

City of Cupertino
Audit Committee Regular Meeting
Minutes
October 22, 2019

1. CALL TO ORDER

At 4:04 p.m., Chairman Eno Schmidt called the meeting to order at Cupertino City Hall Conference Room A, 10300 Torre Avenue, Cupertino CA 95014.

2. ROLL CALL

Committee Members Present: Chairman Eno Schmidt, Councilmember Paul, Mayor Scharff, Daisy Liang

City Staff Present: Kristina Alfaro, Zach Korach, Mariela Vargas, Beth Viajar, Thomas Leung

Absent:

Guests: Chris McGarry (Chandler), Rick Rosenthal, Carolyn Cox (USBank via conference call), Mitch Barker, Jennifer Meza (PARS), Kathy Lai and Matt Gerdes (Crowe)

3. APPROVAL OF MINUTES

Councilmember Paul motioned to approve the July 30, 2019 regular meeting minutes and Mayor Scharf seconded, motion passed unanimously.

4. ORAL COMMUNICATIONS

5. OLD BUSINESS

6. NEW BUSINESS

A. Treasurer's Investment Report for period ending September 30, 2019

Finance Manager, Zach Korach, provided a brief review of questions brought up by Chairman Eno Schmidt on agenda items. First question was regarding the Chandler Investment report determining whether Chandler had discretion over the LAIF balance and whether there needs to be a review of the portfolio consolidation. Chris McGarry from Chandler explained that as a fiduciary they make recommendation that is in the best interest of their clients. When hired they performed a Cash flow analysis to understand where the City was relative to statistical cash flow balances over the past 3 years to evaluate if there are leaving any opportunity out for possibly having higher returns. They referred the committee to a slide on the portfolio, showing interest rates on page 12 (pg. 27 of overall packet), explaining the inversion of the yield curve from June 2019 to September 2019. McGarry explained that now the yield curve is starting to flatten explaining that the City is in good opportunity right now. Korach discussed briefly the additional questions related to the possibility of making additional contributions to OPEB & Pension Trust, building parameters or policy related to additional funding in the future. Chairman Schmidt mentioned that the statement to the ability to meet the cash flow need for next 6 months was absent on

treasurer's report. Korach explained that historically it has been a component council of treasurer's report presentation and it has been included in the packet and presentation. Another question was regarding reconciling the amount of total investment balance reported on Wells Fargo market cost summary report including total balance on staff report since there was a difference. Korach communicated that he will make sure the difference is footnoted and explained on future reports.

Final question addressed by Korach was related to additional cash equivalent holdings for city's general checking account, workers compensation account, and making sure those are included in Wells Fargo market cost reports. Korach will check to make sure those are incorporated in the report otherwise he will provide Wells Fargo statements. Korach continued with a couple supplemental slides information presented historical liquidity, cash flow analysis, and financial forecasting since which were new additions to the quarter.

Several questions arise regarding liquidity ration and baseline.

Korach turned it over to Chris McGarry from Chandler who gave a brief overview of the current economic situation. McGarry talked about diversification and changes that happened in the first quarter. Mentioned that the economy will continue growing at a slower pace. Explaining positive results such as unemployment rate and consumer sentiment. One of the challenges mentioned was the slowing global growth. McGarry continued discussing how the Fed had lowered rates twice in the end of July and September but now expecting more of a normalization of the yield curve. McGarry highlighted the unemployment rate country level of 3.7%, Bay area 2.6%, and California 4.1%. mentioned how they seen normalization of housing market. Finished by mentioning that the Portfolio has had more diversification. Councilmember Paul motioned to accept treasurers staff report and provide recommendations as provided by the committee, Daisy Seconded, motioned passed unanimously.

