TOWN OF LOS GATOS
TOWN COUNCIL FINANCE COMMITTEE MEETING
JUNE 17, 2019
TOWN COUNCIL CHAMBERS – 110 E. MAIN STREET
LOS GATOS, CA
6:00 PM

**Steve Leonardis, Chair*
**Barbara Spector, Vice-Chair*
Terry Duryea, Committee Member
Rick Tinsley, Committee Member

MEETING CALLED TO ORDER

ROLL CALL

CONSENT ITEMS (TO BE ACTED UPON BY A SINGLE MOTION) *(Items appearing on the Consent Calendar are considered routine and may be approved by one motion. Unless there are separate discussion and/or actions requested by the Board/Commission/Committee, staff, or a member of the public, it is requested that items under the Consent Calendar be acted on simultaneously. Any member of the Board/Commission/Committee or public may request to have an item removed from the Consent Calendar for comment and action.)*

1. Approve Council Finance Committee Meeting Draft Minutes of March 11, 2019.

COMMUNICATIONS *(Members of the Committee may provide written information to other Committee members.)*

CALPERs Training Investment Risk Return

VERBAL COMMUNICATIONS *(Members of the public may address the Committee on any matter that is not listed on the agenda. Unless additional time is authorized by the Committee, remarks shall be limited to three minutes.)*

OTHER BUSINESS *(Up to three minutes may be allotted to each speaker on any of the following items.)*

2. Review and Provide Recommendations for Future Revenue Opportunities for the Town of Los Gatos
3. Review and Provide Direction on Additional Discretionary Payment Strategies

ADJOURNMENT

IN COMPLIANCE WITH THE AMERICANS WITH DISABILITIES ACT, IF YOU NEED SPECIAL ASSISTANCE TO PARTICIPATE IN THIS MEETING, PLEASE CONTACT THE CLERK DEPARTMENT AT (408) 354-6834. NOTIFICATION 48 HOURS BEFORE THE MEETING WILL ENABLE THE TOWN TO MAKE REASONABLE ARRANGEMENTS TO ENSURE ACCESSIBILITY TO THIS MEETING [28 CFR §35.102-35.104]

DRAFT
MINUTES OF THE COUNCIL FINANCE COMMITTEE MEETING
MARCH 11, 2019

The Council Finance Committee of the Town of Los Gatos conducted a meeting on Monday, March 11, 2019, at 6:00 p.m.

MEETING CALLED TO ORDER AT 6:00 P.M.

ROLL CALL

Present: Mayor Steve Leonardis, Council Member Barbara Spector, Committee Member Terry Duryea, and Committee Member Rick Tinsley.

Staff Present: Town Manager Laurel Prevetti, Assistant Town Manager Arn Andrews, Finance Director Stephen Conway, Town Attorney Rob Schultz, and Finance and Budget Manager Gitta Ungvari

ELECTION OF CHAIR AND VICE CHAIR

MOTION: **Motion** by **Council Member Barbara Spector** to elect Mayor Steve Leonardis as Chair and Council Member Barbara Spector as Vice-Chair. **Seconded** by **Mayor Steve Leonardis.**

VOTE: **Motion passed unanimously.**

CONSENT ITEMS

1. Approve Council Finance Committee Meeting Draft Minutes of December 10, 2018.

MOTION: **Motion** by **Mayor Steve Leonardis** to approve the Consent Item, **Seconded** by **Council Member Barbara Spector.**

VOTE: **Motion passed unanimously.**

VERBAL COMMUNICATIONS

Jak VanNada

- Commented on the importance of the Council Finance Committee work and on the proposed decrease in the number of Council Finance Committee meetings. Recommended that the Town Council should consider paying available funds directly to CalPERS instead to

the IRS 115 Trust and that the Town's budget should be analyzed by the Council Finance Committee before it goes to the full Council.

OTHER BUSINESS

2. Approve the Council Finance Committee Meeting Schedule for the Rest of the Calendar Year 2019.

The Committee Members discussed the proposed meeting schedule.

Opened Public Comment.

Phil Koen

- Commented on that the Council Finance Committee work is very important and that the number of meetings should not be decreased.

Closed Public Comment.

MOTION: **Motion** by **Council Member Barbara Spector** to have four additional meetings in rest of Calendar Year 2019: June, August, October, and December. **Seconded** by **Mayor Steve Leonardis.**

VOTE: **Motion passed unanimously.**

3. Recommend to the Town Council to adopt the proposed Internal Service Funds (ISF) Policy

Steve Conway presented an analysis of the Town's Internal Service funds and a proposed Internal Service Fund Policy.

Committee members asked questions which staff addressed.

Opened Public Comment.

Phil Koen

- Provided a handout to the Finance Committee members containing his analysis of the historical spending of the Internal Service Funds and the Internal Service Fund forecast provided in the staff report

Closed Public Comment.

The Finance Committee discussed the matter further and were in general agreement that the Town should reduce the number of Internal Service Funds. The Committee discussed that the

proposed Policy needed more work. Specifically, the draft Policy should set benchmarks based on actual expenditures instead of forecasted needs, state all assumptions, use clear and unambiguous language, and be reviewed by the Policy Committee prior to going to Town Council.

MOTION: **Motion** by **Mayor Steve Leonardis** to recommend to the Town Council consideration to eliminate the Stores and the Vehicle Maintenance Internal Service Funds and explore the opportunity to combine the Information Technology, Equipment Replacement, and Facilities Maintenance Internal Service Funds. **Seconded** by **Council Member Barbara Spector.**

VOTE: **Motion passed unanimously.**

ADJOURNMENT:
The meeting adjourned at 8:07 p.m.

This is to certify that the foregoing is a true and correct copy of the minutes of the March 11, 2019 meeting as approved by the Council Finance Committee.

_____
Gitta Ungvari, Finance and Budget Manager

TOWN OF LOS GATOS
COUNCIL FINANCE COMMITTEE
AGENDA REPORT

MEETING DATE: 06/17/2019
ITEM NO: 1
DESK ITEM

DATE: JUNE 17, 2019

TO: COUNCIL FINANCE COMMITTEE

FROM: LAUREL PREVETTI, TOWN MANAGER

SUBJECT: MINUTES OF THE COUNCIL FINANCE COMMITTEE MEETING MARCH 11, 2019

REMARKS:

Attachment 1 contains public comments received between Friday 11:01 a.m. June 14, 2019 and Monday 11:00 a.m. June 17, 2019.

Attachment received with this Desk Item:

1. Public Comments Received between Friday 11:01 a.m. June 14, 2019 and Monday 11:00 a.m. June 17, 2019

Subject: June 17, 2019 Town Council Finance Committee Meeting
Attachments: ATT00001.htm

From: Terry Duryea <tduryea@aol.com>
Date: June 16, 2019 at 10:11:12 AM PDT
To: Laurel Prevetti <LPrevetti@losgatosca.gov>
Cc: Arn Andrews <aandrews@losgatosca.gov>, Stephen Conway <sconway@losgatosca.gov>
Subject: June 17, 2019 Town Council Finance Committee Meeting

Date: June 16, 2019 (Sunday)
To: Finance Committee Members and Town Staff (bcc'd to all Town Council as I recently learned they receive all FC correspondence)
From: Terry Duryea, Committee Member

I am disappointed that I will not be able to attend the Monday, June 17 Finance Committee meeting as a personal matter has interceded. I do expect to be at the August meeting.

Based on the material distributed as of this weekend, I have the following comments for the Finance Committee members and Town Staff to consider as part of the general discussion.

I am sorry they are delivered in writing rather than in person.

Item 1—Approve Draft Minutes from March 11, 2019
I have no comments

Item 2—Review and Provide Recommendations for Future Revenue Opportunities
The 5 page staff report does a nice job of listing possible revenue sources, but it doesn't provide sufficient information to make recommendations. There is no discussion of dollars that could be raised and the pros and cons of alternatives are not presented.

In making a list, I would add the following additional revenues sources to the list:

- Audit Transit Occupancy Tax compliance and Business License Tax compliance if the forecasted additional revenue would be expected to exceed the cost of the audit. If there is a staffing limitation, these audits can be outsourced.

I believe any discussion of future revenue opportunities that include raising taxes on our residents in one form or another should include a discussion of why the Town needs the additional revenue.

In my limited time involved with Town finances, I see cash balances increasing at the same time money seems to be available for necessary projects. For example, three years ago the Town was struggling with a declining PCI that was under 70 and projected to decline further, while the recent budget discussions seem to indicate the Town now believes it can meet and sustain a PCI of 72.

In addition, the community continues to request greater transparency in budgeting and financial reporting. In my opinion, before asking the voters to approve an additional tax, the Town needs to update its budgeting process to reflect greater transparency and follow current best practices in the government sector, and to provide greater transparency in its financial reporting.

Item 3—Review and Provide Direction on Additional Discretionary Payment Strategies

The topic is "additional discretionary payment strategies" but it seems the memo also introduces the idea of changing the asset allocation of the OPEB Trust and the 115 Pension Trust.

I would expect these to be discussed separately as they are only obliquely related.

ATTACHMENT 1

But since the memo combines the tow, my comments below follow the staff memo, trying to distinguish between the two issues.

As a general comment on asset allocation, to make an informed recommendation on asset allocations for the two post-employment trusts (115 Pension & OPEB), the Committee needs to understand the Town's "risk capacity" and "risk tolerance" over the next 10 years?

Hopefully a consideration of risk and risk capacity will integrate a discussion of the significance of the "standard deviation" information disclosed for the three investment alternatives for the OPEB Trust (per page 4 of memo: 11.83% to 7.28%)? Should I conclude that Strategy 1 is more than 60% riskier than Strategy 3 since the Strategy 1 standard deviation is 62.5% larger than the Strategy 3 standard deviation? Or is that even a relevant question?

Here are my comments on each of the Trusts

Town OPEB 115 Trust
Observations on Staff Memo:

- The 8.33% inception to date return following Strategy 1 is impressive. It's important not to conclude that i) that Trust is getting a superior return over CALPERs or other investment vehicles (CALPERs had a 8.1% return for the five years ended June 30, 2018 that is the closest comparison), or ii) that the fund will earn these type of returns in the future. The first money was invested on June 29, 2009 after the 2008 financial market meltdown just as the market was beginning a historical 10 year climb to record high equity values. The timing of the Town Council recommendation was fortunate.
- It's also important to recall that Strategy 1 was the only strategy available at the time of the initial investment in the OPEB Trust. Again, the Town was fortunate that the only option available at the time was the option with the greatest equity exposure when compared to the 3 options offered today.

Unanswered questions and information needed to make a decision on 115 Trust asset allocation:

- To make a decision on asset allocation, it's necessary to understand the Town's investment horizon. When does the Town expect to begin making <u>net</u> drawdowns of Trust assets as a result of payments to employees/their beneficiaries.
    - If the Town does not expect to make a net drawdown to this trust in the next 10 years, it can take greater risk and invest the funds in a more aggressive asset allocation with a higher standard deviation
- Why does the Town continue to prefund the OPEB Plan increasing its funded status, while the Pension Plan funding status declined over 6 ½ percentage points from 2014 to 2017 (latest reported info)? Other factors that should impact the decision of how to allocate funds between the OPEB Plan or the Pension Plan include:
    - The assumed interest rate on the OPEB plan at 6.75% that is lower than the 7% assumed interest rate on the Pension plan
    - There is no "California Rule" for the Town's post-employment medical benefits. Thus the Town has more flexibility in meeting OPEB obligations than it does in fulfilling its PENSION obligations. This becomes important in the face of a financial crisis
    - 10 years have passed since he 2009 Town Council approval of a Finance Department recommendation to initiate a 10 year phase in of pre-funding of OPEB obligations
    - A commitment was made by Staff to the Finance Committee at an earlier Committee meeting to revisit this commitment of continuing to pre fund the OPEB Trust at the same rate it has the last few years

My position on any prefunding of OPEB Trust , and on allocation of OPEB trust assets:

- I would <u>not</u> continue to <u>pre</u>fund the OPEB Trust until Staff presents a comparison of the benefits of using funds to fund the OPEB Trust vs funding the Town's pension obligations—my instincts tell me the funds are better used to fund the Pension obligation—see further discussion below
- Personally, so long as the Town does not believe it will need a net withdrawal of funds from this trust, I see no reason to change asset allocation based on information provided UNLESS there is reasonable expectation that the equity markets will suffer as much in the next downturn as they did during the financial market induced equity market meltdown in 2008, i.e. a greater than 2 standard deviation decline on the entire asset portfolio. I do not believe that is the case.

CALPERs Town Miscellaneous and Safety Plans

Observations

- Some of the Disadvantages listed seem pretty hollow:
  - "No control over the discount rate"—technically true but Bartels can run the payments and UUAL using different discount rates holding all other assumptions constant so the Town could make funding decisions using the Bartels analysis
  - "Assets restricted to pension benefits"—yes, that is the same as with the 115 Trust
  - "Pooled liability risk with Safety Plan"—it's unclear to me how discussion of assets impacts "pooled" nature of Safety Risk

Additional information requested to make decision on ADP to CALPERs [and/or 115 Pension Trust]

- What is the UUAL and funded status for the Town's Pension obligations using the same 6.25% and 5.5% discount rate as used for the OPEB analysis? If the Staff presents this information for the Committee to consider prefunding the OPEB obligation, please provide the same for the Pension obligation so we when we consider an ADP for the Pension obligation?
  - I believe a discount factor of 5.5% will show the Pension Obligations will overwhelm the Town's ability to continue to provide services IF the actual market returns come in close to that amount.

My position on an ADP:

- If we are going to make ADP to CALPERs, we should know where the contribution will have the greatest impact over the next 10 years on our annual pension contributions, so YES, please request the analysis from Bartels that you suggest.

Town Pension 115 Trust

Observations

- The standard deviation for PARS Capital Appreciation is 11.85% which is close to the standard deviation of 11.83% for the current OPEB Strategy 1. They are both the riskiest of the alternatives offered.
- Under ADP Disadvantages in the Staff memo, the "Assets Restricted to Pension Benefits" a not a disadvantage? That is what the Trust was set up for.

Additional information requested and questions to make decision on asset allocation

- To make a decision on asset allocation in 115 Pension Trust assets it's necessary to understand when the Town expects to have a drawdown of these funds for payment to CALPERs to smooth the Town's Pension payments e.g. if it is not probable that the Town will want to use these funds in the next 10 years the Town can absorb a higher risk asset allocation than it could if it is probable the Town will want to access these funds within 10 years
- If it so possible the Town will use these funds to cover pension payment obligations during an economic downturn impacting Town revenues. Its highly probably once will occur in the next 10 years. If it does, you would also expect the assets in the 115 Trust to decline. If the 115 Trust assets could be used for this eventuality, they should not be invested in a high risk asset allocation.
- What is the standard deviation for each of PARs investment options? This is necessary to compare risks.
  - How do these "standard deviations" relate to risk capacity and risk tolerance during the period when the Town may want to draw on these assets?

TOWN OF LOS GATOS
COUNCIL FINANCE COMMITTEE REPORT

MEETING DATE: 06/17/2019
ITEM NO: 2

DATE: JUNE 11, 2019

TO: COUNCIL FINANCE COMMITTEE

FROM: STEPHEN CONWAY, FINANCE DIRECTOR

SUBJECT: REVIEW AND PROVIDE RECOMMENDATIONS FOR FUTURE REVENUE OPPORTUNITIES FOR THE TOWN OF LOS GATOS

RECOMMENDATION:

Review and provide recommendations for future revenue opportunities for the Town of Los Gatos.

BACKGROUND:

With the economic downturn and the subsequent Great Recession, the Town of Los Gatos reduced the number of employees, eliminated services, and took other cost cutting measures. As the economy improved, the Town has had a slight increase in the workforce; however, it is unlikely that the Town would return to its pre-recessionary headcount. In addition, many cost containment measures remain in place. For example, even though the Library facility increased in square footage and total patronage, staffing levels remain as they did prior to the new facility opening.

Unlike other municipalities, the Town of Los Gatos does not have dedicated revenue source(s) for its capital improvement program. While there are special purpose funds that the Town receives for particular types of improvements, those are restricted for certain projects (e.g., paving) and cannot be used to support other capital needs. The backlog of deferred maintenance and the interest to maintain the Town's high level of municipal services motivated a past examination of potential additional revenue sources.

In 2015, the Town Council began working along with an appointed Ad-Hoc Citizen Committee and the Council Finance Committee to identify additional revenue sources for the Town. At its

PREPARED BY: STEPHEN CONWAY
Finance Director

Reviewed by: Town Manager, Assistant Town Manager, and Town Attorney

BACKGROUND (Continued):

September 15, 2015 meeting, the Town Council reviewed multiple revenue options. These revenue options are described in the 2015 staff report (see Attachment 1) and are organized into two categories: Options under the Council's authority to enact by majority vote after due notice and options subject to voter approval. The following tables summarize the different options identified in 2015, the Town Council's interest at that time, and Council actions to date.

Revenue Options under the Council 's Authority	Action Taken
Sale of Lease of Property	The Town Council has been actively engaged in the sale and/or lease of Town properties. To date, one property sale resulted in $1.9 M which the Council put towards unfunded pension/Other Post-Employment Benefits (OPEB) obligations.
Allowance and Taxation of Short-Term (Vacation) Rentals	A Short-Term Rental (STR) Ordinance went into effect on March 21, 2019. The ordinance created a regulated environment for STRs and subject to the Town's 12% Transient Occupancy Tax
Commercial Property Business License	Little to no Town Council interest in 2015; Potentially explore further
Business License Tax Audit and Amnesty Program	Unanimous Town Council interest in 2015; To date, lack of available staff capacity to implement.
Sidewalk Repair Cost Sharing	Little to no Town Council interest in 2015; Potentially explore further
Change of Refuse Vehicle Impact Fee	Implementation is underway with a two-year phased approach to bring the total to the maximum allowable amount of $871,800 per year to repair damage caused by heavy refuse vehicles. The annual recovery amount now stands at $619,553 and the Town will reach the maximum in FY 2020/21. Because the nexus for the funds is with pavement maintenance, the funds must be and are being used for the Town's annual Street Repair and Resurfacing Project.
Certificates of Participation	Unanimous Town Council interest in 2015 to "keep on the table"; Potentially explore further

BACKGROUND (Continued):

Revenue Options Subject to Voter Approval	Action Taken
Assessment Districts	Little to no Town Council interest in 2015; Potentially explore further
Utility User Tax (UTT)	Godbe Research surveyed Town residents in 2016, and the Utility User Tax was found not to be supported by the surveyed registered voters.
Increased Transient Occupancy Tax (TOT)	In November 2016, voters approved a 2% increase of the Town's Transient Occupancy Tax from 10% to 12%.
Increased Sales Tax	In November 2018, voters approved a 1/8 cent general sales tax.
Parcel Tax - General or Special	Little to no Town Council interest in 2015; Potentially explore further
General Obligations Bonds	Little to no Town Council interest in 2015; Potentially explore further

DISCUSSION:

As noted, the Finance Committee may wish to consider some of the previous revenue options discussed by the Town Council in 2015 and provide its input as to the viability of the idea(s) in today's environment. For some of these options, additional information is provided below that supplements the 2015 report. In addition, potential new revenue sources are also described in this section.

Sidewalk Repair Cost Sharing

As mentioned in the 2015 report, Los Gatos is among a few jurisdictions that pays the full cost for sidewalk repairs. In other jurisdictions, the cost is partially or fully covered by the property owner. Since 2015, the Town has spent very little in sidewalk replacement since any allocation of capital funds have been spent on compliance with the Americans with Disabilities Act by installing or upgrading sidewalk curb ramps. With certain private developments, property owners are required to build new sidewalks or pay an in lieu fee. The fee is not generating much revenue to cover the need within the Town. As such, this option provides little in the way of cost recovery revenue.

DISCUSSION (continued):

Taxing Digital Services

States initially were slow to enact taxes on internet downloads; however, with recent downturns in tax revenue caused by consumers purchasing more digital downloads, many states have sought ways to impose taxes on purely digital transactions. There are multiple ways that downloads are taxed. Some states use their existing franchise, sales, and use taxes to tax purchases/uses/transactions of internet goods and services. Other states enacted laws specifically aimed at digital downloads. California has not enacted tax codes regarding digital downloads and streaming as of today. Some Bay Area cities are potentially taxing video streaming through the Utility User Tax. For more on the UUT, please see the discussion in the 2015 report (Attachment 1).

Cost Recovery Fees for Town Services

Earlier this year, the Town Council approved an update to the Town's Fee Schedule to bring many of the Town's fees to a cost recovery level as allowed by California law. Certain fees, however, are below a cost recovery level. The new Fee Schedule goes into effect on July 1, 2019. For example, the Town may wish to revisit certain Planning fees to bring them closer to cost recovery during the Mid-Year Budget Review in February 2020.

Parcel Tax - Special

As described in Attachment 1, a parcel tax (otherwise known as a property-tax override) is a special non-ad valorem (non-value based) tax on parcels of property generally based on either a flat per-parcel rate or a variable rate depending on the size, use, or number of units on the parcel. However, since this tax is not based on the value of the property, it is a "fixed" tax. Parcel taxes require two-thirds voter approval and are imposed for any number of special purposes, including funding police and wild fire prevention services, clean water watershed management and flood control, and neighborhood improvement and revitalization. During the sales tax discussion, some community members expressed interest in special taxes. The Finance Committee may wish to consider this option.

CONCLUSION:

The Committee should discuss these and other revenue options and provide a recommendation to the Town Council.

COORDINATION:

The preparation of this report was done in coordination with staff from the Department of Finance, Town Manager's Office, Town Attorney, and Department of Parks and Public Works.

Attachment:

1. September 15, 2015 Staff Report

MEETING DATE: 09/15/15
ITEM NO: 6

COUNCIL AGENDA REPORT

DATE: SEPTEMBER 9, 2015

TO: MAYOR AND TOWN COUNCIL

FROM: LAUREL PREVETTI, TOWN MANAGER Laurel Prevetti

SUBJECT: LONG RANGE CAPITAL FUNDING OPTIONS:

A. IDENTIFY SPECIFIC FUNDING OPTIONS FOR FURTHER EXPLORATION;
B. IF SPECIFIC FUNDING OPTIONS REQUIRING VOTER APPROVAL ARE IDENTIFIED BY THE TOWN COUNCIL, ESTABLISH AN AD HOC CITIZEN COMMITTEE INCLUDING TWO COUNCIL MEMBERS AND THREE LOS GATOS RESIDENTS TO CONDUCT THE EXPLORATION OF THE FUNDING OPTIONS; AND
C. APPOINT TWO COUNCIL MEMBERS TO THE NEWLY FORMED AD HOC CITIZEN COMMITTEE AND INITIATE THE RECRUITMENT FOR THE RESIDENT MEMBERS OF THE COMMITTEE WITH THE INTENTION OF INTERVIEWING AND SELECTING MEMBERS AT OR BEFORE THE OCTOBER 20, 2015 TOWN COUNCIL MEETING.

RECOMMENDATION:

Staff recommends that the Town Council:

1. Identify specific funding options for further exploration.
2. If specific funding options requiring voter approval are identified by the Town Council, establish an Ad Hoc Citizen Committee with two Council members and three Los Gatos residents to conduct the exploration of the funding options; and
3. Appoint two Council members to the newly formed Ad Hoc Citizen Committee and initiate a recruitment for the resident members of the Committee with the intention of interviewing and selecting members at or before the October 20, 2015 Town Council meeting.

PREPARED BY: STEPHEN CONWAY
Director of Finance and Administrative Services

Reviewed by: Assistant Town Manager Town Attorney Finance

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EXECUTIVE SUMMARY:

The Town of Los Gatos has a strong history of prudent fiscal management as demonstrated by meeting or exceeding its reserve targets and using excess General Fund monies to fund the Town's capital improvement program. Unlike other California cities, Los Gatos does not have a structural deficit and the Town is able to make its debt, pension obligation, and Other Post-Employment Benefit (OPEB) payments in a timely manner.

While use of year-end General Fund savings had been the Town's mechanism to fund the Town's capital needs in the past, it has fallen short of the funding needed to support future annual infrastructure maintenance and to construct new facilities. In addition, the uncertainty of the amount of excess General Fund dollars is challenging the Town's ability to plan and deliver needed maintenance and capital improvements. This report identifies opportunities for new revenues that could be directed specifically to the Town's capital needs. The revenue options are organized into two categories: (1) Council authority to approve and (2) subject to voter approval. Establishing dedicated, reliable revenues to fund future capital needs is a solid budgeting and future planning practice which has been employed by many other cities.

BACKGROUND:

As discussed in a separate Council Agenda item regarding the Almond Grove streets project, one-time dollars are identified to fund the completion of that project. The one-time funds include the use of excess reserves and internal service funds (e.g., equipment replacement). This approach is not viable for other maintenance or capital improvements, and is only recommended for Almond Grove because the project is a top Council priority.

Cities across California are grappling with unfunded street maintenance. The Governor's Office recognizes this need and has proposed a framework and revenue package dedicated to transportation funding and the need to address the "crumbling" streets in this state. The proposal would allocate $1.8 billion to cities and counties for street maintenance complete street projects, public transit, and state-local partnerships. The proposal is being discussed at the time of the preparation of this report. If the proposal is approved, Los Gatos would receive approximately $500,000 annually for street maintenance. This money could be dedicated to the Almond Grove rehabilitation or other on-going street repairs and maintenance needs. There is also State legislation (ACA4) proposed to lower the approval threshold to a 55% majority for local agency transportation projects.

Reliable and dedicated revenue source(s) would enable the Town to plan and meets its existing and future infrastructure needs. This is consistent with a longstanding Town goal as highlighted in the Town's Capital Budget message, "Establishing a reliable, dedicated source of funding for basic capital improvements beyond the use of accumulated reserves remains a long-term need and important goal for the Town." Independent, Town controlled revenue source(s) also buffer Los Gatos from the political uncertainty that surrounds the availability of federal and state funding. Such funding would not be subject to State policy impacts.

DISCUSSION:

To fund capital projects, the Town of Los Gatos has consistently relied upon year-end savings which has averaged $2.5 million dollars annually. Other on-going capital funding sources include Road Impact Fees, Gas Tax, Traffic Mitigation revenue, Utility Undergrounding Fees, and Storm Drain revenues. The Town may also receive one-time grants and has approximately $350,000 in Community Benefit dollars which can be used under specified terms and conditions. With increasing costs and growing infrastructure needs, the Town Council directed staff to prepare a list of additional revenue options specifically dedicated to capital funding sources. The revenue options are organized into two categories: (1) Council authority to approve and (2) subject to voter approval.

At the September 15, 2015 Council meeting, staff will prepare an overhead exhibit listing all of the revenue options to assist the Council's discussion. After considering public testimony, the Council should identify which revenue option(s) it would like to explore further. If Council identifies one or more options requiring voter approval, staff recommends the formation of an Ad Hoc Citizen Committee to work with staff as discussed later in this report.

Revenue Options under the Council's Approval Authority

Staff has identified seven revenue options that Council has authority to enact by majority vote after due notice:

- Sale or Lease of Property
- Taxation of Short-Term Vacation Rentals
- Commercial Property Business License
- Business License Tax Audit and Amnesty Program
- Sidewalk Repair Cost Sharing
- Change in Refuse Vehicle Impact Fee
- Certificates of Participation

Sale or Lease of Property
The Town owns four properties that have could potentially be sold or leased, generating approximately $4 million to $10 million one-time funds or $325,000 to $655,000 in on-going annual lease revenue.

Sale or Lease of Property		
Property	**Market Value One-time Revenue**	**Rental Rate On-going Annual Revenue**
14850 Winchester Avenue	$1,800,000 - $4,000,000	$155,000*
4 New York Avenue (Venue)	$700,000- $2,500,000	$50,000-$175,000
75 Church Street (Forbes Mill)	$550,000 - $1,000,000	$50,000 - $100,000
4 Tait Avenue (Museum)	$1,000,000 - $2,500,000	$70,000 - $225,000
Total	**$4,050,000 - $10,000,000**	**$325,000 - $655,000**

*Only one rentable lot

DISCUSSION (cont'd):

Town owned properties located at 20 Dittos Lane and 225 W. Main Street have Below Market Price (BMP) housing requirements and therefore have not been considered for capital funding purposes. Council may direct the sale or lease of any or all of these properties and earmark funds to the General Fund Appropriated Reserve (GFAR) Capital Projects Fund, either for a specific project or general capital funding.

