CITY OF PALO ALTO CITY COUNCIL TRANSCRIPT

Special Meeting
September 9, 2015

The City Council of the City of Palo Alto met on this date in the Council Chambers at 6:05 P.M.

Present: Berman, Burt, DuBois, Filseth, Holman, Kniss, Schmid, Wolbach arrived at 6:20 P.M.

Absent: Scharff

Oral Communications

Mayor Holman: This is the time on the agenda when anyone who'd like to speak to an item that's not on the agenda could do so, and I have no cards. City Clerk? Okay.

Study Session

1. Pension Liability Issues: Status and Options for the Future.

Mayor Holman: Staff.

Suzanne Mason, Assistant City Manager: Mayor Holman, Council Members. As you are well aware, public pensions have a very serious impact on our budget. With unfunded liabilities and projected increases in cost, the Finance Committee felt a presentation on future projections and options for the future was an important presentation we have before beginning the Long Range Forecast this year and looking at next year's budget. With that in mind, the topic seemed to be so important that we thought we'd start this presentation with the entire Council. We're very fortunate tonight to have John Bartel with us. As you are well aware, Mr. Bartel is the leading actuary in California and the best source of data that I know about when it comes to pensions and future costs. With that, I'm going to ask Lalo to say a few words about some background work that this Council and Finance Committee have done.

Lalo Perez, Chief Financial Officer/Administrative Services Director: Thank you. Good evening, Mayor Holman, Members of the Council. Lalo Perez, Chief Financial Officer. As Suzanne mentioned, this was an item that was

referred by the Finance Committee for Staff to come back. It's a very meaty and huge item for the organization. Unfortunately, we have some time limitations today. It was very difficult to calendar the item. We had it originally on September 15th, but that got bumped. Mr. Bartel has to catch a flight to Southern California, so he only has an hour. I'm going to try to hush up here so we can get to his presentation. I wanted to tell you one thing real quick. We have one correction that is an important correction where we made a typo. It's on packet page 15 of your Staff Report—our Staff Report, excuse me—or page 12 of the report itself. Right below the contribution projections for Safety, there's the second line, second sentence that talks about the funding ratio for Public Safety. We listed it at 60.9; that should be 68.9. It's a big, big, big difference there. Packet page 15 or 12 of the report. It's correct in the actuary reports and everything else. It's just when we picked it up, we didn't pick up the right number. The thinking today was that we would have Mr. Bartel start his presentation. We kindly ask that you allow him to complete it. Hopefully we can do this in about 30 minutes, and then give you an opportunity to then—you choose, Mayor, as to how you want to divide the time remaining. With that, let me turn it over to Mr. Bartel, unless you have any other comments.

John Bartel, Bartel and Associates President: Thank you very much. I really want to start this off with a couple of comments. Number one, I absolutely apologize for having to catch the plane, but the meeting tomorrow morning in Southern California is at 8:00 a.m., so I didn't really have any other options. I apologize for that. Number two, I want to tell you something that I do my best every time I talk to Council to try to say the same thing. Hopefully I've said this to you all before, but it is a great honor for me to speak to you all. I will tell you I don't like my work; I love my work. I absolutely look forward to your questions. I am confident, because I've talked with you all before, that you are engaged on this topic. There's two reasons why I'm sorry I have to close at 7:00. Reason number one is I am confident I would enjoy the conversation. Number two, it may cut your questions short. Sorry, sorry, sorry about that. We're going to go through several things. I'm going to go through some of these slides very quickly and try my best to get to what I think are the important ones. The most important one is really what I refer to as CalPERS' upcoming issues. Sometimes when people see the term "issue," they think of it as necessarily bad. I'm going to give you a little caveat here. I'm a lifetime resident of California. I don't know whether I consider myself the leading actuary in this, but I think I know a lot about what CalPERS is doing. What they are doing, these three things that we're going to talk about. My little editorial comment is I think they are absolutely moving down the right path. I may not have said that if we were talking about this issue a few years ago. Thing number one that they're changing is what I refer to as a contribution policy

