CITY OF NEWPORT BEACH
FINANCE COMMITTEE AGENDA

Council Conference Room, 3300 Newport Blvd., Newport Beach
Monday, September 10, 2012 – 2:00 PM

Finance Committee Members:	***Staff Members:***
Keith Curry, Mayor Pro Tem, Chair	Dave Kiff, City Manager
Leslie Daigle, Council Member	Dan Matusiewicz, Finance Director
Mike Henn, Council Member	

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

Approval of minutes of the Finance Committee meeting of June 11, 2012.

5) CURRENT BUSINESS

A. **Big Canyon Reservoir Cover Replacement**: The Public Works Director will present an evaluation of floating cover materials and procurement options.

B. **Quarterly Financial Report Through Quarter Ending 6/30/2012**: The Finance Director will review the preliminary FY 2011-12 closing results and other financial news reported in the Quarterly Financial Report included within the Quarterly Business Report.

C. **Annual Investment Portfolio Performance Review**: The Finance Director will review the performance and characteristics of the City's investment portfolio Fiscal Year Ended 6/30/12.

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.

D. **<u>Annual Investment Policy Review & Update</u>**: The Finance Director will recommend proposed amendments to the City's Investment Policy concerning the annual review of the City's Investment Policy, clarification concerning the distribution of monthly Treasury reports and due diligence procedures concerning broker dealer relationships. There are no proposed changes to the allowable investments or maximum allowable concentration of allowable investments.

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

CITY OF NEWPORT BEACH
CITY COUNCIL FINANCE COMMITTEE
MINUTES

1. CALL TO ORDER

The June 11, 2012, Finance Committee meeting was called to order at 2:05 p.m. in the Council Conference Room, 3300 Newport Blvd., Newport Beach, California 92663.

2. ROLL CALL

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

Excused: Council Member Leslie Daigle

Staff present: Assistant City Manager Dana Smith, Finance Director Tracy McCraner, Deputy Finance Director Dan Matusiewicz, Accounting Manager Rukshana Virany, Budget Manager Susan Giangrande and Administrative Coordinator Tammie Frederickson

Members of the public: Jim Mosher

Outside entities: Nitin Patel and Daphne Munoz of White Nelson Diehl Evans

3. PUBLIC COMMENTS

Mr. Mosher commented it is hard to reconcile the financial structure of Business Improvement Districts (BIDs) with the Streets and Highways Code Section that calls out district boards as advisory bodies. He noted the City Council, not the BIDs, actually spends the BID levy through normal City mechanisms. He also questioned what a cash basis fund is, as referred to in a section of the Charter that puts certain limits on what can be done with capital improvement funds.

Deputy Director Matusiewicz explained the cash basis fund is old terminology and should be updated to reflect modified accrual basis accounting.

4. APPROVAL OF MINUTES

The minutes for the Finance Committee meeting of May 7, 2012, were approved with the recommendation going forward to change footer reference from Administrative Services Department to Finance Department.

5. CURRENT BUSINESS

A. <u>Audit Entrance Conference</u>

Finance Director McCraner introduced the outside auditors from White Nelson Diehl Evans who will conduct the Fiscal Year 2011-12 audit for the City.

Nitin Patel, Partner with White Nelson Diehl Evans, went over the scope of the audit and the work plan. He stated the auditor's responsibility is to express an opinion on whether the financial statements are prepared in conformity with generally accepted accounting principles. It is the responsibility of management and those in charge of governance to communicate any concerns or ask any pertinent questions. The audit is designed to give reasonable assurance that the financial statements are free of material misstatements. Any significant matters will be communicated at the conclusion of the audit.

Beginning July 16, the interim phase of fieldwork will commence for the audit of all City funds and a single audit of Federal grants using a threshold of $500,000. Mr. Patel explained internal control procedures will be tested during the interim phase. Final fieldwork is expected to start October 29, with the completion of the audit by the end of November. The auditor opinion will be issued in December.

Mr. Patel noted during the initial planning meeting with staff, significant financial transactions that happened during the year were discussed in addition to new GASB standards that are pertinent for the current fiscal year, as well as upcoming applicable GASB standards. Mr. Patel remarked GASB Statement 68 on pension disclosure is expected to impact fiscal year ending June 30, 2015, with a required implementation for all governmental entities. He discussed further the details of Statement 68. Mayor Pro Tem Curry noted it is important keep in mind that nothing has changed other than the way the math is computed and the numbers the accounting authority has directed be used which causes a big spike in the perceived liability.

Council Member Henn commented on the practice of producing a financial statement five months after the close of the fiscal year and questioned whether it is standard timing in other cities for production of an audit. Mr. Patel replied it is standard in the municipal environment to complete the audit and financial statements by the end of December. Ms. McCraner added that tax revenues are not known or received until the end of August.

In response to a question raised by Mr. Mosher, Mr. Patel indicated the auditors do not express an opinion about adequate bonding of City officers.

Having no further discussion on this agenda item, Mayor Pro Tem Curry stated the Finance Committee would meet with the auditors at the conclusion of the audit without staff present.

B. <u>Assessment District Bond Issuance Update</u>

Council Member Henn recused himself on discussion of this item since it involves a financial impact on Assessment District 100 of which he is a participant. Prior to leaving the room, he requested staff provide a district-by-district impact of the proposal.

Deputy Director Matusiewicz stated requests for bids were sent to 11 different banks and the most favorable bid received which included a financing rate of

2.26% was from BBVA Compass. The low financing rate makes it financially feasible to include all 14 outstanding assessment districts into one reassessment district. He noted with this rate a net present value (PV) savings of $1.1 million will be achieved. Mr. Matusiewicz added that including all of the districts with this current refunding represents a cash flow savings to the customers. Mayor Pro Tem Curry confirmed that because the cost of issuance is shared and the market is at a low, it is a good time to proceed.

Mr. Matusiewicz outlined the closing scheduled for July 2, 2012, is pending City Council approval on June 26, 2012.

Mr. Mosher inquired how much the savings would be if the districts were refinanced separately. Mr. Matusiewicz explained there would not be any additional savings and the benefit of consolidating to one district spreads the loan origination fees across all the districts. Mayor Pro Tem Curry added that it is an improvement because the districts' credit quality is enhanced by a higher number of people who make up the reassessment district.

With the discussion of this item concluded, Council Member Henn returned to the meeting.

C. Proposed FY 2012-13 Budget

Ms. McCraner reviewed the details of the budget checklist and provided explanation on any items that changed since the City Council budget discussion at the May 22, 2012, meeting. She summarized the checklist recommendations total an increase of $2.4 million to the operating and CIP budget. Additionally, the checklist recommendations were funded by reprioritization or by using restricted reserves, as in the purchase of the fire trucks. The increases did not affect any General Fund reserves.

In response to a question raised by Mr. Mosher, Ms. McCraner explained relinquishment funds received from the State are dedicated to a certain area and Public Works will verify the area qualifies as an eligible use for that revenue.

D. Facilities Financing Plan (FFP) Update

Mr. Matusiewicz explained the Facilities Financing Plan (FFP) developed several years ago needs certain improvements to make it a more usable document for the public. He noted one of the improvements includes separating the FFP balance from the project balance to show the amount in reserves versus the funds dedicated for a specific project. Other improvements include the addition of some visual aids to better show the solvency of the Plan, enhanced analytical tools, and modernization to enable easier updates. Mr. Matusiewicz requested Finance Committee guidance on further improvements to incorporate in the FFP.

Without something specific to review at this time, Mayor Pro Tem Curry and Council Member Henn determined their comments would be offered when the next draft of the FFP is presented. Council Member Henn also offered assistance on discussing concepts.

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

No future agenda items were discussed.

7. ADJOURNMENT

The Finance Committee adjourned at 2:45 p.m.

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

Attest:

Keith Curry, Mayor Pro Tem Finance Committee Chair	Date

Agenda Item 5A

CITY OF NEWPORT BEACH
FINANCE COMMITTEE STAFF REPORT

September 10, 2012

TO: HONORABLE CHAIR AND MEMBERS OF THE COMMITTEE

FROM: Public Works Department
Dave Webb, Public Works Director
(949) 644-3328 or dawebb@newportbeachca.gov

SUBJECT: BIG CANYON RESERVOIR FLOATING COVER REPLACEMENT MATERIAL OPTIONS AND BIDDING OPTIONS REVIEW

ABSTRACT:

Staff and its consulting team are in the final design preparation for the floating cover replacement project. There are only two material choices for the cover and limited manufacturing firms. For one of the materials, only one manufacturer in the United States is available. Industry standard is to design for one material or the other to minimize design costs, though bidding both covers materials is an option. This meeting provides the Finance Committee with a review of the material and bidding options along with the related costs impacts.

BACKGROUND:

The City-owned and operated Big Canyon Reservoir (BCR) is a 600-acre foot (200M gallon) potable water storage reservoir located in Corona del Mar. This reservoir at full capacity provides enough water to supply the City with 10 days of average demand. The facility was originally constructed in the early 1960's as a main delivery point for imported water from the Metropolitan Water District. When it was constructed, an open water reservoir was a more typical and acceptable facility. However, as water quality standards have become more stringent over the years, the Department of Health Services (DOHS) mandated that the City cover the reservoir or abandon the facility. This mandate has been in effect since 1994 and in 2005 the City completed the installation of the current floating cover to satisfy this state requirement.

The BCR cover was intended to last 20 years; however, City staff noticed a significant amount of degradation to the cover after approximately one-fourth of the 20-year lifespan. Due to the significant amount of degradation, staff recommended replacement of the cover to avoid failure that might result in taking the reservoir out of service. City Council approved the design Professional Services Agreement with MWH Global for this effort on March 27, 2012.

DISCUSSION:

Contract document preparations for the replacement cover are at the 60 percent point and decisions related to final material selection and bidding options are required. The MWH Global (MWH) team has prepared a Technical Memorandum regarding the two available material options: reinforced chlorosulfonated polyethylene (CSPE) and reinforced polypropylene (RPP).

MWH along with the City Staff is recommending the use of CSPE because of its longer life cycle. The use of RPP is not recommended because of the recent product failures, including failure at the City's Big Canyon Reservoir prompting this replacement project.

Staff would note that there are limited manufacturers of either material. Only one manufacturer nationally exists for CSPE and only two are available for RPP. One of the RPP firms was the manufacturer of the failed material we currently have in service. Staff has had discussions with the manufacturers and believes bidding both materials would not result in any true competition since we expect a single bid from each industry.