Taxation of Short-Term Vacation Rentals

Under Town Code, short-term vacation rentals are not currently permitted within the Town of Los Gatos. Short-term vacation rentals are typically defined as a dwelling unit, other than a dwelling unit located in a hotel, that is rented to a tenant for a period of not more than 30 consecutive days. With the advent of independent online booking websites such as Airbnb.com, municipalities are experiencing a trend in what is being described as an emerging "peer-to-peer" economy. In these "peer-to-peer" economics, owners rent out something they are not using, such as a house, to a stranger on a short-term basis. The Town of Los Gatos does not currently permit these short-term vacation rentals, however has received a handful of inquiries during the summer of 2015 about how to legally register short-term rentals as businesses within the Town. Many jurisdictions are currently grappling with how to treat these types of rentals, local examples being the City of San Jose and San Francisco. The Town could consider permitting these rentals thereby requiring a short-term vacation rental permit, Business License Tax and Transient Occupancy Tax (TOT).

Should Council wish to pursue this funding source further staff would request additional time to draft Town Code language permitting short-term rentals and identifying appropriate fee structures for permits and business license tax. At this point staff estimates permitting short rentals could result in at least $100,000 in additional revenue annually.

Council has the following options for short-term vacation rentals:

1. Change Town Code and authorize short-term vacation rentals within Town limits, or within designated districts, or
2. Maintain current practice of not permitting short-term vacation rentals

Commercial Property (Landlord) Business License

In enforcement of the Town's business license tax program, commercial property owners are not required to pay a business license tax since the tenant of the commercial property is required to have a business license for their business operating out of the commercial property. Taxing the commercial property owner could be considered a double tax of the property. However in practice, taxing commercial property owners would be taxing rental revenue derived from that building, whereas the tenant of the building is required to pay a business license tax on their business. Staff surveyed fourteen Santa Clara County jurisdictions and found that four, Los Altos, Milpitas, San Jose and Sunnyvale, tax commercial properties. The tax charged ranges from a $35 annual fee in Milpitas and a maximum annual fee of $5,000 in San Jose (based on square feet). Staff estimates taxation of commercial property owners could result in at least $100,000 in additional business license tax revenue annually.

DISCUSSION (cont'd):

Council has the following options for taxation of commercial property owners:

1. Maintain current practice, not requiring business license taxation for commercial property owners, or
2. Authorize staff to enforce business license taxation of commercial property owners. Staff would recommend fees be charged for FY 2015/16 forward. No Town Code change is required.

Business License Tax Audit and Amnesty Program

All businesses operating within the Town of Los Gatos are required to pay a business license tax. There are approximately 3,200 businesses operating within the Town and during the summer of 2015 staff audited 23% of these businesses to assess the Town's exposure to non-licensing. Based on this audit, staff found that approximately 8% of businesses are operating without a valid business license. Since business license tax varies depending on the classification of the business, (i.e. retail, service, professional, etc.), it is difficult to determine the lost revenue from these non-licensed businesses.

The Town could elect to initiate a Business License Amnesty program, in which staff would mail notification letters to all Town addresses outlining the requirement for obtaining a business license and offering a penalty free period of time for anybody with past tax due to the Town to bring their license current without penalty. This would generate one-time money as well as on-going revenue as the business would then be captured in the Town's database for future collection.

Amnesty programs often work best when combined with a business license audit. The audit completed during the summer only captured business operating out a business location within the Town. Home-based businesses are difficult to identify and were not part of the scope of the audit completed this summer. There are a variety of independent companies that perform contract business license audit services. Saratoga, San Jose and Campbell have all conducted business license audits with varying success. The City of Saratoga hired an outside consultant to complete their business license audit and estimated to receive approximately $150,000 in additional tax revenue. City of Saratoga did not offer an amnesty program and did advise that they received significant complaints from the community during the audit process. If Council wishes to pursue a business license audit further, staff recommends a request for proposal (RFP) be issued to identify a vendor to provide these services.

Council has the following four business license tax options:

1. Offer a Business License Amnesty Program only,
2. Conduct a Business License Audit and offer a Business License Amnesty Program,
3. Issue an RFP for a service provider and conduct a Business License Audit only, or
4. Maintain current in-house enforcement of business license program.

Sidewalk Repair Cost Sharing

The Town of Los Gatos currently operates a sidewalk replacement service to residents at no cost. Some municipalities in Santa Clara County (SCC) offer these programs with a cost-sharing attribute. For example, the City of Gilroy requires a 50% cost sharing while San Jose requires residents to pay the full cost of sidewalk replacement.

DISCUSSION (cont'd):

The Town currently expends approximately $300,000 annually for residential sidewalk repairs. With residents sharing 50% of the costs, the Town could receive an additional $150,000 in revenue annually. Cost-sharing programs require significant administrative support at an estimated cost of $70,000 annually. Therefore, a 50% cost sharing agreement for residential sidewalk replacement would likely result in approximately $80,000 in annual revenues that could be allocated for other capital improvements.

Council may direct staff to further pursue a cost sharing arrangement for sidewalks repairs. The Council may also indicate an initial percentage or range of cost sharing percentages as this option is explored further.

Change in Refuse Vehicle Impact Fee

West Valley Collection and Recycling (WVCR) submits proposed rates to the West Valley Solid Waste Management Authority (WVSWMA) on an annual basis. The WVSWMA votes to ratify the proposed rates [including a consumer price index (CPI) increase for collection services], new increased fees assessed by other agencies, new services, and any fees requested by local agencies. Staff recommends requesting an increase in Refuse Vehicle Impact fees for the next three years of $120,000 annually to more fully recapture the damage incurred to Town streets by refuse vehicles. The Town's recommended fee increase is based on the Refuse Vehicle Street Maintenance Cost Analysis study completed by the Town in spring 2015. These fees would be incorporated into the WVCR's fee calculation and recommendation submitted to the WVSWMA Board for ratification.

The WVSWMA is a four member Joint Powers Authority (JPA) and rates are considered at a public meeting, requiring three votes to ratify. The Town Council could elect to specifically designate these dollars to the fund capital projects. Three of the West Valley cities, Campbell, Saratoga and the Town of Los Gatos dedicate Refuse Vehicle Impact Fee revenues to infrastructure repairs and maintenance. This is an option that Council may affirmatively select for further exploration.

Certificates of Participation

The Town has in the recent past issued Certificates of Participation (COP), including approximately $15 million in 2010 for the new Library and $10 million in 2002 for Downtown Street and Park improvements. These certificates were passed with a simple majority vote. The annual debt service of approximately $2 million per year was secured by a lease with the Town's Redevelopment Agency. The result being that no ongoing Town revenues like sales or property tax was needed to fund the annual debt service. With the loss of the Town's Redevelopment Agency in 2012, this mechanism for funding is no longer available. If a new COP were to be considered by the Town, an ongoing funding source (e.g., parcel tax, increased sales tax, or increased transient occupancy tax) would need to be identified to make the annual debt service payment out of Town's annual operating budget.

DISCUSSION (cont'd):

Revenue Options Subject to Voter Approval

Local agencies may impose taxes, subject to voter approval, using a variety of methods. Pursuant to Proposition 218, these taxes are classified as either "general" or "special."

Whether the ballot measure requires a simple majority (50% + 1 vote) or a super majority (two-thirds of those voting in the affirmative) depends upon the ballot language and whether the question is placed upon the ballot as a general tax increase or a special tax increase

A "general tax" may be used for any public purpose — the funds are fully discretionary and may be deposited into the General Fund. A majority vote (50%+1) of the electorate is required to impose, increase, or extend a general tax.

A "special tax" is a tax imposed for a specific purpose. For example, some cities dedicate tax revenues for the payment of law enforcement or street maintenance costs rather than using the taxes for the general operations of government. A two-thirds majority of voters is required to impose, increase, or extend a tax for a specific purpose. Special tax revenues must be accounted for in a separate fund.

General taxes may only be put on the ballot at the same general election when the Town Council election is held, unless the Council unanimously finds that there is an urgent need to impose the tax measure. Upon such unanimous declaration, the general tax measure may be put before the voters at a special election. Special taxes may be placed before the electorate at any time, either during a general election or in a special election.

If Council would like to move forward with any of these initiatives, staff recommends that the Council establish an Ad Hoc Citizen Committee with two Council Members and three Los Gatos residents to work with staff to study the issues, seek public input (including a community survey), and report back to Council with a recommendation and drafted ballot language, if any. Staff's recommended timeline is as follows:

March 2016 – Citizen Committee presents report and draft language to Council
April 2016 – Further Consideration by Town Council of draft language for ballot measures and authorizing Ordinances and Council Resolution
June 2016 – Approval of Town Council Resolution placing revenue generating measure on November 2016 election

Any initiative passing with a vote of the electorate would begin to generate additional revenue for the Town in January 2017.

DISCUSSION (cont'd):

The following six new revenue options, all requiring voter approval, have been identified for Council consideration:

- Assessment Districts
- Utility User Tax (UUT)
- Increased Transient Occupancy Tax (TOT)
- Increased Sales Tax
- Parcel Tax – General or Special
- General Obligation Bonds

To the extent possible, staff has gathered information from in-county jurisdictions to provide comparative information for Council to use in assessing new taxing mechanisms for the Town.

Assessment Districts

An Assessment District is a special district that includes property that will receive direct benefit from new public improvements or from the maintenance of existing public improvements. The most common types of assessments are for roads, storm water, parks, landscaping, and street lighting. Formation of an Assessment District requires voter approval, which must be done in the form of a mailed ballot. Assessment Districts require that at least as many ballots (as weighed by the amount of the assessment against the parcel submitting the ballot) are returned in favor of the assessment as are returned in opposition to the assessment.

Each property is assessed a certain amount based on the percentage of benefit received by the property. Factors that determine the amount of benefit received may include the size of the lot or the proximity to the improvement being financed. The collection of the assessment charges occurs through County property tax collections, and is earmarked for the special assessment district as defined. Unless specified by a sunset clause, the collection will continue into the future at a minimum growth allowable by Proposition 13. A CPI (consumer price index) may also be added to the collection so as to keep revenues growing at a rate equal to expenditures.

Utility User Tax (UUT)

Government Code Section 37100.5 authorizes cities to collect a utility user's tax on electric, gas, cable television, water, and telephone services. The tax is collected by the utility as part of its regular billing and then remitted to the Town. The tax rate set by the Town Council is typically defined by the voter referendum used to authorize the tax. Statewide, there are approximately 150 cities and 4 counties with UUTs. The particular utility to which the tax is applied varies. In some cities, different rates apply to residential versus commercial users. The most common rate is 5%, applied broadly among many types of utilities. The average rate is 5.5%. Most large cities have UUTs, meaning roughly half of California residents and businesses pay a utility user tax.

DISCUSSION (cont'd):

An UUT may be imposed as a special tax earmarked for a specific purpose. However, all California cities impose the UUT as a general tax to be used for a variety of municipal service needs.

The Town of Los Gatos does not have any UUT's, however some in-county jurisdictions do impose UUTs. Staff's survey of the 14 in-county jurisdictions found that:

- **Intrastate Only Telephone UUT** – City of Sunnyvale imposes a 2% tax and is the only Santa Clara County (SCC) jurisdiction to do so.
- **Telephone UUT** – Imposed by Cupertino, Los Altos, Palo Alto, San Jose, Gilroy and Mountain View at rates ranging between 2.4% in Cupertino to 4.75% in Palo Alto.
- **Electricity UUT** – Imposed by Cupertino, Los Altos, Palo Alto, San Jose, Gilroy, Mountain View and Sunnyvale at rates ranging between 2.0% in Sunnyvale to 5.0% in Palo Alto, San Jose, and Gilroy.
- **Gas UUT** - Imposed by Cupertino, Los Altos, Palo Alto, Gilroy, Mountain View, San Jose, and Sunnyvale at rates ranging between 2.0% in Sunnyvale to 5.0% in Palo Alto, San Jose, and Gilroy.
- **CATV UUT** – Imposed by Cupertino, Los Altos, and Gilroy at rates ranging between 2.4% in Cupertino to 4.5% in Gilroy.
- **Water UUT** – Imposed by Cupertino, Los Altos, Palo Alto, and San Jose at rates ranging between 2.4% in Cupertino to 5.0% in both Palo Alto and San Jose.

The Town could generate approximately $2,000,000 in additional revenue should UUT's be imposed for telephone, gas, electricity and water.

Increased Transient Occupancy Tax (TOT)

The Town currently collects TOT at a rate of 10% per rental by all entities renting lodging for 30 days or less. Those taxes are remitted monthly or quarterly to the Town, and that revenue stream accounts for 4.0% of the General Fund revenues, budgeted for $1.5 million for FY 2015/16. An increase from the current 10% to 11% will result in approximately $150,000 annually in increased TOT revenues. An increase to 12% would result in approximately $300,000 annually in increased TOT revenues.

The average TOT in SCC is 11%, with Palo Alto being the highest at 14%, followed by Campbell and Cupertino at 12%. The City of Gilroy has the lowest TOT at 9%. Because TOT taxes short-term rentals, it is primarily non-residents who pay this tax.

A TOT may be imposed as a special tax earmarked for a specific purpose. However, all other cities in California impose the TOT as a general tax to be used for a variety of municipal service needs at the discretion of the Town Council.

DISCUSSION (cont'd):

Increased Sales Tax

California has many special taxing jurisdictions (districts), which are funded by a transaction (sales) and use tax rate that is added to the standard statewide rate of 7.50%. The tax rates for these districts range from 0.10% to 1.0% per district. In some areas, there is more than one district tax in effect (Capitola, El Cajon, El Cerrito, Eureka, Ft Bragg, Nevada Town, Placerville, Santa Rosa, Sebastopol and Woodland). In others, there is no district tax in effect. The Town of Los Gatos does not have a sales tax add-on. An increase in sales tax would minimize the burden on local residents because those who visit the community pay approximately one-third of sales taxes paid within the Town.

A Sales Tax increase may be imposed at a rate of 0.25% or a multiple thereof. The ordinance proposing the tax must be approved by majority vote of the voters in the city if the tax is for general purposes or two-thirds vote of all members of the governing body if the tax is for a specific purpose. The maximum combined rate of transactions and use taxes in any location may not exceed 2%. Currently, Santa Clara County has transactions and use tax in the amount of 1.25%.

The City of Campbell is the only SCC jurisdiction that has a Sales Tax add-on at 0.25%. With a 0.25% add-on the Town is estimated to generate approximately $2,000,000 in additional sales tax revenue annually.

Parcel Tax – General or Special

A parcel tax (otherwise known as a property-tax override) is a special non-ad valorem (non-value based) tax on parcels of property generally based on either a flat per-parcel rate or a variable rate depending on the size, use, or number of units on the parcel. However, since this tax is not based on the value of the property, it is a "fixed" tax. Parcel taxes require two-thirds voter approval and are imposed for any number of purposes, including funding police and fire services, clean water watershed management and flood control, and neighborhood improvement and revitalization. There are approximately 10,000 taxable parcels in the Town. Therefore a $100 parcel tax would generate approximately $1.0 million in new revenue which could be designated for capital projects.

General Obligation Bond

General Obligation (GO) bonds are secured by a pledge of revenues legally available to the municipality. The bonds are typically secured by an annual property tax levy on real property equal to the annual debt service on the bonds. As the property tax levy on real property is considered to be the most secure of debt issuances a municipality can make, the ratings for GO bonds are usually the highest rated bonds a city can issue. The higher ratings lowers the cost of borrowing (interest rate paid to the bondholders), which can lead to greater amounts issued at a lower cost. The bonds are a "general obligation" and as such the levy is usually made against all taxable properties in the city.

CONCLUSION:

While the Town's solid financial status allows for the use of some existing reserves to fund specific projects such as Almond Grove street rehabilitation project in the short-term, the need for reliable ongoing sources of funds for other street improvements, street lighting, utility replacements, building maintenance, etc. warrant a review of the above new sources and serious consideration of an action plan to generate additional capital improvement and related maintenance funds. Other jurisdictions have done so. Therefore, staff recommends the following:

1. Identify specific funding options for further exploration.

2. If specific funding options requiring voter approval are identified by the Town Council, establish an Ad Hoc Citizen Committee with two Council members and three Los Gatos residents to conduct the exploration of the funding options; and

3. Appoint two Council members to the newly formed Ad Hoc Citizen Committee and initiate a recruitment for the resident members of the Committee with the intention of interviewing and selecting members at or before the October 20, 2015 Town Council meeting.

COORDINATION:

The preparation of this report was done in coordination with staff from the Department of Finance, Town Manager's Office, Town Attorney, and Department of Parks and Public Works.

FISCAL IMPACT:

A variety of on-going new revenue sources have been identified for Town Council consideration. Depending on which revenue sources are identified for further consideration, new dedicated capital projects revenues of $1 million to $4 million dollars annually.

ENVIRONMENTAL ASSESSMENT:

This item is not a project defined under CEQA, and no further action is required.

TOWN OF LOS GATOS
COUNCIL FINANCE COMMITTEE REPORT

MEETING DATE: 06/17/2019
ITEM NO: 2
DESK ITEM

DATE: JUNE 17, 2019

TO: COUNCIL FINANCE COMMITTEE

FROM: STEPHEN CONWAY, FINANCE DIRECTOR

SUBJECT: REVIEW AND PROVIDE RECOMMENDATIONS FOR FUTURE REVENUE OPPORTUNITIES FOR THE TOWN OF LOS GATOS

REMARKS:

Attachment 2 contains public comments received between Friday 11:01 a.m. June 14, 2019 and Monday 11:00 a.m. June 17, 2019.

Attachment (previously distributed with the Staff Report):
1. September 15, 2015 Staff Report

Attachment received with this Desk Item:
2. Public Comments Received between Friday 11:01 a.m. June 14, 2019 and Monday 11:00 a.m. June 17, 2019

PREPARED BY: STEPHEN CONWAY
Finance Director

Reviewed by: Town Manager, Assistant Town Manager, and Town Attorney

Subject: Finance Committee agenda item #2 - does Town lack enough general revenue sources to fully fund it capital needs?

Attachments: GFAR FY2020.pdf; ATT00001.htm; GFAR FY 2016.pdf; ATT00002.htm

From: Phil Koen <pkoen@monteropartners.com>
Date: June 16, 2019 at 9:11:41 AM PDT
To: "sleonardis@losgatosca.gov" <sleonardis@losgatosca.gov>, "bspector@losgatosca.gov" <bspector@losgatosca.gov>, "tduryea@aol.com" <tduryea@aol.com>, "rnt97@yahoo.com" <rnt97@yahoo.com>
Cc: "jvannada@gmail.com" <jvannada@gmail.com>, "leefagot@gmail.com" <leefagot@gmail.com>, "lprevetti@losgatosca.gov" <lprevetti@losgatosca.gov>, "aandrews@losgatosca.gov" <aandrews@losgatosca.gov>, "sconway@losgatosca.gov" <sconway@losgatosca.gov>
Subject: Finance Committee agenda item #2 - does Town lack enough general revenue sources to fully fund it capital needs?

Dear Finance Committee Members,

The underlying assumption presented in the Staff report for agenda item #2 is the Town has insufficient revenue sources to fund its capital plan. To support this the statement is made that there is a backlog of deferred maintenance projects, but no data is provided to inform us as to the validity of this claim.

Where is the list of these deferred maintenance projects? How much is required and in what timeframe? What is the negative impact on the Town of having deferred maintenance? Was this deferred maintenance problem vetted during the just completed budget cycle?

Before this Committee spends anytime on trying to identify additional taxes to levy on the Town's already heavily taxed residents, it would be more appropriate for the Committee to examine how effectively the Town is deploying its current revenue resources to fund its capital needs and if there are reasonable opportunities to redeploy the Town's massive GFAR funds. Let's not forget that the Town just implemented a sales tax which was sold to the voters based on the ability to generate $800k in additional revenue for critical infrastructure needs.

I have attached the approved GFAR programs for the FY 2016 and FY 2020 budgets. Comparing the GFARs is eye opening. If we exclude the Almond Grove project from both GFARs, you will find that the total project dollars committed by the Town has increased 82% in five years! The FY 2016 GFAR budget programmed on an adjusted basis $9.3m for capital projects. The FY 2020 GFAR budget programmed $16.9m on the same basis. The conclusion here is that the Town had no problem identifying an incremental $7.6m in funds to budget these incremental projects. Remember that when a project is opened in the GFAR, that project must be fully funded.

To drive this point home, let's also compare the total GFAR revenue sources that were budgeted in FY 2016 vs. FY 2020. In FY 2016, the total revenue for the GFAR was $1.4m with $600k coming from General Fund transfers. In FY 2020 the total revenue for the GFAR was $11.7m with $7m being transferred from the General Fund. That is an increase of $10.2m with 65% of this being funded by the General Fund.

The conclusion here is the Town has more than enough general revenue sources to fund an 82% increase in GFAR projects. The fact that this revenue flows to the Town through various general revenue tax sources as opposed to a dedicated source is the important point. Simply because there isn't a

ATTACHMENT 2

"dedicated revenue source" doesn't mean the Town is suffering from a lack of total revenue available to fund the GFAR.

This Committee's time and expertise will be wasted if it focuses on identifying additional tax revenue sources when there is no evidence to suggest the Town has insufficient revenue to address its capital needs. Rather, the Committee should inspect the current approved projects in the GFAR to determine if some of these projects should be cancelled to free up funds for more valuable projects and address the backlog of deferred maintenance.

Thank you.

Phil Koen

Sent from my iPad

GENERAL FUND APPROPRIATED RESERVES (GFAR)
STATEMENT OF SOURCE AND USE OF FUNDS

	Adjusted Budget 2014/15	Estimated 2014/15	Budget & Carryfwd 2015/16	Proposed 2016/17	Proposed 2017/18	Proposed 2018/19	Proposed 2019/20
SOURCE OF FUNDS							
Beginning Fund Balance							
Designated for Parking	$ 1,460,210.00	$ 164,210.00	$ 164,210.00	$ 164,210.00	$ 164,210.00	$ 164,210.00	$ 164,210.00
2002 COP Construction and Acq Fund	38,256	38,256	38,256	38,256	38,256	38,256	38,256
Reserved for Comcast PEG	45,234	45,234	45,234	45,234	45,234	45,234	45,234
Unrestricted	6,758,627	6,758,627	13,411,403	1,540,000	1,193,124	866,248	692,248
Total Beginning Fund Balance	$ 8,302,327	$ 7,006,327	$ 13,659,103	$ 1,787,700	$ 1,440,824	$ 1,113,948	$ 939,948
Revenues							
Construction Impact Fees	$ 80,000	$ 523,181	$ 288,000	$ 288,000	$ 288,000	$ 288,000	$ 288,000
Refuse Vehicle Road Impact Fee	102,000	102,000	238,000	102,000	102,000	102,000	102,000
General Plan Update Reimbursement	-	51,000	-	-	-	-	-
Oak Meadow Gazebo- Community Contribution	10,000	1,000	-	-	-	-	-
Developer's Contribitions	78,000	-	78,000	78,000	78,000	78,000	78,000
Cost sharing - curbs & gutters	10,000	79,805	10,000	10,000	10,000	10,000	10,000
Cost sharing - traffic calming	10,000	-	10,000	10,000	10,000	10,000	10,000
Friends of the Library Pledge	-	397,000	-	-	-	-	-
Little League Contribution to BHP Backstop	-	-	25,000	-	-	-	-
Measure B Funding	329,078	183,262	160,000	160,000	160,000	160,000	160,000
Operating Transfers In	8,115,274	8,153,487	600,000	400,000	400,000	400,000	400,000
Total Revenues	$ 8,734,352	$ 9,490,735	$ 1,409,000	$ 1,048,000	$ 1,048,000	$ 1,048,000	$ 1,048,000
TOTAL SOURCE OF FUNDS	$ 17,036,679	$ 16,497,062	$ 15,068,103	$ 2,835,700	$ 2,488,824	$ 2,161,948	$ 1,987,948
USE OF FUNDS							
Total Completed Projects	$ 613,256	$ 549,611	$ -	$ -	$ -	$ -	$ -
Carryforward Projects							
Town Beautification Projects	10,160	-	10,160	-	-	-	-
Audio / Video System Upgrade	58,160	-	58,160	-	-	-	-
Information System Upgrade	83,169	8,784	74,385	-	-	-	-
Tiburon CAD / RMS Upgrade	42,000	-	42,000	-	-	-	-
Town-wide Document Imaging Project	21,775	-	21,775	-	-	-	-
Town Digital Aerial Photo/Topographic Map	88,000	-	88,000	-	-	-	-
Building Replacement at Corporation Yard	20,000	-	420,000	-	-	-	-
HVAC Upgrades - Old Library	643,379	-	38,995	-	-	-	-
Old Library Re-use Project	901,062	604,384	8,553	-	-	-	-
Former Library Roof Improvements	-	892,509	90,000	-	-	-	-
Fuel System Enhancement	-	-	75,000	-	-	-	-
Police Interoperability Radio Project	150,000	-	150,000	-	-	-	-
Engineering Document Archiving	20,000	-	40,000	20,000	-	-	-
Civic Center Energy Assessment	25,000	-	25,000	-	-	-	-
PPW Interoperability Radio Project	150,000	-	150,000	-	-	-	-
Street Repair & Resurfacing	774,603	6,638	1,292,965	525,000	525,000	525,000	525,000
Annual Street Restriping	80,878	-	105,878	25,000	25,000	25,000	25,000
Traffic Calming Projects	36,152	19,000	27,152	10,000	10,000	10,000	10,000
Curb, Gutter & Sidewalk Maintenance	329,585	2,950	576,635	250,000	250,000	250,000	250,000
Pavement Rehabilitation - Crack Seal	329,078	-	489,078	160,000	160,000	160,000	160,000
Retaining Wall Repairs	771,324	350,066	521,258	100,000	100,000	100,000	100,000
Quito Road - Bridge Replacement	299,681	-	299,681	-	-	-	-
Almond Grove Street Rehabilitation	3,912,583	173,320	3,739,263	-	-	-	-
Hillside Road Repair & Resurfacing	111,000	-	111,000	-	-	-	-
Guardrail Replacement Projects	223,625	125,680	97,945	-	-	-	-
Electrical Panel Replacement on Pageant Way	45,000	-	45,000	-	-	-	-
224 W. Main Street Property Acquisition (Parking Lot 6)	1,196,000	-	1,196,000	-	-	-	-
Downtown Parking Lots Seal Coat & Restriping	100,000	-	100,000	-	-	-	-
Monument Control Network Update	20,000	-	20,000	-	-	-	-
Downtown Parking Signs Enhancements	-	-	50,000	-	-	-	-
Shannon/LGB/ Cherry Blossom Sidewalk Improvements	20,000	-	130,000	-	-	-	-
Stonybrook & Kennedy Sidewalk Improvements	40,000	-	300,000	-	-	-	-
Parking Lot 4	50,000	-	400,000		-	-	-
Intersection Safety & Traffic Flow Improvements	50,000	-	50,000	-	-	-	-
Sidewalk Improvements - Multiple Locations	60,000	-	60,000	-	-	-	-
Oak Meadow Park Upgrades	30,000	-	330,000	-	-	-	-
Open Space Trail Upgrades	250,000	-	250,000	-	-	-	-
Parks Playground Fiber Project	26,603	3,016	48,587	25,000	25,000	25,000	25,000
Plaza Park Improvements	37,000	-	37,000	-	-	-	-
Blossom Hill Park Restroom Building Upgrades	40,000	-	40,000	-	-	-	-
Park Rehabilitation - Bachman Park	225,000	-	325,000	-	-	-	-
Blossom Hill Park Upgrades to OMP Park	30,000	-	30,000	-	-	-	-
New Projects				-	-	-	-
Silicon Valley Interoperability Project (SVRIP) Service Fee	-	-	152,876	152,876	152,876	-	-
Civic Center Improvements	-	-	150,000	-	-	-	-
Energy Efficiency Upgrades - Town-wide	-	-	-	25,000	25,000	25,000	-
Crosswalk Lighting Upgrade	-	-	50,000	-	-	-	-
Crosswalk Improvements at Santa Cruz/Blossom Hill	-	-	60,000	-	-	-	-
Pegeant Way Parking Lot Reconstruction	-	-	175,550	-	-	-	-
Montebello Way Island Removal	-	-	19,550	-	-	-	-
LED Streetlights	-	-	400,000	-	-	-	-
Los Gatos Creek Trail Improvements at Charter Oaks	-	-	30,000	-	-	-	-
Worcester Park	-	-	28,150	-	-	-	-
Blossom Hill Park Little League Backstop	-	-	50,000	-	-	-	-
Total Project Expenditures	$ 11,914,073	$ 2,735,959	$ 13,080,595	$ 1,292,876	$ 1,272,876	$ 1,120,000	$ 1,095,000
Operating Transfers Out							
Traffic Impact Transfer to GF	$ 102,000	$ 102,000	$ 199,808	$ 102,000	$ 102,000	$ 102,000	$ 102,000
Total Operating Transfers Out	$ 102,000	$ 102,000	$ 199,808	$ 102,000	$ 102,000	$ 102,000	$ 102,000
Ending Fund Balance							
Designated for Parking	$ 164,210	$ 164,210	$ 164,210	$ 164,210	$ 164,210	$ 164,210	$ 164,210
2002 COP Construction and Acq Fund	38,256	38,256	38,256	38,256	38,256	38,256	38,256
Reserved for Comcast PEG	45,234	45,234	45,234	45,234	45,234	45,234	45,234
Unrestricted	4,772,905	13,411,403	1,540,000	1,193,124	866,248	692,248	543,248
Total Ending Fund Balance	$ 5,020,606	$ 13,659,103	$ 1,787,701	$ 1,440,824	$ 1,113,948	$ 939,948	$ 790,948
TOTAL USE OF FUNDS	$ 17,036,679	$ 16,497,062	$ 15,068,103	$ 2,835,700	$ 2,488,824	$ 2,161,948	$ 1,987,948

