Finance Committee – (2016)

Barbara Spector, Vice Mayor
Steve Leonardis, Council Member

TOWN OF LOS GATOS
SPECIAL
TOWN COUNCIL FINANCE COMMITTEE
AGENDA

TOWN COUNCIL CHAMBERS
110 East Main Street
February 18, 2016 – 2:30 p.m.

MEETING CALLED TO ORDER

ROLL CALL

VERBAL COMMUNICATIONS *(Three minute time limit)*

TOWN COUNCIL FINANCE COMMITTEE

1. Approval of January 22, 2016 Council Finance Committee Meeting Minutes

2. Review and Accept the FY 2014/15 Comprehensive Annual Financial Report (CAFR)

3. Options to Address Unfunded Liabilities

Attachments
1. January 22, 2016 Finance Committee Meeting Minutes
2. December 21, 2015 Finance Committee Final Minutes
3. FY 2014/15 Comprehensive Annual Financial Report
4. Options to Address Unfunded Liabilities Staff Report

ADJOURNMENT

cc: Post *(also posted on Town Web)*
Town Council

DRAFT

TOWN OF LOS GATOS
COUNCIL FINANCE COMMITTEE
January 22, 2016, 11:00 a.m.

110 E. Main Street
Town Council Chambers
Los Gatos, California

ACTION MINUTES

Call to Order
The Council Finance Committee meeting was called to order at 11:00 a.m.

Members and Staff present:
Mayor Barbara Spector
Council Member Steve Leonardis
Laurel Prevetti, Town Manager
Jennifer Callaway, Assistant Town Manager
Gitta Ungvari, Finance Administrative Analyst
Stephen Conway, Finance & Administrative Services Director (by phone)

Verbal Communications
None.

Agenda Items

1. **Approval of December 21, 2015 Council Finance Committee Meeting Minutes**

The December 21, 2015 Council Finance Committee meeting minutes are approved with a correction and clarification (Attachment 2).

2. **Discussion of Finance Committee questions and staff's response**

The Committee acknowledged the good staff report and discussed the Finance Department responses with the intent of looking into scenarios to pay off or partially pay off the Town's unfunded pension liabilities. The Committee intends to report to the whole Council before the FY 2016/17 budget discussion.

Stephen Conway summarized that the Town's unfunded liability amount is determined by a combination of factors, including market returns and actuarial assumption changes that are not analogous to a mortgage. Even if the Town pays off its unfunded liability at a certain point of time, the liability might come back in future years. There is also a possibility that the market can correct itself and the Town's unfunded liability ratio might change favorably.

Mayor Barbara Spector expressed that it would be wise to establish a process to pay down the Town's unfunded pension liability.

Councilmember Steve Leonardis expressed interest in the effect of an accelerated payment schedule on the balance of unfunded liabilities.

Stephen Conway explained that the Council's recent action saved on CalPERS costs. Specifically, the Town paid the safety plan Fiscal Year (FY) 2015/16 required contribution as a lump sum amount instead of a monthly payment to save interest costs. There is no excess reserve available for another lump sum payment at this time since all of the excess funds from the Revenue Stabilization and Catastrophic Reserves (required to have 25% of the operating expenditures) and available Internal Service Fund Reserves were appropriated to the Almond Grove Street Rehabilitation Reserve.

Mayor Barbara Spector expressed interest finding other funding sources available for unfunded pension liability pay off.

Stephen Conway explained that the Council can choose to temporary lower the 25% required funding level of the Revenue Stabilization and Catastrophic Reserves to 15% of operating expenditures to free up funding for a one-time payment toward unfunded liability.

Both Committee members expressed interest in real world scenarios for extra payments and saving options for the Town's unfunded liability.

Stephen Conway confirmed that staff will follow up with CalPERS to run scenarios for accelerated payments options and potential savings, and will report back to the Finance Committee within one and a half months, depending on the timeliness of CalPERS' response.

Councilmember Steve Leonardis discussed other potential future revenue sources such as income from rental properties or sales of surplus property, and a potential User Utility Tax (UUT) and an increased Transient Occupancy Tax (TOT).