The net cost of the CSPE 30-year cover is essentially the same as a 20-year RPP cover. However, we do not believe the RPP cover will last 20 years based on the City's and other agencies experience. The recommended 45 millimeter thick CSPE material is estimated to cost $2.14 million in comparison to RPP that is estimated to cost $660,000. Total difference in materials price is approximately $1.5 million, however, we believe the CSPE cover will last twice as long thus justify the upfront increase in capital cost. The total project cost has yet to be finalized, but for rough numbers, we would estimate $5.0 million for the CSPE cover in comparison to the $3.5 million RPP cover. These costs are based on bids received on other similar cover projects.

If the City proceeded with a dual material bidding process added cost and time will be required to modify the contract documents. However, we do not anticipate the material cost to change much from what we know today. In the interest of time and to minimize design costs (and additional time) of dual material bidding, Staff is recommending the sole use of CSPE. Competition still exists for the cover fabrication and installation as there are several firms that do those portions of the project.

Submitted by:

/s/Dave Webb
David Webb
Public Works Director

Attachment: A. BCR Cover Life Cycle Cost Technical Memorandum
B. Cover Material Summary PowerPoint

TECHNICAL MEMORANDUM

MWH

BUILDING A BETTER WORLD

To:	Mike J. Sinacori, P.E.	**Date:**	August 30, 2012
From:	Jay Cooke, P.E. Kandarp Patel, P.E.	**Reference:**	Big Canyon Reservoir Floating Cover Project (MWH Project #10500406)
Subject:	Life Cycle Cost Analysis – Floating Cover Membrane Materials		

INTRODUCTION

The City of Newport Beach is replacing the existing 23-acre floating cover located on the 200 million gallon (MG) Big Canyon Reservoir due to premature failure of the existing reinforced polypropylene (RPP) cover membrane. Careful consideration is necessary during the design of the replacement cover to select the appropriate floating cover membrane material. This technical memorandum provides a comparative description of the two floating cover membrane types available for the potable water industry and presents results of life cycle cost comparison between RPP and CSPE membranes.

MEMBRANE MATERIAL COMPARISON

Flexible membrane materials (commonly known as geomembranes) have been used extensively in the water industry for lining and covering water storage reservoirs for over forty years. Reinforced chlorosulfonated polyethylene (CSPE) elastomeric membrane materials were introduced in the mid-1970's and reinforced polypropylene membrane materials (RPP) were introduced in the late 1980's. Although a number of other elastomeric membrane materials have occasionally been used for reservoir lining and floating cover applications, reinforced CSPE and RPP are the most prevalent in the water industry today due to their superior characteristics and benefits. CSPE and RPP materials were considered exclusively for use as cover material alternatives for Big Canyon Reservoir.

Chlorosulfonated Polyethylene (CSPE)

Chlorosulfonated Polyethylene was originally introduced under the trade name Hypalon®, a registered trademark of the DuPont Company. Since it was first introduced to the water industry over 40 years ago, Hypalon has become the most widely used geomembrane material for reservoir liners and floating cover applications. The familiarization of the liner/cover industry with the physical properties, characteristics, seaming methods and performance of this material and the long history of demonstrated performance has become one of its greatest advantages.

Reinforced CSPE membranes contain a reinforced scrim layer located between two layers of CSPE material. CSPE is available with a “15 + 15”, 30-year material performance warranty (non-prorated through 15 years, plus prorated from years 16-30) from Burke Industries, who manufactures the reinforced membrane from the CSPE resin.

Polypropylene

Polypropylene has been used as a lining and floating cover material for over 23 years, with most installations in the past 15 years. Its long-term, real-life performance history is shorter than that of CSPE.

Reinforced polypropylene (RPP) membrane material contains a scrim layer of reinforcing between two layers of polypropylene material. Material warranties for RPP have historically not been as strong as warranties for CSPE membranes and are usually 20-years (pro-rated). However, one manufacturer may match the “15 + 15” 30-year warranty on the thickest (60-mil) RPP membranes, at additional cost and only for potable water installations.

There have been a growing number of reported “failures” of RPP floating covers over approximately the past 11 years due to cracking and flaking. The industry is slowly acknowledging this issue; however the reason(s) for the cracking have not been clearly disseminated within the industry. The City is fully aware of this issue based on degradation problems of the existing floating cover at Big Canyon Reservoir and the decision to proceed with replacement.

A listing of the distinct differences (advantages/disadvantages) between both CSPE and RPP membrane materials used for lining and cover applications is shown in Table 1.

Table 1 - Membrane Material Comparison

CSPE	Polypropylene
Advantages: • No recorded (known) cover failures in recent history • Material guaranteed for 30 years • Greater installed experience, ≈ 40 years	**Advantages:** • Lower material cost • Retains tear strength with age • Higher puncture resistance
Disadvantages: • Higher material cost • Reduced tear strength (with age) but has not proven to cause failure of the reservoir during its service life	**Disadvantages:** • Multiple cover failures recorded in first 10 years of service • Existing Big Canyon Reservoir floating cover (RPP) did not last seven (7) years after installation • Limited installed experience, <23 Years (most installations < 15 years) • Repair procedures not as well proven over time • Long term reparability (not fully proven) • Premature material cracking/flaking issue unresolved at this time

LIFE CYCLE COST ANALYSIS

A life cycle cost analysis has been performed to provide an economic basis for comparison between cover membrane materials. This analysis has been performed solely to quantitatively evaluate the relative attractiveness of the material options analyzed, and is not intended to function as a cost estimate or financing analysis. Some capital costs, O&M, and other outlays that are not relevant for a comparative analysis have been left out of the analysis. These additional costs should be considered after the membrane material is selected and project elements are refined, to determine the total construction cost of the project.

Results of the life cycle cost analysis are shown in Table 2. For both membrane materials, the full standard warranty period was used for the useful life of the cover (30 years CSPE; 20 years RPP). In light of the premature RPP failures that have occurred at Big Canyon Reservoir and other reservoirs, 45-mil RPP was also analyzed at other replacement intervals to determine the useful life of RPP that would break even in terms of cost compared to a 30-year, 45-mil CSPE cover. This scenario is highlighted in green below.

Table 2 – 50-Year Life Cycle Cost Analysis ($1,000s)

Material Thickness and Type	Years in Service		Life Cycle Present Value – Year 2014			
		Initial Capital Costs[1]	Capital Costs[2]	O&M[3] and Intangibles[4]	Net Costs After 50-Years	Relative to 45-mil CSPE
45-mil CSPE	30-yr	4,788	7,861	---	7,861	---
60-mil CSPE	30-yr	5,525	9,042	---	9,042	+15%
60-mil CSPE	35-yr	5,525	8,564	---	8,564	+8.9%
45-mil RPP	20-yr	3,647	7,596	---	7,596	-3.4%
45-mil RPP	19-yr	3,647	7,807	---	7,807	-0.7%
45-mil RPP	18-yr	3,647	8,035	---	8,035	+2.2%
45-mil RPP	15-yr	3,647	9,111	---	9,111	+16%
45-mil RPP[5]	10-yr	3,647	12,098	---	12,098	+54%
60-mil RPP	20-yr	4,016	8,307	---	8,307	+5.7%

1. Initial Capital Cost does NOT Include ancillary costs or contingency allowances.
2. Present Value Capital Cost includes ancillary costs and contingency allowances. (See description below)
3. O&M costs are assumed equal for all scenarios, so are not included in this comparative analysis.
4. Intangibles have not been quantified, so are not included in comparative analysis.
5. Current BCR floating cover (RPP) life cycle (approx. 7 years) costs are higher than the 10-yr capital cost of $12.1M shown on this line item. Note that current cover is 60-mil thickness.

Methodology and Assumptions

Capital costs were obtained from a reputable membrane installer, and adjusted to account for the different material costs, assuming fabrication and installation costs are comparable between different materials (adjustment is made for material cost only). For 60-mil material, an additional 18% markup for shipping was assumed due to the added volume and weight of material.

The analysis assumed 7.75% sales tax, 3.5% construction cost inflation, 3.0% O&M inflation, a 5.25% discount rate, and a 5.25% financing interest rate. The analysis also assumes ancillary costs including an additional 13.25% for engineering, 9% for construction management, 12.25% for administration, and 0.5% for permitting costs.

A 50-year life cycle period was utilized, as this is typical for economic analysis and meaningful results cannot normally be expected beyond this interval. At the end of the 50-year period, the value of remaining useful life of the facility is returned as present value (subtracted from the cost).

Operation and maintenance costs (energy consumption, pump O&M, cover cleaning and inspection, etc) are assumed to be the same for all options, and have been excluded from the life cycle cost analysis.

A different contingency has been applied to material costs versus other project costs. Membrane quantities are well defined and unlikely to change, so only a 10% contingency is applied to account for material price fluctuations. A 30% contingency was applied to all other project costs due to uncertainty in the overall project scope. These separate contingencies were proportionally weighted against the portion of project costs associated with materials, and aggregated into an overall contingency of approximately 23% for CSPE and 27% for RPP.

Membrane thicknesses of 45-mil and 60-mil have been included for comparison. 60-mil membrane material adds some value through greater durability and potentially longer useful life; however there is only a short track record of field installations with 60-mil material (45-mil has historically been the standard). Therefore the added useful life of 60-mil can be difficult to quantify, and the material has been analyzed at both 30-year (standard warranty length) and 35-year useful life for the CSPE material option (assuming arbitrary additional 5-years life).

ANALYSIS RESULTS

- Using the available warranty periods (30-year CSPE and 20-year RPP) as the full useful life (replacement interval), the results of the life cycle cost analysis predicts a roughly 3% cost advantage over 50-years for 45-mil RPP versus 45-mil CSPE membrane material.

- Life cycle costs of RPP and 30-year CSPE break even when the useful life of RPP is assumed to be between 18 and 19 years.

- These results demonstrate that the life cycle costs of either membrane material are highly sensitive to the assumptions used for useful life and replacement interval. For comparison, failures were first reported in the existing cover after approximately 4 years, and it will be replaced after approximately 9 years of service.

- The life cycle cost for the existing RPP floating cover based on the 9-yr replacement period (2004 – 2013) would result in a 50-year present worth capital cost of over $12.1M if constructed in 2014, significantly higher than the $7.9M capital cost calculated for the 45-mil CSPE material.

RECOMMENDATION

Despite a 31 percent higher initial capital cost, MWH recommends using 45-mil CSPE material for the Big Canyon Reservoir Floating Cover Replacement Project based on the following reasons:

- The premature cracking/flaking failure experienced in the Big Canyon Reservoir RPP cover membrane is unresolved at this time and the reinforced polypropylene geomembrane manufacture has not fully addressed the failure issue.