change. They used to determine the contribution based on an actuarial value of assets. That in and of itself is actually a wonderful thing to do. The problem was their old methodology did not adequately recognize in particular investment losses. It really deferred the recognition of those losses. Their new methodology no longer uses the actuarial value of assets and essentially calculates your unfunded liability on a market value basis and then steps into what your contribution rate should be over a five-year period. Just to be very, very simple. If your old rate was 15 and on a market value you should be at 20, CalPERS will go 16, 17, 18, 19, 20, and in five years you'll be at that rate. It is in effect a form of smoothing, but it absolutely gets you to the right rate. It just gets you there a little bit later. Thing number two that they are changing is they had an experience study. They discovered the same thing they discovered in each of the last probably six or seven experience studies that they've done, all of which have been well done. Big surprise, people are living longer. What CalPERS is actually doing though is not just taking into account that their experience study, which looks backwards, that saying people have been living longer, they're taking into account that people will be living, or an expectation that people will be living longer into the future. Actuaries think of that as sort of a generational approach. If you really think people are going to continue to live longer than they have been, then you are way better off factoring that into your liability now. Now, two comments on that. From a contribution perspective, that will not be included until the next valuation. From an accounting perspective, the information that you have from CalPERS under the new accounting standard, they have built that into those liabilities. The third thing is something that you may in effect be seeing articles or things from the League on this, and that is that CalPERS' Chief Actuary, their Chief Investment Officer and their Chief Financial Officer—I suspect the Chief Executive Officer as well, I just have not heard this from her yet, but certainly from the other three executive office team at CalPERS—are all saying the same thing. They are saying that the CalPERS population, not just active employees but retirees, is becoming much, much more mature. What that means is that investment volatility can have a very significant adverse impact on the unfunded liability and where contributions are going to go. CalPERS is in the process of trying to decide how they're going to accommodate that. CalPERS Staff is recommending something like targeting a much lower rate of return in a fixed period of years. For example, 6 1/2 rather than 7 1/2 percent investment return and phasing into that over a 20-year period. How they phase in, whether it's a 6 1/2 or a 7, whether it's 20 years or 30 years, is not yet certain. They're in the process of having that conversation, but I am a fan of what they are doing. What that will mean though, everybody should understand this. It will mean that contribution rates will need to be higher. If you are investing in riskier investments, in the long run you might expect things to be good, but you

will have significant volatility. The less volatility, the lower the long-term expected return. The lower the long-term expected return, the higher the cash contributions have to be, if you will. Slide 2, again I'm going to go through some of these slides relatively quickly. This is the history of CalPERS' market value rate of return. What you really see is that volatility on a market value basis. Great returns in the late '90s. Crummy returns due to the dot-com bubble, if you will, in the early 2000s. Great, crummy, great, crummy. You kind of go through these two, three, four years of investment return cycle. When the old method was smoothing that over a 15-year period, you didn't see that big of an impact on your contribution rate. Because the rates now will be based on market value, you will see much, much more volatile contribution rates on a go forward basis. Not only will you see your unfunded liability being more volatile, but you will see your contribution rate. That word, that "the" word, the volatility, it just is something we're all going to need to live with, if you will. Slide 3 really just shows a couple of snapshots of the history. I'm going to take a look in particular at the number of active employees at 2013, 789. You had 989 folks in payment status. This is your non-Safety Plan; this is your Miscellaneous Plan. That is a large number of retirees compared to active employees. That's really indicative of the maturity of this City as well as CalPERS in particular. Slide 4, there's really two bars on Slide 4 you should really look at. I guess I'd call it the light red line; that's the number of active employees. Even though there's a bit of a wave there, increase, decrease, it's relatively stable over this period of time. The one line that is not stable is that dark blue line. That's the dark blue line, indicates the number of people receiving benefit payments. Relatively low compared to actives back in '94, and now you see more people receiving benefit payments than active employees. Even more dramatic when we get to Safety. If we look at the 184 actives compared to 400 folks receiving benefits, so Safety is a more interesting case. Non-Safety folks, you have a fair number of non-Safety folks that really don't work their full career here. Safety, much, much more common. Not only do you have twice as many people receiving benefit payments, but their benefits are by and large career level benefit payments. What that means is a very large portion of your liability for Safety belongs to people who are no longer working at the City. This whole issue of what I'll call, you can call it sort of whatever you want, but the maturity of the plan, you have a large portion of your liability and consequently a portion of your unfunded liability for people who are not rendering service to today's taxpayer. Taxpayer generationally equitable contribution becomes all related to that. You can really see that blue line really going up, the number of active folks relatively stable, and you're now in the position where more than twice as many people are receiving a benefit as active employees rendering service. Slide 7 is the plan funded status. What we really show here are two, a left-hand side and a right-hand