Stephen Conway explained that Netflix sales tax revenue is decreasing since the company changed the business model from a traditional retail to internet commerce.

Councilmember Steve Leonardis asked how we can replace the decreasing sales tax revenues.

Stephen Conway explained that the action of reclassifying Netflix from a retail business category to an e-commerce business category generated a significantly higher business license tax payment to the Town. However, according to recent trends, consumers are more reliant on on-line retail versus local mortar and brick shopping. The Town and its Sales Tax Advisor (Muniservices) are closely monitoring pending legislation on internet commerce taxation.

Jennifer Callaway noted that at the time of the FY 2015/16 mid-year budget discussion, staff will bring forward the FY 2014/15 audited fiscal year and savings amount of approximately $5 million. Out of the $5 million, $2.7 million is already programmed for the Almond Grove Street Rehabilitation Reserve and other approved one-time funding needs. A portion of the balance could be used to pay down unfunded liabilities per Council discretion.

The next Finance Committee meeting is scheduled for the week of February 15, 2016,at which time the Committee will consider the Comprehensive Annual Financial Report and continue its discussion of unfunded liabilities if CalPERS data are available by that time.

Meeting adjourned at 12:02 p.m.

FINAL

TOWN OF LOS GATOS
COUNCIL FINANCE COMMITTEE
December 21, 2015, 10:15 a.m.

110 E. Main Street
Town Council Chambers
Los Gatos, California

ACTION MINUTES

Call to Order
The Council Finance Committee meeting was called to order at 10:15 a.m.

Members and Staff present:
Mayor Barbara Spector
Council Member Steve Leonardis
Laurel Prevetti, Town Manager
Gitta Ungvari, Finance Administrative Analyst

Verbal Communications
None.

Agenda Items

1. Finance Department Responses to: "CALPERS' protracted plan for reducing investment risk leaves pension system vulnerable" by Daniel Borenstein.

The Committee discussed the Finance Department responses. With the intent of ensuring that the Town retains a strong fiscal position in the long term, the Committee requested responses to the following questions prior to its next meeting:

- What is the total amount of Los Gatos' unfunded pension liabilities?
- What is the annual cost or payment the Town is required to pay at this time?
- If the minimum payment or required payment is made, does the balance grow, stay constant or amortize?
- How do Los Gatos' liabilities compare to neighboring municipalities our size such as Campbell, Saratoga, and others?
- Recently Saratoga paid off its unfunded liabilities and was able to save $5 million? What approach did Saratoga use and why?
- Please provide an historical perspective of where Los Gatos has been in the past, our present, and our projected future with our pension liabilities and payments.
- What is the amount of pensions paid by CALPERS?

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- What is the rate of return on their investments (actual versus projected)?
- What are the assumptions behind the CALPERS estimate for the Town?
- Verify that if the projected rate of return is too high, then the pension costs of the Town rise.
- Near the bottom of page 3 of Director Conway's responses, he states "These potential future cost increases for both employer and employee costs are likely to have an impact on future labor negotiations." How should unfunded liabilities be a factor in labor negotiations?
- What is the annual shortfall?
- What is the Town's annual payment to CALPERS and what percentage of the budget does this number represent?
- What is the Town's total indebtedness?
- What can be done now as part of a long term strategy to maintain the Town in a strong position over time?
- What are the Council's options to pay the liability down and reduce risk over the long term? Provide pros and cons of each option.
- What "buckets" can the Council use to eliminate its liabilities?
- What if CALPERS goes bankrupt? What would the costs be to the Town under that scenario? What options would the Town have?
- What if the Town wanted to leave CALPERS and have its own retirement program?
- How can the Town avoid bankruptcy?
- Please provide other information so the Committee has the whole picture.

2. Discuss Finance Committee 2016 Work Plan and Schedule

The Chair asked the Committee to give thought to the January Town Council meeting at which time the Council is expected to discuss budget principles.