- In general, not all RPP floating covers have reached the 20-year life span described in the RPP full standard warranty period due to premature membrane failures. RPP replacement intervals less than 19-years result in higher life cycle costs compared to CSPE material at 30-year replacement intervals.

- The life cycle cost analysis shows a 45-mil RPP floating cover having approximately 3% savings of total present worth costs over a 50-year life cycle period compared to CSPE membrane. This cost saving value assumes the RPP geomembrane cover does not fail prior to the full 20 year warranty period, which is a very optimistic assumption.

Big Canyon Reservoir Floating Cover Replacement Project

Floating Cover Membrane Summary

Sept. 10, 2012

MWH
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Membrane Material Comparison

CSPE	Polypropylene
Advantages	
• No recorded (known) cover failures in recent history • Material guaranteed for 30 years • Greater Installed Experience, ≈ 40 years • Repair Procedures Well Proven	• Lower Material Cost • Retains Tear Strength w/ age • Higher Puncture Resistance
Disadvantages	
• Higher Material Cost • Reduced Tear Strength (with age) but has not proven to cause failure of the reservoir during its service life	• Multiple cover failures recorded in first 10 years of service (including the current cover on BCR) • Existing Big Canyon reservoir floating cover (RPP) did not last seven(7) years prior to replacement • Limited Installed Experience, <23 Years (most installations < 15 years) • Repair Procedures Not As Well Proven Over Time • Long Term Reparability (not fully proven) • Premature Material Cracking/Flaking Issue Unresolved at This Time

MWH recommends CSPE membrane material

Material Cost and Warranty

Membrane Thickness	Chlorosulfonated Polyethylene (CSPE)		Reinforced Polypropylene (RPP)	
	Cost ($/sf)	Warranty (years)	Cost ($/sf)	Warranty (years)
36-mil	$1.21	20-year PR	$0.45	10 NPR + 5 PR
45-mil	$1.55	15 NPR + 15 PR	$0.48	15 NPR + 5 PR
60-mil	$1.90	15 NPR + 15 PR	$0.70	15 NPR + 15 PR

- MWH recommends 45-mil membrane thickness
- BCR total estimated cover/baffle material cost: CSPE – $2.14 M; RPP – $0.66M
- Total material cost difference between CSPE & RPP = $1.48 M

Membrane Manufacturers

Membrane Type	Manufacturers
CSPE	• Burke Industries, Inc.
RPP	• Firestone Specialty Products Co. • Carlisle SynTec Inc. (leaving env. market) • Cooley/Group

Floating Cover Bid Strategy

- Industry Standard: Bid single membrane material
  - CSPE **or** RPP
- Alternative Process: Bid dual membrane materials
  - CSPE **and** RPP
  - RPP lowest construction cost each time

MWH recommends bidding single material

Life Cycle Cost Analysis

Material Thickness and Type	Years in Service	Initial Capital Costs	Life Cycle Present Value – Year 2014			Relative to 30-year, 45-mil CSPE
			Capital Costs	O&M and Intangibles	Net Costs After 50-Years	
45-mil CSPE	30-yr	$4,788	$8,721	---	$8,721	---
45-mil CSPE	25-yr	$4,788	$9,314	---	$9,314	+6.8%
45-mil RPP	20-yr	$3,647	$8,429	---	$8,429	-3.4%
45-mil RPP	10-yr	$3,647	$13,402	---	$13,402	+54%

MWH recommends installing <u>CSPE</u> membrane material

Existing BCR Floating Cover: Representative of Pre-Mature Failures

BCR RPP exposed scrim reinforcement

BCR RPP exposed scrim reinforcement

RRP walkway float material failures, Marion Co., OR - 2008

RPP walkway float material exposed scrim, Marion Co., OR - 2008

Agenda Item 5B

CITY OF NEWPORT BEACH
FINANCE COMMITTEE STAFF REPORT

September 10, 2012

TO: HONORABLE CHAIR AND MEMBERS OF THE COMMITTEE

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

SUBJECT: QUARTERLY FINANCIAL REPORT – UPDATE JUNE 30, 2012

ABSTRACT:

The Finance Department has completed the quarterly financial status report for quarter ending June 30, 2012. While it will be presented at the September 11, 2012, City Council meeting with the City Manager's Quarterly Business Report (QBR), the Finance Director will provide a brief summary of the financial status report.

BACKGROUND:

Below is an outline highlighting the major financial results and activities for the quarter ending June 30, 2012:

- ❖ The General Fund is expected to close the year with a balance of approximately $70.6 million, which is $7.8 million higher than the previous fiscal year ending balance of $62.8 million. The increase in fund balance is a result of higher than expected revenue results, management conservation efforts and pension costs sharing.

- ❖ The Orange County Assessor's office released the 2012-13 changes to the property tax roll for Orange County cities. The City's secured and unsecured 2012-13 tax roll increased $1.1 billion or 2.87% from prior year. The increase was the fourth highest in Orange County and the City remains the second highest overall assessed valuation in the County.

- ❖ Fitch rating agency affirmed their credit rating on the City's Civic Center COPs of AA+ and the City's implied general obligation credit rating as AAA. In the midst of much media attention regarding the eventual downgrade of many municipal ratings, it was welcome news to receive affirmation of the City's current overall fiscal strength and anticipated fiscal strength moving forward.

- ❖ The assessment district refinancing of fourteen districts into one Reassessment District successfully closed on July 2, 2012. The new financing rate of 2.26%

achieved a total financial savings of $3.2 million to assessed parcel owners and a savings in excess of $1.1 million on a net present value (NPV) basis.

CONCLUSION:

Overall, the quarter ending June 30, 2012, was a c ontinuance of the City's strong financial and economical performance highlighted by the General Fund's expected FY 2011-12 fund balance increase of $7.8 million over prior year, and positive news from the Orange County Assessor's office and Fitch rating agency on the strength of economic indicators and factors.

Prepared by:	Submitted by:
/s/Trevor Power	/s/Dan Matusiewicz
Trevor Power	Dan Matusiewicz
Accountant	Finance Director

Attachment: Quarterly Financial Report for Quarter Ending June 30, 2012

Quarterly
Financial Report

city of newport beach | finance department

newportbeachca.gov | 949.644.3127

quarter ending june 30, 2012

MARKET UPDATE

"Uncertainty" has been the word and worry of the financial market for the last several fiscal years. Fiscal Year 2011-12 was no different. While most would agree that the economy is slowly recovering with some trepidation, uncertainty regarding an ultimate resolution to the European debt crisis continues to be the worry of the day. While gross domestic product (GDP) growth over the next few quarters is expected to be positive, the growth rate will likely be sluggish.

Monetary policy in the U.S. remains very accommodative with assurance from the Federal Reserve that the fed funds rate will remain exceptionally low through late 2014. The Federal Open Market Committee (FOMC) announced that it would leave monetary policy unchanged between 0 and .25% and extend "Operation Twist," a program intended to lower interest rates and stimulate the economy, further is an acknowledgement the economy had slowed. The FOMC expects modest improvements in the economy in the upcoming quarters, but nonetheless downgraded its economic forecasts as the feds see significant downside risk to the outlook due to various unresolved uncertainties.

Executive Summary

PRELIMINARY UNAUDITED FISCAL YEAR 2011-12 RESULTS

Overall, the General Fund is expected to close the year $7.8 million higher than the previous fiscal year. The General Fund balance of approximately $70.6 million, combined with the Facilities Financing Plan (FFP) fund of $35.9 million, total in excess of $106 million in reserves.

The $7.8 million General Fund balance increase was the net result of many factors including higher than projected revenue performance, management conservation efforts to achieve budgetary savings and bargaining unit cooperation to share pension costs, all of which contributed to a positive end result. A $10 million increase in the FFP fund was primarily driven by a $13.5 million development contribution received in July of 2011.

FOR THE FUTURE

Due to strong underlying economic factors in Newport Beach, we believe revenues will continue at their upward trajectory, albeit at a slower pace compared to the pre-recession era. Strong economic factors, good governance and management's commitment to keep expenditures in check are all key factors which bolster the City's prospects of maintaining a long-term structural balance.

In alignment with the City's core values to preserve a high quality physical environment by maintaining and reinvesting in the City's infrastructure, the City has strategically built up reserves to an all-time high at the close of Fiscal Year 2011-12. However, strategic savings plans come with an ultimate plan to reinvest those resources in the community. Consequently, reserve balances are expected to subside modestly in fiscal years 2012-13 and 2013-14 as strategic plans are executed. Examples of these plans include increased contributions to the FFP, increased investments in the City's Information Technology (IT) infrastructure, increased lower bay dredging efforts, increased General Fund capital projects to maintain our streets, alleys and sidewalks, and many other initiatives consistent with our core principles articulated in the Fiscal Year 2012-13 Performance Plan.

The City's budget documents can be found online at newportbeachca.gov/budget.

GENERAL FUND & FACILITIES FINANCING PLAN (FFP) RESERVES

	Audited 2011	Preliminary & Unaudited 2012	Change
Non-spendable	$ 1,031,742	$ 832,379	$ (199,363)
Restricted	1,681,333	2,263,049	581,716
Committed			
Facilities Financing Plan *	31,300,000	4,016,812	(27,283,188)
Contingency Reserve	21,841,467	21,582,798	(258,669)
Recreation Reserves	452,448	484,809	32,361
Parking Reserves	238,876	297,662	58,786
Cable Franchise	1,360,385	1,425,876	65,491
Other Miscellaneous	3,726,726	5,904,702	2,177,976
Assigned			
Capital Reappropriations	2,516,600	603,167	(1,913,433)
PERS Rate Reserve	5,000,000	5,000,000	-
Neighborhood Revitalization	650,000	-	(650,000)
Lower Newport Bay Dredging - Loans	2,500,000	3,800,000	1,300,000
Additional Surplus to FFP	-	1,816,330	1,816,330
IT Strategic Fund	-	3,000,000	3,000,000
Increase to FY 13 CIPs	-	1,600,000	1,600,000
Other Miscellaneous	1,199,235	1,394,133	194,898
Unassigned (Appropriations Reserve)	20,570,033	20,570,033	-
Pre FFP Transfer	94,068,845	74,591,750	(19,477,095)
FFP Transfer Out*	(31,300,000) *	(4,016,812)	27,283,188
General Fund Balance	**$ 62,768,845**	**$ 70,574,938**	**$ 7,806,093**
FFP Fund Balance**	**25,625,644**	**35,930,370**	**10,304,726**
Total General & FFP Reserve	**$ 88,394,489**	**$ 106,505,308**	**$ 18,110,819**