GENERAL FUND APPROPRIATED RESERVES (GFAR)
STATEMENT OF SOURCE AND USE OF FUNDS

	Adjusted Budget 2018/19	Estimated 2018/19	Budget & Carryfwd 2019/20	Proposed 2020/21	Proposed 2021/22	Proposed 2022/23	Proposed 2023/24
SOURCE OF FUNDS							
Beginning Fund Balance							
Designated for Parking	$ 1,460,210	$ 154,025	$ 308,050	$ 154,025	$ 154,025	$ 154,025	$ 154,025
Reserved for Comcast PEG	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Reserved for Almond Grove	5,571,087	-	-	-	-	-	-
VTA Vehicle Registration Fees	606,936	-	-	-	-	-	-
Unrestricted	4,486,827	11,971,035	9,398,371	1,410,832	1,136,216	886,600	611,984
Total Beginning Fund Balance	$ 12,175,060	$ 12,175,060	$ 9,756,421	$ 1,614,857	$ 1,340,241	$ 1,090,625	$ 816,009
Revenues							
Construction Impact Fees	110,000	104,794	110,000	110,000	110,000	110,000	110,000
Refuse Vehicle Road Impact Fee	493,429	287,834	619,553	745,676	871,800	871,800	871,800
School Busing Fare Revenue	20,160	20,880	46,500	-	-	-	-
Developers Contributions	78,000	-	78,000	78,000	78,000	78,000	78,000
Cost Sharing - Curbs & Gutters	10,000	47,173	10,000	10,000	10,000	10,000	10,000
Cost Sharing - Traffic Calming	10,000	-	10,000	10,000	10,000	10,000	10,000
Slurry Seal	-	11,280	-	-	-	-	-
Pavement Rehab-Crack & Seal - Measure B Funding	180,000	188,475	180,000	180,000	180,000	180,000	180,000
Other Contributions - City of Campbell	130,000	-	-	-	-	-	-
Other Contributions - City of San Jose	-	110,771	-	-	-	-	-
Misc CIP refund	-	28,290	-	-	-	-	-
Misc Operating Revenue	51,000	-	-	-	-	-	-
In kind for Oak Meadow Park Exercise Equipment	30,000	-	30,000	-	-	-	-
2016 Measure B Funding	1,161,326	-	1,741,989	580,663	580,663	580,663	580,663
Albright Development Fee (9901)	182,470	486,461	350,000	-	-	-	-
PG&E Financing for Energency Efficiency Upgrades (2008)	1,439,995	-	1,439,995	-	-	-	-
Operating Transfers In							
From General Fund	2,335,220	2,335,220	5,557,500	550,000	550,000	550,000	550,000
From Open Space Reserve	-	-	152,000	-	-	-	-
From Library Trust Funds	51,111	21,048	20,755	-	-	-	-
From Equipment Replacement	-	-	525,000	-	-	-	-
From IT Fund	300,000	300,000	-	-	-	-	-
From Facility Maintenance	50,000	50,000	788,000	-	-	-	-
Total Revenues	$ 6,632,711	$ 3,992,225	$ 11,659,292	$ 2,264,339	$ 2,390,463	$ 2,390,463	$ 2,390,463
TOTAL SOURCE OF FUNDS	$ 18,807,771	$ 16,167,285	$ 21,415,713	$ 3,879,196	$ 3,730,704	$ 3,481,088	$ 3,206,472
USE OF FUNDS							
Total Completed Projects	$ 1,284,169	$ 379,885	$ -	$ -	$ -	$ -	$ -
Carryforward Projects							
Open Space Trail Upgrades	152,000	-	152,000	-	-	-	-
Parks Playground Fibar Project	36,540	-	36,540	25,000	-	25,000	-
Forbes Mill Footbridge Improvements	73,729	2,227	71,502	-	-	-	-
Charter Oaks Trail Repair Project	15,000	109	364,891	-	-	-	-
Creek Trail & Parks Path & Parking Lot Seal & Striping	225,000	-	225,000	-	-	-	-
Town Plaza Turf Repairs	28,000	-	28,000	-	-	-	-
Outdoor Fitness Equipment	60,000	-	60,000	-	-	-	-
Trailhead Connector	44,440	-	44,440	-	-	-	-
Building Replacement at Corporation Yard	149,108	149,000	975,108	25,000	25,000	25,000	25,000
Neighborhood Emergency Preparedness	50,000	5,910	44,090	-	-	-	-
Library Carpet Replacement	56,500	-	56,500	-	-	-	-
Energy Efficiency Upgrade - Town-wide	1,697,039	1,000,000	697,039	-	-	-	-
Facilities Assessment	80,000	-	80,000	-	-	-	-
Information System Upgrade	180,579	7,794	172,785	-	-	-	-
Audio/Video System Upgrade	42,552	-	42,552	-	-	-	-
Town-wide Document Imaging Project	16,990	-	16,990	-	-	-	-
Engineering Document Archiving	51,716	40,000	11,716	-	-	-	-
Town Beautification	15,000	8,114	16,886	10,000	10,000	10,000	10,000
Silicon Valley Regional Interoperability Project (SVRIP) Service	65,489	1,888	63,601	-	-	-	-
EOC Communications Upgrade	50,000	20,411	29,589	-	-	-	-
IT Disaster Recovery Improvements	200,000	-	200,000	-	-	-	-
Street Repair & Resurfacing	2,482,289	750,760	4,759,245	1,626,339	1,752,463	1,752,463	1,752,463
Annual Street Restriping	119,772	-	144,772	25,000	25,000	25,000	25,000
Traffic Calming Projects	48,286	38,787	19,499	10,000	10,000	10,000	10,000
Curb, Gutter & Sidewalk Maintenance	509,153	172,040	1,237,113	300,000	300,000	300,000	300,000
Retaining Wall Repairs	393,340	56,216	437,124	100,000	100,000	100,000	100,000
Quito Road - Bridge Replacement	235,087	-	235,087	-	-	-	-
Almond Grove Street Rehabilitation	5,571,087	3,069,386	2,501,701	-	-	-	-
Guardrail Replacement Projects	93,043	-	93,043	-	-	-	-
Cut-Through Traffic/Wood Road Roundabout	143,676	57,380	86,296	-	-	-	-
Downtown Parking Lots Seal Coat & Restriping	75,085	-	75,085	-	-	-	-
224 W. Main Street Property Acquisition (Parking Lot 6)	1,231,100	-	1,231,100	-	-	-	-
Downtown Parking Study	200,000	-	200,000	-	-	-	-
Sidewalk Improvements Shannon/LGB/Cherry Blossom	129,896	-	129,896	-	-	-	-
Sidewalk Improvements - Multiple Locations	60,000	-	60,000	-	-	-	-
One-Way Downtown Street Pilot	238,686	13,000	225,686	-	-	-	-
Pilot School Busing Program	414,180	350,216	63,964	-	-	-	-
Bicycle & Pedestrian Improvements	538,550	22,728	815,822	-	-	-	-
Stormwater Master Plan	200,000	-	200,000	-	-	-	-
Stormwater System - Pollution Prevention Compliance	300,000	1,422	298,578	-	-	-	-
Public Art Gateway	25,000	-	25,000	-	-	-	-
Police Headquarters Roof Repair	50,000	-	50,000	-	-	-	-
New Projects							
Vegetation Management - Town-wide	-	-	200,000	-	-	-	-
Fence Replacement - Shire Court	-	-	60,000	-	-	-	-
ADA Upgrade for Public Restrooms - Rec Building	-	-	183,000	-	-	-	-
Fire Suppression (Halon) for Server Rooms	-	-	200,000	-	-	-	-
Plaza Level Railings - Code Upgrade	-	-	30,000	-	-	-	-
Waterproofing Town-wide	-	-	75,000	-	-	-	-
ADA Upgrade Staff Restroom - Civic Center	-	-	300,000	-	-	-	-
Sound Mitigation in Library Lobby	-	-	22,000	-	-	-	-
Computer-Aided Dispatch and Records Management System	-	-	525,000	-	-	-	-
Downtown Revitalization	-	-	1,000,000	-	-	-	-
Massol Intersection Improvements	-	-	450,000	-	-	-	-
ADA Transition Plan	-	-	110,000	-	-	-	-
Total Project Expenditures	$ 17,632,081	$ 6,147,273	$ 19,433,240	$ 2,121,339	$ 2,222,463	$ 2,247,463	$ 2,222,463
Operating Transfers Out							
Transfer to GF	417,616	417,616	417,616	417,616	417,616	417,616	417,616
Total Operating Transfers Out	$ 417,616	$ 417,616	$ 417,616	$ 417,616	$ 417,616	$ 417,616	$ 417,616
Ending Fund Balance							
Designated for Parking	$ 154,025	$ 154,025	$ 308,050	$ 154,025	$ 154,025	$ 154,025	$ 154,025
Reserved for Comcast PEG	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Reserved for VTA Vehicle Registration Fees	37,437						
Unrestricted	554,048	9,398,371	1,206,807	1,136,216	886,600	611,984	362,368
Total Ending Fund Balance	$ 758,073	$ 9,602,396	$ 1,564,857	$ 1,340,241	$ 1,090,625	$ 816,009	$ 566,393
TOTAL USE OF FUNDS	$ 18,807,771	$ 16,167,285	$ 21,415,713	$ 3,879,196	$ 3,730,704	$ 3,481,088	$ 3,206,472

Subject: June 17, 2019 Town Council Finance Committee Meeting
Attachments: ATT00001.htm

From: Terry Duryea <tduryea@aol.com>
Date: June 16, 2019 at 10:11:12 AM PDT
To: Laurel Prevetti <LPrevetti@losgatosca.gov>
Cc: Arn Andrews <aandrews@losgatosca.gov>, Stephen Conway <sconway@losgatosca.gov>
Subject: June 17, 2019 Town Council Finance Committee Meeting

Date: June 16, 2019 (Sunday)
To: Finance Committee Members and Town Staff (bcc'd to all Town Council as I recently learned they receive all FC correspondence)
From: Terry Duryea, Committee Member

I am disappointed that I will not be able to attend the Monday, June 17 Finance Committee meeting as a personal matter has interceded. I do expect to be at the August meeting.

Based on the material distributed as of this weekend, I have the following comments for the Finance Committee members and Town Staff to consider as part of the general discussion.

I am sorry they are delivered in writing rather than in person.

Item 1—Approve Draft Minutes from March 11, 2019
I have no comments

Item 2—Review and Provide Recommendations for Future Revenue Opportunities
The 5 page staff report does a nice job of listing possible revenue sources, but it doesn't provide sufficient information to make recommendations. There is no discussion of dollars that could be raised and the pros and cons of alternatives are not presented.

In making a list, I would add the following additional revenues sources to the list:

- Audit Transit Occupancy Tax compliance and Business License Tax compliance if the forecasted additional revenue would be expected to exceed the cost of the audit. If there is a staffing limitation, these audits can be outsourced.

I believe any discussion of future revenue opportunities that include raising taxes on our residents in one form or another should include a discussion of why the Town needs the additional revenue.

In my limited time involved with Town finances, I see cash balances increasing at the same time money seems to be available for necessary projects. For example, three years ago the Town was struggling with a declining PCI that was under 70 and projected to decline further, while the recent budget discussions seem to indicate the Town now believes it can meet and sustain a PCI of 72.

In addition, the community continues to request greater transparency in budgeting and financial reporting. In my opinion, before asking the voters to approve an additional tax, the Town needs to update its budgeting process to reflect greater transparency and follow current best practices in the government sector, and to provide greater transparency in its financial reporting.

Item 3—Review and Provide Direction on Additional Discretionary Payment Strategies

The topic is "additional discretionary payment strategies" but it seems the memo also introduces the idea of changing the asset allocation of the OPEB Trust and the 115 Pension Trust.

I would expect these to be discussed separately as they are only obliquely related.

But since the memo combines the tow, my comments below follow the staff memo, trying to distinguish between the two issues.

As a general comment on asset allocation, to make an informed recommendation on asset allocations for the two post-employment trusts (115 Pension & OPEB), the Committee needs to understand the Town's "risk capacity" and "risk tolerance" over the next 10 years?

Hopefully a consideration of risk and risk capacity will integrate a discussion of the significance of the "standard deviation" information disclosed for the three investment alternatives for the OPEB Trust (per page 4 of memo: 11.83% to 7.28%)? Should I conclude that Strategy 1 is more than 60% riskier than Strategy 3 since the Strategy 1 standard deviation is 62.5% larger than the Strategy 3 standard deviation? Or is that even a relevant question?

Here are my comments on each of the Trusts

Town OPEB 115 Trust
Observations on Staff Memo:

- The 8.33% inception to date return following Strategy 1 is impressive. It's important not to conclude that i) that Trust is getting a superior return over CALPERs or other investment vehicles (CALPERs had a 8.1% return for the five years ended June 30, 2018 that is the closest comparison), or ii) that the fund will earn these type of returns in the future. The first money was invested on June 29, 2009 after the 2008 financial market meltdown just as the market was beginning a historical 10 year climb to record high equity values. The timing of the Town Council recommendation was fortunate.
- It's also important to recall that Strategy 1 was the only strategy available at the time of the initial investment in the OPEB Trust. Again, the Town was fortunate that the only option available at the time was the option with the greatest equity exposure when compared to the 3 options offered today.

Unanswered questions and information needed to make a decision on 115 Trust asset allocation:

- To make a decision on asset allocation, it's necessary to understand the Town's investment horizon. When does the Town expect to begin making <u>net</u> drawdowns of Trust assets as a result of payments to employees/their beneficiaries.
    - If the Town does not expect to make a net drawdown to this trust in the next 10 years, it can take greater risk and invest the funds in a more aggressive asset allocation with a higher standard deviation
- Why does the Town continue to prefund the OPEB Plan increasing its funded status, while the Pension Plan funding status declined over 6 ½ percentage points from 2014 to 2017 (latest reported info)? Other factors that should impact the decision of how to allocate funds between the OPEB Plan or the Pension Plan include:
    - The assumed interest rate on the OPEB plan at 6.75% that is lower than the 7% assumed interest rate on the Pension plan
    - There is no "California Rule" for the Town's post-employment medical benefits. Thus the Town has more flexibility in meeting OPEB obligations than it does in fulfilling its PENSION obligations. This becomes important in the face of a financial crisis
    - 10 years have passed since he 2009 Town Council approval of a Finance Department recommendation to initiate a 10 year phase in of pre-funding of OPEB obligations
    - A commitment was made by Staff to the Finance Committee at an earlier Committee meeting to revisit this commitment of continuing to pre fund the OPEB Trust at the same rate it has the last few years

My position on any prefunding of OPEB Trust , and on allocation of OPEB trust assets:

- I would <u>not</u> continue to <u>pre</u>fund the OPEB Trust until Staff presents a comparison of the benefits of using funds to fund the OPEB Trust vs funding the Town's pension obligations—my instincts tell me the funds are better used to fund the Pension obligation—see further discussion below
- Personally, so long as the Town does not believe it will need a net withdrawal of funds from this trust, I see no reason to change asset allocation based on information provided UNLESS there is reasonable expectation that the equity markets will suffer as much in the next downturn as they did during the financial market induced equity market meltdown in 2008, i.e. a greater than 2 standard deviation decline on the entire asset portfolio. I do not believe that is the case.

CALPERs Town Miscellaneous and Safety Plans

Observations

- Some of the Disadvantages listed seem pretty hollow:
  - "No control over the discount rate"—technically true but Bartels can run the payments and UUAL using different discount rates holding all other assumptions constant so the Town could make funding decisions using the Bartels analysis
  - "Assets restricted to pension benefits"—yes, that is the same as with the 115 Trust
  - "Pooled liability risk with Safety Plan"—it's unclear to me how discussion of assets impacts "pooled" nature of Safety Risk

Additional information requested to make decision on ADP to CALPERs [and/or 115 Pension Trust]

- What is the UUAL and funded status for the Town's Pension obligations using the same 6.25% and 5.5% discount rate as used for the OPEB analysis? If the Staff presents this information for the Committee to consider prefunding the OPEB obligation, please provide the same for the Pension obligation so we when we consider an ADP for the Pension obligation?
  - I believe a discount factor of 5.5% will show the Pension Obligations will overwhelm the Town's ability to continue to provide services IF the actual market returns come in close to that amount.

My position on an ADP:

- If we are going to make ADP to CALPERs, we should know where the contribution will have the greatest impact over the next 10 years on our annual pension contributions, so YES, please request the analysis from Bartels that you suggest.

Town Pension 115 Trust

Observations

- The standard deviation for PARS Capital Appreciation is 11.85% which is close to the standard deviation of 11.83% for the current OPEB Strategy 1. They are both the riskiest of the alternatives offered.
- Under ADP Disadvantages in the Staff memo, the "Assets Restricted to Pension Benefits" a not a disadvantage? That is what the Trust was set up for.

Additional information requested and questions to make decision on asset allocation

- To make a decision on asset allocation in 115 Pension Trust assets it's necessary to understand when the Town expects to have a drawdown of these funds for payment to CALPERs to smooth the Town's Pension payments e.g. if it is not probable that the Town will want to use these funds in the next 10 years the Town can absorb a higher risk asset allocation than it could if it is probable the Town will want to access these funds within 10 years
- If it so possible the Town will use these funds to cover pension payment obligations during an economic downturn impacting Town revenues. Its highly probably once will occur in the next 10 years. If it does, you would also expect the assets in the 115 Trust to decline. If the 115 Trust assets could be used for this eventuality, they should not be invested in a high risk asset allocation.
- What is the standard deviation for each of PARs investment options? This is necessary to compare risks.
  - How do these "standard deviations" relate to risk capacity and risk tolerance during the period when the Town may want to draw on these assets?

TOWN OF LOS GATOS
FINANCE COMMITTEE REPORT

MEETING DATE: 06/17/2019
ITEM NO: 3

DATE: JUNE 10, 2019

TO: COUNCIL FINANCE COMMITTEE

FROM: LAUREL PREVETTI, TOWN MANAGER

SUBJECT: REVIEW AND PROVIDE DIRECTION ON ADDITIONAL DISCRETIONARY PAYMENT STRATEGIES

RECOMMENDATION:

Review and provide direction on additional discretionary payment strategies.

BACKGROUND:

Based on direction from the Town Council and Town Pension and Other Post-Employment Benefits (OPEB) Trusts Oversight Committee (Pension/OPEB Committee), staff presented a report to the Town Pension and OPEB Trusts Oversight Committee on March 5, 2019 entitled "Review and Provide Direction on Additional Discretionary Payment (ADP) Strategies" (Attachment 1). The ADP strategies are intended to reduce unfunded Pension and OPEB obligations. The staff report provided high level informational material about the three primary types of ADP strategies available: (1) long-term capital accumulation and appreciation, (2) pension contribution management, and (3) direct payments to CalPERS. The report concluded that to date, the primary strategies utilized by the Town have been the prefunding of OPEB obligations and ADPs provided to PARS for long-term capital accumulation and appreciation of the Town's pension assets.

On June 4, 2019 the Town Council adopted the FY 2019/20 Operating Budget which among other items identified an additional $3.2 million allocation to reducing either outstanding OPEB or pension unfunded obligations. Also on June 4, 2019, the Town Pension and OPEB Trusts Oversight Committee held its quarterly meeting. As with past meetings, both bodies expressed

PREPARED BY: ARN ANDREWS
ASSISTANT TOWN MANAGER

Reviewed by: Town Manager, Finance Director, and Town Attorney

BACKGROUND (Continued):

an interest in the Town Finance Committee reviewing previous guidance for the exclusive allocation of ADPs to the PARS 115 Pension Trust and analyzing alternative allocation approaches. In addition, there have been recent discussions regarding the appropriateness of the current asset allocations for both the OPEB and Pension Trusts. The Town Council and the Pension/OPEB Committee would also like the Finance Committee to review previous asset allocation decisions and report back to both bodies.

DISCUSSION:

The following report is intended to be informational and summarize previous data, analysis, and Committee decisions regarding the allocation of ADPs and pension/OPEB plan asset allocations. Based on the Finance Committee's deliberations, staff will return at the August Committee meeting with more detailed analysis based on the Committee's direction. If in August the Committee is ready to make a recommendation to the Town Council, the topic would be scheduled in coordination with the Mayor as is the Town's practice. Assuming a September Town Council discussion, this would align well with the anticipated availability of the actuarial valuations update and year end performance reports for both the pension and OPEB plans.

The Town has four primary vessels for receiving additional discretionary payments which include: Town OPEB 115 Trust, CalPERS Town Miscellaneous Plan and Safety Plan, and Town Pension 115 Trust. The following summaries will outline the advantages and disadvantages associated with each one of those vehicles.

Town OPEB 115 Trust

The Town's retiree healthcare plan is an Internal Revenue Code Section 115 Trust which is administered by the Town Pension and OPEB Trusts Oversight Committee. The Oversight Committee is responsible for the management and control of the healthcare assets. In 2009, the Town Council approved a Finance Department recommendation to initiate a ten-year phase in of pre-funding future OPEB obligations. Prior to 2009, the Town like most other cities, followed the generally accepted government accounting principle of paying OPEB benefits on a "pay as you go" basis. The Finance Department recommendation also included participating in the CalPERS managed California Employers' Retiree Benefit Trust (CERBT) Fund. As the table below illustrates, as of July 31, 2018 the Town pre-funded $12,360,000 since the Trust Fund was established. In addition, the Town's investment in CERBT Strategy 1 has earned approximately $4.2 million in investment earnings with an average annualized rate of return of 8.33%.

DISCUSSION (Continued):

Account summary as of July 31, 2018 (Source: CalPERS Annual Review)	
Initial contribution (6/29/2009)	$400,000
Additional contributions	$11,960,000
Disbursements	($0)
CERBT expenses	($53,431)
Investment earnings	$4,212,256
Total market value of assets	$16,518,825
Average annualized internal rate of return (6/29/2009-7/31/2018)	8.33%

CalPERS CERBT Asset Allocation Strategies

The California Employers' Retiree Benefit Trust (CERBT) provides multiple options for investment of the Town's retiree healthcare assets. The CalPERS managed CERBT provides three distinct asset allocations. Each asset allocation has varying degrees of exposure to equity, fixed income, Treasury Inflation Protected Securities (TIPS), Real Estate Investment Trusts (REITs), and commodities. Following are the three asset allocations:

2018 Asset Allocation Targets	Strategy 1	Strategy 2	Strategy 3
	2018	2018	2018
Global Equity	59%	40%	22%
Fixed Income	25%	43%	50%
Global Real Estate (REITs)	8%	8%	8%
Treasury Inflation Protected Securities (TIPS)	5%	5%	16%
Commodities	3%	4%	5%

DISCUSSION (Continued):

The three investment options represent varying degrees of investment risk/return profiles. As the table below illustrates, a reduction in equity exposure correlates to a reduction in long-term expected returns and a reduction in the variability of those returns as expressed by standard deviation.

2018 Asset Allocation Strategies	Strategy 1	Strategy 2	Strategy 3
	2018	2018	2018
Expected Long Term Annualized Rate of Investment Return	7.59%	7.01%	6.22%
Discount Rate	Determined by Actuary (Currently 6.75%)	Determined by Actuary (Currently 6.75%)	Determined by Actuary (Currently 6.75%)
Standard Deviation of Expected Investment Returns	11.83%	9.24%	7.28%

OPEB Funding Status

Since the initial $400,000 prefunding in 2009, the OPEB funded status has grown steadily due to the additional contributions and investment earnings. Based on the June 30, 2017 Retiree Healthcare Plan Actuarial Valuation performed by Bartel Associates, the funded status of the plan has grown to 55%.

Valuation Date	Total OPEB Liability	Actuarial Value of Assets	Funded Status
6/30/2013	$19,211,000	$4,866,000	25%
6/30/2015	$20,977,000	$8,238,000	39%
6/30/2017	$24,773,000	$13,605,000	55%
Projected 6/30/2018	$26,390,000	$16,148,000	61.2%

Source: Bartel Associates Actuarial Valuations

DISCUSSION (Continued):

It is important to note that during the development of the 2017 actuarial valuation, the Oversight Committee elected to lower the discount rate from 7.25% to 6.75%. In addition, since the development of the 2017 actuarial valuation, the Town's bargaining groups and Management and Confidential employees agreed to eliminate the current retiree healthcare benefit prospectively for new employees. During labor negotiations, staff asked Bartel Associates to perform a preliminary review of what the implications may be for the funding status and potential funded status if ADPs were allocated to the OPEB plan. Provided below is a summary of the preliminary data:

2018 Asset Allocation Strategies & Discount Rates (Amounts in 000's)	CERBT Strategy1	CERBT Strategy 2	CERBT Strategy 3
	6.75%	6.25%	5.50%
Actuarial Accrued Liability (AAL)	$26,390	$28,020	$30,785
Market Value of Assets (MVA)	16,277	16,277	16,277
Unfunded AAL (UAAL)	10,113	11,743	14,508
Funded Percentage	61.7%	58.1%	52.9%
$ Amount Needed for 80% Funded %	$4,835	$6,139	$8,351

OPEB Trust ADP Advantages

- Multiple asset allocation options
- Control over asset allocation
- Control over discount rate/assumed rate of return
- Control over amortization period
- Immediate unfunded actuarial accrued liability (UAAL) and contribution impact
- Less UAAL interest cost
- Reduces accounting net pension liability

OPEB Trust ADP Disadvantages

- Market timing risk
- Assets restricted to OPEB benefits

DISCUSSION (Continued):

CalPERS Town Miscellaneous and Safety Plans

The Town's pension plans are administered by the Board of Administration of the California Public Employees' Retirement System (CalPERS). In addition, the Board has exclusive control of the administration and investment of funds. The Miscellaneous Plan is administered by CalPERS and invested in the Public Employees' Retirement Fund (PERF A). Sworn employees are covered under the Safety Plan which is a pooled cost-sharing plan and invested in PERF C. According to the 2017 Annual Valuations provided by CalPERS, the Miscellaneous Plan and Safety Plan had $69.5 million and $62.5 million calculated Market Value of Assets, respectively. According to CalPERS, 59 cents of every dollar paid out of the PERF fund has historically been from investment returns.

CalPERS Public Employees Retirement Fund (PERF) Asset Allocation

The PERF was established by statute in 1931 and provides retirement, death and disability benefits to members of its participating employers, which include the State of California, non-teaching, non-certified employees in schools, and various other public agencies. The benefits options for the public agencies are established by statute and voluntarily selected by contract with the system in accordance with the provisions of the Public Employees' Retirement Law.

In December 2017, the CalPERS Board voted on the asset allocation of the PERF's investment portfolio for the next four years. The Board examined four potential portfolios and their impact on the PERF. Each portfolio represented different distributions of assets based on varying rates of expected return and risk of volatility. The Board selected the portfolio with expected volatility of 11.4 percent and a return of 7.0 percent, which aligns with the December 2016 decision to lower the discount rate to 7.0 percent over three years. The following tables provide the PERF investment returns for the 12-month period that ended June 30, 2018, as well as five-year, ten-year, and twenty-year periods since inception.

CalPERS Investment Return	2018	5 Years	10 Years	20 Years	PERF Since Inception (1988)
	8.6%	8.1%	5.6%	6.1%	8.4%

The current asset allocation is provided in the next table.

DISCUSSION (Continued):

2018 PERF Asset Allocation Targets	PERF A	PERF C
	2018	2018
Global Equity	49%	49%
Private Equity	8%	8%
Global Debt Securities	22%	22%
Real Assets	12%	12%
Liquidity	3%	4%
Inflation	6%	6%

Miscellaneous and Safety Pension Plan Funding Status

As of June 30, 2017, the funded status of the PERF was 70.1 percent. The funded status as of June 30, 2018, is estimated to be approximately 71.0 percent. PERF funded status values were calculated using a 7.00 percent discount rate. In December 2016, the CalPERS board voted to lower the discount rate from 7.5 percent to 7.0 percent. Also in February 2018, the CalPERS Board voted to shorten the period over which actuarial gains and losses are amortized from 30 to 20 years. The table below illustrates the funding history for both the Town's Miscellaneous and Safety Plans.