side. The left-hand side is June 30, 2012. The right-hand side is June 30, 2013. What I want you to do is just kind of take a look. June 30, 2012, CalPERS was determining your contribution based on the actuarial value of assets or that smooth market number, $128.4 million. Really on a market value, your unfunded liability was $202 million. When we go to June 30, 2013 valuation, CalPERS is determining your contribution now based on $190 million. That's the market value unfunded. That big change, what really will drive your contribution rate up, we'll quantify that for you in a few slides. If we look at Slide 8, what you really see is this volatility that I've been talking about. The red bar is what's referred to as the actuarial liability. The actuarial liability is the value of benefits due to service that's already been rendered. Actuaries think of that as a target asset value. That's how much money we would like to have you have set aside. One of the things that's fascinating about this particular graph is that red bar just kind of keeps growing. Why does it keep growing? Because people retire and they don't die immediately and you have new people coming along earning benefits. Then you have the green bars which are the market value of assets. You can see assets greater than liabilities in the late '90s, and then you see the liability bar continuing to grow. The big gap in the liability bar really occurs in that 2009 year when you really have the big reduction in the stock market. What you really should be able to take a look at this is the big portion of the unfunded liability not generated by the higher benefit levels, but really generated by the reduction in the stock market. No question the unfunded liability would be lower had benefits not been enhanced, but the majority of that unfunded liability really due to poor investment returns rather than higher benefit levels. Then we see the same thing on Safety. 68.9 million at June 30, 2012 is the basis of your June 30, 2012 valuation. You really had a $112 million unfunded liability on a market value basis. Now, we go to June 30, 2013, the most recent valuation. Your contribution based on a $105 million unfunded liability. Again, graph on Slide 10 looks amazingly similar to the Miscellaneous. Order of magnitude of the numbers is just different. You can see the liability bar continues to grow over that period of time. With the green bar, the market value of assets, quite volatile over that period of time. That volatility is what is going to create the difference, the contribution rate changes as we go forward. Slide 11, I actually think Slide 11 is quite a fascinating chart. This happens to be your non-Safety Plan. What it shows is what percentage of the actuarial liability is due to people who are rendering service to the taxpayers on the valuation date and what percentage applies to people who have already retired. The blue line here is the active. If you look back in 1997, about 55 percent of your liability was for actives. Now you go to June 30, 2013 valuation, about 35 percent of your liability is for actives. When you look at retirees, about 35 percent in '97 was for retirees and almost 60 percent is for retirees. If you look at this graph, this falls under the category of really

just being a true definition of what a mature population is. When you look at your Safety Plan and you look out at '97, you were mature back in '97. Even more so in 2013, more than 70 percent of your liability is for people who are receiving benefit payments. Less than 30 percent, about 25 percent, for active employees. Again, a large portion of your liability for people who are not rendering service to taxpayers. Slides 13 and 14, I'm going to go through it very, very quickly. Just so you know, we took a look at—all of this information is public information. We got a list of comparative cities that the City looks to. You all are the green bar. This happens to be the ratio of the unfunded liability to wages. If you just looked at your unfunded liability and did a comparison from agency A to Agency B, if you're comparing City of San Jose to City of Palo Alto, the dollar amount of the unfunded liability kind of dwarves everything. Then you compare that, for example, to Menlo Park, and the Menlo Park bar would hardly show. If you show these, however, as a percentage of pay or you could also do it as a percentage of budget. Both of those would work well. I'm kind of a fan of percentage of pay; that's kind of what we're showing here. What you really see is that your unfunded liability very, very similar to most others, slightly higher than the average, if you will. If we look at the same graph for Safety, very, very similar result. You're probably slightly higher than the average. The reason you are higher in both instances is that you all as a City have been in CalPERS longer than many other cities. It's that relationship between the number of retirees you have compared to actives which really drives your number up higher than it does for other folks. Slide 15 shows the history of your Miscellaneous contribution rates. There's really two lines on this graph. The dark green line is your total rate. This is as a percentage of pay. The light green is what's referred to as the normal cost rate. The normal cost is if the actuarial liability represents the value of benefits due to services that have already been rendered, your normal cost is the value of benefits being earned expressed as a percentage of pay in the current year. I think of the normal cost as a value of benefits for services being rendered to taxpayers this year. From an actuarial perspective, I want you to get to the point where your contribution is that number. That will get you into a taxpayer generally equitable contribution. The reason you're not there is because you have an unfunded liability, so you're paying that unfunded liability down. By the way, the reason you were below that in these earlier periods is because you had an excess of assets over the liability. In both cases, you add something to the normal cost to pay down your unfunded liability or you reduce the normal cost if you have an excess asset. Now, in the interest of full disclosure, there was a change in the law. If you ever get to the point where you have an excess asset, CalPERS will not allow you to contribute less than the normal cost. Safety, Slide 16, what you really see is over the past several years, both Safety and Miscellaneous, your contribution rates have escalated dramatically. The reason for that