**In FY 11 $31.3 million was transferred to a separate Facilities Financing Plan Fund.*
***The FFP balance grew significantly during FY 12 due to a $13.5 million developer contribution.*

OTHER SIGNIFICANT UNRESTRICTED CASH RESERVES

	2011	Preliminary & Unaudited 2012	Change
Other Strategic Reserves			
Insurance Reserve	$ 21,562,899	$ 22,029,633	$ 466,734
Compensated Absences	2,286,093	1,824,229	(461,864)
Equipment Maintenance	18,582,415	21,445,406	2,862,991
IT Equipment Fund	-	1,588,364	1,588,364
Total Assigned	**$ 42,431,407**	**$ 46,887,632**	**$ 4,456,225**

Top "3" Revenues

PROPERTY TAX

Overall, Property Tax collections finished the year down nearly $260K or 0.4%, when compared to the previous fiscal year. This was a net result of a $728K or 1.3% increase in Secured Property Tax revenues and a nearly $1 million decrease in all other property tax categories. The year-over-year change in Property Tax categories are as follows:

Property Tax Category	YOY Dollar Increase	YOY Percent Increase
Secured Property Tax	$728k	1.3%
Unsecured Property Tax	-$233k	-8.7%
Prior Year Taxes, Penalties & Interest	-$474k	-27.1%
Supplemental Taxes*	-$349k	-46.3%
All Other Property Taxes	$68k	0.8%
TOTAL	-$260k	-0.4%

*As reported in the March 31, 2012, Quarterly Financial Report, the County Assessor's Office has struggled to deliver the Supplemental Roll information to the Treasurer Tax Collector due to a system conversion, so the decrease in Supplemental Tax collection should only be temporary and we should expect to recover most of the shortfall during fiscal year 2012-13 depending on the actual supplemental roll remittances.

SALES TAXES

Sales Tax revenue continues to trend upward, finishing nearly $1.6 million or 8.5% higher over the prior fiscal year. While improving, this activity remains approximately $1.8 million or 8.4% below pre-recession levels. These figures still remain an estimate because the final "true-up" information for the economic quarter ended June 30, 2012, will not be available from the State Board of Equalization (BOE) until September 18, 2012.

Based on the latest information that is available from the BOE (quarter ended March 31, 2012), restaurants and auto sales lead the way in overall sales tax generation, while the highest growth industries include light industry (12%), service stations (11%) and apparel stores at (10%) but represent a much less significant portion of overall sales tax generated in the City.

TRANSIENT OCCUPANCY TAXES

Transient Occupancy Taxes (TOT) collections increased $1.7 million or 13.1% over the prior year. Pelican Hill Resort, the Fairmont and the Island Hotel generated the largest increases to transient tax collections. While up substantially, with the removal of Pelican Hill Resort remittances, which opened at the height of the recession, TOT revenues would still be well short of pre-recession levels similar to Sales Tax revenues.

Top "3" Tax Categories	YOY Dollar Increase	YOY Percent Increase
Property Taxes	-$260k	-0.4%
Sales Taxes	$1,600k	8.5%
Transient Occupancy Taxes	$1,700k	13.1%

GENERAL FUND COMPARATIVE INCOME STATEMENT

	Fiscal Year			
	2011	Preminary & Unaudited 2012	$ Change	% Change
General Fund Revenues:				
Property Taxes	$ 71,630,345	$ 71,369,822	$ (260,523)	-0.36%
Sales Taxes	18,455,181	20,014,950	1,559,769	8.45%
Sales Taxes In Lieu	6,284,266	6,523,492	239,226	3.81%
TOT Taxes	13,082,451	14,798,661	1,716,210	13.12%
All other Revenues	41,283,081	42,392,171	1,109,090	2.69%
Total Revenues	150,735,324	155,099,096	4,363,772	2.89%
General Fund Expenditures:				
General Government *	14,934,808	11,838,586	(3,096,222)	-20.73%
Public Safety **	57,177,787	67,712,425	10,534,638	18.42%
Public Works	24,669,717	26,299,554	1,629,837	6.61%
Community Development	7,644,104	8,494,943	850,839	11.13%
Community Services	14,215,086	17,738,746	3,523,660	24.79%
Capital outlay	2,085,096	4,366,794	2,281,698	109.43%
Debt Service	961,139	780,000	(181,139)	-18.85%
Total Expenditures	121,687,737	137,231,048	15,543,311	12.27%
Income before transfers & other sources	29,047,587	17,868,048	(11,179,539)	-38.49%
Other Financing Sources (Uses)				
Transfers in	331,088	69,511	(261,577)	-79.01%
Transfers out (Excluding FFP Transfer) ***	(17,467,696)	(6,114,653)	11,353,043	-64.99%
Total other financing sources (uses)	(17,136,608)	(6,045,142)	11,091,466	-62.81%
Net Change in Fund Balance (Pre FFP Transfer) ***	11,910,979	11,822,906	(88,073)	-0.74%
Fund Balances, beginning	82,157,866	62,768,845	(19,389,021)	-23.60%
General Fund, Ending (Pre FFP Transfer) ***	94,068,845	74,591,751	(19,477,094)	-20.71%
FFP Transfer Out ***	(31,300,000)	(4,016,812)	27,283,188	-87.17%
General Fund Balance, ending (Post FFP Transfer) ***	$ 62,768,845	$ 70,574,939	$ 7,806,094	12.44%

**Formerly a part of General Government, a separate IT cost center was created and distributed across all departments during FY 12.*
***During FY 12, revisions to the cost allocation methodology for distributing Fire Department costs to the Tidelands Fund resulted in a significant increase to the Public Safety charge to the General Fund but also reduced the General Fund subsidy of the Tidelands Fund.*
****In FY 11, $31.3 million was transferred to a separate Facilities Financing Plan (FFP) Fund.*

FACILITIES FINANCING PLAN

Council Policy F-28, Facilities Replacement Program, approved in August 2009, establishes a long-term facilities financing plan (FFP) for the replacement of all General Fund-supported facilities (Civic Center, fire stations, police station and parks). The FFP provides a consistent, level funding plan to minimize negative impacts on the General Fund in any given year, while also ensuring the City is able to maintain its high quality facilities.

FFP revenues include transfers from the General and other funds, developer contributions and investment income. FFP expenditures include cash funding of construction projects as well as the debt service on debt funded capital projects. The first beneficiaries of the FFP include the popular OASIS Senior Center that reopened in 2010 and the new Civic Center, currently under construction. Other planned uses of the fund include Sunset Ridge Park, Marina Park, West Newport Community Center and Fire Station 2 located next to the existing City Hall, not to mention many other planned facilities projects.

As depicted in the chart above, the preliminary unaudited balance of the FFP Reserve was $35.9 million at the close of FY 12 on June 30, 2012.

COMPARATIVE INCOME STATEMENT

	Audited 2011	Preliminary & Unaudited 2012	
Beginning Balance 7/1/11	$ -	$ 25,625,644	
Revenues			
Transfer In	31,300,000	5,057,585	*
Interest Income	275,381	343,796	
Developer Contributions	-	13,545,000	
Total Revenues	31,575,381	18,946,381	
Expenditures			
2010 Civic Center COPs Debt Service	(682,755)	(8,165,374)	
OASIS Construction Contribution	(5,266,982)	-	
Civic Center Signage Contribution	-	(476,281)	
Total Expenditures	(5,949,737)	(8,641,655)	
Ending Balance 6/30/12	$ 25,625,644	$ 35,930,370	

**Includes a General Fund transfer of $4,016,812 and residual transfer from the final close-out of the OASIS Construction Fund.*

GENERAL AND TIDELANDS FUNDS EXPENDITURES BY DEPARTMENT

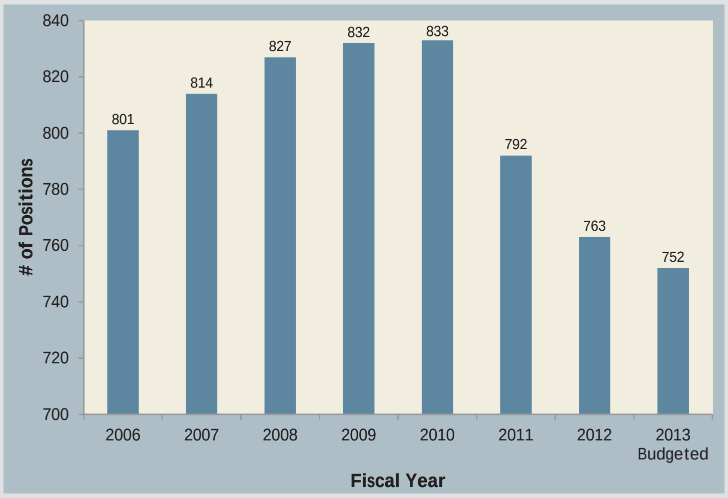
	FY 2011-12				FY 2010-11	
Department	Amended Budget	Preliminary 6/30/12	Variance	Percent Expended	Audited 6/30/11	Percent Expended
City Council	$ 1,136,927	$ 1,071,895	$ 65,032	94%	$ 1,150,733	99%
City Clerk	568,399	583,502	(15,103)	103%	453,521	90%
City Manager	1,979,009	2,003,307	(24,298)	101%	3,725,021	86%
Human Resources	2,549,399	2,654,631	(105,232)	104%	2,179,992	92%
City Attorney	2,302,827	2,001,771	301,057	87%	2,734,090	103%
Finance	7,496,593	7,013,005	483,588	94%	7,849,470	95%
Police	42,579,783	40,864,906	1,714,876	96%	41,717,033	96%
Fire	35,209,923	34,447,689	762,234	98%	33,343,269	96%
Planning	3,265,282	3,090,979	174,304	95%	2,962,531	90%
Building	5,793,440	5,636,256	157,183	97%	4,265,660	98%
MOD	22,582,307	22,088,211	494,096	98%	20,992,892	94%
Library	7,874,274	7,360,090	514,184	93%	6,598,199	95%
Recreation	8,756,586	8,407,435	349,151	96%	7,296,534	93%
Public Works	8,203,684	7,972,410	231,274	97%	5,701,252	95%
Electrical	1,918,786	1,713,934	204,852	89%	1,883,950	86%
C.I.P.	14,537,118	13,584,763	952,356	93%	5,277,128	50%
OPEB	2,314,000	2,314,000	-	100%	2,128,000	100%
FFP	4,016,812	4,016,812	-	100%	31,300,000	100%
Debt Service	1,551,057	1,551,057	-	100%	1,002,062	99%
Total	**$ 174,636,207**	**$ 168,376,653**	**$ 6,259,554**	**96%**	**$ 182,561,336**	**93%**

Chart includes encumbrances.

