



MINUTES FINANCE COMMISSION

Wednesday, November 16, 2022 - 5:00 p.m.
City of Huntington Beach
Zoom Webinar
Civic Center – Lower Level Conference Room B-8
2000 Main Street
Huntington Beach, CA 92648

For the audio recording of the November 16, 2022 Finance Commission Meeting, please visit the City's website at: <https://huntingtonbeach.legistar.com/Calendar.aspx>

Acting Chair Frank Lo Grasso called the meeting to order at 5:00 p.m., and led the Pledge of Allegiance.

MEMBERS PRESENT:

Tony Strickland, Vice-Chair
Janet Michels, Commissioner
Stephanie Gledhill, Commissioner
Frank Lo Grasso, Commissioner
Robert Sternberg, Commissioner

MEMBERS ABSENT:

Jamie Craver, Chair
Lawrence Owen, Commissioner

STAFF PRESENT

Dahle Bulosan, Chief Financial Officer
Sunny Rief, Assistant Chief Financial Officer
Thuy Vi, Administrative Aide, Finance

PUBLIC COMMENTS

There were no public comments.

CONSENT ITEMS

Approval of Meeting Minutes

(2:17) Motion: Moved by Commissioner Robert Sternberg and seconded by Vice-Chair Strickland to approve the Finance Commission Meeting Minutes dated September 28, 2022, as presented

The motion carried by the following votes: 3-0-1-3

Ayes: Lo Grasso; Sternberg; Strickland

Noes: None

Abstain: Michels

Absent: Craver; Gledhill; Owen

DISCUSSION ITEMS AND POTENTIAL RECOMMENDATIONS

(3:35) Chief Financial Officer Dahle Bulosan stated that this was our last official meeting of the year, and thanked and recognized the outgoing Finance Commissioners by presenting certificates of appreciation to Frank Lo Grasso, Tony Strickland, Stephanie Gledhill and Lawrence Owen.

(5:27) Bulosan presented the Fiscal Year 2021/2022 Year-End Review. He stated that the City is estimated to end FY 2021/22 with a \$5.5 million surplus, primarily due to a stronger recovery in sales tax and transient occupancy tax than anticipated. He noted that recent 2022 economic indicators signal caution. The Federal government raised interest rates six times in 2022, up to 3.75%-4.00%. There is an inverted yield curve, and looking at the two-year and ten-year treasury, it may be a sign of a recession in the future. Inflation has been high; it peaked in June 2022 at 9.1%, but took a downward turn at 8.2% in September 2022. The latest data for October 2022 was at 7.7%, which is positive, and has had positive effects on the equity market. We had two consecutive negative gross domestic products (GDPs) in the first and second quarter. The third quarter has turned slightly positive to 2.6%, and the equity markets have been dismal for the calendar year to date. There have been some improvements in the past 1.5 months, and we hope that it continues moving forward.

These economic factors are creating headwinds for the economy in the terms of expansion, investment, and consumer demand. Consumers are saving less, drawing from savings, and increasing credit usage. The bright spot is that the unemployment levels have been relatively low. The State unemployment was low in September 2022 at 3.9%. It peaked in May 2020 after COVID at 16.1%, although the ratio of job openings to job seekers is starting to decline (2.0 in July to 1.87 in Aug).

The General Fund surplus for FY 20/21 was \$5.2M. The projected surplus for FY 21/22 is \$5.5M, and a \$2M surplus is projected for FY 22/23.

Bulosan provided a CalPERS update. For FY 21/22, CalPERS originally estimated a -6.1% return, but the numbers have been updated to -7.5%, which requires escalating UAL payments by the City. In October 18, 2022, the City Council approved \$3M to fund the Section 115 Trust to address CalPERS' unfavorable return. The fund was set up to address volatility with CalPERS. As of June 30, 2022, our Section 115 Trust balance is \$15.4M. As part of our policy, which the Finance Commission blessed and subsequently approved by City Council, we dedicate annually approximately \$1.5M ongoing funds, adjusted for inflation, so that we have sufficient funds to flatten out any spikes in UAL payments. CalPERS' gains and losses are amortized over 20 years, with a 5-year ramp-up to give agencies time to adjust their budgets to the rising costs. Projections assume CalPERS earns 6.8% in FY 23/24 going forward, which is CalPERS' discount rate. Perhaps in future years, there could be positive returns over the 6.8% discount to offset costs. CalPERS' investment policy focuses on long-term plan returns. Pension Obligation Bonds (POBs) are financially advantageous, as long as CalPERS' long-term return is greater than 2.925%.