B. Socially Responsible Investing and Environmental, Social and Corporate Governance (Fossil-fuel divestment)

Finance Manager, Zach Korach, provided a brief high-level presentation on fossil-fuel divestment idea. Korach provided a brief history and background mentioning the City of New York as one of the leaders in this movement, who have divested funds. Korach also mentioned local agencies participating in divestment such as the city of Mountain View who divested 13.9 million and realized an immediate \$125,000 loss in the general portfolio, the City of Palo Alto made a policy amendment, and the City of Davis who divested 124 Million. Korach mentioned high level cost considerations such as; Market Performance, Diversification Costs, one-time and ongoing transaction costs, and higher expense ratios. Korach continued explaining how the portfolio make up is solely of mutual funds making and implementing a policy change such as this would require 100% liquidation of portfolio. If Audit Committee where make a recommendation to take to this idea to the City council it would be at a policy level, with management directive to be provided to Chandler and USBank. If requested the staff recommendation would

be a with a prospective divestment for the general portfolio. Carolyn Cox from Chandler added that the costs to the participant tend to suffer when adding these filters to the portfolio. Cox mentioned they already do a level of review of environmental and social factors in putting a value to a bond and have an approved list by their internal credit process. Committee accepted the report.

C. OPEB and Pension Section 115 Trust Performance Report

Korach explained that the OPEB and Pension Trust Performance Report was added as a desk item. Rick Rosenthal from USBank briefly presented the Investment Review. Referred committee to first page of the report looking at the history of asset growth, city began at \$25.7 million and mentioned the internal transfer from the old account number to the new account number of \$28 million. Interest earned of nearly \$400,000 and gains of nearly \$3.2 million. Rosenthal continued to reviewed quarter performance thru the end of September and mentioned that the majority of the performance comes from equity side the traditional and real estate. Chairman Schmidt asked about the gap within the net of fees. Korach discussed the inception to date figure and how there is still work to do. For purpose of analyzing the discount rate they used 67-month net of fee return applying that to inception to date and applying that quarter over quarter. In comparing they arrived at 6.56% net figure applied same logic in September and arrived at a 6.38%, rounding up to 6.4%. Staff will be recommending a reduction to the OPEB plans discount rate of 6.5% based on the gross return figure. Committee accepted the Portfolio report.

D. OPEB & Pension Discount Rate Analysis (1:25)

Korach turned it over to Thomas Leung, Senior Management Analyst. Leung began presentation on OPEB trust background, discount rate, sensitivity analysis, and how it affects financial forecast and concluding with staff recommendations. Leung mentioned current assets of 29.2 million at a discount rate of 7%. Leung continued explaining how these are funded by contributions from employer and employees. Staff recommendation is a 6.5% OPEB trust 6.25% Pension trust based on projections, long term expected return and historical returns. Chairman Schmidt asked USBank if the expected rates of return lower the band over risk profile that the city has been maintaining. Cox confirmed as there was a reevaluation earlier the year. Chairman Schmidt requested having a summary of the band in the next meeting. Thomas continued with staff recommendations at a lower discount rate in the OPEB trust and Pension trust with a more conservative rate of return. Chairman Schmidt requested an additional sensitivity analysis. Mayor Scharff motioned to accept and approve the staff report with minor adjustments, Daisy Seconded. Motion passed unanimously.

E. FY 18-19 Audit Update

Matt Gerdes from Crowe highlighted briefly the planned timeline. Gerdes explained that the field work was completed last week and is working on getting a

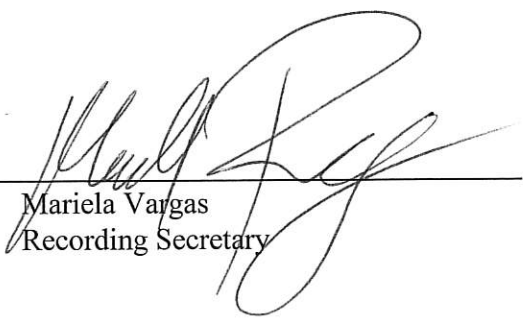
few last pieces of information. Chairman Schmidt mentioned that the reports are historically available November and December. The timing of the PARS trust audit report is out of staff and Crowe's control. Korach added that committee can approve the CAFR with the exception of the issuance of the PARS financial statement. Committee agreed on tentative date, December 10, 2019 for special meeting to review CAFR and Management letter. Chairman Schmidt closed this item subject to next meeting on December 10, 2019.

F. Budget Format Review

The Budget Format Reviews to be carried forward to first item on agenda for next meeting.

3. ADJOURNMENT

The meeting adjourned at 6:02 PM



Mariela Vargas
Recording Secretary