MANAGEMENT AND EXPENDITURE TRENDS

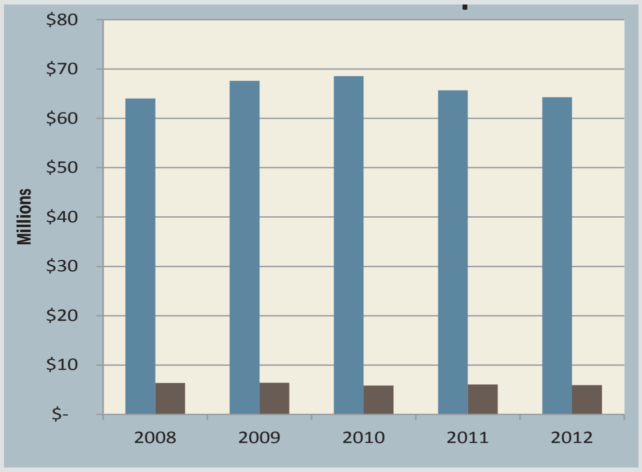
Full Time Positions Trend

The chart to the left demonstrates the sharp decline in full-time positions to mitigate recent declines in revenues and rising pension costs.



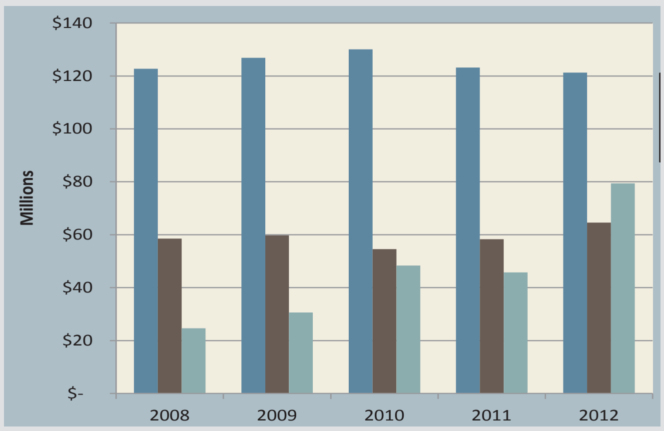
Salaries & Overtime Comparison

The chart to the left illustrates salaries are down $1.4 million or 2% in FY 2012 in a year-over-year comparison. It also demonstrates overtime has been held flat even while salaries and full-time positions have been declining.



Expenditure Trends-All Funds

The chart to the left depicts a decline in salary and benefit costs despite sharply increasing pension costs. Maintenance and operations costs are increasing reflecting the trend to outsource operating activities. It also demonstrates a dramatic shift of resources to maintain, renovate and rebuild capital facilities.



Other Financial News

Following is some important financial news that has developed since the close of the quarter.

ASSESSED PROPERTY VALUES

On July 27, 2012, the Orange County Assessor's Office released the changes to the FY 2012-13 property tax roll for all Orange County cities. Newport Beach's secured and unsecured tax roll increased $1.1 billion or 2.87%, the second in overall assessed value in the County. This increase was the fourth highest in the County. While the assessed property tax growth is positive news and perhaps is another signal the worst of the housing market woes are over, the budgetary impact is relatively insignificant because the ending FY 2011-12 base value for our projected increase was slightly lower than projected and we have already factored in a nearly 1.75% increase in the FY 2012-13 budget. Overall, we may only realize an additional $300,000 increase over what was initially forecasted. Though small, it is still better than what other cities may be facing with the loss of redevelopment funding and other economic factors.

CITY'S BOND RATING AND CREDIT RATING

In the wake of recent media attention about the likelihood of some California cities declaring bankruptcy due to continued fiscal and economical distress, two major rating agencies, Moody's and Fitch, are updating their ratings analyses of California cities and are expected to downgrade some municipal ratings. However, on August 20, 2012, Fitch affirmed the City's AA+ rating on the Civic Center Certificates of Participation (COPs) and the City's AAA implied general obligation (GO) rating.

In its report, Fitch outlines "key rating drivers" that led them to affirm the City's AAA implied GO rating. One such "driver" is the current and expected performance of the local economy. Many of Newport Beach's underlying economic characteristics have remained strong through the economic downturn, as demonstrated by our low unemployment rate that is nearly half of the state rate; our very high wealth levels confirmed by a per capita income almost three times the national average; and, a stable housing market with stable assessed valuation resulting in growing property tax revenues. These factors are expected to remain above average, thus demonstrating the continued overall strength of the local economy.

In addition to economic factors, Fitch stated that the City's "financial management policies are impressive" and management has implemented strategies to ensure strong financial performance. The report went on to state, "management has proven successful in expenditure savings including labor salary and pension concessions and Fitch expects the city will maintain strong financial performance and very high reserve levels." In four of the past five fiscal years, the City's successful actions in reducing expenditures to mitigate recent declines in revenues, has produced net surpluses. Some of the examples of the City's proactive approach used to maintain our long-term structural balance were noted in the report and include "superior financial management," "impressive financial policies," the "15-step fiscal sustainability plan" and "working with ... bargaining units to balance rising pension and salary costs".

Fitch's affirmation of the City's AAA implied GO rating shows the current overall fiscal strength of the City, as well as the anticipated fiscal strength moving forward.

ASSESSMENT DISTRICT REFINANCING

The City has participated in the formation of numerous special assessment districts to finance public improvements that provide a special benefit to area-specific property owners. On June 26, 2012, City Council approved the refinancing of 14 existing Assessment Districts into one Reassessment District. The refinancing transaction successfully closed on Monday, July 2. The new financing rate of 2.26% achieved a total financial savings of $3.2 million to assessed parcel owners and a savings in excess of $1.1 million on a net present value (NPV) basis. Approximately 1,893 parcels will experience savings ranging from $98 to $887 per parcel per year. The savings will be applied beginning with the 2012-2013 assessment roll. The savings by district are outlined in the chart to the right.

In addition, staff was directed to distribute remaining construction fund surplus totaling $834,845 in Assessment Districts 92, 99-2, and 101. Approximately 612 parcels received either a cash refund or a reduction to their total outstanding assessment via a bond call and/or levy credit.

For those parcels in which the original assessment was prepaid or subsequently paid off, a direct refund check was issued to the current property owner. On August 31, approximately 295 direct refund checks, totaling $369,504 were issued. The total individual property refund was calculated in the same pro rata share as the original confirmed assessment, and the refund amount per check ranged from $246 to $13,375.

For those property owners who chose not to prepay the assessment, the City issued bonds to finance their share of the construction. The remaining $465,341 of the construction surplus was used to redeem outstanding bonds to the fullest extent possible, with the remaining balance applied as levy credit. As with the direct refunds, the total individual property credit was calculated in the same pro rata share as the original confirmed assessment, and 317 parcels received a reduction to their total outstanding assessment ranging from $118 to $15,649.

District	*Average Annual Savings*	*Average Annual Savings Per Parcel*
68	$ 38,342	$121
69	53,217	146
70	16,620	112
74	4,706	121
75	11,298	155
78	33,882	239
79	23,189	483
82	7,345	319
86	5,566	98
92	33,700	887
99-2	47,246	442
100	24,142	141
101	50,086	280
103	24,746	119

CITY OF NEWPORT BEACH
FINANCE COMMITTEE STAFF REPORT

September 10, 2012

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

DISCUSSION:

The City Investment Portfolio balances for each quarter of Fiscal Year 2011-12 are summarized as follows:

Quarterly Market Value				
FY 2011-12				
Operating Portfolios	**Q1**	**Q2**	**Q3**	**Q4**
Demand Deposit Accounts	11,692,855	10,019,569	10,154,738	12,350,414
Local Agency Investment Fund	16,547,486	12,067,286	9,578,233	13,090,919
Managed Investment Portfolio (MIP)	154,586,128	165,009,926	165,526,382	170,946,156
TOTAL OPERATING FUNDS	**$ 182,826,469**	**$ 187,096,780**	**$ 185,259,353**	**$ 196,387,490**
Operating Portfolios	**Q1**	**Q2**	**Q3**	**Q4**
2011 Civic Center COPs	90,025,359	78,820,531	69,570,894	56,879,300
Assessment Districts	3,020,584	1,301,695	917,440	1,255,323
Special Improvement Districts	2,925,519	1,829,056	2,512,494	2,954,713
TOTAL BOND FUNDS	**$ 95,971,462**	**$ 81,951,282**	**$ 73,000,828**	**$ 61,089,336**

Market Review

Information received since the Federal Open Market Committee (FOMC) met in June suggests that economic activity decelerated somewhat over the first half of this year. Growth in employment has been slow in recent months and the unemployment rate remains elevated. Household spending has been rising at a somewhat slower pace than earlier in the year. Despite some further signs of improvement, the housing sector remains depressed.

The FOMC expects economic growth to remain moderate over coming quarters and then to pick up very gradually. Consequently, the FOMC anticipates that the unemployment rate will decline slowly toward levels that it judges to be consistent with its dual mandate of fostering maximum employment and price stability. Furthermore, strains in global financial markets continue to pose significant downside risks to the economic outlook. The FOMC anticipates that inflation over the medium term will run at or below the rate that it judges most consistent with its dual mandate.

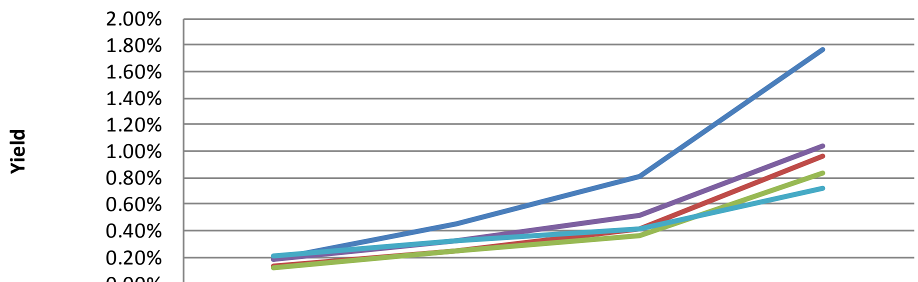
The FOMC decided on August 1, 2012, to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that economic conditions--including low rates of resource utilization and a subdued outlook for inflation over the medium run--are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014.

The FOMC also decided to continue through the end of the year its program to extend the average maturity of its holdings of securities in a program popularly known as "Operation Twist" which was expected to end in June, and it is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The FOMC will closely monitor incoming information on economic and financial developments and will provide additional accommodation as needed to promote a stronger economic recovery and sustained improvement in labor market conditions in a context of price stability.