The next Finance Committee meeting is scheduled for January 22, 2016 at which time the Committee will consider the Comprehensive Annual Financial Report and continue its discussion of the issues raised under the first agenda item.

Meeting adjourned at 10:55 a.m.

MEETING DATE: 02/18/16
ITEM NO: 2

DATE: FEBRUARY 12, 2016

TO: FINANCE COMMITTEE

FROM: LAUREL PREVETTI, TOWN MANAGER Laurel Prevetti

SUBJECT: REVIEW AND ACCEPT THE TOWN'S COMPREHENSIVE ANNUAL FINANCIAL REPORT DATED JUNE 30, 2015

BACKGROUND:

The Town contracts with an independent certified public accountant to examine the books, records, inventories, and reports of all officers and employees who receive, handle, or disburse public funds each fiscal year. The FY 2014/15 audit was performed by Chavan & Associates, LLP CPA's, an experienced firm specializing in audit services for California public agencies. Mr. Sheldon Chavan, C.P.A. is the managing partner of the firm is available via teleconference at the Thursday afternoon meeting, and is also available by telephone 650-346-1329 through the weekend of February 20-22 for any questions that Committee members may wish to explore. The Town's CAFR has been awarded the Achievement in Excellence in Financial Reporting for fifteen consecutive years and staff will be submitting the Town's CAFR for award consideration by the February 29, 2016 deadline.

The CAFR is a critically important document in that it is reviewed by the rating agencies annually and the financial data gleaned from this document is the one of the primary reasons for the high ratings the Town is currently enjoying. In 2015 Moody's rating service upgraded the Town's credit rating from Aa1 to Aaa (per Moodys, the highest credit rating a California city can obtain for its population size). Moody's press release in 2015 made the following comment, "The Aaa rating also reflects the town's strong financial management, as demonstrated by a consistent trend of large operating surpluses throughout the recession, resulting in robust reserves and liquidity. The rating additionally reflects recent actions taken by the town to lower its moderate debt and pension burdens."

PREPARED BY: STEPHEN CONWAY
Director of Finance & Administrative Services

Reviewed by: Assistant Town Manager Town Attorney Finance

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Updated: 11/2013

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DISCUSSION

Finance staff will present to the Town's Finance Committee the Town's audited Comprehensive Annual Financial Report (CAFR) Dated June 30, 2015. Town staff will be discussing the audited financial results with the Committee focusing on the following:

Financial Section. The auditors have given the Town's financial statements a "clean" audit opinion for the year ended June 30, 2015, (see third paragraph of the auditor's opinion on Page 1 of the Financial Section of the report) giving reasonable assurance that the financial statements are "free of material misstatement."

Statement of Net Position. The Statement of Net Position (page 29) may serve as a useful indicator of a government's financial position. The Town had positive net assets of $106.5 million at fiscal year end as compared to $142.1 million the prior year, an overall decrease of $35.6 million for the fiscal year.

The decrease in net position is reflective of the first year of the Town's implementation of the new Governmental Accounting Standards Board (GASB) Statement 68, Accounting and Financial Reporting for Pensions and the related GASB Statement 71, Pension Transition for Contributions Made Subsequent to the Measurement Date. Under the new pension reporting standards, the annual pension expense recognized by the Town is no longer the actuarially required contribution (ARC). Instead, pension expense for the fiscal year is recognized in the change in net pension liability from measurement year to measurement year (for 2015 this measurement will be between June 30, 2013 and June 30, 2014. For the first time the Statement of Net Position (page 29) includes a liability termed Net Pension Liability of $39.2 million as of June 30, 2015. Net pension liability is the difference between the total pension liability (the present value of projected benefit payments to employees based on their past service) and the assets (mostly investments reported at fair value) set aside to pay current employees, retirees, and beneficiaries. Prior to this implementation governments only reported as a liability the difference between the contributions they are required to make to a pension plan (the ARC) in a given year versus what is actually funded.

The Finance Committee's second agenda item "Options to Address Unfunded Liabilities" will focus on the pension liabilities in more depth and staff will be exploring various strategies on how to address these liabilities in future years.