escalation is absolutely related to the downturn in the investments in 2009. There's a strong argument you should have escalated to those higher contribution rates sooner than you did. The reason you didn't was because of CalPERS' old asset smoothing. Under the new method, if we had a downturn, you would get to that higher contribution rate much, much sooner. Slide 17 is sort of a actuarial caveat. This is the projection of our contribution rates. What we're doing is projecting your rates using CalPERS' assumed or expected return of 7 1/2, and we're also doing it at what we refer to as a poor expectation or a good expectation. Poor and good are not worst case and best case scenarios. They are consistently bad investment return or consistently good investment return. If you take a look at Miscellaneous, that green line in the middle says for '14/'15 your Miscellaneous contribution rate 27.7; for '15/'16 27.7. The ramp up in the methodology and the assumption changes will get you, if CalPERS earns exactly 7 1/2 percent, to a contribution that's really in the mid 30s. If they consistently have good investment return, your rate over that same period of time will drop to the, if we go to the end of that period, '25/'26 will drop to the teens but it will gradually come down. If, on the other hand, investment return is particularly bad, poor investment return, you can see your contribution rate for Miscellaneous will get to mid to upper 40s. We obviously don't know what the investment return is going to be, but that volatility, that range in contribution rate is really the indicator of volatile contributions. My staff loves this slide. My eyes are not very good. I probably could not read a single number on this graph. I actually don't think reading the numbers matters. What matters is looking at the shape of those lines. What you really see is this is a long-term 30-year projection of where your contribution rate might go, again with the good and the poor investment return. If you take a look at that green line in the middle, if CalPERS gets that 7 1/2 percent return, what you really see is your contribution rate will escalate rapidly. It will remain at a plateau, and then it will come down in sort of what I refer to as fits and spurts. At the end of that 30-year period, your contribution will be the normal cost rate. Under CalPERS' old methodology, that did not happen. What you're hearing me say is that is the exceptionally good thing about their new methodology. Now, in point of fact, if investment return is poor, your rates will get high, they will remain high for a very long period of time. If investment return is good, they will drop much, much more rapidly over that period of time. The good news here is really not what the numbers will be on that solid green line. It's the very fact that it is coming down. The same thing is really true for Safety. The difference is order of magnitude. For your '15/'16 Fiscal Year, you're sitting at about 42 percent and then escalating to really the mid 50s if CalPERS earns exactly 7 1/2, and then really remaining a little flat, coming down very gradually. The poor investment return, your rates could easily be, if investment return is poor, into the 60s and 70s. On the other