"Risk Free" Treasury Yields

Treasury rates declined in July as domestic economic activity weakened and concerns remained about the European debt crisis. The recent yield curve flattening most likely reflects the continued influence of the Federal Reserve's accommodative monetary policy.

Treasury Yield Curve



	1 Yr	2 Yr	3 Yr	5 Yr
06/30/2011	0.19%	0.45%	0.81%	1.76%
09/30/2011	0.13%	0.25%	0.42%	0.96%
12/31/2011	0.12%	0.25%	0.36%	0.83%
03/30/2012	0.19%	0.33%	0.51%	1.04%
06/30/2012	0.21%	0.33%	0.41%	0.72%

The Chart above shows the overall decline in yield over the past year as well as the more pronounced flattening of the back end of the yield curve.

Short-term Portfolio

The City manages liquidity through its demand deposit accounts, money market funds and Local Agency Investment Fund (LAIF) managed by the California State Treasurer's office. While money market funds return practically zero yield, LAIF is the primary vehicle used for liquidity. Per California Government Code section 16429.3, the State may not impound, seize, transfer or borrow funds in order to resolve their budget deficits. The average investment life of the LAIF fund is 268 days. The average effective yield during the fiscal year was 0.36%

The City has maintained higher balances in its demand deposit accounts than it has historically. The reason for this is our primary banking institution offers a compensating balance credit of 0.6% to offset banking fees. This compensating balance credit is better than other available short-term yields.

Medium-Term Portfolio

The California Government Code restricts municipal investments to not exceed five years in term. The City uses three professional investment advisors to manage the bulk of its investment portfolio, which is referred to as the Managed Investment Portfolio (MIP) in the table on page 1.

The portfolio manager directive is to focus on m aintaining safety of the invested principal and achieving the City's long-term investment objective of maintaining a safe, well diversified, high quality portfolio while continuing to evaluate all the sectors available to the City and capitalize on investment opportunities presented by the market. As long as interest rates remain at historic lows, portfolio managers will likely continue to manage the portfolio with a c onservative duration bias, but also capitalize opportunities in selective corporate investments. By regularly and selectively adding long-term investments to the portfolios, this strategy has historically generated consistently favorable long-term returns relative to our benchmark (BAML 1-3 Year Treasury Index with Corporate Securties).

A summary of the current yield spread to treasuries is as follows:

Mixed Credit Spreads	Spread to Treasuries		
Credit Spreads	**May**	**June**	**Change**
3-Month Top-Rated Commercial Paper	0.13%	0.17%	0.04%
2-Year AA Corporate Note	0.30%	0.26%	-0.04%
2-Year Agency Note	0.10%	0.07%	-0.03%
5-Year AA Corporate Note	0.75%	0.68%	-0.07%
5-Year Agency Note	0.34%	0.34%	0.00%

Sector Review

Treasuries/Agencies – With anxieties on the rise over Euro sovereigns and banks, the front end of the curve did not flatten as much as the long end of the Treasury curve. The 10-year Treasury dipped to historic lows but Treasuries inside of one year held their ground. Front end rates have maintained their levels as a result of the Fed's Operation Twist program and a large amount of Treasuries settling into the system.

Commercial Paper – For the most part, the commercial paper market displayed a muted reaction to the Moody's downgrade news. High quality commercial paper rates cheapened slightly in June but mostly remained range bound as investors had either shortened maturities or reduced exposure to the Global Capital Market Intermediaries (GCMIs) that were downgraded by Moody's.

Corporate Notes – Investment-grade corporate bonds outperformed the broad bond benchmark average, buoyed by strong corporate fundamentals and investor demand for yield, benefiting from a late-quarter risk rally triggered by the Fed extending its Operation Twist program and the European Union drafting a bank-recapitalization plan.

When Agency yield spreads are narrow, managers will likely shy away from Treasury and Agency notes. As opportunities for yield spreads increase with Commercial Paper and selective corporate notes, investment advisors will likely seek out opportunities to diversify the portfolio and pick-up additional yield, always cognizant of security of principal.

A summary of each advisor's historical rate of return is as follows:

TOTAL RETURN			
	1 Yr	3 Yr	5 Yr
Benchmark*	0.79%	1.60%	3.28%
Chandler	1.38%	2.20%	3.77%
Cutwater	1.07%	1.50%	3.31%
PFM	1.19%	2.00%	3.72%

While historically, the long-term performance of these advisors has been similar, short-term returns have become more volatile as investment advisors have taken defensive positions against the long trend of falling interest rates. Securities are being called more frequently and the City's demand for liquidity has increased in recent years due to cash funded construction projects including the OASIS Senior Center, Rhine Channel and Lower Bay Dredging phases I & II.

A more robust summary of portfolio characteristics and performance by each investment advisor is summarized and attached for your review. I have attached both Fiscal Years 2010-11 and 2011-12 for comparative purposes.

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

Attachments:

A. FY 2011-12 Summary of Managed Investment Portfolio Characteristics
B. FY 2010-11 Summary of Managed Investment Portfolio Characteristics
C. FY 2011-12 Credit Concentration Report

Managed Investment Portfolio (MIP)

June 30, 2012

Summary	Chandler	Cutwater	PFM
Cash	1,848,223	1,226,718	473,062
Fixed Income	56,411,499	53,054,587	57,962,067
Duration	1.705	1.698	1.761
Weighted Avg Life	1.720	1.481	1.880
Weighted Avg Maturity	1.769	2.562	1.899
Weighted Avg Eff Maturity	1.720	1.481	1.880
Avg Credit Rating	AA-/Aa3/AA-	AA/Aa2/AA	AA/Aa2/AA
1yr Total Rate of Return	1.38%	1.07%	1.19%
3yr Total Rate of Return	2.20%	1.50%	2.00%
5yr Total Rate of Return	3.77%	3.31%	3.72%
Yield to Maturity @ Market	0.492%	0.563%	0.457%
Yield to Maturity @ Cost	1.270%	0.786%	0.691%

Security Type	Chandler	Cutwater	PFM
Agency	51.71%	60.60%	44.93%
Corporate Notes*	24.82%	24.50%	18.86%
US Government	16.61%	12.63%	34.19%
Commercial Paper	3.69%	0.00%	0.00%
MM Fund	2.42%	2.25%	0.70%
Cash	0.75%	0.02%	0.11%
Certificate of Deposit	0.00%	0.00%	0.00%
Municipal Bonds	0.00%	0.00%	1.21%
Total %	**100.0%**	**100.0%**	**100.0%**
Note*: FDIC Guaranteed	1.13%	0.00%	0.00%

Market Sectors	Chandler	Cutwater	PFM
Agency	51.71%	60.60%	44.93%
Government	16.61%	12.63%	34.19%
Financial	15.67%	16.94%	14.10%
Industrial	11.72%	7.57%	4.76%
Cash	3.17%	2.26%	0.81%
FDIC Guaranteed	1.13%	0.00%	0.00%
Municipal	0.00%	0.00%	1.21%
Total %	**100.0%**	**100.0%**	**100.0%**

Managed Investment Portfolio (MIP)

June 30, 2011

Summary	Chandler	Cutwater	PFM
Cash	73,278	3,160,862	75,563
Fixed Income	57,391,627	35,646,023	57,672,560
Duration	1.724	1.091	1.570
Weighted Avg Life	1.773	1.199	1.724
Weighted Avg Maturity	1.889	2.003	1.724
Weighted Avg Eff Maturity	1.773	0.961	1.724
Avg Credit Rating	AA/Aa2/AA	AAA/Aaa/AAA	AA/Aa2/AA
1yr Total Rate of Return	1.84%	0.98%	1.77%
3yr Total Rate of Return	3.62%	2.97%	3.53%
5yr Total Rate of Return	4.60%	4.16%	4.58%
Yield to Maturity @ Market	0.684%	0.509%	0.602%
Yield to Maturity @ Cost	1.589%	1.602%	1.045%
Security Type	**Chandler**	**Cutwater**	**PFM**
Agency	50.93%	73.48%	55.80%
Corporate Notes*	29.31%	7.99%	26.32%
US Gov	18.63%	5.23%	13.91%
Commercial Paper	1.00%	0.00%	0.00%
MM Fund	0.12%	13.30%	0.13%
Currency	0.01%	0.00%	0.00%
Certificate of Deposit	0.00%	0.00%	2.60%
Municipal Bonds	0.00%	0.00%	1.23%
Total %	**100.0%**	**100.0%**	**100.0%**
Note*: FDIC Guaranteed	5.50%	0.00%	5.31%
Market Sectors	**Chandler**	**Cutwater**	**PFM**
Cash	0.13%	8.15%	0.13%
Government	18.63%	5.23%	13.91%
Agency	50.93%	78.63%	55.80%
Municipal	0.00%	0.00%	1.23%
Financial	16.34%	2.68%	15.02%
Industrial	6.52%	5.32%	8.59%
Utility	1.96%	0.00%	0.00%
FDIC Guaranteed	5.50%	0.00%	5.31%
Total %	**100.0%**	**100.0%**	**100.0%**

Issuer Concentration	Chandler	Cutwater	PFM
Government of the United States	19.84%	12.63%	34.19%
Federal National Mortgage Association Fannie Mae	15.67%	19.31%	22.94%
Federal Home Loan Banks Office of Finance	12.60%	13.34%	12.43%
Federal Home Loan Mortgage Corporation	11.14%	27.95%	9.56%
Federal Farm Credit Banks Consolidated Systemwide Bonds	9.07%	0.00%	0.00%
JPMorgan Chase & Co.	2.59%	0.00%	2.26%
Toyota Motor Corporation	1.97%	0.00%	0.00%
General Electric Company	1.96%	3.92%	2.00%
U.S. Bancorp	1.96%	0.00%	1.74%
Wal-Mart Stores, Inc.	1.95%	1.91%	0.00%
Wells Fargo & Company	1.93%	0.00%	2.37%
The Bank of Nova Scotia	1.72%	0.00%	0.00%
Berkshire Hathaway Inc.	1.71%	3.54%	3.48%
HSBC Holdings plc	1.51%	0.00%	0.00%
International Business Machines Corporation	1.50%	0.00%	3.90%
The Bank of New York Mellon Corporation	1.32%	1.97%	0.00%
Kimberly-Clark Corporation	1.28%	0.00%	0.00%
BlackRock, Inc.	1.27%	0.00%	0.00%
The Coca-Cola Company	1.21%	0.00%	0.00%
The Walt Disney Company	1.01%	0.00%	0.00%
eBay Inc.	0.99%	0.00%	0.00%
Pepsico, Inc.	0.58%	0.00%	0.00%
Northern Trust Corporation	0.58%	0.00%	0.00%
Praxair, Inc.	0.47%	0.00%	0.00%
Pfizer Inc.	0.47%	0.00%	0.00%
United Technologies Corporation	0.28%	0.00%	0.00%
Deere & Company	0.25%	0.00%	0.00%
Metropolitan Life Global Funding I	0.00%	3.76%	0.00%
Microsoft Corporation	0.00%	1.93%	0.00%
Teachers Insurance and Annuity Association of America	0.00%	1.88%	0.00%
Johnson & Johnson	0.00%	1.87%	0.00%
The Procter & Gamble Company	0.00%	1.86%	0.86%
New York Life Global Funding	0.00%	1.86%	0.00%
Caterpillar Inc.	0.00%	0.00%	2.26%
State of California	0.00%	0.00%	1.21%
MMF - FEDERATED GOVT OBLIGATION	2.42%	0.00%	0.70%
MMF - GOLDMAN SACHS	0.00%	2.25%	0.00%
Net Payables/Receivables	0.75%	0.01%	0.11%
Total %	100.0%	100.0%	100.0%