The largest portion of the net assets, $93.7 million, represents the Town's investment in its capital assets and infrastructure. Restricted assets of $5.6 million are resources that are subject to external restrictions on how they may be used. The remaining $7.1 million in net assets are unrestricted legally, but have been designated as to use in various reserve accounts or held in Internal Service Funds. Again, this is an overall financial position indicator and is not the amount of current resources available for budgetary purposes.

Management's Discussion and Analysis (MD&A) (Page 16 through 25)

Page 16 of the CAFR begins the MD&A section of the report wherein summaries are presented for the Town on an entity-wide basis and fund type basis. Information is provided in this section with a year-to-year view, explaining how fund balances have changed between fiscal years ending June 30, 2014 and June 30, 2015. Information is also presented on the adopted General Fund budget and any significant budget adjustments made during the FY 2014/15 fiscal year (page 23).

Basic Financial Statements (Page 27 through 77, Including Footnotes)

Located within this section are basic financial statements, including the "entity-wide" Statement of Net Position and Statement of Activities, Governmental Funds, the General Fund Budget and Actual (page 36), Proprietary, Fiduciary Funds (Library Trust and Parking Assessment District) and the Private Purpose Trust Funds (RDA Successor Agency). An important item for consideration is the General Fund Budget and Actual presented on page 36. Presented on this statement is a $5.8 million excess of revenues over expenditures for the fiscal year. This result for the fiscal year provided a source of funding for the approximately $2 million in funds available from FY 2014/15 to fund the Almond Grove street project. Per Town Council policy, prior year savings in excess of 25% of ongoing budgeted expenditures rolls to the Town's General Fund Reserve for Future Capital account.

The footnotes section provides details on significant items such as the Town's cash and investments (Note 2 beginning on page 57), its long term obligations (Certificates of Participation) related to bonded debt (Note 6 Page 63), the net pension liability is discussed in for both the Town's miscellaneous and safety pension plans (Note 9 page 66), followed by a discussion of the Town's other post-employment benefit plan (Note 10 Page 72).

Required Supplementary Information (Page 81 through 84)

Provided in the section are budget to actual results for the Towns Appropriated Reserves Fund and a Schedule of Pension Plan Contributions.

Supplementary Information (Page 85 through 106)

This section provides budget to actual information for "non-major" funds which represent less than 10% of the Town's total assets/liabilities/revenues or expenditures.

Statistical Section (Pages 109 through 125)

This section presents demographic statistics and ten year historical financial data for the Town, including information on assessed valuations, fund balances, debt, property tax rates, full-time equivalent history in terms of personnel, and principal employers, among other financial and demographic disclosures.

Other Independent Auditors Reports (Pages 127 through 129)

This section includes the Independent Auditors report on Internal Control. Of note here is in the fourth paragraph on page 128, the auditor states, "during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be a material weakness."

CONCLUSION

Upon review and approval of the CAFR by the Council Finance Committee staff anticipates bringing the CAFR forward to Town Council for approval on Tuesday, March 1, 2016.

MEETING DATE: 02/18/16
ITEM NO: 3

DATE: February 12, 2016

TO: FINANCE COMMITTEE

FROM: LAUREL PREVETTI, TOWN MANAGER Laurel Prevetti

SUBJECT: OPTIONS TO ADDRESS UNFUNDED LIABILITIES

BACKGROUND:

On January 22, 2016 the Finance Committee discussed the Town's unfunded liabilities with respect to retirement benefits. To recap, the Town's pension unfunded liability as of June 30, 2015 was $35 million.

During this discussion the Finance Committee asked Town staff to return to the Committee with various pay off options for the pension-related unfunded liability.

Upon receiving this direction, staff has contacted the Town's assigned California Public Employees Retirement System (CalPERS) actuary to discuss various pay off options. The assumption of pay off options includes a variety of factors and amortization bases. The options presented below are "level percent" estimates (actuaries recommended method), however, with further Council direction on which option staff should pursue, refined cost savings estimates can be provided.

