9) and 12 should be unnumbered.

Mayor Curry questioned including repos and whether it is anticipated they will be used. Mr. Palomba explained a repo and a reverse repo are instruments the City could invest in for liquidity needs. He said it could be beneficial to the City because it would offer liquidity, safety and a higher return. Ms. McCraner asked for confirmation whether to leave it in the policy since it isn't being used and Mayor Pro Tem Henn commented that leaving it allows for the flexibility to use it in the future.

Ms. McCraner confirmed the Committee wanted to leave the Orange County Pool explicitly identified as an investment specifically not permitted.

Mayor Curry commented that the policy needs to be consistent in specifying whether diversification of investment parameters in any one non-governmental issuer is limited to 5 percent or 10 percent. Ms. McCraner noted that 5 percent is more restrictive than the Government Code. Mayor Curry said the policy should be consistent throughout whether it is limited to 5 percent or 10 percent.

Mr. Kiff asked for clarification on purchasing securities on credit watch. Mr. Palomba expressed his opinion that it would not be wise to

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purchase anything on credit watch negative or outlook negative. He said depending on the maturity, he would purchase an A1 or A+ security on stable or positive outlook.

Mr. Matusiewicz noted the policy previously permitted only AAA rated municipal bonds and he confirmed concurrence to permit municipal bonds with AA rating.

Mayor Curry said there is a section in the Government Code on providing monthly transaction reports and he said to consider whether that is appropriate to incorporate. Mr. Matusiewicz said he will be expanding on the reporting.

Ms. McCraner said she will make the changes to the F-1 Policy as discussed and bring it to the City Council with a recommendation for approval as amended by the Finance Committee.

c. Revisions to Council Policy F-14, Authority to Contract

City Attorney David Hunt reviewed proposed policy issue related to Council Policy F-14. He noted that these policy revisions were prepared in conjunction with the contracting procedure protocols. He provided handouts that reflect his staff's research into what other cities do with respect to outside contracts, authority levels as well as Public Works.

He said the policy sets forth contracting authority of the City Manager and staff. It covers professional services contracts and does not cover purchasing or Public Works contracts. He said the current policy gives the City Manager authority to approve up to \$50,000 and department directors have authority up to \$30,000. He said revisions to F-14 will consolidate all policies regarding contracting into one concept and raise the potential authority levels to \$100,000-\$125,000 for the City Manager and \$50,000-\$75,000 for department directors.

Mr. Hunt explained how developing an Administrative Procedures Code would work in the context of F-14 which sets forth policy. He said the procedure would require that contracts be awarded using a Quality Based Selection (QBS) but with an element of competition through the utilization of at least opening three different proposals for rate comparison. He further explained a contract SOP that guides contract workflow and responsibilities.

In response to Council Member Daigle's question, Mr. Hunt said policy F-14 addresses QBS in section F. Mr. Hunt said the goal of the process is to identify the most qualified consultants and determine the bid range of the top three qualified companies. Council Member

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Daigle expressed concern that the proposed changes will limit the transparency. Mr. Hunt replied that this only changes amounts and it's consistent with how other agencies have brought competition to the professional services market. Council Member Daigle requested a provision be included on reporting to Council on contract allocation so that Council has knowledge of consultant work. Mayor Curry said there could be an informational item on the City Council consent calendar to inform Council what contracts the City Manager has awarded. He commented that he wants to be sure we are not backing ourselves into what amounts to a low bid situation for professional services. Mr. Hunt said awards would not be based solely upon dollar amount and making the choice of the best qualified individual would still be left to the managing department so long as they are priced within the ballpark. He said the process introduces a significant element of competition with these types of awards. He said currently the process is to determine the most qualified individual or firm and open only that proposal. If the amount can't be negotiated to what is perceived fair in the market, then the number two proposal is opened. He said the proposed policy would result in opening three or a predetermined number of proposals to identify what the market is as related to the proposal. In response to a question raised by Mayor Pro Tem Henn, Mr. Hunt said only the proposal that is awarded the contract becomes public record. Mr. Hunt noted this process is used for Public Works contracts using QBS in Huntington Beach.

Assistant City Manager Smith expressed concern about the process for all professional services contracts let by the City that are different from Public Works contracts which are more concrete in its execution. She said there may be difficulty with the small or mid-size contracts that are more limited in the field of experience or more qualitative in nature such as financial advisory services or plan check services. Mr. Hunt noted that F-14 exempts legal services from this process.