hand, if investment return is good, could easily drop into the 40s and the 30s. Where it is will absolutely not be a function of anything other than actual investment return. The single biggest driver of your contribution rate is absolutely CalPERS' investment return. Same sort of a graph for Safety on the long-term projection. Contribution escalates to arguably what it should be, remains relatively flat, coming down very slightly, and then coming down a little more steeply as you get to the end of that 30-year period. Again, you get to the same thing. When you get out to the end, you have your contribution rate equal to the normal cost which means that in about 30 years, a long time, your unfunded liability is really targeted to be paid off. That gets you to high funded ratio. Clearly if investment return is worse than that, your funded ratio is going to be less than that. Clearly if investment return is better than that, you will get to that 100 percent funded status earlier than what's shown here. I wanted to talk just for a quick moment about the impact of PEPRA. PEPRA was a bill signed by the Governor in 2012, effective January 1, 2013. PEPRA had no impact—everybody should understand this—did not change any benefits for current employees, only impacted benefits for people that were being hired in the future. It had no impact on the City's unfunded liability. It, however, does reduce benefits and consequently normal cost rates for people that you are hiring in the future for some people. In the long term, your total liability will be lower and your total contribution rate will be lower and your unfunded liability should be less volatile. It will take a very long time for that to really play out. In fact, take a look at Slide 24. We're being a little simplistic here. Two lines here. The green line is what we show before. This is with PEPRA, and then you see a blue line if PEPRA had not happened. In this we're not showing investment return volatility; we're just showing contribution assuming the 7 1/2 percent rate of return. For Miscellaneous, you really see the difference in the contribution rate out in '25 and '26 is very, very modest for this City. This has everything to do with what the City negotiated with the bargaining groups before PEPRA was enacted. There's a very strong argument this City created its own version of PEPRA, getting the contribution rate down, and then PEPRA came along and sort of made a couple of what I'll refer to as a little bit more minor tweaks. What you really see is very, very low impact. A little bigger impact for Safety but even so, when you look out at '25, '26, the difference in the contribution rate between with and without PEPRA relatively minor. The one issue we're trying to make sure that all of our clients understand is there is for PEPRA employees, people that you hire who are new to the system, there is a compensation limit that is tied to the Social Security taxable wage base. I'm just going to give you my little editorial comment. I have a degree of confidence, a lot of folks significantly disagree with me, I think that was a silly thing to do. At best, it was a silly thing to do. 140,000, that sounds like a high limit. That number is adjusted up a little bit if you're not in Social Security. If you compare that

to the private sector pension compensation limit, it's about 53 percent of it. The common sense thing to do would have been to tie the PEPRA compensation limit to match that of the private sector compensation limit. Here's what's going to happen, and this is not going to happen for a lot of agencies right away. We're starting to see it happen as people will hire people to senior positions outside. We think in the long run this is going to have an adverse impact on Safety as well. You hire somebody from the outside; they get the PEPRA 2 percent, outside the state for example or from the private sector. If they have a $160,000 salary, that really reduces the 2 percent at 62 formula to an effective 1.75 or, if they make $200,000, it results in a 1.4 percent. Now, I'm confident there are people who will say, "That's okay." The challenge, of course, is when you're recruiting very senior people from outside, the compensation that they are getting outside, the compensation that they are getting outside in the public sector at senior positions is much higher than what the City can pay. One big advantage, a recruiting advantage, is a pension formula. The bigger impact you have on that pension formula, and it will be higher as time goes by, will make it I think harder for you to recruit. I also think in the long run this will impact Safety more than it will impact non-Safety. There is a provision in PEPRA, you can supplement this with a defined contribution plan. My comment is you should just be aware of this and just recognize that if you're going to supplement it, you should start that defined contribution plan sooner rather than later. I'm going to go through the next couple slides very, very quickly, since I think I've probably gotten to my 30 minutes. What we're talking about is ways to pay down the unfunded liability. In the interest of full disclosure, I'm putting items here; I do not necessarily advocate all of the items that you see here. From a informational standpoint, there certainly are agencies that are looking at pension obligation bonds. Pension obligation bond is you go out and borrow the money and you give that money to CalPERS. The interest of full disclosure, if you had done that in June of 2007 when the market was at the upper limit, you buy into CalPERS at the upper limit, and in two short years you will have a haircut of 30 percent of what you handed to CalPERS. The challenge with the pension obligation bond is not whether theoretically it is a good idea, but practically can you tolerate that risk that is there. I will tell any client who wants to do a pension obligation bond, I will not tell them don't do it because that is out of my area of expertise. I will tell them don't do it unless you understand completely the risk you are getting yourself into. Second way to do that is to borrow from the General Fund. You just borrow from unallocated assets. You pay that General Fund back. You're earning probably 50, 75 basis points on the investments. Taking that money, giving it to CalPERS, you would have a much higher expectation that CalPERS is going to earn more than what you're currently getting. I would advocate doing that if and only if you kind of pay that back. You treat it as kind of a loan from one pocket