(13:00) Commissioner Michels asked if the October 2022 City Council approval of the \$3.5M to fund the Section 115 Trust was budgeted, if the amount was in addition to the \$1.5M set aside, and

if the funds came out of the surplus. Bulosan stated that it was not budgeted, the \$3.5M was in addition to our UAL policy that requires a set-aside of \$1.5M every year, and has already come out of the surplus funds. This was to help infuse more money into the market, and in case we need those funds in the future.

Bulosan shared the CalPERS UAL payment projection, comparing scenarios of volatility that come with the UAL, and the changes in CalPERS returns rates ranging from 3.4%, 6.8% and 10.2%. There is a two-year lag for impacts of CalPERS returns to show as a payment. We will pay \$6M in the current year and no payment is required next year because in FY2020/21 CalPERS had a 21.3% return rate. Bulosan stated that his recommendation would be to set aside funds that would have gone to CalPERS next fiscal year in the Section 115 Trust to pay for any future fluctuations. In FY 24/25, the payment projection escalates to \$4M, and then the payments begins to part depending on CalPERS' investment returns. If CalPERS has lesser returns, our UAL payment is higher. In FY 25/26 with a 3.4% rate of return, our payment would be \$9M, at a 6.8% return, we would pay \$8M, and at a 10.2%, we would pay \$7M. The payments peak in FY 32/33, at 3.4%, our payment would be \$26M, at 6.8%, we would pay \$20M, and at 10.2%, we would pay \$15M. Bulosan stated that the rates are subject to the returns we receive this year and the years to follow, and our hope is that there would be a bounce back in investment returns. He wanted to illustrate the variabilities that we want to plan for. His recommendation to the City Council is to commit to setting aside additional funds to the Section 115 Trust in order to help us through difficult financial times.

Michels said that since the amounts that we have to pay will grow exponentially despite the rate of return, and with the \$15.4M balance that we do have, will there be a recommendation for next year's budget to set aside more than \$1.5M? Bulosan stated that his recommendation for FY 23/24, since we do not have an UAL payment due, is to set aside in the 115 Trust the \$6M that we already have budgeted and that we would have paid, over the \$1.5M. He stated that we are hoping for a better year this year or the following year, which would offset some of the high payments projected in the future.

Bulosan shared an illustration of the Section 115 Trust balance in the future, based on the three different scenarios of CalPERS returns rates of 3.4%, 6.8% and 10.2%. For the current fiscal year, our Section 115 Trust is projected to be overdrawn at 3.4%, and at 6.8%, seven to eight years out. The illustration substantiates the importance of putting more money in the Section 115 Trust to plan for the worst and hope for the best. With a 10.2% CalPERS return in FY 22/23, we would have adequate funds.

Michels asked what the practical implications are if the worst-case scenario happens and we become overdrawn in year six or seven, and what the City has to do to mitigate the risk.

(25:01) Bulosan stated that we would have to look at ways to cut back in operational areas, such as personnel costs and trimming operations. We have General Fund reserves that could be used, but not long-term. We are hoping there will be a bounce back at some point that will offset some of the negative returns.

Lo Grasso stated that the City's investments are super conservative, but it appears that CalPERS' investments do not keep with the same rule. Bulosan stated that CalPERS' policies are different

because in order to pay for pensions and fulfill commitments of their contracts with all the cities, they need to have the long-term earnings to pay for those benefits. The way they achieve that is by paying retirees with investment income versus agency contributions, which makes it sustainable in the long term. Lo Grasso stated CalPERS has to take more risks because the system is putting out more money than they are taking in. Bulosan stated that CalPERS is implementing risk mitigation efforts to have a lower discount rate than 6.8%. The discount rate was previously 8%, but CalPERS is slowly bringing the rate down so that is more sustainable, and so that there are less risky assets. The CalPERS board is working on ways to ensure this is sustainable long term.