Council Member Daigle questioned why Council approves contracts for EIR consultants but doesn't have input on contracts for legal services such as a CEQA lawyer. She suggested F-14 should be rewritten to allow Council to have some checks and balances in place on outside law firms that are retained. Council Member Daigle said in striving for consistency Council should have approval authority over legal services just as they do for other professional services. She cited the upcoming JWA agreement as an example of something the Council should have input on what individual or firm is hired to negotiate on behalf of the City. She asked that more controls be put in place over legal services in A-4 of the proposed policy.

Mayor Pro Tem Henn said a policy discussion on the issue of City Attorney exemption should take place at whatever point this matures

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to Council consideration. He concurred with the idea of looking at the three top quality-based selections to ensure the fee schedule is within reason. He suggested that it would be reasonable to produce a qualitative description summarizing the selection process to show how the prices of the top qualified bidders compared. Ms. Smith suggested a quality based analysis with weighted criteria that are ranked with price becoming one of the key pieces that give an outcome. She noted the biggest difficulty and cost to the entire contracting operation is the time it takes to get work started quickly when there is a need and a method that streamlining the approval process would be beneficial.

Mayor Curry said the outcome doesn't work well to try and hire professional services using a Public Works model. Using appraisal services as an example, he said all the proposals should be opened first and if the desired individual's fee is not in line with the market, an attempt to negotiate the fee could take place. Mr. Hunt said under the government code, certain amounts of competition can be introduced in a State let quality based selection contract but the Federal contract is more circumscribe about what we can do. Mr. Kiff asked for clarification on the threshold under which that rigor is not required and what the threshold should be.

Ms. Smith suggested separating the Public Works contract issues from the rest of the professional services contracting. Mr. Hunt said this discussion was not intended to be about QBS which will come back later. He said the issue is determining the appropriate amount of authority for the City Manager to have for signing professional services contracts that can be managed at a staff level so long as Council policy goals are met which are set in Council policies. Mayor Pro Tem Henn generally agreed that Council Policy should set the boundaries and shouldn't get into too much level of detail. Ms. McCraner commented that documenting the process can be done in administrative procedures.

Mayor Curry said he concurs with setting the thresholds of \$50,000 and \$125,000. He said the guiding principles need to be that we have a process that is fair, transparent and cost competitive, and enables us to select the best qualified firm for these services with the least amount of procedural hoops required.

Council Member Daigle agreed the process should be fair, transparent and cost competitive. She said it isn't clear on what is being contemplated to accomplish the transparency. She noted the drive to move to QBS was because the same firms were being selected and a more worthwhile process was needed. She said she is troubled by the threshold increases and she doesn't feel Council is overburdened by the contracts they get at the current level because there isn't an

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excessive amount of contracts on the Council agendas. Ms. Smith said if there is a Council goal to increase the diversity and have the departments that are letting contracts make sure they are broadly looking at other firms, management staff should report on how that can be accomplished. She said opening up processes is important and demonstrating how selections are made is important for the sake of transparency. She said there may be good reasons that some firms are coming back and we'd like to be able to document those reasons. She said the executive staff should be held accountable for delivering in the way the Council wants us to deliver. The administrative policies that the City Attorney is suggesting can accomplish the changes that are needed in the processes. .

Mayor Pro Tem Henn said he is generally of the view that staff should have the authority and the ability to execute contracts so they can move forward and couple that with post facto succinct reporting that accomplishes transparency. He expressed his view that Council Policies should establish the boundaries and be succinctly written.

In response to Council Member Daigle's question, Mr. Hunt said the revised policy is trying to make the process simpler so that the business of the City can move forward more quickly while still honoring transparency, fairness and cost competition as Council has directed.

Mayor Pro Tem Henn said he thinks we can get there if we couple policy level description with good reporting. Mr. Kiff suggested we give that a try for a period of time and revisit the policy if needed. Mayor Pro Tem Henn said to provide a much more succinct policy and the administrative procedure that would go with it and include in the administrative procedure a Council reporting section that describes succinctly what is reported to Council on contracts that are being let.