to the other, if you will. A third one is to go to CalPERS, request a shorter amortization period. I know this is not a perfect example, but it's no different than buying a house, paying it off over 15 rather than 30 years. Much higher payment, hard to meet your budget, but you get that note paid off. You end up paying a lot less interest. Certainly lower interest, lower long-term payments. The other one is you come up to the end of the fiscal year, you discover "we have a $1 million budget surplus." We have clients who take that $1 million and they split it three ways. Way number one is you use it for one-time projects, use a third of it for one-time projects. You use a third of it to replenish reserves, and you use a third of it to pay down your CalPERS unfunded liability. I think that's certainly a fiscally prudent approach to take. The next approach is, we indicate this as one approach; it's really two different approaches. Approach number one is you set up a reserve to take care of contribution volatility or pay down the unfunded liability. The challenge with that reserve is that you can't restrict the use into the future. You're earning, for sake of argument, 50, 75 basis points on that money. What might be a better approach is a relatively new option. There are somewhere in the neighborhood now, I think we say here one trust established so far. There are about half a dozen agencies around the state that have set up these supplemental trusts. They are what's referred to as a Section 115 trust. It reduces your GASB 68 liability, but you treat it as a contribution volatility fund. You put some money in there to try to mitigate the volatility of the contribution because of investment return. There are two entities that have established these trusts where you can go to. You could certainly set up your own. The two are PARS and PFM. Again, about a half a dozen agencies around the state. The more we study these, if you think of them as a contribution volatility, something to mitigate that volatility, I'm beginning to think they work extremely well. The modeling that we have done so far is very, very promising, but it's very, very new. The very first one that was set up was Irvine Ranch Water District. They essentially took money out of their reserves, paid their unfunded liability down. Now they have no GASB 68 unfunded liability. The challenge for them is they have to make a conscious decision to take money out of that trust and give it to CalPERS; otherwise, they end up being overfunded. We would suggest thinking about that might be one thing you may want to direct Staff to do. Slide 29 and 30 look at the cost sharing. What we're really showing is Tier 1 for Miscellaneous, 2.7 at 55; Tier 2, this is the change that you all made before PEPRA. It's referred to as the 2 percent at 60 formula. You see a total normal cost rate of 13.7 percent, and under PEPRA at about 12.5 percent. What you really see is the difference in the City's normal cost versus the Tier 3 normal cost between Tier 2 and the PEPRA formula, less than 1/2 percent. That's why there's a very, very small difference in the PEPRA rates before. You look at Safety. The City went to 3 at 55 from 3 at 50 as the Tier 2 formula. Tier 3 formula is what's referred to

as 2.7 at 57. Total normal cost rate about 3.4 percent difference. Normal cost rate for the City though is still about 5.6, 5.7 percent difference. I went through this relatively quickly. I'd be happy to answer any questions.

Mayor Holman: My first question for you is do you have a 7:00 hard stop?

Mr. Bartel: Yeah, unfortunately I do. I wish I did not. Sorry about that.

Mayor Holman: Council Members, we have 15 minutes only. That gives us each 2 minutes. If you have a question specifically for Mr. Bartel, please put your light on. If it will wait for Staff, then please hold your question.

Council Member Kniss: This should be fairly quick. On one of your very first slides, you compared us with the other cities. Are they all CalPERS?

Mr. Bartel: No.

Council Member Kniss: Could you explain then if you are? I don't think San Jose is CalPERS.

Mr. Bartel: My recollection is all but two. If we look at Slide 13, there's City of San Jose which is not in CalPERS. They have their own system. I thought, maybe it's under the Safety slide. Yeah. San Ramon Valley Fire is in Contra Costa County. It's in CCCERA. All the rest I believe are in CalPERS.

Council Member Kniss: Would you deduce in any way that those in CalPERS will come out ahead in the long run over those that are self-insured or not?

Mr. Bartel: I'm going to do my best to give you a short ...

Council Member Kniss: Not that we can afford to get out, but ...

Mr. Bartel: Yeah. Let's take what I'll refer to as three groups. There's the CalPERS group, which is the majority of the folks. There is the folks, San Ramon Valley that's in a large system; it's just not as large as CalPERS. It is true, I think what CalPERS is doing is what most systems should be doing. In my opinion, CalPERS is absolutely moving in the right direction. Historically they have not always been in the right direction. What I will tell you is the City of San Jose plan, I absolutely think from a structure standpoint they have been particularly for Police and Fire, maybe a little less so for the federated plan, but certainly for Police and Fire, have been absolutely moving in the same kind of direction that CalPERS has now started moving in, maybe a little earlier than CalPERS. One of the things you see is the San Jose rates being relatively high, unfunded liability being relatively high, but I think that's a reflection of lower investment return

assumptions, so better reflecting what I will suggest is the long-term, what the market will likely do in the long term. I am a fan of the things that the City of San Jose retirement systems are doing. I think they are moving in the right direction. I'm not sure I feel the same way about CCCERA. This is a complicated answer, and I tried to answer it quickly.