Bulosan discussed the General Fund Long-Term Financial Plan, looking out five years with the three different scenarios of CalPERS returns rates of 3.4%, 6.8% and 10.2%. Each scenario assumes CalPERS earns 6.8% in FY 23/24 going forward. Scenario 1 with a CalPERS 3.4% return is the least favorable scenario and requires use of Section 115 Trust reserves based on our UAL Policy, starting in FY 25/26. A deficit is projected in FY 25/26 and FY 26/27 at which time would be picked up by our Section 115 Trust to structurally balance the budget. Insufficient funds are projected to be available starting in FY 29/30. Scenario 2 with a CalPERS 6.8% return (CalPERS discount rate) requires use of Section 115 Trust reserves in FY 25/26 and FY 26/27. We would be overdrawn in FY 30/31. Scenario 3 is the most favorable scenario, and would require use of the Section 115 Trust reserves in FY 26/27 to FY 32/33 (7 years). Sufficient funds are projected to be available in the Section 115 Trust to structurally balance the budget. Bulosan stated that his recommendation is consistent with the City Council's, which is to set aside as much as we can in the 115 Trust, and to plan prudently moving forward.

Bulosan discussed the FY 2021/22 Year-End Budget Adjustments that were approved by the City Council on November 15, 2022. With the \$5M surplus, staff recommended to the City Council to transfer \$2M to the Infrastructure Fund (314) to comply with Section 617 of the City Charter that requires the City to spend 15% of General Fund revenue on infrastructure and address rising labor and material costs. A recommendation was made to transfer \$2M to the Equipment Fund (324) to ensure adequate funding for essential capital equipment needs and address rising equipment costs. We have faced supply challenges with vehicle orders, and are still waiting until next year to receive vehicles. Staff recommended a \$6K transfer to the HOME Fund (240) to reimburse the HOME Fund for prior year administrative expenditures that were ineligible under the grant program.

Michels asked with regard to the \$2M transfer to the infrastructure fund, did we need to spend a larger percentage than the 15% on infrastructure, and what percentage of the General Fund that equates to. Bulosan stated that we are at approximately 15.5%. Much of the money is going to existing projects where costs were estimated, but when bid out, ended up costing more due to the increase in labor and material costs

(37:53) Bulosan shared the General Fund Surplus with Year End Adjustments. He stated that we started with a \$5.5M surplus, and with the City Council approved General Fund adjustments to the infrastructure, equipment and HOME funds transfers, we are ending the fiscal year with a \$1.5M surplus. We have a fund balance policy where one-half of the surplus would go to our Section 115 Trust, 25% would go towards our economic uncertainty fund, and the remaining would be split between capital and equipment once we finalize our Annual Comprehensive Financial Report (ACFR).

Bulosan discussed what is on the Budget horizon. In January 2023, we will have our Mid-Year Budget Review and Budget-Kickoff, and introduce our new Finance Commissioners. In February 2023, we will return to the City Council with a Mid-Year FY 2022/23 Update, and will present our Final Year-End Audit Results for FY 2021/22.

He shared details of the Budget Development Calendar for FY 2023/24. From December 2022 through May 2023, we will begin the FY 2023/24 Budget Development Process with all departments and the City Manager, do some community outreach and have discussions with Finance Commission. If Commissioners have items they would like to discuss, we can discuss those items at our January meeting when we develop the budget. On May 16, 2023, we will have FY 2023/24 Proposed Budget Study Session with the City Council. On June 6, 2023, we will hold a City Council Public Hearing for the FY 2023/24 Budget Adoption, or alternatively adopt the budget at the June 20, 2023 City Council meeting. The Fiscal Year 2023/24 begins July 1, 2023.

Sternberg asked how the financial audit was going and if it would be completed on time. Bulosan stated that the auditors have completed the fieldwork, we are finishing up with the draft of our report, and are looking to issue the report in mid-December. We received our results for last year's report from the Government Finance Officers Association (GFOA), and are happy to report that we received a GFOA award. Sternberg asked if there were any surprises from the financial audit. Bulosan stated not at this time.

Discussion ensued regarding the holiday luncheon.

COMMISSIONER COMMENTS

(46:13) The Finance Commission congratulated Strickland on being elected to the City Council. Lo Grasso thanked the Finance Commission.

ADJOURNMENT

(47:13) **Motion: Moved by Michels and seconded by Gledhill to adjourn the meeting at 5:47 p.m.**

The motion carried by the following votes: 5-0-2

Ayes: Gledhill; Lo Grasso, Michels; Sternberg; Strickland

Noes: None

Absent: Craver; Owen

Submitted by:

Sunny Rief, Acting Chief Financial Officer

By: Thuy Vi, Administrative Aide, Finance