Pension Plan	Valuation Date 6/30/11	Valuation Date 6/3014	Valuation Date 6/30/17
Miscellaneous	72.6%	76.2%	69.6%
Safety	71.7%	82.2%	73.9%

DISCUSSION (Continued):

Provided below is the schedule of amortization bases for the Miscellaneous Plan as of June 30, 2017. Similar to the early analysis performed on the OPEB Plan by Bartel Associates, if the Finance Committee were interested, staff could ask Bartel Associates to run scenarios which illustrate the effects on contribution rates and funding status for paying down/off varying amortization bases.

Reason for Base	Date Established	Ramp Up/Down 2019-20	Amorti-zation Period	Balance 6/30/17	Expected Payment 2017-18	Balance 6/30/18	Expected Payment 2018-19	Balance 6/30/19	Scheduled Payment for 2019-20
ASSUMPTION CHANGE	06/30/03	No Ramp	6	$1,780,035	$266,995	$1,632,584	$273,196	$1,468,020	$280,479
METHOD CHANGE	06/30/04	No Ramp	7	$(166,052)	$(22,588)	$(154,698)	$(23,102)	$(141,989)	$(23,720)
BENEFIT CHANGE	06/30/07	No Ramp	9	$1,646,511	$190,679	$1,568,412	$194,828	$1,480,355	$200,062
ASSUMPTION CHANGE	06/30/09	No Ramp	12	$2,566,712	$247,607	$2,496,373	$252,637	$2,415,725	$259,458
SPECIAL (GAIN)/LOSS	06/30/09	No Ramp	22	$2,100,631	$142,257	$2,105,604	$144,524	$2,108,588	$148,467
SPECIAL (GAIN)/LOSS	06/30/10	No Ramp	23	$1,755,770	$116,186	$1,762,739	$117,992	$1,768,343	$121,214
ASSUMPTION CHANGE	06/30/11	No Ramp	14	$1,710,594	$150,016	$1,679,253	$152,924	$1,642,629	$157,063
SPECIAL (GAIN)/LOSS	06/30/11	No Ramp	24	$809,430	$52,416	$813,831	$53,210	$817,729	$54,664
PAYMENT (GAIN)/LOSS	06/30/12	No Ramp	25	$199,878	$12,683	$201,234	$12,870	$202,495	$13,222
(GAIN)/LOSS	06/30/12	No Ramp	25	$1,791,787	$113,697	$1,803,946	$115,376	$1,815,246	$118,531
(GAIN)/LOSS	06/30/13	100% →	26	$10,388,059	$419,466	$10,706,787	$567,711	$10,895,099	$729,061
ASSUMPTION CHANGE	06/30/14	80% ↗	17	$4,484,869	$166,960	$4,637,116	$255,108	$4,709,113	$349,398
(GAIN)/LOSS	06/30/14	80% ↗	27	$(7,403,556)	$(202,526)	$(7,730,575)	$(308,168)	$(7,971,898)	$(422,159)
(GAIN)/LOSS	06/30/15	60% ↗	28	$3,320,211	$46,754	$3,512,507	$94,780	$3,669,008	$146,078
ASSUMPTION CHANGE	06/30/16	40% ↗	19	$1,502,722	$(42,200)	$1,655,372	$31,238	$1,743,036	$64,186
(GAIN)/LOSS	06/30/16	40% ↗	29	$4,225,172	$0	$4,531,497	$62,882	$4,794,909	$129,230
ASSUMPTION CHANGE	06/30/17	20% ↗	20	$1,176,961	$(50,144)	$1,314,221	$(51,586)	$1,462,925	$27,570
(GAIN)/LOSS	06/30/17	20% ↗	30	$(1,513,779)	$0	$(1,623,528)	$0	$(1,741,234)	$(24,135)
TOTAL				**$30,375,955**	**$1,608,258**	**$30,912,675**	**$1,946,420**	**$31,138,099**	**$2,328,669**

Miscellaneous and Safety Pension Plan ADP Advantages

- Immediate UAL and contribution impact
- Can elect shorter amortization (Fresh Start)
- Can elect to pay specific amortization bases
- Less UAL interest cost

Miscellaneous and Safety Pension Plan ADP Disadvantages

- Single asset allocation option
- No control over discount rate/assumed rate of return
- Market timing risk
- Assets restricted to pension benefits
- No current benefit to accounting net pension liability
- Pooled liability risk with Safety Plan

Town Pension 115 Trust

On August 15, 2017, Town Council approved Public Agency Retirement Services (PARS) as the administrator of the Town's Section 115 Pension Trust. The 115 Pension Trust acts as an additional investment vehicle for the overall funding of pension liabilities associated with the

DISCUSSION (Continued):

Town's Miscellaneous and Safety Pension Plans (the "Pension Plans"). The 115 Pension Trust provides the Town with flexibility in a variety of ways, including making lump sum payments directly to CalPERS and augmenting budget stability by using trust assets to defray pension costs in future years. In addition, the 115 Pension Trust can be utilized to either mimic or alter the risk/reward profile of assets currently invested with CalPERS.

On December 4, 2017, the Council Finance Committee recommended to invest in the PARS Capital Appreciation Index Plus. PARS utilizes the services of Highmark Capital for the management of the 115 assets. In addition, the Committee recommended that assets placed in the 115 Pension Trust be dollar cost averaged over the next year to mitigate risks associated with a single market entry point. On December 19, 2017, the Town Pension and OPEB Trusts Oversight Committee affirmed the Committee recommendations.

Asset Allocation Strategies

Highmark Capital Management currently provides the 115 Pension Trust with five different asset allocation options. Each asset allocation has varying degrees of exposure to equity, fixed income, and cash. The five asset allocations are intended to provide the Pension Plans with five distinct risk/reward profiles. The following are the equity exposures and investment objectives for the asset allocations provided by PARS:

PARS Strategy	Investment Objective	Equity Allocation	Fixed Income	Cash
Capital Appreciation	Provide growth of principal and income	65-85%	10-30%	0-20%
Balanced	Provide growth of principal and income	50-70%	30-50%	0-20%
Moderate	Provide growth of principal and income	40-60%	40-60%	0-20%
Moderately Conservative	Provide current income and moderate capital appreciation	20-40%	50-80%	0-20%
Conservative	Provide a consistent level of inflation-protected income over the long-term	5-20%	60-95%	0-20%

DISCUSSION (Continued):

The asset allocation for the PARS Capital Appreciation Index Plus portfolio as of April 30, 2019 is provided below.

PARS Strategy	Equity Allocation	Fixed Income	Cash
Capital Appreciation	76%	22%	2%

For the period ending April 30, 2019 the investment returns for the PARS Capital Appreciation Index Plus portfolio are provided below with an expected standard deviation of 11.85%.

PARS Strategy	1 Month	3 Month	1 Year*
Capital Appreciation	2.37%%	5.99%	6.79%

*Plans Inception Date 3/20/2018

PARS Funding Status

In March 2018 the initial $300,000 was deposited into the PARS account with additional $300,000 deposits programmed monthly for a current total of $4.4 million in assets as of April 30, 2019.

PARS Pension Trust ADP Advantages

- Actuarial equivalence with CalPERS for interest savings if assumed rate of return achieved
- Multiple asset allocation options
- Control over asset allocation
- Assets can be used to pay CalPERS directly or reimburse the Town for CalPERS contributions

PARS Pension ADP Disadvantages

- Market Timing Risk
- Assets Restricted to Pension Benefits
- No Current Benefit to Accounting Net Pension Liability

CONCLUSION:

Staff looks forward to the discussion with the Committee and its direction on next steps

ATTACHMENT:

1. Public Comment

ɔject: What should the Town do with the $7m available to address unfunded pension liabilities?

Attachments: F1---Pension-liabilities.pdf

From: Phil Koen <pkoen@monteropartners.com>
Sent: Wednesday; June 12, 2019 9:24 AM
To: Arn Andrews <aandrews@losgatosca.gov>
Cc: Laurel Prevetti <LPrevetti@losgatosca.gov>; Stephen Conway <sconway@losgatosca.gov>; Terry Duryea >; Rick Tinsley > >; Steven Leonardis <SLeonardis@losgatosca.gov>; BSpector <BSpector@losgatosca.gov>; jvannada@gmail.com
Subject: What should the Town do with the $7m available to address unfunded pension liabilities?

Hello Arn,

As you know there has been much discussion regarding how Town should address the high level of unfunded pension liabilities in both the Miscellaneous and Safety Pension Plans. This was one of the top priorities identified by the Council for FY 2020 and was specifically identified as a core goal.

To date, the actions taken by the Town (excluding the total pay off to Calpers of the Safety sidecar fund in June 2014) have been - 1) to deposit approximately $4.4m into a separate 115 Trust; and 2) to set aside approximately $2.6m (this ·ludes the recently approved $1.9m) in the General Fund Pension Reserve. As of today, there is a total of ,.proximately $7m that can be freely used by the Council to reduce the unfunded pension liabilities.

However, it is important to note that the just approved FY 2020 budget, does not include a single penny of additional payments to Calpers despite making additional discretionary payments (ADP's) to Calpers a FY 2020 strategic priority. The budget only reflects the **minimum legally required payments** toward the unfunded liabilities. This strikes me as major failing in the FY 2020 budget.

I understand that the Council has now requested the Finance Committee to review the current status of the unfunded pension liabilities and to make a recommendation to the Council on how best to use the $7m in financial resources.

We are not the only city in California that is going through this analysis. As an example, I have attached a recent analysis (dated March 5, 2019) which was prepared by the City of Menlo Park for their Council's consideration. If you review this analysis, you will find the fact pattern between Menlo Park and the Town are very similar. As of the last actuarial valuation, Menlo Park had $54.5m in unfunded pension liabilities while the Town had $52.5m. Both entities use Bartels Associates as independent actuarial consultants. But unlike the Town, the City of Menlo Park adopted as part of its FY 2020 budget a long term funding strategy to material reduce their unfunded pension liabilities by making additional discretionary payments to Calpers, which over time will save the City approximately $18.1m.

The City of Menlo Park requested Bartel Associates to assist them in developing their long term funding strategy. The Bartel report can be found at the end of the Menlo Park report. Of particular interest is Bartel's present value analysis of making additional discretionary payments to Calpers targeting specific amortization bases versus making contributions to a 115 Trust. This is exactly the type of financial analysis required to arrive at a fact based understanding of the impact making ADP's to Calpers vs. additional contributions to a 115 Trust. In my opinion the Town has never done this and is major oversight.

ATTACHMENT 2

The is point the Finance Committee must engage in a factual review of alternatives, including making one time additional discretionary payments or discretionary payments over time, just like Menlo Park has done. This requires a significant amount of financial modeling and actuarial analysis. I do not believe the Staff has the capability to do this alone. Certainly Menlo Park, which has a much larger finance staff, determined they needed the help.

I would respectively request you review the attached Menlo Park report and at the upcoming Finance Committee discuss the merit of the Town engaging Bartels to assist in a similar study with the goal of developing a recommendation as to how the Town should use the $7m currently available to reduce the Town's unfunded pension liabilities.

Thank you.

Phil Koen

CITY OF MENLO PARK

STAFF REPORT

City Council
Meeting Date: **3/5/2019**
Staff Report Number: **19-038-CC**

Informational Item: **Planned budget strategy for unfunded pension liability**

Recommendation

This is an informational item and does not require City Council action.

Policy Issues

The City Council has prioritized periodic review of the City's employee pension obligations and controls budgetary assumptions and appropriations. City Council has a reserve policy which dedicates 25 percent of a given fiscal year's operating surplus toward strategic pension funding opportunities and staff has recommended a change to the fiscal year 2019-20 budgetary principles to explicitly include addressing pension liabilities.

Background

In accordance with past practice, the City Council has directed staff to retain the services of an independent actuary to review the forecasts of employee pension obligations. The most recent report provided to the City Council from the independent actuary was November 13, 2018. It addressed recent changes made by the California Public Employees Retirement System (CalPERS) to strengthen the plan's long-term health, in addition to responding to the 2017-18 San Mateo Civil grand jury's recommendation that all cities in San Mateo County hold public meetings discussing projected pension obligations. At that meeting, the City Council directed staff to investigate specific options to reduce the City's unfunded pension liability and return with recommendations.

Analysis

Retirement plan distinction

Under the City's retirement contract with CalPERS, City staff are grouped by a number of characteristics that ultimately result in four distinct pension plans, each of which has assets, requirements and liabilities. One characteristic distinguishing employee membership in a plan is the type of service provided to the City. Sworn police personnel are members of the safety group, while all other regular employees are classified under the miscellaneous group. Another set of characteristics are based on the date that the employee began working as a regular employee with the City and with a CalPERS agency. The statewide Public Employee Pension Reform Act (PEPRA) created a differentiation between "classic" and "new" or "PEPRA" CalPERS members, and before this legislation, the City enacted multiple retirement tiers for its employees. Those employees who were hired before the implementation of tiers are considered Tier 1, those employees hired afterward as "classic" CalPERS members are Tier 2, and those employees hired into both CalPERS and the City after the implementation of statewide pension reform are PEPRA. The final characteristic which distinguishes plans is the number of employees participating. Plans with a sufficiently

large number of participants are independent while those with smaller numbers of participants are pooled with other small agency plans. The number of miscellaneous employees in the City is sufficient to be considered a combined plan while each of the tiers of safety employees is a separate pooled plan. These various plans and distinguishing characteristics are outlined below in Table 1.

Table 1: City of Menlo Park retirement plans

Service type	City hire date	CalPERS hire date	Benefit level	CalPERS plan name
Miscellaneous	Before 10/23/2011	Before 10/23/2011	Tier 1	Miscellaneous
	10/23/2011 or after	Before 1/1/2013	Tier 2	
	1/1/2013 or after	1/1/2013 or after	PEPRA	
Sworn safety	Before 11/20/2011	Before 11/20/2011	Tier 1	Tier 1 safety
	11/20/2011 or after	Before 1/1/2013	Tier 2	Tier 2 safety
	1/1/2013 or after	1/1/2013 or after	PEPRA	PEPRA safety

Funding history

One measure of a pension plan's ability to meet the obligations promised to participating members is the funded ratio, or the market value of the assets owned by the plan divided by the accrued liability for employees retiring at the plan's normal age. The difference between the market value of assets and the aforementioned accrued liability is the unfunded accrued liability (UAL), or the amount outstanding at a given point in time. Based on the most recent valuations provided by CalPERS and further analyzed by the City's independent actuary, two of the City's four pension plans, those for miscellaneous and Tier 1 safety, have funded ratios below 90 percent and combined UAL in excess of $54 million. CalPERS has taken a number of actions to address unfunded liabilities across its member plans which should ultimately result in the City's plans reaching 100 percent funded status, though these measures come at the cost of a substantial amount of interest paid by the City. The City may avoid some of this interest expense by pursuing additional actions to reduce the unfunded liability faster than under the current CalPERS amortization schedule. The two plans outlined below overwhelmingly comprise the City's unfunded liability and current funded status over recent years for these underfunded plans is displayed in Tables 2 and 3 below.

Table 2: Miscellaneous plan funding history as of June 30

	2013	2014	2015	2016	2017
Unfunded accrued liability	$21,461,088	$19,482,011	$25,097,845	$32,145,956	$29,919,760
Funded ratio	77.5%	81.5%	77.6%	72.8%	76.1%

Table 3: Tier 1 safety plan funding history as of June 30

	2013	2014	2015	2016	2017
Unfunded accrued liability	$15,662,295	$14,595,759	$18,504,614	$24,164,032	$24,600,148
Funded ratio	77.5%	81.0%	77.0%	71.6%	73.1%

Prospective contributions

While a portion of pension contributions for the miscellaneous group is born by funds other than the general fund, it is anticipated that the general fund will have responsibility for between 87 percent and 88 percent of the unfunded liability over the next 10 years. As a result, this analysis will focus on general fund options. Using the City's current 30-year amortization schedule, expected general fund contributions to the unfunded liability portion of the miscellaneous and Tier 1 safety plans are outlined in Tables 4 and 5 below. It is important to note that the required payments assume that CalPERS meets its discount rate assumption in each year, and that any actual return above or below the assumed rate will change the required payments.

Table 4: Miscellaneous plan anticipated general fund contributions by fiscal year

	2019-20	2020-21	2021-22	2022-23	2023-24
UAL payment	$2,114,483	$2,353,302	$2,634,996	$2,856,840	$2,986,116
General Fund expenditure ratio	3.2%	3.5%	3.8%	3.9%	4.0%

Table 5: Tier 1 safety plan anticipated general fund contributions by fiscal year

	2019-20	2020-21	2021-22	2022-23	2023-24
UAL payment	$1,665,796	$1,897,000	$2,168,000	$2,392,000	$2,527,000
General Fund expenditure ratio	2.6%	2.8%	3.1%	3.3%	3.4%

Potential City Council actions

In conjunction with the independent actuary, staff previously presented a number of factors under the control of the City Council to address the unfunded liability. Included in the list were options to:

- Adopt a shorter amortization schedule
- Make supplemental payments to CalPERS
- Reduce non-pension costs
- Adopt a rate smoothing policy and mechanism
- Address employee cost-sharing and payroll growth assumptions
- Issue pension obligation bonds
- Pursue legislative advocacy
- Withdraw from CalPERS

These options can be grouped more generally into three categories of factors and with a range of expected returns when considered from a net present value (NPV) perspective, displayed below in Table 6. It is important to note that the expected return is a qualitative assessment and relative only to the factors under consideration, though expected values are presented when reasonably estimable. NPV, where reasonably estimable, is calculated over the life of an amortization plan or a 10-year period for non-amortized options using a 2.5 percent discount rate, reflecting the City's expected investment returns. For options with discretionary investment amounts, NPV is reported in terms of return per $1.0 million invested in the current year as determined by the City's independent actuary in Attachment A and noted as variable investment levels. Of note, NPV calculations include only resource returns and do not incorporate productivity costs or market risks associated with pursuit of the given strategy, though the expected return displayed does incorporate staff's best estimate of the net effect of such productivity costs and other risks.

Table 6: Options available to address unfunded pension liability			
No.	Option	Category	Expected return
1	Adopt shorter amortization schedule	Return focused	High
2	Make supplemental payments	Return focused	High
3	Reduce non-pension costs	Certainty focused	Medium
4	Adopt rate smoothing policy and mechanism	Certainty focused	Medium
5	Maintain employee cost-sharing	Certainty focused	Low
6	Meet payroll growth assumptions	Certainty focused	Low
7	Issue pension obligation bonds	Certainty focused	Very low
8	Pursue legislative advocacy	Uncertain	Uncertain
9	Withdraw from CalPERS contract	Certainty focused	Negative

Potential returns, benefits, and risks for each strategy option are discussed in greater detail below and summarized in Table 7 presented after the discussion.

Adopt shorter amortization schedule

For each of its current plans, the City follows CalPERS' standard, 30-year amortization schedule. CalPERS offers shortened amortization schedules of 20, 15, or 10 years under a "Fresh start" of existing unfunded bases. Under these shortened amortization schedules, the City would pay off its unfunded liability at an increased pace while simultaneously paying less in accrued interest. Under this strategy, however, the majority of savings are back-loaded and the expected rates charged by CalPERS are largely unchanged until the end of the shortened amortization period. As such, while savings under this option can be high, future rates remain largely unchanged. At risk under such a strategy is the flexibility afforded the City, as adoption of shortened amortization schedules is an irrevocable decision and the City loses some freedom in resource allocation as it must meet the required annual payments prescribed in the new schedule. In addition, while CalPERS makes investment return assumptions, actual market returns will affect the value of the payments made to CalPERS. This could result in a lower NPV in the event that market returns do not meet CalPERS' assumptions, but similarly will result in a greater NPV if market returns exceed CalPERS' assumptions.

The expected NPV for adoption of shortened amortization schedules are:

- Miscellaneous plan 15-year schedule: $0.80 million
- Miscellaneous plan 10-year schedule: $4.91 million
- Safety tier 1 plan 20-year schedule: $0.16 million
- Safety tier 1 plan 15-year schedule: $3.91 million

Option summary

Potential return: $0.16 million to $8.82 million

Benefits: High expected NPV and relatively fast elimination of unfunded liability

Risks: Reduced freedom to allocate resources during the shortened amortization period; lower NPV if market returns do not meet the CalPERS assumed discount rate

Make supplemental payments

CalPERS allows contracted agencies to make additional payments to existing unfunded liability bases on an

ad hoc basis outside of the aforementioned "fresh start" schedule. Due to the length and magnitude of bases differing as a result of their origination time and source, the NPV of making payments differs depending on the base targeted. "Shorter" bases, or those with less time remaining on the amortization schedule, generally have lower NPV than "longer" bases, or those with a greater amount of time remaining. Depending on preference for having a greater savings or fewer unfunded liability bases, the City could elect to target any type or some combination at its discretion. One notable benefit of such a strategy is a high NPV without constraint in future resource allocation as the City would not be locked into an alternate amortization schedule. While this strategy offers high NPV, it does little to change the expected rates charged by CalPERS in future years as the gains are spread out over the length of the targeted base. The primary risk associated with this strategy is market risk similar to that of the "Fresh start" option, notably that CalPERS may not meet its investment return assumptions and that the value of the additional payment(s) to CalPERS would be lower than expected.

Illustrative NPV for several funding options are (variable investment level, per $1.0 million supplemental payment):

- Miscellaneous plan short base: $0.12 million
- Miscellaneous plan long base: $0.64 million
- Safety plan short base: $0.32 million
- Safety plan long base: $0.65 million

Option summary
Potential return: Varies depending on targeted base and size of payment
Benefits: High NPV and no loss of flexibility for future resource allocation
Risks: Lower than expected NPV if market returns do not meet the CalPERS assumed discount rate

Reduce non-pension costs

In comparison with other strategies, this strategy does not directly address unfunded liability but rather the availability of general fund monies. This option includes a number of components, including potential elements such as reducing the use of contract services or general fund transfers to the capital improvement plan. The primary benefit of such a strategy is its flexibility, where the reduction of expenditures in a given year need not necessarily continue into future years and where scale can change relatively easily. As such, this strategy's focus would be directed more toward the certainty of being able to achieve a balanced budget in each fiscal year, though a structural reduction in non-pension costs and commensurate increase in fund allocation toward pension liabilities would result in a large, positive expected NPV. It is important to note that some non-pension benefits, such as current-year staffing costs, are more difficult to adjust on a year-to-year basis, while others such as transfers or contract services can change nearly instantaneously. Similarly, while some expenditures are subject to both increases and decreases, other categories such as unfunded pension liability payments have one-sided flexibility and can only potentially increase beyond a prescribed minimum level except as a result of factors outside of the City's control. As a final note on the mechanism involved with this strategy, while reducing non-pension costs does free resources, it does not itself reduce the City's unfunded liability. As such, pursuit of this strategy as it relates to reducing pension liabilities also necessarily includes selecting another of the strategies described.

At risk in the strategy of reducing non-pension costs is the resultant effect on service to the community. Each reduction in non-pension costs constrains the City's ability to provide service to the community either directly or indirectly. Identifying which services should be reduced, to what degree, and at what time becomes a complex and difficult side effect if pursued.

Option summary
Potential return: Varies, depending on timing and degree of non-pension cost reductions plus selection of accompanying strategy
Benefits: Flexibility in timing, scale and type of cost reduction
Risks: Reduction in service to the community

Adopt rate-smoothing policy and mechanism
In contrast with the first two options mentioned, the City Council may elect to pursue a strategy which intentionally results in a lower expected NPV but provides the benefit of increased rate stability. Through a variety of mechanisms, including the establishment of an irrevocable Section 115 Trust and/or continued investment of the City's committed general fund reserve amount, the City may opt to save current funds for use when rates rise above a certain amount. Under this strategy, the City would invest current and/or future funds until CalPERS rates exceeded a certain point, then make payments to CalPERS to reduce rates as a percentage of payroll to lower the "peak" rates expected to be experienced under the current amortization schedule.

For illustrative purposes, Attachment A includes two potential scenarios, a miscellaneous plan example and a safety plan example, which demonstrate this strategy. Under the miscellaneous scenario, the City creates a Section 115 Trust with $1.0 million invested for the express and irrevocable purpose of paying pension obligations and targets a City rate above 24.1 percent to begin disbursements. This occurs in fiscal year 2022-23 and continues until fiscal year 2030-31, during which time the City draws down the Trust to reduce its net payments in each fiscal year to 24.1 percent. Under such a scenario, the City would save $0.48 million with an NPV of $0.19 million.

This strategy introduces risk in one or two categories, market and irrevocability, depending on the choice of investment vehicle. While a Section 115 Trust may invest in a broader range of investment products than are allowed under the City's investment policy, returns are not guaranteed and may be lower than the City's conservative approach depending on overall market conditions. Additionally, a Section 115 Trust is an irrevocable election and the City may not use any funds invested in such a Trust for any purpose other than pension obligations and loses the flexibility to redirect funds to other needs or opportunities.

Option summary
Potential return: $0.19 million (miscellaneous) to $0.32 million (safety) with a Section 115 Trust (variable investment level, per $1.0 million invested)
Benefits: Reduced uncertainty in future rates
Risks: Market exposure and reduced flexibility if invested in a Section 115 Trust

Maintain employee cost-sharing
The City currently has cost-sharing agreements with four of its represented collective bargaining units and with the unrepresented management and confidential employees. The rates paid by employees differ and in the current fiscal year range from 0.35 percent to 3.81 percent depending on the unit; rising up to a high of 4.89 percent before the end of the current contracts as City employees assume some of the costs of rising CalPERS rates. As the cost-sharing arises from a negotiated agreement between the City and its represented units, the resource cost associated with maintaining the cost-sharing is low from a monetary standpoint.

Cost-sharing agreements between the City's miscellaneous units do not currently have a cap on the amount that they contribute toward the City's pension costs, and the share for Public Employee Pension Reform Act (PEPRA) employees in the City's non-supervisory unit is anticipated to rise above the total normal cost for that group by the 2023-24 fiscal year. This may introduce the risk of prospective employees showing

preference for other agencies as they judge the pension benefit to be a net cost to employment rather than a benefit (e.g., the actuarial value of the pension is lower than the cost paid by the employee) if not ufficiently offset by other non-pension compensation. As a result, while not a resource cost, there is some risk to recruitment and retention for pursuing this strategy, which would manifest as a productivity cost if realized. It is also important to note that because cost-sharing is negotiated between the City and its represented units, the City does not have the freedom to act unilaterally in the manner available for all other options presented.

The NPV of cost-sharing is anticipated to be $9.85 million for miscellaneous and $2.03 million for safety when considered irrespective of any effects on recruitment and retention, which, with other conditions remaining the same, are judged to be substantial.

Option summary
Potential return: $11.89 million
Benefits: Evenly reduces City's pension costs in proportion to direct staffing costs
Risks: May negatively affect recruitment and retention if not offset by increased non-pension compensation

Meet payroll growth assumptions
In the City's current 10-year forecast, settled contract terms are calculated deterministically but future years are expected to grow at an average of 3.0 percent per year, reflecting a combination of anticipated long-term inflation as well as a regional adjustment. The United States federal reserve's long-run inflation expectation, one component of its dual mandate, is 2.0 percent and sets the baseline for the City's wage and salary growth expectation. Average consumer price index (CPI) in the San Francisco-Oakland-Hayward region has outpaced nationwide city average CPI over the previous 10 years by slightly above 1 percent, which when combined with the aforementioned national expectation creates the 3.0 percent expectation also assuming that the active employee base remains the same.

The assumption used by CalPERS for payroll growth is 2.75 percent per year starting with the June 30, 2018, valuation, suggesting that the City is likely to exceed the payroll growth assumption in a majority of years if it follows the forecast, creating an unfunded liability each time it does. As the City has substantial control of growth rates through a variety of factors, it could prioritize meeting the CalPERS assumed rate; however, this strategy would introduce risk in the form of recruitment and retention if other local agencies do not follow a similar policy and the City becomes an increasingly less competitive employer. In addition, while this option is separate from the option to maintain the employee cost-sharing agreement, they do not operate wholly independently, as the aforementioned cost-sharing agreements do have the potential to affect current and prospective employees' views of the City's attractiveness as an employer.

Given the mismatch between the City's payroll growth assumptions and the assumptions used by CalPERS, an optimistic outcome would be a NPV of $0 or the creation of no new unfunded liability due to payroll growth. As the risk to recruitment and retention is largely tied to productivity costs rather than actual liabilities or expenditures, its NPV is not included.