DISCUSSION:

Based on conversations with the Town's CalPERS actuary, staff determined three options for the Finance Committee to consider: status quo, fresh start, and additional lump sum contributions.

Option 1: Status Quo

The status quo option essentially entails that the Town continues to pay down gradually the unfunded liability with the existing rates that CalPERS is charging the Town. Under this option,

PREPARED BY: STEPHEN CONWAY
Director of Finance & Administrative Services

Reviewed by: _____Assistant Town Manager _____Town Attorney _SC_ Finance

ATTACHMENT 4

the pay off duration is estimated to be 35 years. As previously discussed, the rates and pay off duration will fluctuate based on market conditions.

Option 2: Fresh Start

The Town's second option is to make a "fresh start." A fresh start is a CalPERS term for re-amortizing the current unfunded liability over a shorter period of time. There are two fresh start choices described below, one for a 20-year fresh start and the second for a 15-year fresh start. Staff notes that future actuarial valuations could create new "unfunded" liabilities that will not be addressed by the fresh start option.

Table 1 below summarizes the savings for a 20-year fresh start. These are provided as estimates only as the payments under a fresh start are expected to increase by a flat 3% each year. The Town could commit to a 20-year fresh start, amortizing the Town's liability over a 20-year period. Under this scenario, the Town's estimated fiscal year (FY) 16/17 contribution would increase by approximately $400,000 and the Town would save an estimated $1.88 million over the 20-year period.

Table 1: 20-year Fresh Start (Estimate)

	Current Minimum Contributions	New Contribution Amount to Reduce to a 20 Year Pay Down Period*	Increased Town Contribution*	20 Year Pay Down Projected Savings
Safety	$ 755,232	$ 1,023,864	$ 268,632	$ 961,955
Miscellaneous	$ 1,487,193	$ 1,631,812	$ 144,619	$ 921,044
Total	$ 2,242,425	$ 2,655,676	$ 413,251	$ 1,882,999

*Payment will increase by 3% for each year into the future.

Alternatively, as illustrated in Table 2 below, the Town could commit to a 15-year fresh start, amortizing the Town's liability over a 15-year period. Under this scenario, the Town's estimated FY 16/17 contribution would increase by approximately $1 million and the Town would save approximately $13.27 million over the 15-year period.

Table 2: 15-year Fresh Start (Estimate)

	Current Minimum Contributions	New Contribution Amount to Reduce to a 15 Year Pay Down Period*	Increased Town Contribution*	15 Year Pay Down Projected Savings
Safety	$ 755,232	$ 1,243,051	$ 487,819	$ 5,354,155
Miscellaneous	$ 1,487,193	$ 1,981,148	$ 493,955	$ 7,921,236
Total	$ 2,242,425	$ 3,224,199	$ 981,774	$ 13,275,391

* Payment will increase by 3% for each year into the future.

Based on the Town's financial projections at this time, an annual expenditure increase of either $400,000 to $1 million does not appear sustainable over the 20- or 15-year cycles of these two choices.

Option 3: Additional Lump Sum Contributions

Alternatively, the Town could chose to make lump sum payments above the existing required contributions when resources are available to do so. Staff would recommend that the lump sum payments be applied towards the Town's safety liability to achieve the greatest projected savings. The safety plan for the Town is paid over a longer period of time and at a higher rate so any additional contributions to this plan will result in more cost savings for the Town.

Lump sum contributions could be a one-time payment or multiple one-time payments throughout the term, depending on the Council preference and available resources. Assuming the Town experiences $1 million in year-end savings (excess revenues over expenditures), a portion of that money could be allocated to lump-sum payments towards the Town's liability. A few alternatives are identified in Table 3 below (all assume a level percent), however, there are multiple choices with respect to an amount to contribute towards these liabilities.