Council Member Kniss: Thank you very much.

Mr. Bartel: Sorry about that.

Council Member Filseth: Hi. Thank you very much for this. I've got three questions, hopefully all pretty quantitative and short. The first one is, all these charts with sort of the big, thick green line in the middle and so forth. You assumed a 7 1/2 percent (crosstalk)?

Mr. Bartel: That's correct.

Council Member Filseth: The high ones and the low ones, is that like 3 percent and 12 percent? Is that roughly there?

Mr. Bartel: Yeah. We show that on, this falls under what I refer to the minutiae of this Slide 17. Poor investment return kind of ranges through the low single digit.

Council Member Filseth: Big difference between .2 percent and 4 percent though.

Mr. Bartel: I understand that. What it is is actually .2 in the short run, 4 percent in the long run. Similarly, if you look at that good investment return, 11 to 15 ...

Council Member Filseth: Eleven in the long run, 15 in the short run.

Mr. Bartel: Yes, that's right. That's exactly right.

Council Member Filseth: Super, thank you. Second one. The $300 million unfunded aggregate pension liability, that also assumes 7 1/2 percent investment return?

Mr. Bartel: Yes, it is.

Council Member Filseth: How sensitive is that to 6 1/2 percent instead?

Mr. Bartel: In the interest of full disclosure, that's something I ought to be able to answer off the top of my head, but I can't. I know that in the City's

GASB 68 information, they have that information because CalPERS has provided it. I'm sorry I don't know what it is.

Council Member Filseth: My last question is, we've got a lot of discussion, there's sort of not anything we can really do about the unfunded liability as it exists today. In fact, it must vary quite a bit with the average raise that we give out ...

Mr. Bartel: Yeah, no question.

Council Member Filseth: What assumptions did you make about the average raise that we give out? Wage increase over the next 30 years.

Mr. Bartel: You mean the average pay—I'm sorry. I want to make sure I'm understanding the question.

Council Member Filseth: I think, I mean it must depend a lot on if we give everybody a 3 percent raise or a 4 percent raise. It must have a huge impact on the unfunded liability.

Mr. Bartel: Not as big an impact as investment return. No question. I just want you to understand that. The current unfunded is based on what I'll refer to as two assumptions. Assumption number one is what will general inflation be and future pay increases will really be tied to future inflation plus increases above inflation. The increases above—I know this is a more detailed answer. By and large they are assuming people who are newly hired get much bigger increases than inflation because they're going through step rate increases. In the long run, they are expected to get slightly higher than inflation. CalPERS' inflation assumption, 2 3/4. By and large long-term salary increases are expected to be a little over 3 percent for long-term employees. Short-term, step rate increases, all that much, much higher.

Council Member Filseth: That's a minority of employees. Most of them have been ...

Mr. Bartel: That's right.

Council Member Filseth: You're looking at 3 1/2 percent as probably a ...

Mayor Holman: Council Member Filseth ...

Mr. Bartel: Yeah, that's very consistent with the expectation that CalPERS would have.

Council Member Filseth: All right. Thank you so much.

Council Member DuBois: Thank you. It's like drinking from a fire hose. I'm trying to understand. Is there a system risk that's not captured here of, say, something catastrophic happening to CalPERS where if we prepay our unfunded liability ahead of time, there's actually some risk that that's a bad thing to do?

Mr. Bartel: Let me make sure I'm understanding your question. I think I'm hearing two questions. You can tell me if there is. People use the term to prepay. Sometimes they mean to prepay the current year contribution. The alternative to prepaying the current contribution would be if you have a $300 million unfunded, if you wrote CalPERS a $300 million check. Are you asking ...

Council Member DuBois: I'm asking is there a risk like that CalPERS goes bankrupt and any advance payment you made is actually lost money. Kind of related to that, because I know we're going to run out of time, the difference between, say, paying through your General Fund directly to CalPERS versus a Section 115. Is that just a difference of who's making the investment decision? You're essentially looking for ...