Option summary
Potential return: $0 (no new liability created and no decrease in current unfunded liability)
Benefits: Increased certainty payments if payroll growth assumptions are not exceeded, as no unfunded liability is created in each year where actual payroll growth is at or below the assumed rate
Risks: May negatively affect recruitment and retention if actual area inflation exceeds CalPERS expectations and compensation adjustments do not keep pace

Issue pension obligation bonds

Under this strategy, the City would issue bonds, use the proceeds to pay the unfunded liability, and receive an overall savings of the difference between the rate paid on the debt service and the market returns of the proceeds. Given the very strong financial position of the City and anticipated debt service rates lower than those of other agencies, this strategy may result in a positive NPV. However, while debt service payments are determined before issuance, market returns are not guaranteed. As a result, this strategy may result in a negative NPV if the returns are lower than the costs of debt service. In addition, PEPRA prevents City contributions from dropping below normal cost, so savings may be offset in cases where returns are high.

Option summary

Potential return: Uncertain without additional investigation
Benefits: High certainty given set payment schedule for debt service
Risks: Negative return if market returns do not exceed debt service requirements; savings may be offset due to PEPRA in cases where returns are high

Pursue legislative advocacy

This option represents a wide range of possible actions by the City Council, but does not specify any given strategy due to the non-exclusivity of the option. This option is materially unaffected by the pursuit of any combination of alternative strategies due to a low expected monetary cost. This option also offers commensurately low risk as any failure to influence future legislation results in maintenance of the status quo rather than a loss of either capital or opportunity.

Option summary

Potential return: Uncertain depending on direction
Benefits: Potential for future pension legislation favorable to the City with a variety of possible outcomes such as assistance from the State, increased certainty in rates, or increased flexibility in offering future retirement benefits
Risks: The City faces only the costs associated with crafting, presenting and advocating for future legislation, which carries a low chance of loss in resources or other opportunities

Withdraw from CalPERS contract

All other options presented assume that the City will continue its retirement agreement with CalPERS as it reduces pension liability, but the City may also pursue the termination of the agreement. It is important to note that this does not relieve the City of any currently accrued unfunded liability and that termination of the contract would exclude the City from pursuing other options with the exception of legislative advocacy and potentially the issue of pension obligation bonds. In addition, while the City would avoid future normal cost payments to CalPERS, it would remain obligated to provide some form of retirement plan for City staff.

The primary benefit of such an option is that the overall cost of eliminating unfunded liabilities would be known with no variability, though at the cost of using a much lower long-term discount rate. Due to this lowered discount rate, CalPERS can provide for already-earned benefits by making essentially risk-free investments; however, this results in higher initial liability and therefore lower NPV relative to the status quo. The primary associated cost is that the entire difference between the market value of assets in the plan and the actuarially accrued liability must be paid at the time of plan termination.

At risk in such an option is that market returns will vastly outpace the risk-free returns assumed by CalPERS at the end of the contract, resulting in the City having paid substantially more than the alternative cost. In addition, termination of the contract risks the attractiveness of the City as a prospective employer to current CalPERS members as accepting employment with the City would halt accumulation of service within the CalPERS system and risk a lower benefit payment for current "classic" members.

Option summary
Potential return: ($204 million) to ($156 million)
Benefits: Known and invariable liability at time of termination
Risks: Market returns are expected to outpace the risk-free investments that CalPERS would purchase; potential reduction in attractiveness as an employer

Table 7: Summary of options by return, benefits and risks

No.	Option	Return	Benefits	Risks
1	Adopt shorter amortization schedule	$0.16 million to $8.82 million	High expected NPV, relatively fast elimination of unfunded liability	Reduced freedom to allocate resources; lower NPV depending on market
2	Make supplemental payments	$0.12 million to $0.65 million (per $1.0 million invested)	High expected NPV, no loss of future flexibility	Lower NPV depending on market returns of investment
3	Reduce non-pension costs	Variable depending on timing, scale	High flexibility in timing, scale and type of reduction	Reduction in service provided to community
4	Adopt rate smoothing policy and mechanism	$0.19 million to $0.32 million (per $1.0 million invested)	Reduced uncertainty in future rates paid	Market exposure and reduced flexibility if Section 115 Trust used
5	Maintain employee cost-sharing	$11.89 million	Even reduction in pension rates	May affect recruitment and retention
6	Meet payroll growth assumptions	$0 (no increase or reduction in unfunded liability)	Increased certainty in future payments	May affect recruitment and retention
7	Issue pension obligation bonds	Uncertain – would need additional investigation	High certainty in payment schedule	Negative return if market returns do not exceed debt service; savings may be offset in cases of high returns
8	Pursue legislative advocacy	Uncertain – would need additional direction	Variety of potential benefits	Low – related only to resource costs to develop
9	Withdraw from CalPERS contract	($204 million) to ($156 million)	Known and invariable liability at time of termination	Opportunity cost in market returns; potential reduction in attractiveness as employer

Staff recommendation
Based on the expected returns of the options presented and associated risks and unless given alternate direction by City Council, staff plans to pursue Option 2, supplemental payments, to match the payment schedules of Option 1, adopting a shorter amortization schedule, without formal adoption of a "Fresh start" amortization schedule and beginning with the City Manager's proposed budget for fiscal year 2019-20. To meet the funding requirements necessary to make the additional payments outlined below in Table 9, staff will incorporate the assumption of receiving the full excess educational revenue augmentation fund (ERAF) from the County each year in addition to use of any necessary strategic pension reserve funds.

Anticipated benefits
Using the aforementioned City discount rate of 2.5 percent, or the long-run expected earnings on its investments, pursuit of such a strategy results in an expected NPV of $4.91 million for the miscellaneous plan and $3.91 million for the Tier 1 safety plan over the remainder of the respective amortization schedules. In terms of absolute savings, such a strategy results in a reduction in payments of $18.1 million over the remainder of the respective amortization schedules.

Potential risks
The greatest risk posed by pursuing such a strategy is that actual returns on CalPERS assets do not meet the discount rate assumption. While actual earnings in some years are expected to be lower than the discount rate, years with returns greater than the discount rate should offset these lower-than-expected earnings over the long run. The risk posed to the City is that the particular years where returns are lower than the discount rate are those years in which the City makes additional contributions, lowering the value of those additional contributions. It is important to note that while this would reduce the value of the additional contributions made, those additional contributions would nevertheless reduce the unfunded liability compared to the alternative of forgoing additional contributions in those years.

Execution mechanics
Given the available alternate amortization schedules outlined by CalPERS, the City would follow the payment schedule for the 10-year amortization schedule for the miscellaneous plan and the 15-year amortization schedule for the Tier 1 safety plan, making a supplemental payment of the difference between the required UAL payment of the current schedule and the payment specified in the alternative amortization schedule. The outstanding UAL and additional payments compared to the current amortization by plan are outlined in Table 9 below.

Table 9: Schedule of UAL balance and additional payments				
	Miscellaneous plan		Safety plan	
Valuation date	Balance	Additional payment	Balance	Additional payment
6/30/2019	$ 30,418,613	$ 1,122,768	$25,932,451	$ 692,265
6/30/2020	28,717,107	976,827	25,370,508	560,739
6/30/2021	26,779,919	812,793	24,697,616	415,034
6/30/2022	24,586,734	732,027	23,903,711	322,884
6/30/2023	22,115,669	778,335	22,977,945	326,856
6/30/2024	19,343,161	800,712	21,908,620	336,252
6/30/2025	16,243,839	1,223,850	20,683,132	345,919
6/30/2026	12,790,393	1,241,687	19,287,897	355,865
6/30/2027	8,953,427	1,277,383	17,708,283	366,096
6/30/2028	4,701,308	2,137,116	15,928,530	376,622
6/30/2029		(2,810,165)	13,931,666	387,450
6/30/2030		(2,890,959)	11,699,419	398,589
6/30/2031		(2,401,862)	9,212,118	410,048
6/30/2032		(2,289,908)	6,448,592	550,377
6/30/2033		(1,903,442)	3,386,058	698,436
6/30/2034		(1,701,574)		(2,320,320)
6/30/2035		(1,406,492)		(2,531,903)
6/30/2036		(1,093,036)		(2,345,975)
6/30/2037		(968,960)		(1,199,145)
6/30/2038		(836,849)		(1,112,179)
6/30/2039		(771,268)		(1,073,735)
6/30/2040		(793,441)		(1,104,605)
6/30/2041		(593,617)		(885,588)
6/30/2042		(447,898)		(834,684)
6/30/2043		(207,251)		(666,969)
6/30/2044				(367,192)
6/30/2045				(123,191)
6/30/2046				(62,570)
Total additional payments		**$ (10,013,224)**		**$ (8,084,624)**

Risk mitigation

In order to mitigate the risk posed by actual market returns being lower than the CalPERS discount rate's assumption, the City will plan to spread the additional payment across the year, for instance on a quarterly

basis. This introduces an additional potential liability beyond that specified in the alternative amortization schedule as payments would receive a pro-rata share of investment earnings for the year but is offset by a lower potential liability for years in which the actual returns do not meet the discount rate assumption. If CalPERS were to meet the discount rate assumption in each year, such a strategy would reduce the NPV by $0.65 million across both plans as one additional payment would be made in the year following the end of the shorter amortization schedule to account for the compounded losses. Staff will evaluate the need for additional payments closer to the 100 percent funding level for each plan.

Impact on City Resources

There is no impact on City Resources in the current fiscal year unless City Council directs staff to use some portion of the General Fund's unassigned fund balance. Unless provided with different direction, staff will incorporate use of resources into the City Manager's proposed budget and into the 10-year forecast.

Environmental Review

This action is not a project within the meaning of the California Environmental Quality Act (CEQA) Guidelines §§ 15378 and 15061(b)(3) as it will not result in any direct or indirect physical change in the environment.

Public Notice

Public Notification was achieved by posting the agenda, with the agenda items being listed, at least 72 hours prior to the meeting.

Attachments

A. Analysis of employee pension obligations by Bartel Associates
B. Miscellaneous Plan of the City of Menlo Park Annual Valuation Report as of June 30, 2017, report dated July 2018 – hyperlink: calpers.ca.gov/docs/actuarial-reports/2017/menlo-park-city-miscellaneous-2017.pdf
C. Safety Plan of the City of Menlo Park Annual Valuation Report as of June 30, 2017, dated August 2018 – hyperlink: calpers.ca.gov/docs/actuarial-reports/2017/menlo-park-city-safety-2017.pdf
D. Safety Police Second Tier Plan of the City of Menlo Park Annual Valuation Report as of June 30, 2017, report dated August 2018 – hyperlink: calpers.ca.gov/docs/actuarial-reports/2017/menlo-park-city-safety-police-second-tier-2017.pdf
E. PEPRA Safety Police Plan of the City of Menlo Park Annual Valuation Report as of June 30, 2017, report dated August 2018 – hyperlink: calpers.ca.gov/docs/actuarial-reports/2017/menlo-park-city-pepra-safety-police-2017.pdf

Report prepared by:
Edith Weaver, Human Resources Technician
Dan Jacobson, Finance and Budget Manager

Report reviewed by:
Lenka Diaz, Administrative Services Director

ATTACHMENT A

CITY OF MENLO PARK

CITY OF MENLO PARK
MISCELLANEOUS & SAFETY PLANS

BARTEL ASSOCIATES LLC

CalPERS Actuarial Issues – 6/30/17 Valuation

Doug Pryor, Vice President
Bianca Lin, Assistant Vice President
Kevin Yang, Actuarial Analyst
Bartel Associates, LLC

November 13, 2018

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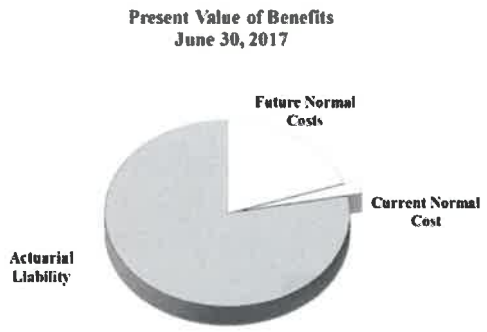
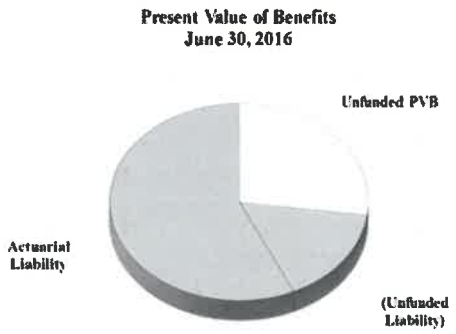
DEFINITIONS

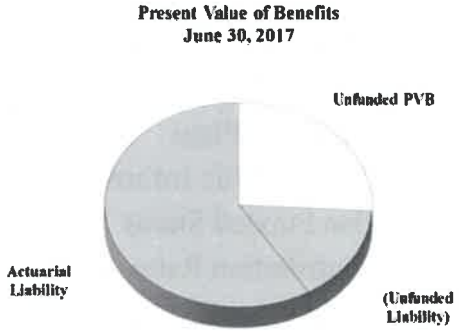


- **Present Value of all Projected Benefits:**
  - The value now of amounts due to be paid in the future
- **PVB - Present Value of all Projected Benefits:**
  - Discounted value (at valuation date - 6/30/17), of all future expected benefit payments based on various (actuarial) assumptions

- **Current Normal Cost:**
  - Portion of PVB allocated to (or "earned" during) current year
  - Value of employee and employer current service benefit
- **Actuarial Liability:**
  - Discounted value (at valuation date) of benefits earned through valuation date [value of past service benefit]
  - Portion of PVB "earned" at measurement

DEFINITIONS



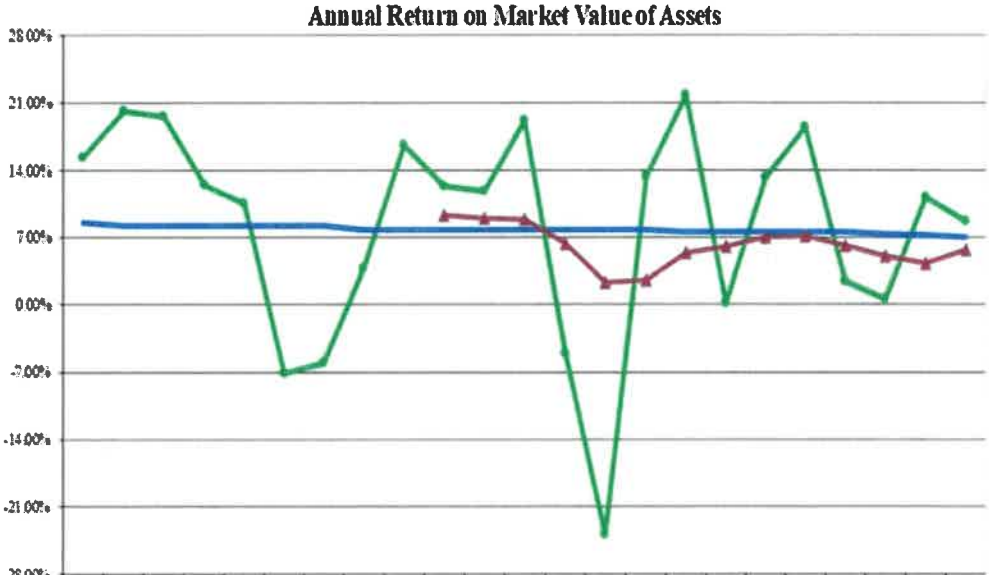


- **Target-** Have money in the bank to cover Actuarial Liability (past service)
- **Unfunded Liability -** Money short of target <u>at valuation date</u>
- **Unfunded Liability -** Money short of target <u>at valuation date</u>
  - If all actuarial assumptions were always exactly met, then the plan assets would always equal AAL
  - Any difference is the unfunded (or overfunded) AAL
  - Every year, the actuary calculates the difference between the expected UAAL and Actual UAAL. This is a new layer or amortization base
  - Each new layer gets amortized (paid off) over a period of time as part of the contribution [rate].

How We Got Here

- Investment Losses
- CalPERS Contribution Policy
- Enhanced Benefits
- Demographics

How We Got Here – Investment Return



	'96	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18
MVA	15.3%	20.1%	19.5%	12.5%	10.5%	-7.2%	-6.1%	3.3%	16.6%	12.3%	11.8%	19.1%	-5.1%	24.0%	13.3%	21.7%	0.1%	13.2%	18.4%	2.4%	0.6%	11.2%	8.6%
Discount Rate	8.50%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%	7.75%	7.75%	7.75%	7.75%	7.75%	7.75%	7.75%	7.75%	7.50%	7.50%	7.50%	7.50%	7.50%	7.375%	7.25%	7.00%
10-Year Rolling Average										9.3%	9.0%	8.9%	6.4%	2.3%	2.6%	5.4%	6.1%	7.0%	7.2%	6.2%	5.1%	4.3%	5.8%

Above assumes contributions, payments, etc. received evenly throughout year.

How We Got Here – Old Contribution Policy

- Effective with 2003 valuations:
  - Slow (15 year) recognition of investment losses into funded status
  - Rolling 30 year amortization of all (primarily investment) losses
- Designed to:
  - First smooth rates and
  - Second pay off UAAL
- Mitigated contribution volatility

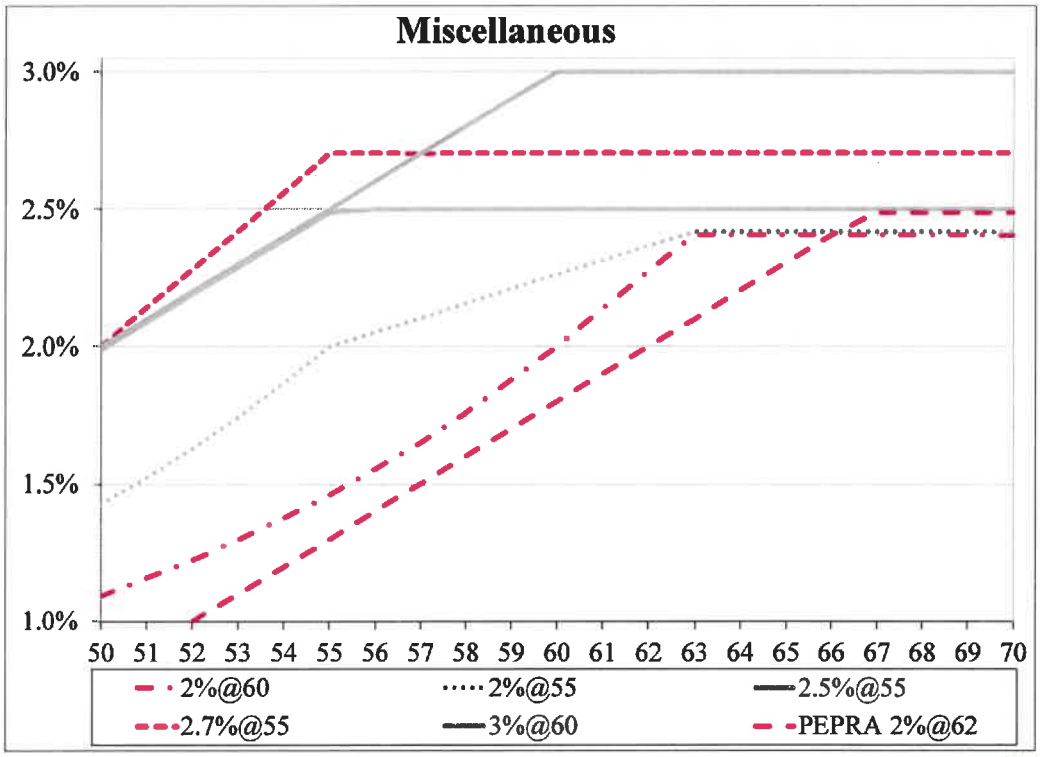
How We Got Here – Enhanced Benefits

- At CalPERS, Enhanced Benefits implemented using all (future & prior) service
- Typically not negotiated with cost sharing
- City of Menlo Park

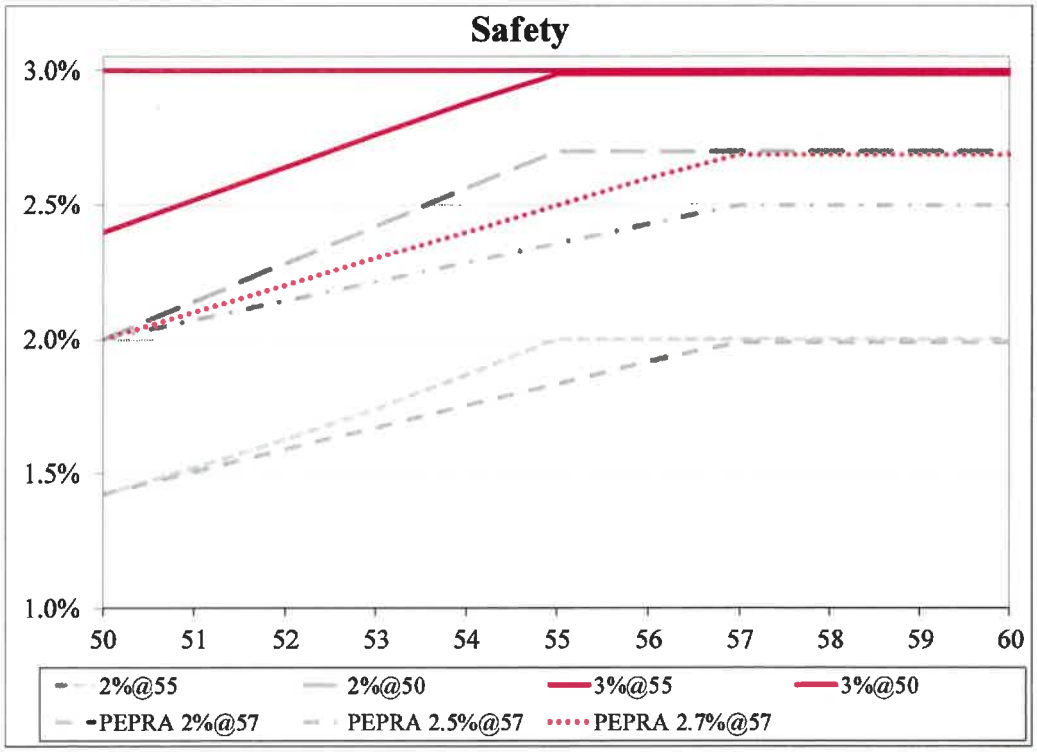
	Tier 1	Tier 2	PEPRA
Miscellaneous	2.7%@55 FAE1	2%@60 FAE3	2%@62 FAE3
Safety	3%@50 FAE1	3%@55 FAE3	2.7%@57 FAE3

  - Note:
    - FAE1 is highest one year (typically final) average earnings
    - FAE3 is highest three years (typically final three) average earnings

How We Got Here – Enhanced Benefits



How We Got Here – Enhanced Benefits



How We Got Here – Demographic

- Around the State
  - Large retiree liability compared to actives
    - State average: 55% for Miscellaneous, 65% for Safety
  - Declining active population and increasing number of retirees
  - Higher percentage of retiree liability increases contribution volatility

- City of Menlo Park percentage of liability belonging to retirees:
  - Miscellaneous 54%
  - Safety 69%

CalPERS Changes

- Contribution policy changes:
  - No asset smoothing
  - No rolling amortization
  - 5-year ramp up
  - Included in 6/30/13 valuation (first impact 15/16 rates; full impact 19/20)
- Assumption changes:
  - Anticipate future mortality improvement
  - Other, less significant, changes
  - Included in 6/30/14 valuation (first impact 16/17 rates; full impact 20/21)
- CalPERS Board changed their discount rate:

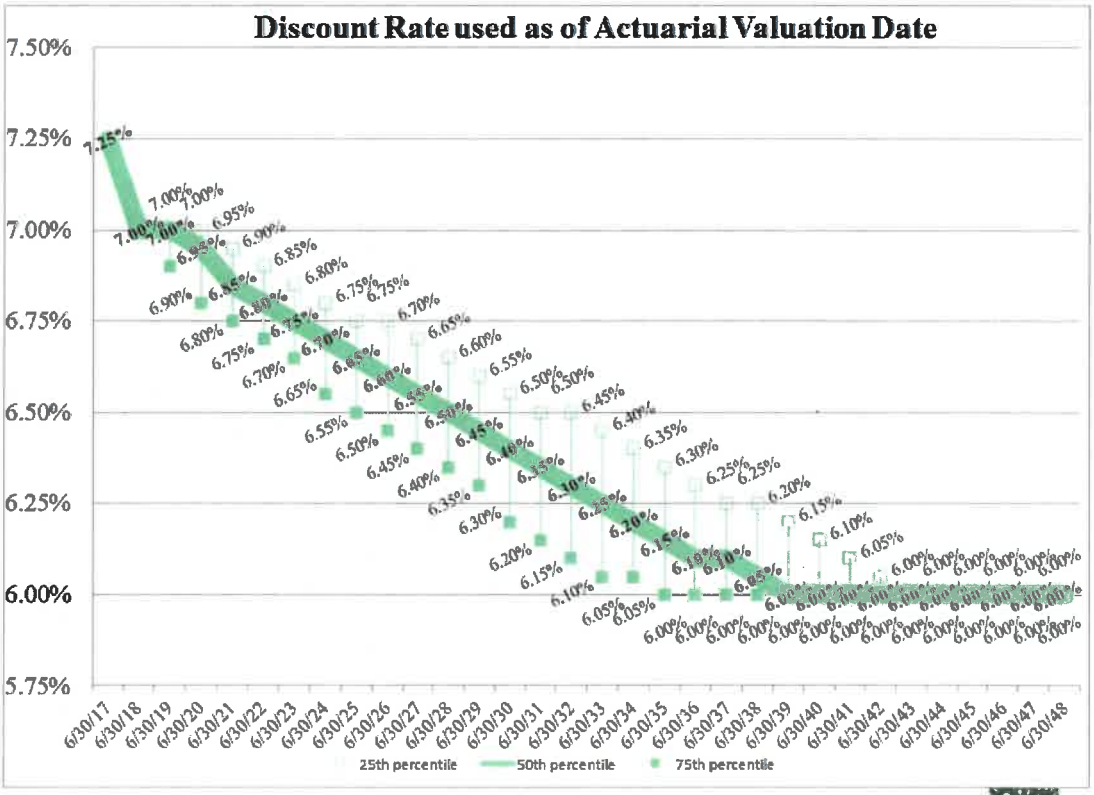
	Rate	Initial	Full
6/30/16 valuation	7.375%	18/19	22/23
6/30/17 valuation	7.25%	19/20	23/24
6/30/18 valuation	7.00%	20/21	24/25

- December 2018: CalPERS Board selected asset allocation similar to current portfolio. No change to the discount rate

CALPERS CHANGES

- Risk Mitigation Strategy
  - Move to more conservative investments over time to reduce volatility
  - Only when investment return is better than expected
  - Lower discount rate in concert
  - Essentially use ≈50% of investment gains to pay for cost increases
  - Likely get to 6.0% over 20+ years
  - Risk mitigation suspended until 6/30/18 valuation
- February 2018 CalPERS adopted new amortization policy
  - Applies only to newly established amortization bases
    - Fixed dollar amortization rather than % pay
    - Amortize gains/losses over 20 rather than 30 years
    - 5-year ramp up (not down) for investment gains and losses
    - No ramp up/down for other amortization bases
  - Minimizes total interest paid over time and pays off UAAL faster
  - Effective June 30, 2019 valuation for 2021/22 contributions
  - Included in this study

CALPERS CHANGES

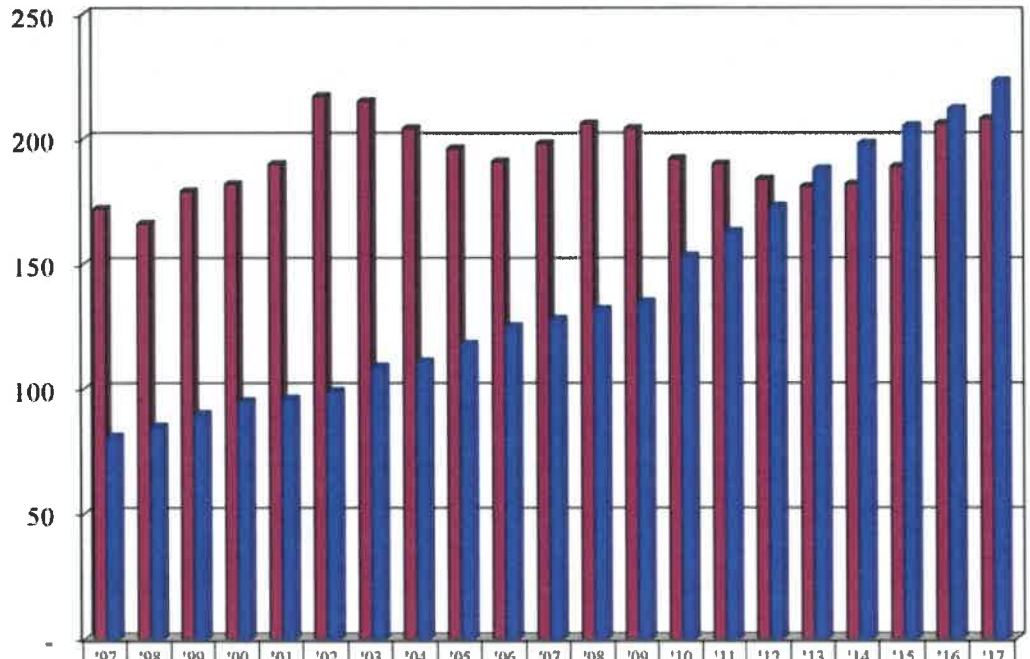


SUMMARY OF DEMOGRAPHIC INFORMATION - MISCELLANEOUS

	1997	2007	2016	2017
Actives				
■ Counts	172	198	206	208
■ Average				
• Age	42	44	44	44
• City Service	8	10	10	9
• PERSable Wages	$ 40,700	$ 64,700	$ 78,400	$ 81,800
■ Total PERSable Wages	7,800,000	14,100,000	17,600,000	18,500,000
Inactive Members				
■ Counts				
• Transferred	32	88	94	94
• Separated	48	120	131	142
• Retired				
◻ Service		100	176	185
◻ Disability		9	11	13
◻ Beneficiaries		19	25	25
◻ Total	81	128	212	223
■ Average Annual City Provided Benefit for Service Retirees[1]	N/A	$ 18,400	$ 25,900	$ 26,100
■ Active / Retiree Ratio (City)	2.1	1.5	1.0	0.9
■ Active / Retiree Ratio (All CalPERS)	N/A	1.7	1.3	1.3

[1] Average City-provided pensions are based on City service & City benefit formula, and are not representative of benefits for long-service employees.