Mayor Pro Tem Henn said another area he expects to see improvements in terms of policy and the accompanying procedure is with on-call contracts. He said Council routinely gets renewals of on-call contracts that come with increased rates. Council Member Daigle added that the cost benefits of using on-call contracts should be looked into since emergency repairs are expensive and there may be better alternatives. She reiterated there should be more checks and balances with attorney contracts and she believes Council should have the opportunity to review the selection of law firms the City hires. Hunt said he working on creating a mechanism for reporting tangible/non-tangible issue success with respect to City Attorney matters both on substantive response and dollar amounts.

2. Civic Center Financing Update

a. Financing Team Update

Mr. Matusiewicz reported on major activities scheduled for the Civic Center financing. He said contracts for the appraiser, bond counsel, disclosure counsel and financial advisor are on the City Council's July 27, 2010, agenda for approval. Pending the approval of those contracts, the appraisers are poised to appraise 18 properties if all 18 properties are chosen for appraisal. The legal team is working on the legal documents and will have the first draft ready for review on August 12, 2010. Work is also beginning simultaneously on the credit presentation with the first draft targeted for August 13, 2010 and the second draft by August 23, 2010. The package will be submitted to the rating agencies by September 6, 2010. A presentation meeting with the rating agencies is scheduled for October 1, 2010. Participation in the credit rating presentation will include Mayor Curry and Mayor Pro Tem to speak about the vision of the City, fiscal stability of the City and demographics.

Mr. Matusiewicz said the RFP for co-manager selection will be sent out the first week of August and selection will be made by August 30, 2010. Mr. Matusiewicz said the key date for the actual authorization by the City Council to sell bonds is October 12, 2010.

Ms. McCraner confirmed in an effort to keep the Finance Committee informed, the credit rating presentation will be emailed to Committee Members when it is in its second draft form.

In response to Mayor Pro Tem Henn's question on what date Council will take action on authorization for the final design of the project and the bond financing, Mr. Matusiewicz said the not to exceed bond authorization will be brought to Council on October 12, 2010. Mr. Kiff said approval for the final project design will be sought from Council on October 26, 2010. Mayor Curry further explained that the amount of the financing will be known after the October 26 meeting and the amount can still be adjusted up until the bond pricing on November 2, 2010. Mr. Kiff confirmed for Council Member Daigle that the size of the issuance is directly related to the cost of the Civic Center. Mayor Pro Tem Henn added that previously the decision was made to not borrow today for projects that aren't ready to be executed.

Mayor Pro Tem Henn said the schedule should include the date for the approval by Council of the design finalization of the Civic Center project and the final conclusion on the amount to borrow will be based upon that Council decision.

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b. Update on Owner Controlled Insurance Program (OCIP))

Risk Manager Lauren Farley said the estimates have been further refined to show a potential savings of about \$653,000 using an OCIP over traditional coverage. She emphasized the OCIP gives the City more control of the insurance paper and eliminates any contractual issues we may have to pay a claim. In response to a question raised by Mayor Curry, Ms. Farley said we are insuring against third party claims which includes general liability and workers comp, bodily injury, property damage, personal injury, etc.

Ms. Farley explained that CW Driver has a Contractor Controlled Insurance Program (CCIP) which doesn't provide the same level of coverage as the OCIP and she pointed out the differences.

Ms. Farley said the OCIP would give the City the ability to oversee and minimize our losses. She added that the coverage is for a 10-year period.

Mr. Hunt indicated this is a great opportunity to hold the insurance papers and it gives great control to limit the transaction cost standpoint in litigation. He said the CCIP that CW Driver has doesn't cover the full expanse of risk.

Mayor Pro Tem Henn confirmed there is a direct savings in the contracting process because the contractors do not have to arrange for coverage. Mr. Rakich explained the differences in how public sector and private contractors charge for insurance. He said in a well-run OCIP, the contractor is provided guidance through the process.

Council Member Daigle asked if other firms have applied to provide the same services. Ms. Farley said there are 7 qualified brokers that run OCIPs and the next step is to go to the broker marketplace with an RFQ. She said a recommendation will be submitted to Council for the selection of the OCIP broker at the first Council meeting in September.

V. MATTERS WHICH A COMMITTEE MEMBER MAY WISH TO PLACE ON A FUTURE AGENDA

No matters were discussed at this time.

VI. ADJOURNMENT

The Finance Committee adjourned at 4:02 p.m.

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

Attest:

Tracy M. McCraner
Administrative Services Director

Date

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administration office of the Administrative Services Department