Table 3: Additional Lump Sum Contributions (Estimate)

	Status Quo	**$750,000 Additional Contribution**	**$500,000 Additional Contributions**	**$1 Million Additional Contribution + Accelerated Payments**
Lump-Sum Amount (additional payment beyond required contribution)	$ -	$ 750,000	$ 500,000	$1,000,000 (year 1) plus $500,000 for 5 additional years
Number of Years	0	5	5	6
Total Additional Contribution	$ -	$ 3,750,000	$ 2,500,000	$ 3,500,000
Projected Savings from Status Quo	**$ -**	**$ 13,784,492**	**$ 10,332,328**	**$ 12,453,428**
Length of Pay-off (in years)	29	20	23	21

*Projected savings from status quo is net of the additional contributions.

Alternatively, Council could elect to make one additional lump sum contribution as illustrated in Table 4 below:

Table 4: One Large Additional Lump Sum Payment (Estimate)

	$3 million Additional Contribution
Lump-Sum Amount (additional payment beyond required contribution)	$ 3,000,000
Number of Years	1
Total Additional Contribution	$ 3,000,000
Projected Savings from Status Quo	**$ 5,555,709**
Length of Pay-off (in years)	29

*Projected savings from status quo is net of the additional contributions.

With one large lump sum contribution in FY 2016/17 of $3 million, the Town is projected to save an estimated $5.5 million and reduce the pay off period by ten years. The single lump sum approach is what the City of Saratoga did to address unfunded liabilities (see Exhibit A).

CONCLUSION:

All of the estimates provided above are only projections at this point in time. There are a variety of variables and factors that determine rates and cost savings. With specific direction from the Council on which option to pursue, staff will continue to refine the payoff projections and cost savings.

Exhibit:

1. Saratoga 's approach to addressing unfunded liabilities

SUMMARY OF HOW SARATOGA ADDRESSED ITS SHARE OF THE CalPERS PRE-2013 UAL

- Back in 1999, in the effort to stabilize pension rates for small employers, employer pension plans with fewer than 100 employees were combined into pension pools. CalPERS grouped the agencies into separate pools by pension plan type and benefit, such as the 2%@55 Miscellaneous pool, the 2.5@55 Miscellaneous pool, and the 2.5@55 Public Safety pool. However, with this change into pooled plans, an employer's actuarial valuation primarily reflected the pool's financial liabilities; very little employer specific information was provided.
- With the October 2014 Actuarial Valuation Report, CalPERS changed their reporting methodology to clearly identify the individual employer's pension plan liabilities. In addition, the employer's share of prior year unfunded accrued liabilities (UAL) for each pooled plan is reported separate from the annual contribution requirement for the current year's 'Normal Cost' contribution.
- In prior years, the UAL and the Normal Cost were rolled into a percentage of payroll rate assessment. As of FY 2015/16, employers are now required to contribute a flat dollar amount payment toward their UAL liability, while the Normal Cost contribution continues to be paid as a payroll percentage rate.
- CalPERS calculated the required UAL contribution amounts by breaking the liability into what they call 'bases'. The first base is comprised of all the prior year liabilities rolled up into one base and titled **Share of Pre-2013 Pool UAL** (a city's share of the pool's liabilities.) For following years, unfunded accrued liabilities are listed by year and updated to current investment earning and revised assumptions.
- The **Pre-2013** base was structured to be repaid over a 22 year period, at a flat dollar amount. The remaining bases are to be repaid over a 30 year plan. The thirty-year base payments escalate 20% in each of the first five years, plateau for twenty years, and then decline over the ending five years. This payment plan structure means employers will see significant cost increases over the first five years.
- If Saratoga were to follow CalPERS payment plan, the City's $7.7 million dollar **total UAL** (at June 30, 2015) would have cost the City more than $18 million over 30 years, with about $10.4 million of that interest, based on a 7.5% discount rate.
- Saratoga's **Pre-2013 UAL** was expected to be $3.4 million at June 30, 2015. The City chose to pay off the **Pre-2013 UAL** in April 2015 saving approximately $3.6 million dollars in interest over 22 years, and lowering the annual required payments to CalPERS by approximately $240,000 per year. This allowed the City more flexibility in how to pay off the remaining UAL.

EXHIBIT A