SUMMARY OF DEMOGRAPHIC INFORMATION - MISCELLANEOUS

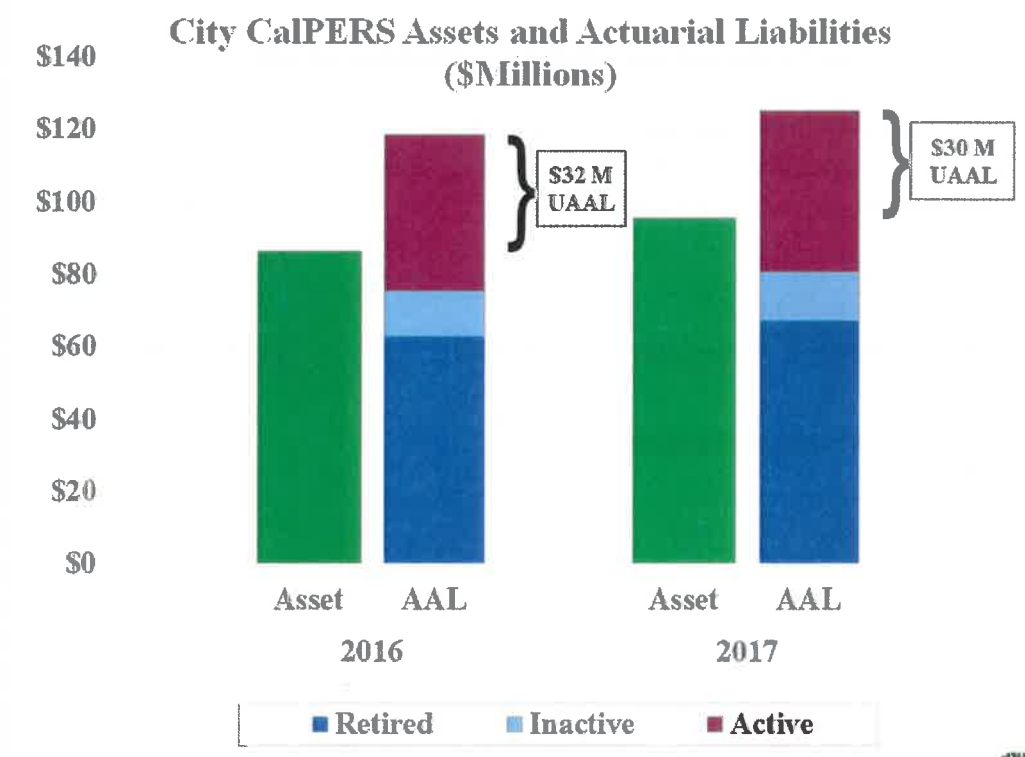


	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17
■ Active	172	166	179	182	190	217	215	204	196	191	198	206	204	192	190	184	181	182	189	206	208
■ Receiving Payments	81	85	90	95	96	99	109	111	118	125	128	132	135	153	163	173	188	198	205	212	223

PLAN FUNDED STATUS - MISCELLANEOUS

	June 30, 2016	June 30, 2017
Active AAL	$43,200,000	$44,900,000
Retiree AAL	62,500,000	67,100,000
Inactive AAL	12,700,000	13,300,000
Total AAL	118,400,000	125,300,000
Assets	86,200,000	95,400,000
Unfunded Liability	32,200,000	29,900,000
Funded Ratio	72.8%	76.1%

PLAN FUNDED STATUS - MISCELLANEOUS



PLAN FUNDED STATUS - MISCELLANEOUS

Discount Rate Sensitivity
June 30, 2017

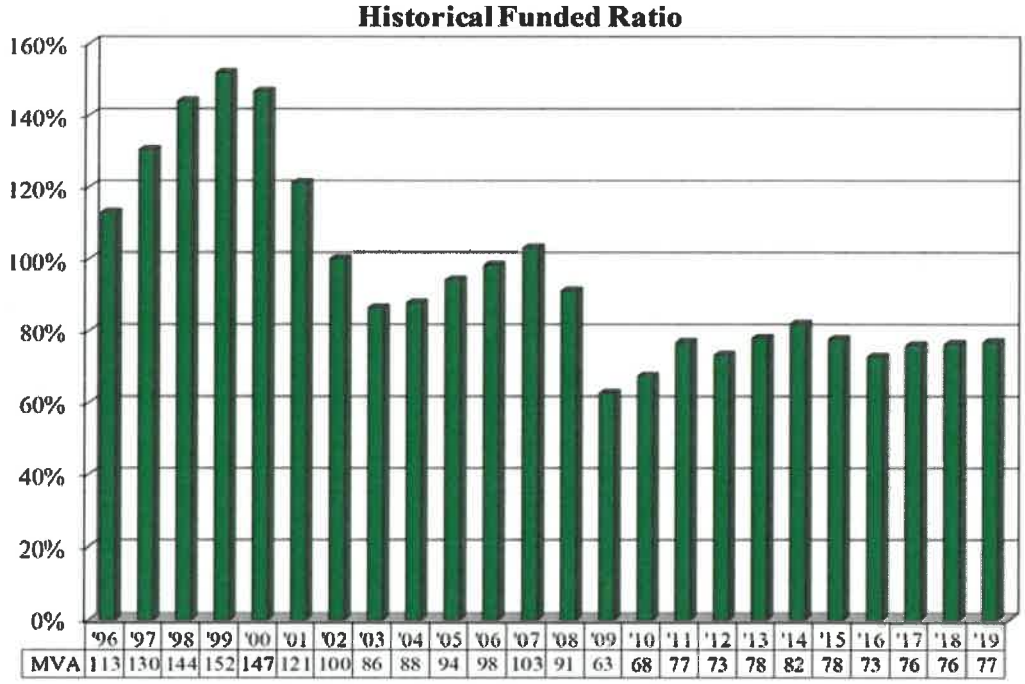
	Discount Rate		
	7.25%	**7.00%**	**6.00%**
AAL	$125,300,000	$128,700,000	$146,200,000
Assets	95,400,000	95,400,000	95,400,000
Unfunded Liability	29,900,000	33,300,000	50,800,000
Funded Ratio	76.1%	74.1%	65.3%

PLAN FUNDED STATUS - MISCELLANEOUS

Unfunded Accrued Liability Changes

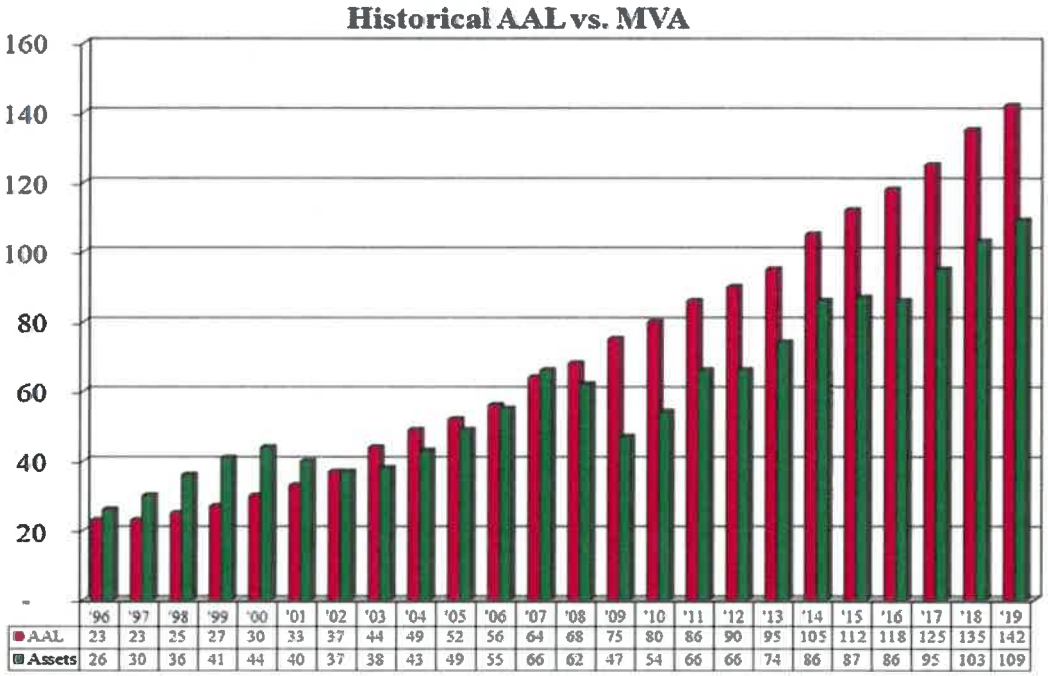
■ **Unfunded Accrued Liability on 6/30/16**		$32,200,000
■ **Expected Unfunded Accrued Liability on 6/30/17**		32,400,000
■ **Other Changes**		
• Asset Loss (Gain)	(3,200,000)	
• Assumption Change	2,100,000	
• Contribution & Experience Loss (Gain)	(1,400,000)	
• Total		(2,500,000)
■ **Unfunded Accrued Liability on 6/30/17**		29,900,000

FUNDED RATIO - MISCELLANEOUS



6/30/18 & 6/30/19 funded status estimated

FUNDED STATUS (MILLIONS) - MISCELLANEOUS



6/30/18 & 6/30/19 funded status estimated

CONTRIBUTION RATES - MISCELLANEOUS

CONTRIBUTION RATES - MISCELLANEOUS

	6/30/16 2018/2019	6/30/17 2019/2020
■ Total Normal Cost	16.9%	17.4%
■ Employee Normal Cost	7.4%	7.3%
■ Employer Normal Cost	9.5%	10.1%
■ Amortization Payments	12.7%	14.3%
■ Total Employer Contribution Rate	22.2%	24.4%

■ 2018/19 Employer Contribution Rate	22.2%
● Payroll > Expected	(0.2%)
● Asset Method Change (5th Year)	0.9%
● 6/30/14 Assumption Change (4th Year)	0.7%
● 6/30/16 Discount Rate Change (2nd Year)	0.2%
● 6/30/17 Discount Rate & Inflation (1st Year)	0.9%
● Other (Gains)/Losses	(0.3%)
■ 2019/20 Employer Contribution Rate	24.4%

CONTRIBUTION PROJECTIONS - MISCELLANEOUS

- Market Value Investment Return:
  - June 30, 2018 — 8.6%[2]
  - Future returns based on stochastic analysis using 1,000 trials

Single Year Returns at[3]	25th Percentile	50th Percentile	75th Percentile
Current Investment Mix	**0.1%**	**7.0%**	**14.8%**
Ultimate Investment Mix	**0.8%**	**6.0%**	**11.4%**

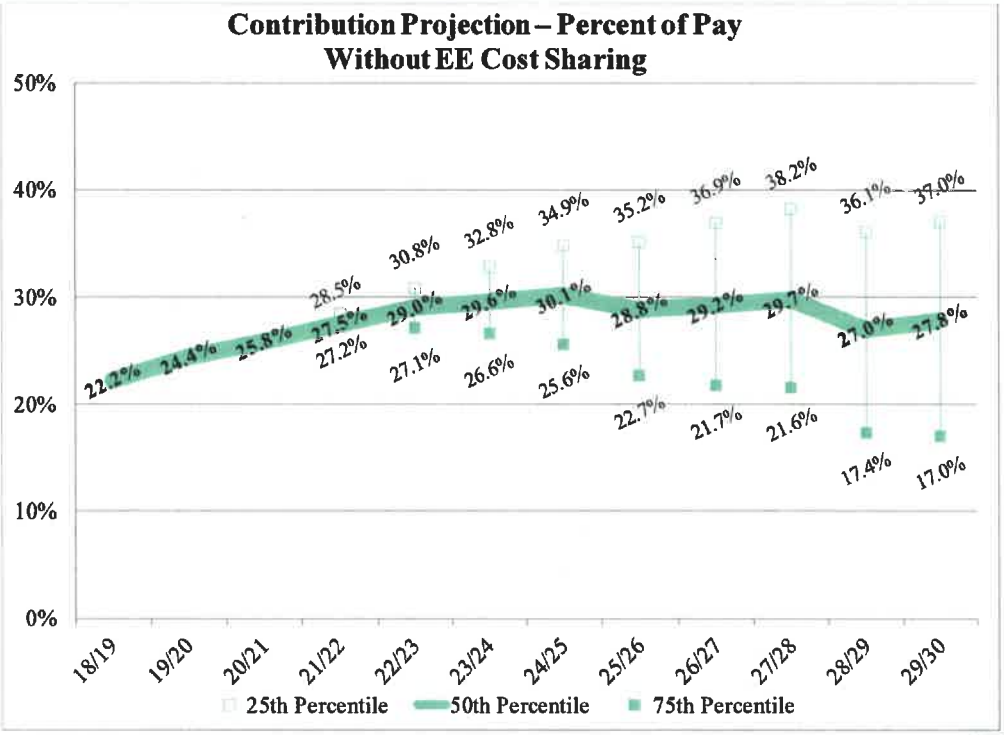
  - Assumes investment returns will, generally be 6.5% (as compared to 7.0%) over the next 10 years and higher beyond that.
- Assumption Changes – Discount Rate
  - Decrease to 7.0% by June 30, 2018 valuation
  - Additional Discount Rate decreases due to Risk Mitigation policy.
- No Other: Gains/Losses, Method/Assumption Changes, Benefit Improvements
- Different from CalPERS projection

[2] based July 2018 CalPERS press release
[3] Nth percentile means N percentage of our trials result in returns lower than the indicated rates.

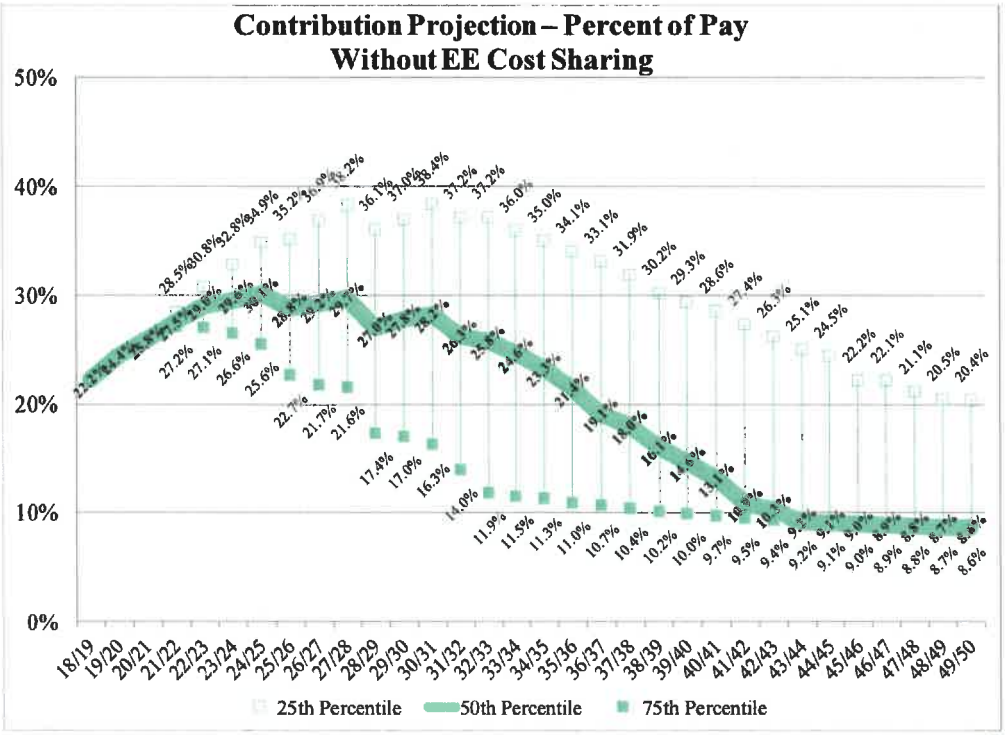
CONTRIBUTION PROJECTIONS - MISCELLANEOUS

- New hire assumptions:
  - 62.5% of 2018/19 new hires are PEPRA members and 37.5% are Classic members
  - Percentage of PEPRA member future hires to increase from 62.5% to 100% over 15 years
- Employee Cost Sharing:
  - Applies to Tier 1, Tier 2, and PEPRA employees
  - SEIU: 50/50 share begins when the employer rate rises above 14.597%
  - AFSCME and unrepresented: 50/50 share begins when the employer rate rises above 15.85%
  - Payroll: 75% for SEIU and 25% for AFSCME

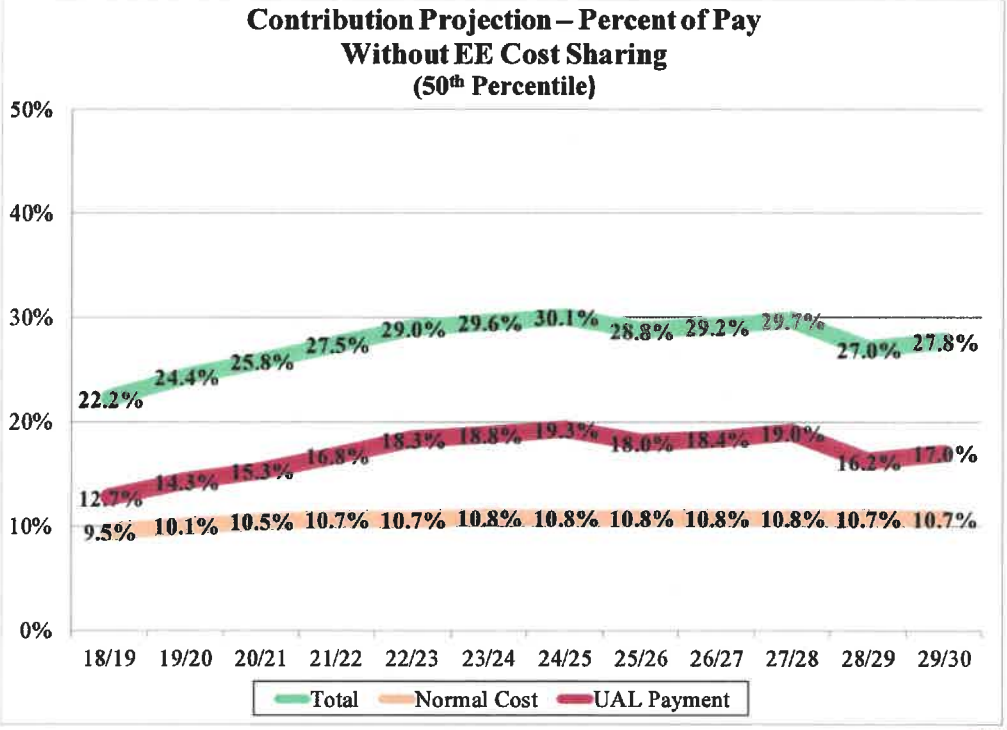
CONTRIBUTION PROJECTIONS - MISCELLANEOUS



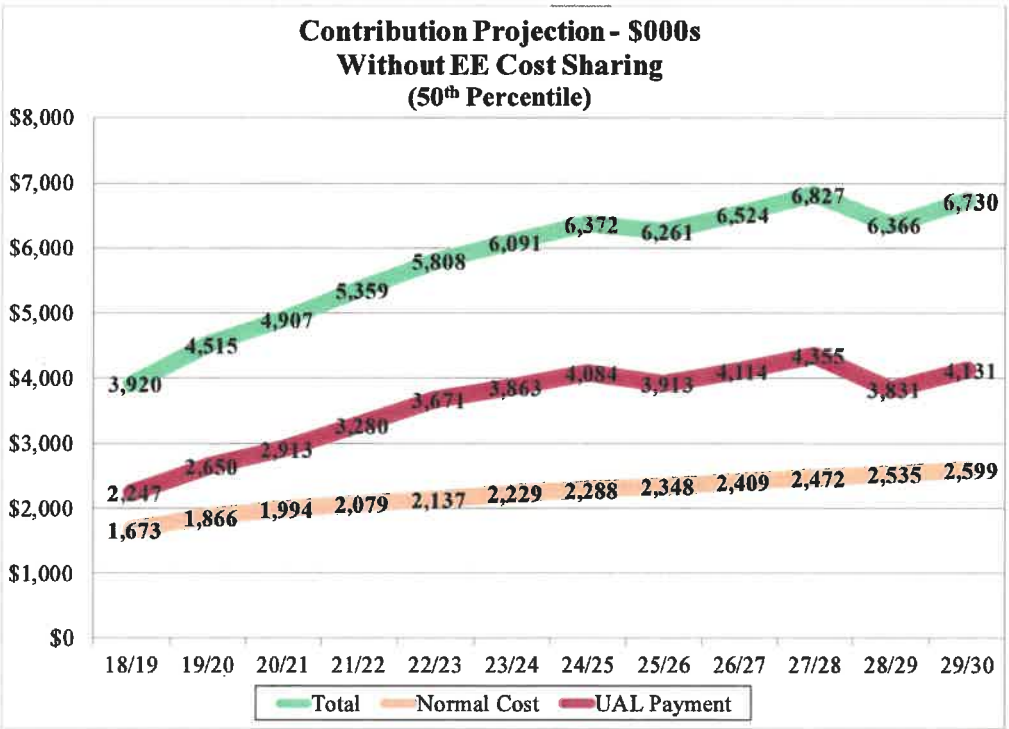
CONTRIBUTION PROJECTIONS - MISCELLANEOUS



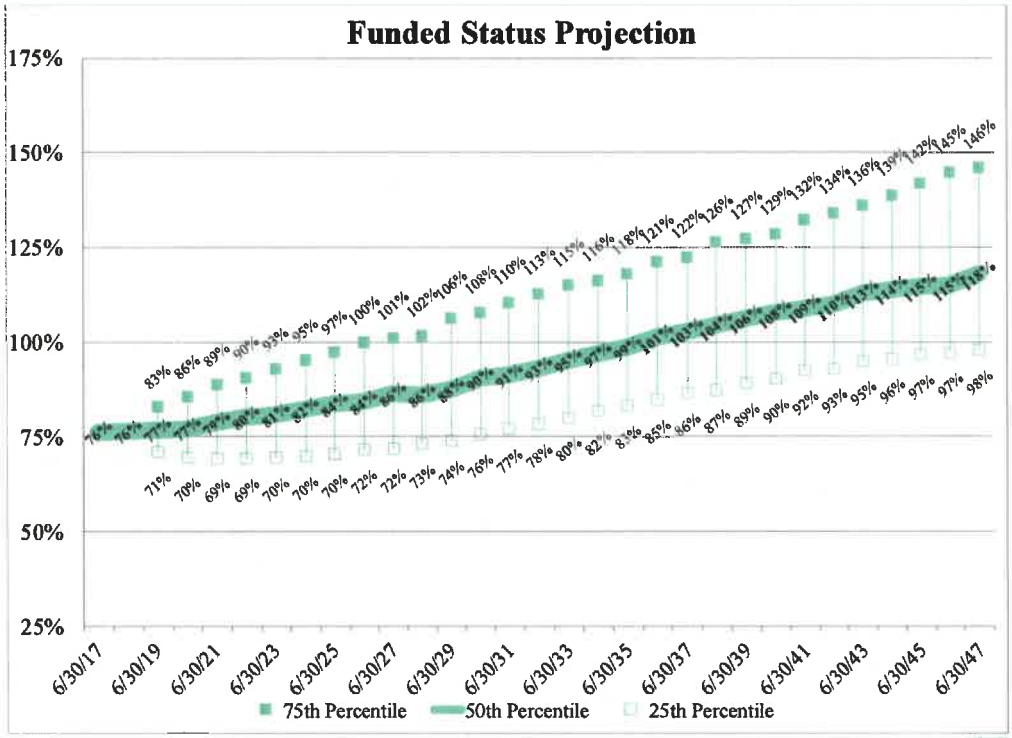
CONTRIBUTION PROJECTIONS - MISCELLANEOUS



CONTRIBUTION PROJECTIONS - MISCELLANEOUS



FUNDED STATUS - MISCELLANEOUS



FUNDED STATUS - MISCELLANEOUS

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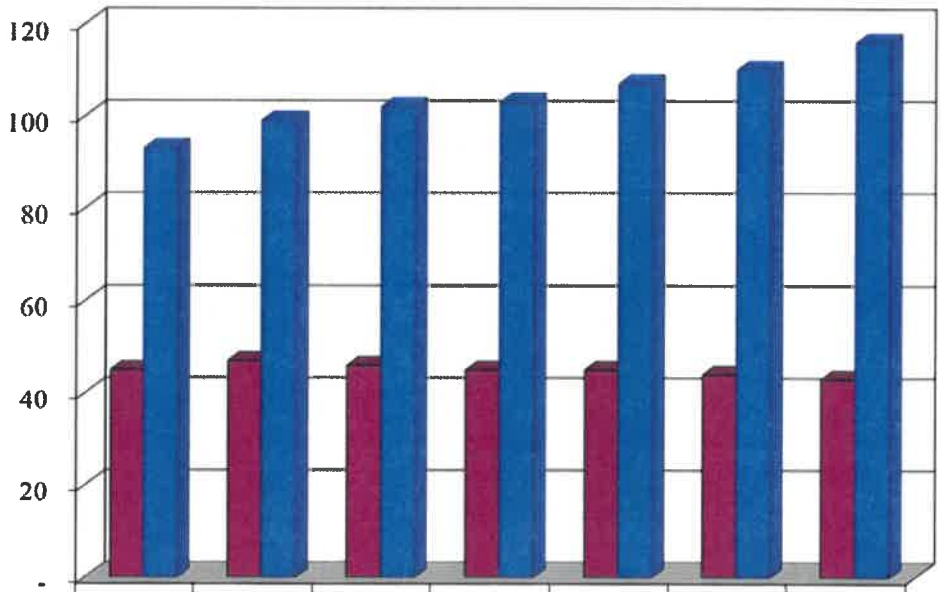
SUMMARY OF DEMOGRAPHIC INFORMATION - SAFETY

	2011	2014	2016	2017
Actives				
■ Counts	45	45	44	43
■ Average PERSable Wages	$ 149,100	$ 144,900	$ 149,600	$ 155,400
■ Total Projected PERSable Wages	6,700,000	6,500,000	6,600,000	6,600,000
Inactive Members				
■ Counts				
• Transferred	28	25	22	22
• Separated	12	12	11	11
• Retired	93	103	110	116
■ Active / Retiree Ratio (City)	0.5	0.4	0.4	0.4
■ Active / Retiree Ratio (All CalPERS)	1.5	1.3	1.3	1.3