Agenda Item 5D

CITY OF NEWPORT BEACH
FINANCE COMMITTEE STAFF REPORT

September 10, 2012

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 POLICY REVIEW AND UPDATE

ABSTRACT:

Consistent with section K-2 of Council Policy F-1, Statement of Investment Policy, the Finance Department has completed an annual review of the City's Investment Policy; changes proposed for Finance Committee consideration will clarify and s treamline several administrative procedures contained within the current policy. No changes are proposed to the allowable investments or maximum allowable concentration of allowable investments.

BACKGROUND:

Below is an outline highlighting the proposed changes to the Statement of Investment Policy:

Section C.3. Delegation of Authority – Finance staff proposes that our invesment adisors are allowed to use their own professional discretion in selecting broker/dealers consistent with their selection process described in SEC Form ADV 2A.

Form ADV is the uniform form used by investment advisors to register with both the Securities and Exchange Commission (SEC) and state securities authorities. Form ADV is for both regulatory purposes and the primary disclosure document that investment advisers provide to their clients. Financial advisors are required to file annually with the Security and Exchange Commission (SEC), or anytime a material change occurs in their business practice. The disclosures are available to the public on the SEC's Investment Adviser Public Disclosure (IAPD) website at www.adviserinfo.sec.gov.

Section E. Broker/Dealers – Finance staff proposes to add qualifying language that the broker/dealer selection criteria stated in this section of the Policy are applicable to transactions placed directly by the City, rather than through an investment advisor.

Section H.4. Investment Parameters – Competitive Transactions – Finance staff proposes to add language to allow for selected transaction placement based on quality based factors, rather than pricing factors alone.

Section I. Portfolio Performance – For sake of consistency and efficiency, Finance staff is also proposing to change how performance is measured by using the Global Investment Performance Standard (GIPS) to make comparisons gross of fees instead of net of fees.

Section J. Reporting – Finance staff proposes language to clarify the current practice of posting monthly Treasury/Portfolio Performance reports on the City's website, rather than submitting hardcopy reports to City Council.

Section K.1. Investment Policy Compliance – Finance Staff proposes that instances of non-compliance would be first reported to the Finance Committee and the Finance Committee can determine whether the technical compliance violation was worthy of futher Council Discussion. For instance, if a s ecurity was downgraded below an investment credit rating threshold, staff would discuss the credit alert with Finance Committee and Finance Committee could determine if the matter required further Council discussion. While many securities have been downgraded within recent years, including U.S. Treasuries, no downgrades resulted in an instance of non-compliance within the City Investment policy.

Section K.2. Investment Policy Adoption – Finance staff proposes that the requirement for City Council to affirm the City Investment Policy be el iminated if no substantive changes are proposed. For purposes of ensuring consistency with the overall objectives of preservation of principal, liquidity and return, and its relevance to current law and financial and economic trends, annual review of the Investment Policy, would **be** delegated to Finance Committee. However, if non-clerical changes are proposed, the policy changes will continue to be submitted for City Council consideration, and will not become effective until approved by City Council.

CONCLUSION:

The changes to Council Policy F-1, Statement of Investment Policy, are deemed to be procedural in nature and do not materially affect investment objectives, allowable investments or the maximum concentration of allowable investments. With Finance Committee concurrence, Finance staff will bring the suggested revisions to Council for formal approval.

Prepared by:	Submitted by:
/s/Sandra Wilcox	/s/Dan Matusiewicz
Sandra Wilcox	Dan Matusiewicz
Senior Accountant	Finance Director

Attachments:
A. Redline Investment Policy Amendment
B. Sample SEC Form ADV 2A for Chandler Investment Advisors

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 listed below.

   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 advisers 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 Director of Finance 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 Director of Finance 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 Director of Finance 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 Director of Finance 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 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,~~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 ~~will be selected~~ 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 Director of Finance 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 either book entry or physical delivery 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.

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.

   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.

   c) Federal Agency - mortgage-backed securities and debentures with a final maturity not exceeding five years from the date of trade settlement.

   d) Mortgage-backed Securities 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 a 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) Medium-Term Notes 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 four years from the date of trade settlement, and rated at least A or the equivalent by a 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. In addition, AAA rated FDIC-guaranteed corporate bonds are herein authorized, within the aforementioned diversification and maturity requirements.

f) Municipal Bonds: General and Revenue obligations of the State of California and local agencies within the State. Municipal bonds must be rated at least AA by two NRSROs with maturities not exceeding three years. No more than five percent (5%) of the City's total portfolio shall be invested in any one issuer and the aggregate investment in municipal bonds shall not exceed fifteen percent (15%) of the City's total 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 U.S. Banks whose underlying securities are rated A-1 or the equivalent by a NRSRO and having assets in excess of $10 billion, so as to insure security and a large, well-established secondary market. Ease of subsequent marketability is 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 with the highest letter and number rating as provided for by a 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 a 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 a 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) Eligible Banker's Acceptances 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 a NRSRO at the time of purchase. Banker's Acceptances shall be rated at least A-1, P-1 or the equivalent at the time of purchase by a NRSRO. If the bank has senior debt outstanding, it must be rated at least A or the equivalent by a NRSRO. The aggregate investment in banker's acceptances shall not exceed twenty percent (20%) 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) Repurchase Agreements and Reverse Repurchase Agreements 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 repos.

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

m) County Investment Funds: 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) Money Market Funds 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.

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 on as provided by this policy.

H. INVESTMENT PARAMETERS
~~H.~~

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 non-governmental issuer. 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 a NRSRO.

   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 Director of Finance. 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
   ~~All~~ Investment advisors shall make best effort to price investment transactions ~~shall be conducted~~ on a competitive basis~~ly~~ with ~~authorized~~ broker/dealers selected consistent with their practices disclosed in form ADV 2A filed with the SEC. 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 ~~will be documented~~. 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 average yield on the U.S. Treasury security that most closely corresponds to the portfolio's weighted average effective maturity. When comparing the performance of the City's portfolio, its rate of return will be computed ~~net of all fees and expenses~~consistent with Global Investment Performance Standards (GIPS).

J. REPORTING

Monthly, the Director of Finance shall ~~submit to the City Council~~~~make available on the City's website~~produce a treasury report of the investment portfolio balances, risk characteristics~~ earnings~~, 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

~~K.~~

1. Compliance

   Any deviation from the policy shall be reported to as soon as practical but no later than the next scheduled Finance Committee. Upon recommendation, of the Finance Committee, the Finance Director shall review deviations from policy to the City Council. ~~at the next scheduled meeting and to City Council at the next scheduled public meeting.as part of the monthly review of the portfolio.~~

   ~~The Director of Finance shall submit the Investment Policy to Finance Committee for review 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 Director of Finance shall promptly notify Finance Committee and City Council of any material change in the policy and any modifications to the policy must be approved by Finance Committee and City Council.~~

2. Adoption

The Director of Finance shall review the Investment Policy with 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.

~~2.~~

~~The Treasurer shall render a written Statement of Investment Policy that shall be reviewed at least annually by Finance Committee and City Council 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 Director of Finance shall annually review the ~~s~~Investment~~-hall promptly notify~~ Policy ~~Finance Committee and -~~with City Council~~-of any material proposed change in the policy, and submit the Investment Policy and any proposed changes therein to City Council for shall consideration and approval at the annual Statement of Investment Policy and any changes therein at anext~~ at a ~~-~~public meeting only if there are any non-clerical changes recommended to the Investment Policy~~.~~

This Policy was last endorsed and adopted by the City Council of the City of Newport Beach on September 25~~8~~, 2012~~0~~. 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 September 25, 2012

ITEM 12 BROKERAGE PRACTICES

ITEM 12A: BROKER-DEALER SELECTION, COMPENSATION & TRADE AGGREGATION

FIXED INCOME & MULTI-ASSET CLASS PORTFOLIO MANAGEMENT

Chandler requires discretionary clients to provide us with written authority to determine broker-dealer selection and commission costs that will be charged to these clients for transactions placed in their account(s).

Broker-dealers are selected by Chandler on the basis of best execution, a combination of most favorable price and the quality of execution. In selecting a broker to execute a transaction for a client, Chandler may consider a variety of other factors, including (but not limited to) the following:

- the broker-dealer's capital depth;
- the broker-dealer's market access;
- the nature of the security or instrument being traded;
- the size and type of transaction;
- the nature and character of the markets for the security or instrument to be purchased or sold;
- the desired timing of the transaction;
- the execution, clearance and settlement capabilities of the broker-dealer selected and others considered;
- the reputation and perceived soundness of the broker-dealer and others considered;
- Chandler's knowledge of any actual or apparent operational problems with the broker-dealer; and
- the reasonableness of the commission for specific transactions.

While Chandler generally seeks competitive commission rates and dealer spreads, it may not necessarily pay the lowest commission. Transactions may involve specialized services on the part of the broker-dealer and thereby justify higher commissions than would be the case with other transactions requiring more routine services.

In regard to commission rates paid, Chandler’s fixed income transactions are generally executed by the broker-dealer on a net basis, which means the execution costs (*e.g.,* commissions) are included in the purchase or sale price of the security. Equity and ETF transactions will be charged commissions.