SUMMARY OF DEMOGRAPHIC INFORMATION - SAFETY

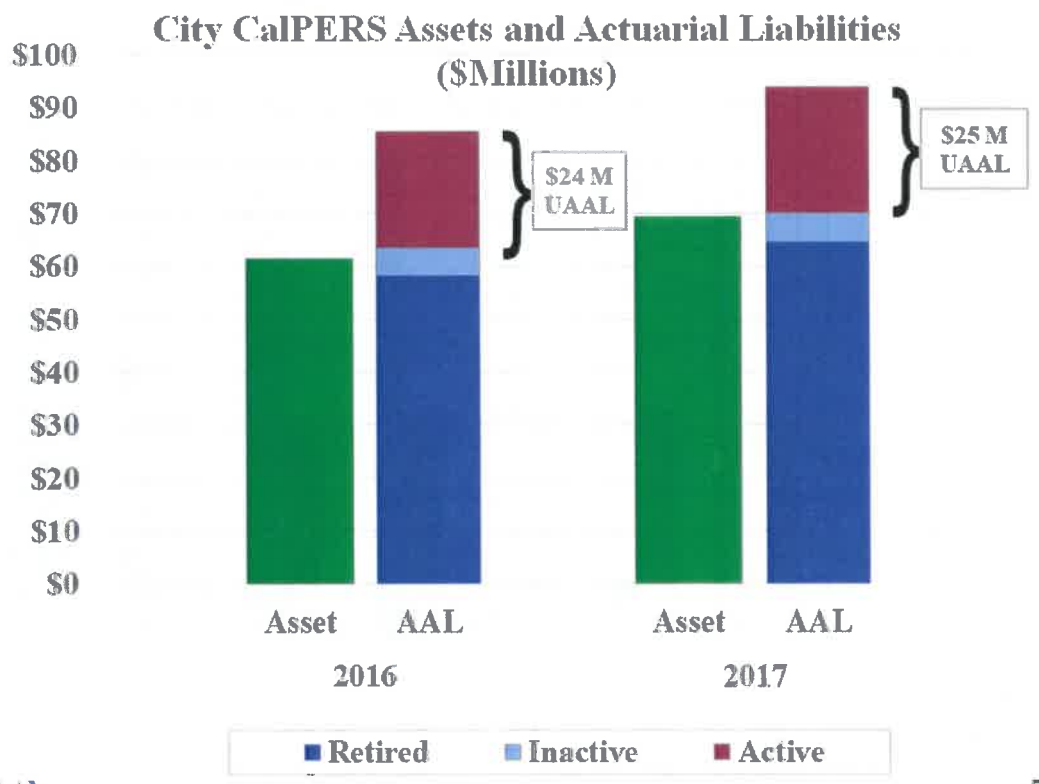


	'11	'12	'13	'14	'15	'16	'17
■ Active	45	47	46	45	45	44	43
■ Receiving Payments	93	99	102	103	107	110	116

PLAN FUNDED STATUS - SAFETY

	June 30, 2016	June 30, 2017
Active AAL	$22,200,000	$24,000,000
Retiree AAL	58,300,000	64,600,000
Inactive AAL	5,100,000	5,300,000
Total AAL	85,600,000	93,900,000
Assets	61,400,000	69,300,000
Unfunded Liability	24,200,000	24,600,000
Funded Ratio	71.7%	73.8%

PLAN FUNDED STATUS - SAFETY



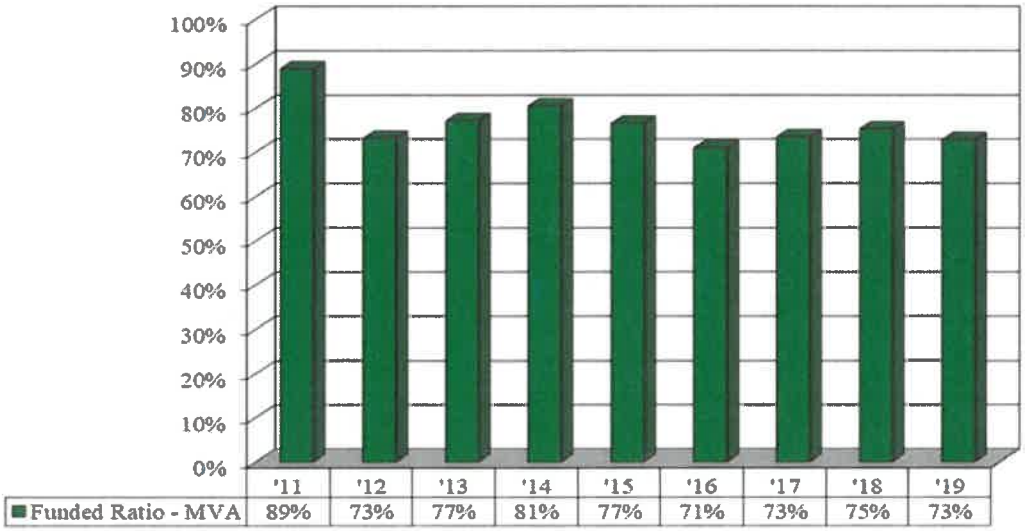
PLAN FUNDED STATUS - SAFETY

Discount Rate Sensitivity

June 30, 2017

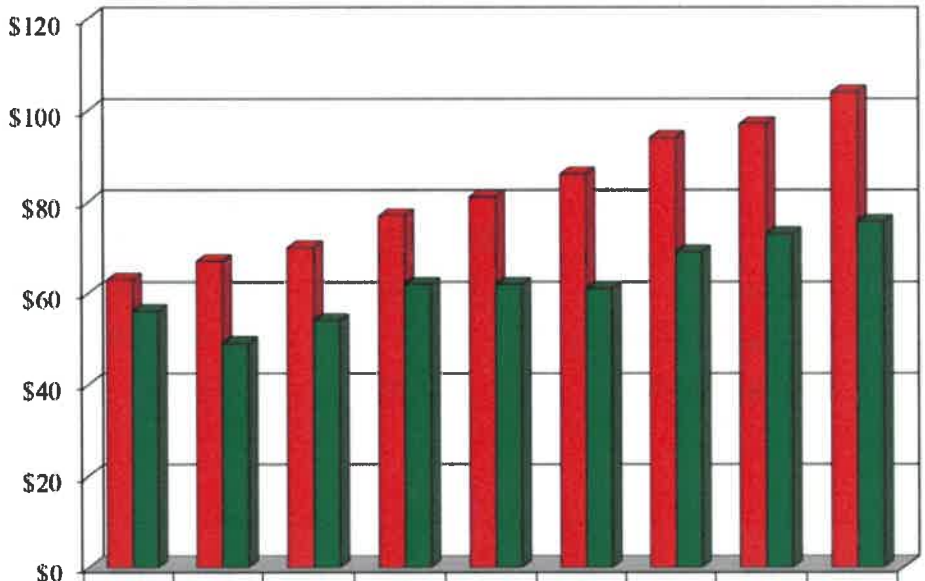
	Discount Rate		
	7.25%	**7.00%**	**6.00%**
AAL	$93,900,000	$96,600,000	$109,800,000
Assets	69,300,000	69,300,000	69,300,000
Unfunded Liability	24,600,000	27,300,000	40,500,000
Funded Ratio	73.8%	71.7%	63.1%

FUNDED RATIO - SAFETY



6/30/18 & 6/30/19 funded status estimated

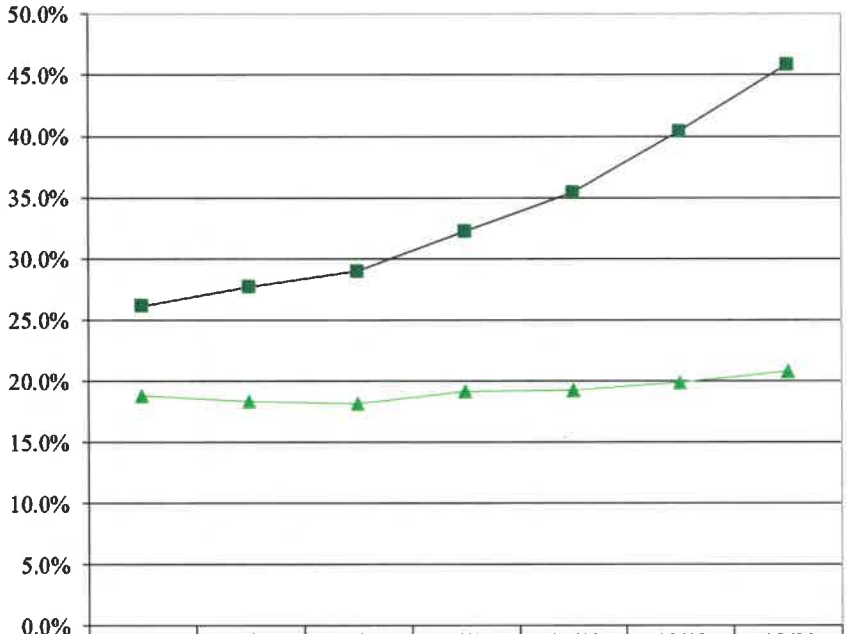
FUNDED STATUS (MILLIONS) - SAFETY



	'11	'12	'13	'14	'15	'16	'17	'18	'19
Actuarial Liability	63	67	70	77	81	86	94	97	104
Market Asset Value	56	49	54	62	62	61	69	73	76

6/30/18 & 6/30/19 funded status estimated

CONTRIBUTION RATES - SAFETY



	13/14	14/15	15/16	16/17	17/18	18/19	19/20
ER Normal Cost	18.8%	18.4%	18.2%	19.1%	19.3%	19.9%	20.8%
Total ER Cont Rate	26.1%	27.7%	29.0%	32.3%	35.5%	40.4%	45.8%

CONTRIBUTION RATES - SAFETY

	6/30/17 Valuation 2019/2020 Contribution Rates			
	Total[4]	Tier 1 3%@50	Tier 1 3%@55	PEPRA 2.7%@57
■ Base Total Normal Cost	29.1%	29.7%	27.9%	25.0%
■ Class 1 Benefits				
● Final Average Comp (1-Year)	1.0%	1.2%	-	-
■ Total Normal Cost	30.1%	30.9%	27.9%	25.0%
■ Formula's Expected EE Contr. Rate	9.3%	9.0%	9.0%	12.0%
■ ER Normal Cost	20.8%	21.9%	18.9%	13.0%
■ Amortization Bases	25.0%	29.0%	-	0.7%
■ Amortization of Side Fund	-	-	-	-
■ **Total ER Contribution**	**45.8%**	**50.9%**	**18.9%**	**13.7%**
■ Employee counts	43	35	1	7
■ Employee payroll (in 000's)	6,681	5,745	146	790
■ **Total ER Contribution $ (in 000's)**	**$ 3,061**			

[4] Weighting of total contribution based on projected classic and PEPRA payrolls

CONTRIBUTION RATES - SAFETY

	6/30/16 2018/2019	6/30/17 2019/2020
■ Total Normal Cost	29.1%	30.2%
■ Employee Normal Cost	9.2%	9.3%
■ Employer Normal Cost	19.9%	20.8%
■ Amortization Payments	20.5%	25.0%
■ Total Employer Contribution Rate	40.4%	45.8%

■ 2018/19 Employer Contribution Rate	40.4%
● Payroll < Expected	0.3%
● Asset Method Change (5th Year)	2.0%
● 6/30/14 Assumption Change (4th Year)	1.3%
● 6/30/16 Discount Rate Change (2nd Year)	0.5%
● 6/30/17 Discount Rate & Inflation (1st Year)	1.5%
● Other (Gains)/Losses	(0.2%)
■ 2019/20 Employer Contribution Rate	45.8%

CONTRIBUTION PROJECTIONS - SAFETY

- Market Value Investment Return:
  - June 30, 2018 8.6%[5]
  - Future returns based on stochastic analysis using 1,000 trials

Single Year Returns at[6]	25th Percentile	50th Percentile	75th Percentile
Current Investment Mix	**0.1%**	**7.0%**	**14.8%**
Ultimate Investment Mix	**0.8%**	**6.0%**	**11.4%**

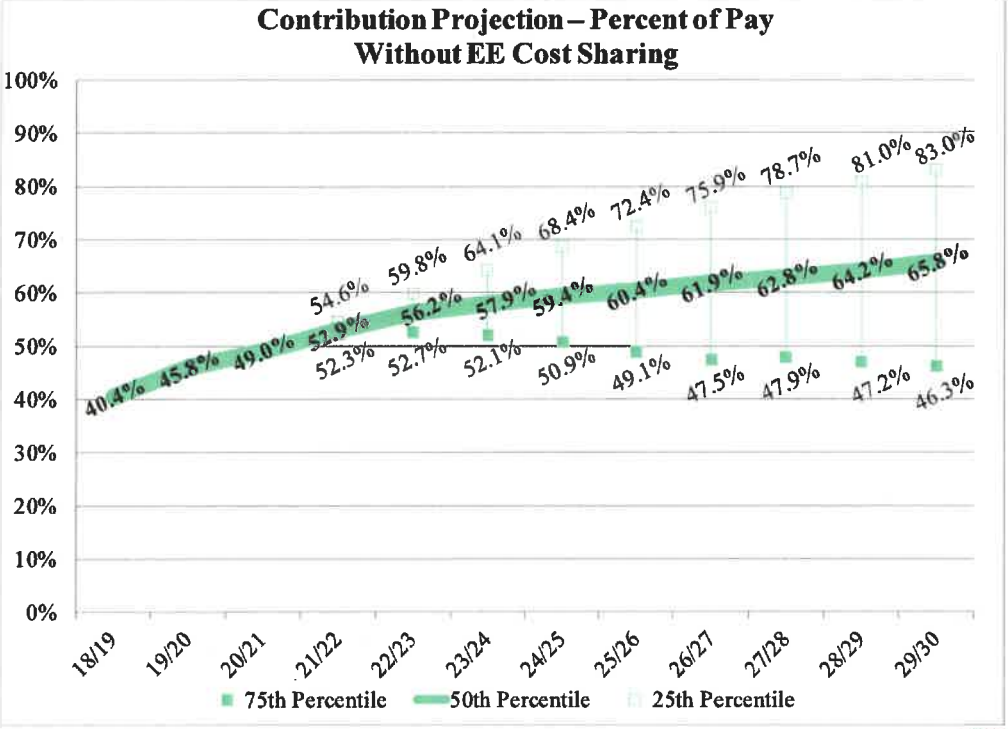
  - Assumes investment returns will, generally be 6.5% (as compared to 7.0%) over the next 10 years and higher beyond that.
- Assumption Changes – Discount Rate
  - Decrease to 7.0% by June 30, 2018 valuation
  - Additional Discount Rate decreases due to Risk Mitigation policy.
- No Other: Gains/Losses, Method/Assumption Changes, Benefit Improvements
- Different from CalPERS projection

[5] based July 2018 CalPERS press release
[6] Nth percentile means N percentage of our trials result in returns lower than the indicated rates.

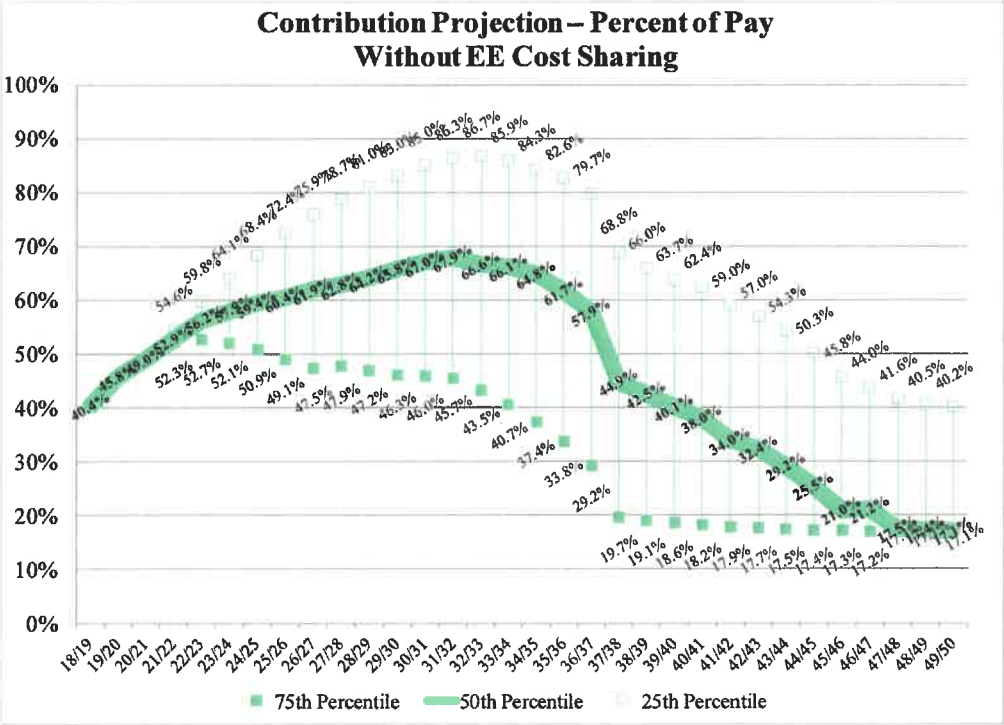
CONTRIBUTION PROJECTIONS - SAFETY

- New hire assumptions:
  - 75.0% of 2018/19 new hires are PEPRA members and 25.0% are Classic members
  - Percentage of PEPRA member future hires to increase from 75.0% to 100% over 5 years
- Employee Cost Sharing:
  - Safety Classic Tier 1 and Tier 2 employees pay 9% member rate plus an additional 3% , for total member contribution of 12%
  - PEPRA employees pay 12% plus ½ of the excess, if any, of the City rate over 12%.

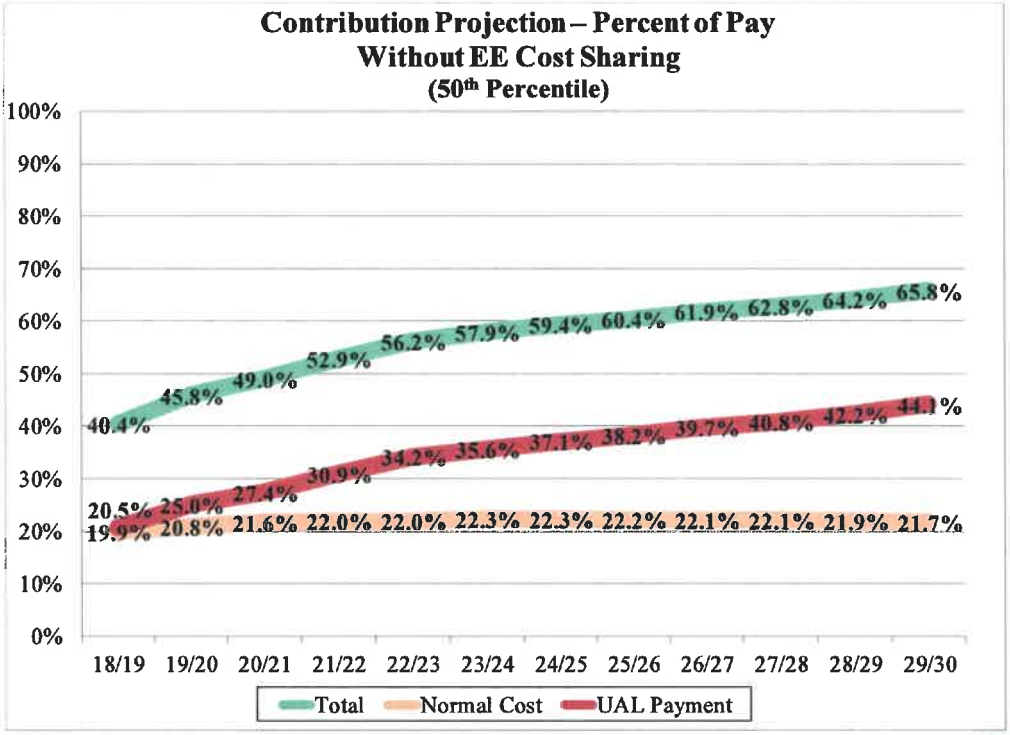
CONTRIBUTION PROJECTIONS - SAFETY



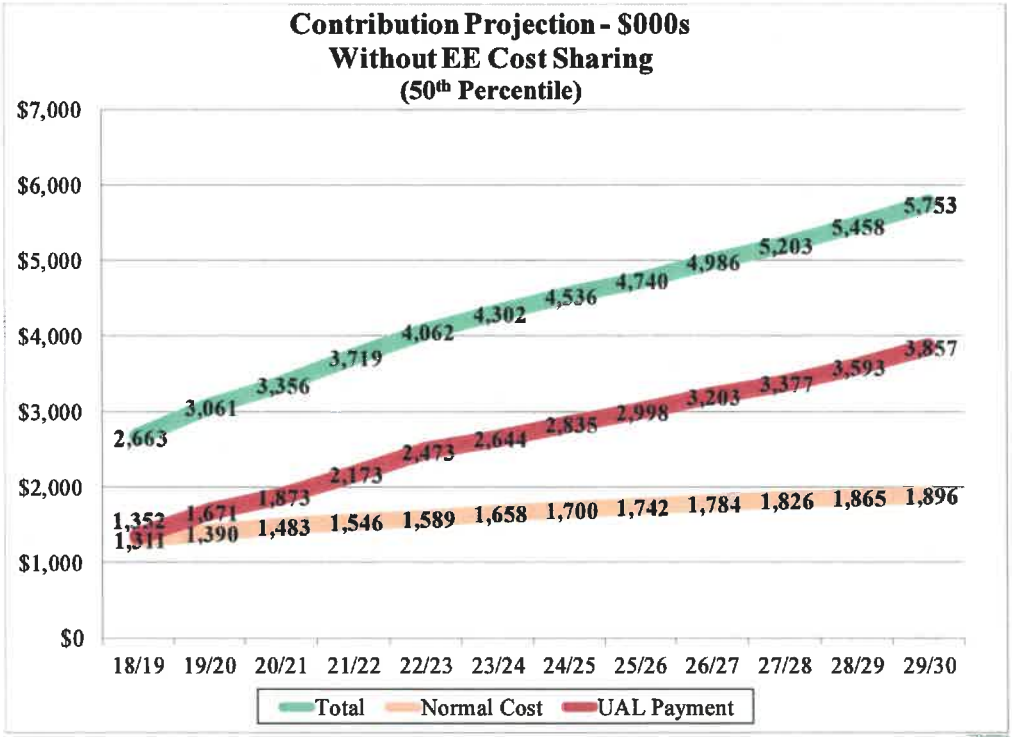
CONTRIBUTION PROJECTIONS - SAFETY



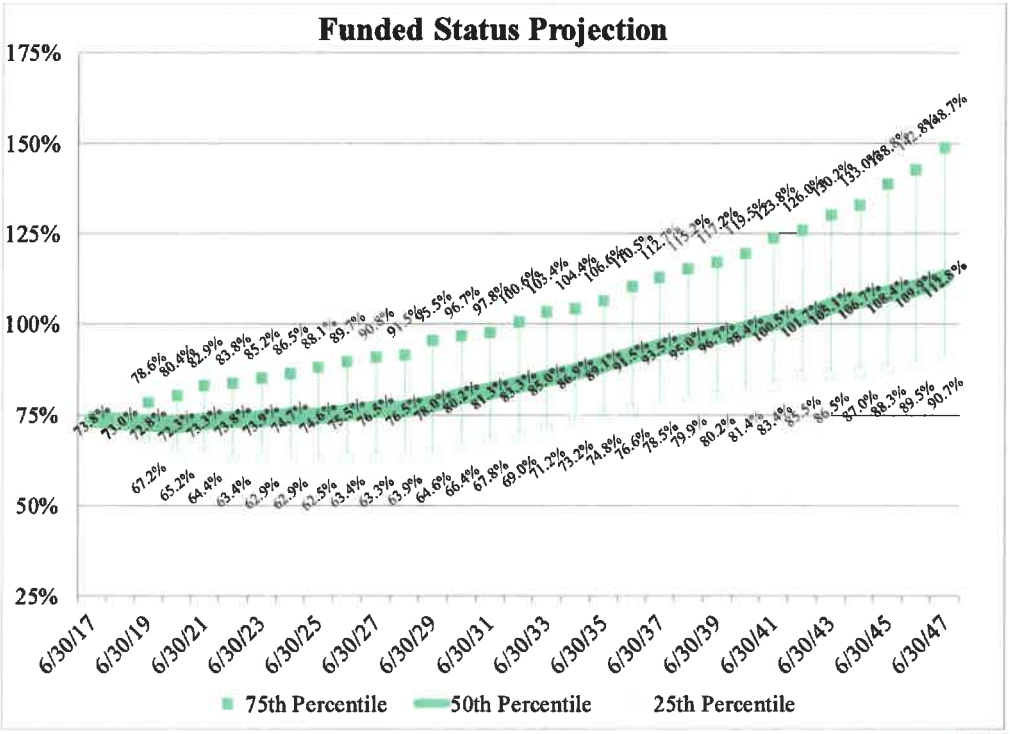
CONTRIBUTION PROJECTIONS - SAFETY



CONTRIBUTION PROJECTIONS - SAFETY



FUNDED STATUS - SAFETY



COMBINED MISCELLANEOUS AND SAFETY

Funded Status Summary on June 30, 2017
(Amounts in $Millions)

	Miscellaneous	Safety	Total
■ AAL	$ 125	$ 94	$ 219
■ Assets	95	69	164
■ Unfunded AAL	30	25	55
■ Funded Ratio	76.0%	73.4%	74.9%

LEAVING CALPERS

- Participation in CalPERS is governed by State law and CalPERS rules
- The following are considered "withdrawing" from CalPERS:
  - Exclude new hires from CalPERS & giving them a different pension
  - Stop accruing benefits for current employees
- "Withdrawal" from CalPERS:
  - Treated as plan termination
  - Liability increased for conservative investments
  - Liability increased for future demographic fluctuations
  - Liability must be funded immediately by withdrawing agency
  - Otherwise, retiree benefits are cut

LEAVING CALPERS

CalPERS Termination Estimates on June 30, 2017 (Amounts in Millions)

	Ongoing Plan	Termination Basis	
Discount Rate	**7.25%**	**1.75%**	**3.00%**
Miscellaneous			
AAL	$ 125	$ 237	$ 210
Assets	95	95	95
UAAL	30	142	115
Safety			
AAL	$ 94	$ 186	$ 165
Assets	69	69	69
UAAL	25	117	96
Total			
UAAL	$ 55	$ 259	$ 211
Funded Ratio	74.9%	38.8%	43.7%

PAYING DOWN THE UNFUNDED LIABILITY & RATE STABILIZATION

- Where do you get the money from?
- How do you use the money?

WHERE DO YOU GET THE MONEY FROM?

- POB:
  - Usually thought of as interest arbitrage between expected earnings and rate paid on POB
  - No guaranteed savings
  - PEPRA prevents contributions from dropping below normal cost
    - Savings offset when investment return is good
  - GFOA Advisory
- Borrow from General Fund similar to State
- One time payments
  - Council resolution to use a portion of one time money, e.g.
    - 1/3 to one time projects
    - 1/3 to replenish reserves and
    - 1/3 to pay down unfunded liability

How Do You Use the Money?

- Internal Service Fund
  - Typically used for rate stabilization
  - Restricted investments:
    - Likely low (0.5%-1.0%) investment returns
    - Short term/high quality, designed for preservation of principal
  - Assets can be used by Council for other purposes
  - Does not reduce Unfunded Liability

How Do You Use the Money?

- Make payments directly to CalPERS:
  - Likely best long-term investment return
  - Must be considered an irrevocable decision
    - Extra payments cannot be used as future "credit"
    - PEPRA prevents contributions from dropping below normal cost
  - Option #1: Request shorter amortization period (Fresh Start):
    - Higher short term payments
    - Less interest and lower long term payments
    - Likely cannot revert to old amortization schedule
      - Savings offset when investment return is good (PEPRA)

How Do You Use the Money?

- Make payments directly to CalPERS (continued):
  - Option #2: Target specific amortization bases:
    - ☐ Extra contribution's impact muted by reduced future contributions
      - CalPERS can't track the "would have been" contribution
    - ☐ No guaranteed savings
      - Larger asset pool means larger loss (or gain) opportunity
    - ☐ Paying off shorter amortization bases: larger contribution savings over shorter period:
      - e.g. 10 year base reduces contribution 12.3¢ for $1
      - Less interest savings vs paying off longer amortization bases
    - ☐ Paying off longer amortization bases: smaller contribution savings over longer period:
      - e.g. 25 year base reduces contribution 6.5¢ for $1
      - More interest savings vs paying off shorter amortization bases

How Do You Use the Money?

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IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

- Can only be used to:
  - Reimburse City for CalPERS contributions
  - Make payments directly to CalPERS
- Investments significantly less restricted than City investment funds
  - Fiduciary rules govern Trust investments
  - Usually, designed for long term returns
- Assets don't count for GASB accounting
  - Are considered Employer assets
- Over 100 trusts established, mostly since 2015
  - Trust providers: PARS, PFM, Keenan
  - California Employers' Pension Prefunding Trust (CEPPT) is coming

IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

- More flexibility than paying CalPERS directly
  - City decides if and when and how much money to put into Trust
  - City decides if and when and how much to withdraw to pay CalPERS or reimburse Agency
- Funding strategies typically focus on
  - Reducing the unfunded liability
    - ☐ Fund enough to make total CalPERS UAAL = 0
    - ☐ Make PEPRA required payments from Trust when overfunded
  - Stabilizing contribution rates
    - ☐ Mitigate expected contribution rates to better manage budget
  - Combination
    - ☐ Use funds for rate stabilization/budget predictability
    - ☐ Target increasing fund balance to pay off UAAL sooner

IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

- Consider:
  - How much can you put into Trust?
    - ☐ Initial seed money?
    - ☐ Additional amounts in future years?
  - When do you take money out?
    - ☐ Target budget rate?
    - ☐ Year target budget rate kicks in?
      - ○ Before or after CalPERS rate exceeds budgeted rate?

IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

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Direct Payment to CalPERS

- Following example illustrates additional contribution of $1 million to CalPERS on June 30, 2019:
- Miscellaneous
  - Long Base: 2016 Gain/Loss
  - Short Base: 2003 Assumption Change
- Safety
  - Long Base: 2017 Non-Asset Gain/Loss and 2016 Asset Gain/Loss
  - Short Base: 2017 Fresh Start and 2014 Assumption Change
- Estimated Savings

	Miscellaneous	Safety
Short Base	**$1 million**	**$1 million**
$ Savings (000's)	$225	$660
PV Savings @ 3% (000's)	120	317
Long Base	**$1 million**	**$1 million**
$ Savings (000's)	$1,549	$1,560
PV Savings @ 3% (000's)	642	646

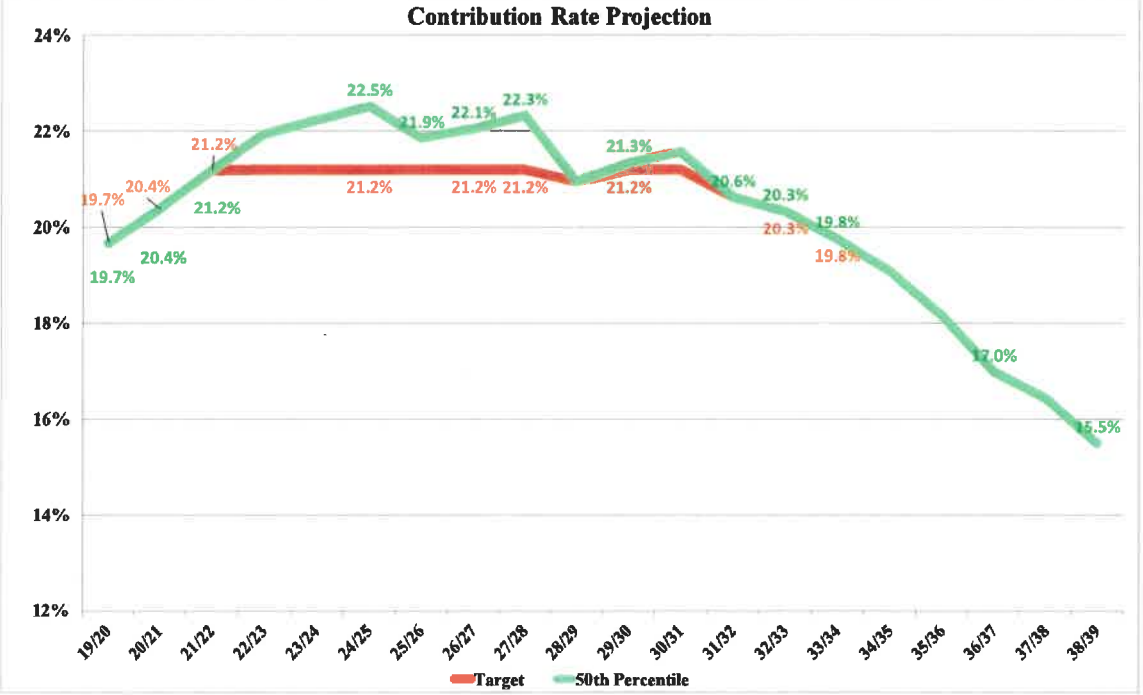
Payment to 115 Trust

	Miscellaneous	Safety
Trust Contributions	**$1 million**	**$1 million**
Trust Earnings	**5%**	**5%**
Trust Target		
- Target Rate	21.2%	61.9%
- 1st Year	2022/23	2028/29
- Last Year	2030/31[7]	2034/35
$ Savings (000's)	$409	$896
PV Savings @ 3% (000's)	170	315

[7] Except 2028/29 where the contribution rate is projected lower than the target rates.

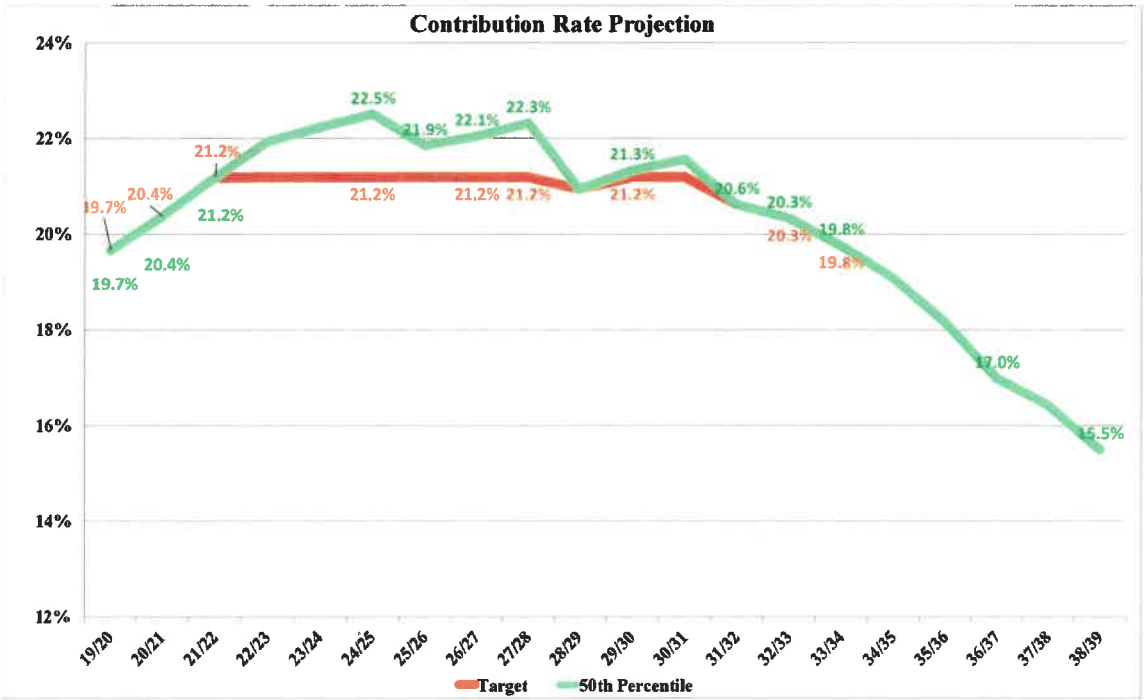
IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

Miscellaneous



IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

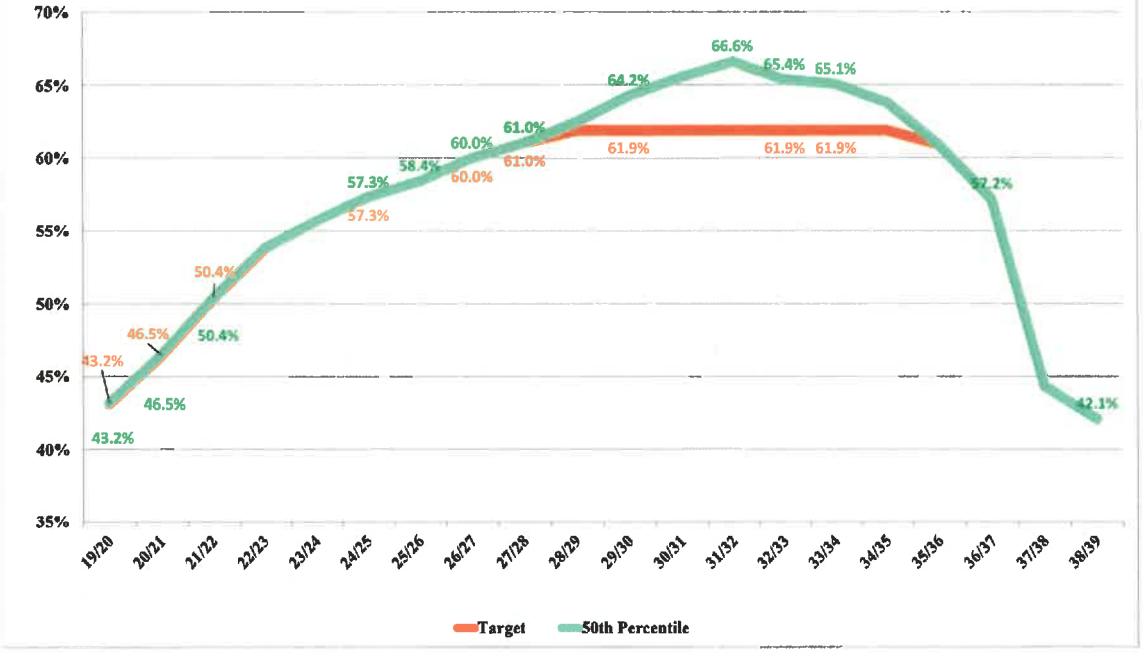
Miscellaneous



IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

Safety

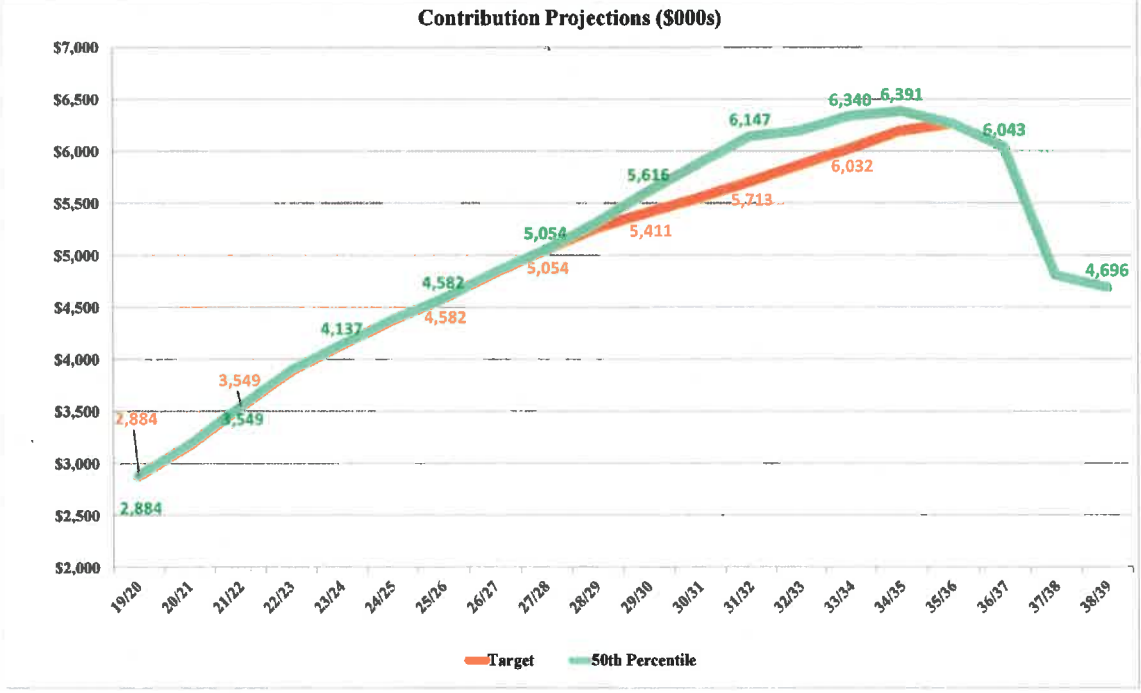
Contribution Rate Projection



IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

Safety

Contribution Projections ($000s)



TOWN OF LOS GATOS

FINANCE COMMITTEE REPORT

MEETING DATE: 06/17/2019

ITEM NO: 3

DESK ITEM

DATE: JUNE 17, 2019

TO: COUNCIL FINANCE COMMITTEE

FROM: LAUREL PREVETTI, TOWN MANAGER

SUBJECT: REVIEW AND PROVIDE DIRECTION ON ADDITIONAL DISCRETIONARY PAYMENT STRATEGIES

REMAKRS:

Attachment 3 contains public comments received between Friday 11:01 a.m. June 14, 2019 and Monday 11:00 a.m. June 17, 2019.

Attachment (previously distributed with the Committee Report):

1. Public Comment

Attachment (previously distributed with the Addendum):

2. Public Comment Received after Publishing the Committee Report and before 11:00 a.m. Friday, June 14, 2019.

Attachment received with this Desk Item:

3. Public Comments Received between Friday 11:01 a.m. June 14, 2019 and Monday 11:00 a.m. June 17, 2019

PREPARED BY: ARN ANDREWS
ASSISTANT TOWN MANAGER

Reviewed by: Town Manager, Finance Director, and Town Attorney

Subject: Why hasn't the Staff asked Bartels for this analysis?
Attachments: D Pryor Amot Base priority table 1'22'19.pdf

From: Phil Koen <pkoen@monteropartners.com>
Sent: Saturday, June 15, 2019 6:14 AM
To: Steven Leonardis <SLeonardis@losgatosca.gov>; BSpector <BSpector@losgatosca.gov>; Terry Duryea >; Rick Tinsley
Cc: Laurel Prevetti <LPrevetti@losgatosca.gov>; Stepnen Conway <sconway@losgatosca.gov>; Arn Andrews <aandrews@losgatosca.gov>; jak vannada < Lee Fagot < >
Subject: Why hasn't the Staff asked Bartels for this analysis?

Dear Members of the Finance Committee,

If the goal of an ADP strategy is to "reduce unfunded Pension and OPEB obligations" as stated in the Staff memo, why wouldn't the Staff request our actuary, Bartels Associates, to make a recommendation as to the best use of the $7m available to that end? The memo from the Staff does not present any financial analysis as to what actually would happen if the Town used all of the funds in the 115 Trust ($4.4m) in addition to all of the Pension Reserve funds in the General Fund (approximately $2.6m) and make an ADP payment to Calpers. How much savings would the Town realize? How would these savings impact future Town Budgets as shown in the 5 year plan? Does a direct ADP payment to Calpers of $7m today give the Town the highest PV savings vs a budget stabilization strategy which was discussed the March 5, 2019 report to the Oversight Committee?

Without actually doing the hard work of modeling the impact of these ADP strategies, a fact based decision can't be made. This has not happened to date.

Attached is an email from Doug Pryor who works for Bartel Associates to Roddy Sloss who is a member of Los Altos Hills Finance Committee where Mr. Pryor presents his analysis of the interest savings which would result from the Town of Los Altos Hills making a $1m additional payment to Calpers for 6 separate amortization bases. My recommendation is to request Bartels to do the same analysis for the Town of Los Gatos.

Once a proper financial analysis is performed, I believe a factual decision can be made.

Thank you.

Phil Koen

ATTACHMENT 3

Subject **RE: Town of Los Altos Hills - Planning for 2019 Pension Prepayment**

From Doug Pryor <dpryor@bartel-associates.com>

To roddy <roddy@rsloss.com>

Cc Kelly Mayes <kmayes@losaltoshills.ca.gov>, Tran Nguyen <tnguyen@losaltoshills.ca.gov>, Bill Silver <wrsilver@gmail.com>, Allan Epstein <Allanepstein@aol.com>

Date 2019-01-22 10:35

roundcube
open source webmail software

- Doug Pryor DRAFT meeting memo Dec 18 2018 (1) with BA Comments.docx (~571 KB)

Hi Roddy,

Sorry for not getting back to you sooner. Following is our calculation of interest savings for the 6 bases that will result in the largest savings to the Town. These calculations use a 7% interest rate.

Base	Amortization Period	6/30/2019 Balance	$1,000 Additional Payment	
			Interest Savings	Present Value Savings @ 3% Discount Rate
2014 non-asset gain/loss	27	$ 1,187	$ 1,302	$ 555
2013 gain/loss	26	1,475,443	1,214	524
2017 assumption change	20	265,147	951	440
2016 assumption change	19	243,195	839	393
pre 2013 UAL	18	972,309	820	381
2014 assumption change	17	664,164	668	321

For the memo, attached are a few updates (tracked).

Thanks,

Doug Pryor
Vice President and Actuary
BARTEL ASSOCIATES, LLC
411 Borel Avenue, Suite 101
San Mateo, California 94402
office: *650/377-1602*
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-----Original Message-----
From: roddy <roddy@rsloss.com>
Sent: Thursday, January 17, 2019 5:13 PM

To: Doug Pryor <dpryor@bartel-associates.com>
Cc: Kelly Mayes <kmayes@losaltoshills.ca.gov>; Tran Nguyen <tnguyen@losaltoshills.ca.gov>; Bill Silver <wrsilver@gmail.com>; Allan Epstein <Allanepstein@aol.com>
Subject: Town of Los Altos Hills - Planning for 2019 Pension Prepayment

Hi Doug:

Kelly Mayes, unfortunately, will be leaving the Town and returning to Kodiak, Alaska. So, for now, I will be following up with you on items from our Dec 3, 2018 meeting.

Please let me know when you will be able to respond. We are still planning to present the subject matter to the Town's Finance and Investment Committee on March 4 with your support. We will need at least four weeks lead time to prepare and review the materials and schedule the meeting.

Thank you and best regards. --- roddy sloss

Subject: June 17, 2019 Town Council Finance Committee Meeting
Attachments: ATT00001.htm

From: Terry Duryea <tduryea@aol.com>
Date: June 16, 2019 at 10:11:12 AM PDT
To: Laurel Prevetti <LPrevetti@losgatosca.gov>
Cc: Arn Andrews <aandrews@losgatosca.gov>, Stephen Conway <sconway@losgatosca.gov>
Subject: June 17, 2019 Town Council Finance Committee Meeting

Date: June 16, 2019 (Sunday)
To: Finance Committee Members and Town Staff (bcc'd to all Town Council as I recently learned they receive all FC correspondence)
From: Terry Duryea, Committee Member

I am disappointed that I will not be able to attend the Monday, June 17 Finance Committee meeting as a personal matter has interceded. I do expect to be at the August meeting.

Based on the material distributed as of this weekend, I have the following comments for the Finance Committee members and Town Staff to consider as part of the general discussion.

I am sorry they are delivered in writing rather than in person.

Item 1—Approve Draft Minutes from March 11, 2019
I have no comments

Item 2—Review and Provide Recommendations for Future Revenue Opportunities
The 5 page staff report does a nice job of listing possible revenue sources, but it doesn't provide sufficient information to make recommendations. There is no discussion of dollars that could be raised and the pros and cons of alternatives are not presented.

In making a list, I would add the following additional revenues sources to the list:

- Audit Transit Occupancy Tax compliance and Business License Tax compliance if the forecasted additional revenue would be expected to exceed the cost of the audit. If there is a staffing limitation, these audits can be outsourced.

I believe any discussion of future revenue opportunities that include raising taxes on our residents in one form or another should include a discussion of why the Town needs the additional revenue.

In my limited time involved with Town finances, I see cash balances increasing at the same time money seems to be available for necessary projects. For example, three years ago the Town was struggling with a declining PCI that was under 70 and projected to decline further, while the recent budget discussions seem to indicate the Town now believes it can meet and sustain a PCI of 72.

In addition, the community continues to request greater transparency in budgeting and financial reporting. In my opinion, before asking the voters to approve an additional tax, the Town needs to update its budgeting process to reflect greater transparency and follow current best practices in the government sector, and to provide greater transparency in its financial reporting.

Item 3—Review and Provide Direction on Additional Discretionary Payment Strategies

The topic is "additional discretionary payment strategies" but it seems the memo also introduces the idea of changing the asset allocation of the OPEB Trust and the 115 Pension Trust.

I would expect these to be discussed separately as they are only obliquely related.

But since the memo combines the tow, my comments below follow the staff memo, trying to distinguish between the two issues.

As a general comment on asset allocation, to make an informed recommendation on asset allocations for the two post-employment trusts (115 Pension & OPEB), the Committee needs to understand the Town's "risk capacity" and "risk tolerance" over the next 10 years?

Hopefully a consideration of risk and risk capacity will integrate a discussion of the significance of the "standard deviation" information disclosed for the three investment alternatives for the OPEB Trust (per page 4 of memo: 11.83% to 7.28%)? Should I conclude that Strategy 1 is more than 60% riskier than Strategy 3 since the Strategy 1 standard deviation is 62.5% larger than the Strategy 3 standard deviation? Or is that even a relevant question?

Here are my comments on each of the Trusts

Town OPEB 115 Trust
Observations on Staff Memo:

- The 8.33% inception to date return following Strategy 1 is impressive. It's important not to conclude that i) that Trust is getting a superior return over CALPERs or other investment vehicles (CALPERs had a 8.1% return for the five years ended June 30, 2018 that is the closest comparison), or ii) that the fund will earn these type of returns in the future. The first money was invested on June 29, 2009 after the 2008 financial market meltdown just as the market was beginning a historical 10 year climb to record high equity values. The timing of the Town Council recommendation was fortunate.
- It's also important to recall that Strategy 1 was the only strategy available at the time of the initial investment in the OPEB Trust. Again, the Town was fortunate that the only option available at the time was the option with the greatest equity exposure when compared to the 3 options offered today.

Unanswered questions and information needed to make a decision on 115 Trust asset allocation:

- To make a decision on asset allocation, it's necessary to understand the Town's investment horizon. When does the Town expect to begin making <u>net</u> drawdowns of Trust assets as a result of payments to employees/their beneficiaries.
    - If the Town does not expect to make a net drawdown to this trust in the next 10 years, it can take greater risk and invest the funds in a more aggressive asset allocation with a higher standard deviation
- Why does the Town continue to prefund the OPEB Plan increasing its funded status, while the Pension Plan funding status declined over 6 ½ percentage points from 2014 to 2017 (latest reported info)? Other factors that should impact the decision of how to allocate funds between the OPEB Plan or the Pension Plan include:
    - The assumed interest rate on the OPEB plan at 6.75% that is lower than the 7% assumed interest rate on the Pension plan
    - There is no "California Rule" for the Town's post-employment medical benefits. Thus the Town has more flexibility in meeting OPEB obligations than it does in fulfilling its PENSION obligations. This becomes important in the face of a financial crisis
    - 10 years have passed since he 2009 Town Council approval of a Finance Department recommendation to initiate a 10 year phase in of pre-funding of OPEB obligations
    - A commitment was made by Staff to the Finance Committee at an earlier Committee meeting to revisit this commitment of continuing to pre fund the OPEB Trust at the same rate it has the last few years

My position on any prefunding of OPEB Trust , and on allocation of OPEB trust assets:

- I would <u>not</u> continue to <u>pre</u>fund the OPEB Trust until Staff presents a comparison of the benefits of using funds to fund the OPEB Trust vs funding the Town's pension obligations—my instincts tell me the funds are better used to fund the Pension obligation—see further discussion below
- Personally, so long as the Town does not believe it will need a net withdrawal of funds from this trust, I see no reason to change asset allocation based on information provided UNLESS there is reasonable expectation that the equity markets will suffer as much in the next downturn as they did during the financial market induced equity market meltdown in 2008, i.e. a greater than 2 standard deviation decline on the entire asset portfolio. I do not believe that is the case.

CALPERs Town Miscellaneous and Safety Plans

Observations

- Some of the Disadvantages listed seem pretty hollow:
  - "No control over the discount rate"—technically true but Bartels can run the payments and UUAL using different discount rates holding all other assumptions constant so the Town could make funding decisions using the Bartels analysis
  - "Assets restricted to pension benefits"—yes, that is the same as with the 115 Trust
  - "Pooled liability risk with Safety Plan"—it's unclear to me how discussion of assets impacts "pooled" nature of Safety Risk

Additional information requested to make decision on ADP to CALPERs [and/or 115 Pension Trust]

- What is the UUAL and funded status for the Town's Pension obligations using the same 6.25% and 5.5% discount rate as used for the OPEB analysis? If the Staff presents this information for the Committee to consider prefunding the OPEB obligation, please provide the same for the Pension obligation so we when we consider an ADP for the Pension obligation?
  - I believe a discount factor of 5.5% will show the Pension Obligations will overwhelm the Town's ability to continue to provide services IF the actual market returns come in close to that amount.

My position on an ADP:

- If we are going to make ADP to CALPERs, we should know where the contribution will have the greatest impact over the next 10 years on our annual pension contributions, so YES, please request the analysis from Bartels that you suggest.

Town Pension 115 Trust

Observations

- The standard deviation for PARS Capital Appreciation is 11.85% which is close to the standard deviation of 11.83% for the current OPEB Strategy 1. They are both the riskiest of the alternatives offered.
- Under ADP Disadvantages in the Staff memo, the "Assets Restricted to Pension Benefits" a not a disadvantage? That is what the Trust was set up for.

Additional information requested and questions to make decision on asset allocation

- To make a decision on asset allocation in 115 Pension Trust assets it's necessary to understand when the Town expects to have a drawdown of these funds for payment to CALPERs to smooth the Town's Pension payments e.g. if it is not probable that the Town will want to use these funds in the next 10 years the Town can absorb a higher risk asset allocation than it could if it is probable the Town will want to access these funds within 10 years
- If it so possible the Town will use these funds to cover pension payment obligations during an economic downturn impacting Town revenues. Its highly probably once will occur in the next 10 years. If it does, you would also expect the assets in the 115 Trust to decline. If the 115 Trust assets could be used for this eventuality, they should not be invested in a high risk asset allocation.
- What is the standard deviation for each of PARs investment options? This is necessary to compare risks.
  - How do these "standard deviations" relate to risk capacity and risk tolerance during the period when the Town may want to draw on these assets?

Subject: Comments on Public Comments received after Committee Report was Published--Newport Beach Staff Report to Finance Committee

Attachments: TCFCJune172019MeetAddlThtsItem3_061619.docx; ATT00001.htm

From: Terry Duryea <tduryea@aol.com>
Date: June 16, 2019 at 11:05:35 PM PDT
To: Laurel Prevetti <LPrevetti@losgatosca.gov>
Cc: Arn Andrews <aandrews@losgatosca.gov>, Stephen Conway <sconway@losgatosca.gov>
Subject: Comments on Public Comments received after Committee Report was Published--Newport Beach Staff Report to Finance Committee

Date: June 16, 2019 (Sunday evening)
To: Finance Committee Members and Town Staff (bcc'd to all Town Council)
From: Terry Duryea

Subject: Comments on Public Comments Received after Committee Report was distributed for June 17, 2019 Finance Committee—not addressed in first memo

As I mentioned in my first memo, I will not be able to attend the Monday, June 17 Finance Committee meeting as a personal matter has interceded. I do expect to be at the August meeting.

Since sending my email earlier Sunday, I have read Addendum to Item 3—the Newport Beach Staff Report to their Finance Committee. My comments are below.

In the Committee Report, Town Staff asked the Finance Committee "what additional information they would like Staff to prepare for the August Finance Committee meeting to be able to make a decision on the possible payment of an ADP?"

The Newport Beach memo provides a good template Town Staff could use to prepare a similar memo for options Los Gatos could consider.

The Newport Beach memo is a good primer for the layman that presents in a coherent way many of the concepts and ideas Town Staff and residents have presented at various times in the past. It pulls all of these together.

Specially:

- The memo is concise—only 8 pages, it is easy to read and understand
- It provides a level of sophistication in its rigorous analysis
- To this laymen, it appears to be objective
- It is consistent with Government Finance Officers' Association (GFOA) and California Actuarial Advisory Panel (CAAP) recommendations
- It recognizes the high cost of waiting for CALPERs actuarial valuation results that lag contribution rates by at least two years
- It introduces a new metric—a repayment efficient measurement (Amortization Efficiency (AE)) and compares Newport Beach to other Orange County government agencies
    - This metric could be useful for Los Gatos to compare different funding strategies
- It addresses the risks and offers Staff and Council options to address the risks in face of future stock market declines and further declines in the discount rate CALPERs uses
- It addresses how to avoid overfunding the CALPERs plans to ensure CALPERs does not retain excess contributions
- Newport Beach Staff make a recommendation for the Newport Beach Finance Committee to discuss
- This recommendation offers their City Council an out if priorities change

If I was at the Finance Committee meeting, I would recommend that the Town Staff prepare a memo for the August Finance Committee meeting using the Newport Beach Staff report as a template.

My hope is that one of the voting members of the Finance Committee will make this recommendation.

If Staff does not feel it has the bandwidth to prepare a similar report for Los Gatos, the Staff could ask Bartel Associates for help to prepare a memo.

As I said before, I am disappointed I have to make this request in writing.

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