FIXED INCOME PORTFOLIO MANAGEMENT IN WRAP FEE OR SUB-ADVISORY PROGRAMS

Managed Accounts Select Program
Chandler participates in the Schwab Institutional (‘SI’) services program offered to independent investment advisers by Charles Schwab & Company, Inc. (Schwab), a FINRA registered broker-dealer unaffiliated with Chandler. Wrap fee clients participating in this program are required to utilize Schwab as the custodian for their assets managed within the program. As part of the SI program, Chandler receives benefits that it would not receive if it did not offer investment advice (See the disclosure under Item 12.A.1 of this Brochure).

Chandler arranges for all securities transactions in wrap program accounts to be executed through the sponsoring party, subject to best execution considerations described above. If Chandler determines that best execution considerations require trading with brokers other than the sponsoring party, clients may incur additional trading costs. These costs are a factor in Chandler's best execution analysis.

Chandler has established a prime brokerage account relationship with Schwab through which it may purchase fixed income products directly from third parties for clients and maintain custody at Schwab. In this situation, Chandler will select those brokers or dealers which will provide the best services at the lowest commission rates possible. The reasonableness of brokerage costs, commissions and mark-up/mark-downs is based on the broker-dealer's ability to provide professional services, competitive execution, and other services that will help Chandler in providing investment management services to clients. Thus, for fixed income transactions, Chandler may request that it be provided with written authority to determine the broker-dealer to use for client fixed income transactions and the costs that will be incurred by clients for these transactions. Any limitations on this discretionary authority shall be included in this written authority statement. Clients may change/amend these limitations as required. Such amendments shall be submitted in writing.

Client trades in fixed income securities may be aggregated with transactions for other advisory clients to achieve better pricing and commission costs. Fixed income trades will be allocated on a pro-rata basis in the best interest of the client as set forth in Chandler's policy and procedures manual.

Manager Select, Manager Access Select and Manager Access Network Programs

Chandler participates as a separate account manager in LPL Financial's Manager Select, Manager Access Select and Manager Access Network Programs offered to independent investment advisers by LPL Financial (LPL), a FINRA registered broker-dealer unaffiliated with Chandler. Wrap fee clients participating in these programs are required to utilize LPL as the custodian for their assets managed within the program(s).

Chandler arranges for all securities transactions in wrap program accounts through the sponsoring party subject to best execution considerations described above. If Chandler determines that best execution considerations require trading with brokers other than the sponsoring party, clients may incur additional trading costs. These costs are a factor in Chandler's best execution analysis. Clients who participate in this Program, however, are also choosing the brokerage services of LPL Financial.

Our experience indicates that certain broker-dealers under clients' wrap fee agreements generally can offer best price for transactions in listed equity securities, but, no assurance can be given that such will continue to be the case with those or other broker-dealers which may offer wrap fee arrangements, nor with respect to transactions in other types of securities. Accordingly, the client may wish to satisfy himself that the broker-dealer offering the 'wrap fee' arrangement can provide adequate price and execution of most or all transactions.

Envestnet Separately Managed Accounts Program

Chandler participates as a separate account manager in Envestnet's Separately Managed Accounts (SMA) Program offered to independent investment advisers by Envestnet Asset Management, Inc., an SEC registered investment adviser unaffiliated with Chandler. SMA Program clients are required to utilize Charles Schwab & Company, Pershing Advisor Solutions, or Fidelity as the custodian for their assets managed within the program.

Chandler arranges for all securities transactions in SMA program accounts through the sponsoring party subject to best execution considerations described above. If Chandler determines that best execution considerations require trading with brokers other than the sponsoring party or client custodian, clients may incur additional trading costs. These costs are a factor in Chandler's best execution analysis.

ITEM 12A.1: RESEARCH AND OTHER SOFT DOLLAR BENEFITS

Chandler's soft dollar policy prohibits us from entering into third party soft dollar arrangements.

As disclosed in Item 4D of this Brochure, clients participating in the Schwab Managed Account Select wrap fee program are required to utilize Schwab as the custodian of their assets being managed within that program. Although participating clients are required to establish accounts at Schwab, it is the client's decision to custody assets with Schwab. Chandler is independently owned and operated and not affiliated with Schwab.

Schwab Institutional provides Chandler with access to its institutional trading and operations services, which are typically not available to Schwab retail investors. These services generally are available to independent investment advisors at no charge to them so long as a specified minimum, generally $10 million, of the advisor's clients' account assets are maintained at Schwab Institutional.

These services are not contingent upon our firm committing to Schwab any specific amount of business (assets in custody or trading commissions). Schwab's brokerage services include the execution of securities transactions, custody, research, and access to mutual funds and other investments that are otherwise generally available only to institutional investors or would require a significantly higher minimum initial investment.

For our client accounts maintained in its custody, Schwab generally does not charge separately for custody services but is compensated by account holders through commissions and other transaction-related or asset-based fees for securities trades that are executed through Schwab or that settle into Schwab accounts.

Schwab Institutional also makes available to our firm other products and services that benefit Chandler but may not directly benefit our clients' accounts. Many of these products and services may be used to service all or some substantial number of our client accounts, including accounts not maintained at Schwab.

Schwab's products and services that assist us in managing and administering our clients' accounts include software and other technology that:

- provide access to client account data (such as trade confirmations and account statements);
- facilitate trade execution and allocate aggregated trade orders for multiple client accounts;
- provide research, pricing and other market data;
- facilitate payment of our fees from clients' accounts; and
- assist with back-office functions, recordkeeping and client reporting.

Schwab Institutional also offers other services intended to help us manage and further develop our business enterprise. These services may include:

- compliance, legal and business consulting;
- publications and conferences on practice management and business succession; and
- access to employee benefits providers, human capital consultants and insurance providers.

Schwab may make available, arrange and/or pay third-party vendors for the types of services rendered to Chandler. Schwab Institutional may discount or waive fees it would otherwise charge for some of these services or pay all or a part of the fees of a third-party providing these services to our firm. Schwab Institutional may also provide other benefits such as educational events or occasional business entertainment of our personnel. In evaluating whether to recommend or require that clients custody their assets at Schwab, we may take into account the availability of some of the foregoing products and services and other arrangements as part of the total mix of factors we consider and not solely on the nature, cost or quality of custody and brokerage services provided by Schwab, which may create a potential conflict of interest. However, Chandler has a fiduciary responsibility to always place client interests before our own and will only recommend Schwab to clients where we believe it would beneficial to those clients.

ITEM 12A.2: BROKERAGE FOR CLIENT REFERRALS

Chandler does not direct brokerage in exchange for client referrals.

ITEM 12A.3: DIRECTED BROKERAGE

Chandler’s policy and practice is not to accept advisory clients’ instructions for directing client’s brokerage transactions.

ITEM 12B: AGGREGATING CLIENT TRADES

Order aggregation is the process of adding together or “blocking” orders to purchase and sell the same security as one large order. Chandler will aggregate or “block” trades where possible and when advantageous to clients. This blocking of trades permits the trading of aggregate blocks of securities composed of assets from multiple client accounts, and in some cases, employees, so long as transaction costs are shared equally and on a pro-rata (or other fair and reasonable) basis between all accounts included in any such block.

Block trading may allow us to execute trades in a timelier, more equitable manner, at a better overall price.

Chandler may aggregate trades for itself or for its associated persons with client trades, providing that the following conditions are met:

1) Chandler's policies for the aggregation of transactions shall be fully disclosed in this Form ADV Part 2A and separately to Chandler's existing clients (if any) and the broker-dealer(s) through which such transactions will be placed;

2) We will not aggregate transactions unless aggregation is consistent with our duty to seek best execution and the terms of Chandler’s investment advisory agreement with each client for which trades are being aggregated;

3) No participating account will be favored over any other account; each account that participates in an aggregated order will participate at the average price for all the aggregated order, with transaction costs shared pro-rata, when applicable, on each account's participation in the transaction;

4) Chandler will enter aggregated orders into Charles River, our Order Management System ("OMS"), specifying the participating accounts and how we intend to allocate the order among those accounts;

5) If the aggregated order is filled in its entirety, it will be allocated among participating accounts in accordance with the allocations entered into the OMS; if the order is partially filled, it will be allocated pro-rata based on the allocations entered into the OMS;.

6) If the security is purchased from multiple dealers at different prices and is to be allocated among multiple accounts, it will be allocated using a weighted average method;

7) Allocations for an aggregated order should constitute no less than 0.50 of 1% (50 basis points) of a selected portfolio. If a proposed allocation would amount to less than 0.50 of 1% (50 basis points) of the selected portfolio, it may be allocated to a more appropriate account different from that specified in the OMS as long as all client accounts receive fair and equitable treatment and the reason for the different allocation is explained in a manner consistent with the procedures listed in number 8 herein;

8) Notwithstanding the foregoing, the order may be allocated on a basis different from that specified in the OMS if all client accounts receive fair and equitable treatment and the reason for the different allocation is explained in writing and is approved in writing by appropriate supervisory personnel no later than one hour after the opening of the markets on the trading day following the day the order was executed;

9) Chandler will receive no additional compensation of any kind as a result of the proposed aggregation;

10) Individual investment advice and treatment will be accorded to each advisory client.

11) Chandler's books and records will separately reflect, for each client account, the orders of which are aggregated, the securities held by, and bought and sold for that account.

12) Funds and securities for aggregated orders are clearly identified on Chandler's records and to the broker-dealers or other intermediaries handling the transactions, by the appropriate account numbers for each participating client.

There may also be times when Chandler does not aggregate trades when we have an opportunity to do so. Portfolio managers may choose not to aggregate trades in the following situations:

- **Non-discretionary clients**: An advisory client electing not to grant investment discretionary authority to Chandler is advised that trades done in his/her account may be executed subsequent to trades effected in discretionary accounts due to the additional time involved in obtaining the required client approval prior to executing any trade in such non-discretionary client accounts. Consequently, we may not be able to aggregate these trades with other discretionary trades which may result in a difference in the price per share/bond of a given security and the commission rates paid.

- **Client direction**: While rare, an advisory client may choose not to have their trades aggregated or may have cash flow needs that prevent Chandler from aggregating a trade with other pending orders. Consequently, we may not be able to aggregate these client trades with other client trades which may result in a difference in the price per share/bond of a given security and the commission rates paid.

- **Portfolio Manager's discretion**: Portfolio managers may choose to trade certain strategies at the same time while waiting to trade others. The timing of the trades and determination of which strategy to trade is dependent on market conditions.

  Additionally, not all portfolio managers will trade their client accounts at the same time and there may be timing differences for trades executed by different portfolio managers. Accordingly, we may not be able to aggregate all trades executed independently by our different portfolio managers, which may result in a difference in the price per share/bond of a given security and the commission rates paid.