Mr. Bartel: No, there's really two differences. The 115 trust, number one it is a difference in who's making the investments. What we would suggest is if you did set up such a trust, you should not try to beat CalPERS' investment return. You should try to mitigate their volatility.

Council Member DuBois: Yes. You're kind of diversifying your risk.

Mr. Bartel: Yeah, that's right. That's exactly the way that I would look at it.

Council Member DuBois: Is there like the system risk that's not captured that some people (crosstalk) CalPERS?

Mr. Bartel: Yeah. Reason number one is you actually mitigate the volatility which in the long run really is what CalPERS is trying to do. That's value number one. Value number two is the best way to describe the trust that I think the best way to use it, if we just kind of look at Miscellaneous. Let's pretend for a moment you look at the Miscellaneous rates and you go, "What we would like to do is we would like to budget over the next six, seven years at 33 percent of pay." I'm just picking 33 as a random number. What you would do is you would set up your trust with a little bit of seed money and, if CalPERS tells you your contribution is below 33, you give them that number and then you move into the trust the difference between 33 and what you're paying to CalPERS. If CalPERS tells you your contribution rate is higher than 33, you take the money out of the trust and give it to CalPERS. From a budget standpoint, you have that level 33 percent of pay. What we find is

entities who want budget certainty end up with this working out really well. The challenge with these trusts is you can't just do it by moving contribution amounts in there. You kind of have to have a little bit of seed money to pay down the unfunded liability, to put it into the trust right away. It's not designed to save you in the event that CalPERS goes bankrupt, by any stretch of the imagination. It's only designed for contribution volatility. That's by far the best use of it.

James Keene, City Manager: Madam Mayor, if I may say something. We're going to run out of time here. I don't know, number one, whether John would be open to also taking written questions from the Council and getting responses or do we also just plan for a subsequent visit with Mr. Bartel. I mean you're not going to get to all nine Council Members even on the first pass.

Mr. Bartel: I'd be happy to answer written questions. What the Council may like to do is maybe sort of push this to the Finance Committee or to a future Council meeting where I promise you I will take whatever time you have.

Mayor Holman: That sounds like a good suggestion, because we had three more Council Members with questions and it's 6:58. It's 6:58. You're saying you would be able to attend another meeting?

Mr. Bartel: No question. It's all with the function of what meetings I currently have scheduled, but of course.

Mayor Holman: Great. I appreciate you participating in this lightning round with Council Members, and Council Members for being pretty succinct. Thank you very much for that. Apologies to the Council Members that we didn't get to; Vice Mayor Schmid, Council Member Burt, and Council Member Berman. Apologies for that, but I understand you have a flight to catch. Thank you very much.

Mr. Bartel: Thank you. I appreciate it.

Mayor Holman: Council Members, if you have—City Manager.

Mr. Keene: If I just might say one thing. The Mayor and I, we could work quickly to look at the agendas going forward as to when a target date would be, so this was fresher in your mind than whatever. We'll then work with Lalo and Suzanne to get John back as soon as it works for your schedule. Thanks.

Mayor Holman: I think there was something that actually got taken off the schedule, so we might have an opening. Council Members, I'm open to if

you want to continue asking questions of Staff, if you want to save your questions, written or otherwise, for Mr. Bartel, or if you have thoughts or a motion about this going to Finance versus the full Council. Looking for what the Council's direction might be for this.

Council Member Burt: I'd just as soon go ahead and direct questions to Staff and those that they can answer in whole or in part, great. Otherwise, they've captured them for Mr. Bartel. That doesn't mean we can't supplement with other written.

Council Member Kniss: I'm not sure, Pat, whether you meant to eliminate the Finance Committee or not. It would seem to me as though this is one of those ideal things to go to Finance where it can be distilled even more. This is such a complicated topic. Then come back to Council after it goes through those deliberations and comes back to Mr. Bartel. Otherwise, I feel that we're—this is a big topic. There are nine of us. Starting with four would be, I would think, advantageous.

Council Member Berman: I guess my (inaudible) question is what are we trying to do. I felt like this was very helpful as an informational and a Study Session, and it'd be great to follow up with questions for Mr. Bartel. Are we trying to drive towards does the City want to take some action to address the issue? I just don't know what the goal was. That would help determine, for me, whether or not we need to go to Finance for more or kind of what the next steps are.

Mayor Holman: Lalo might have actually a best response to this. Certainly tonight we're not going to take action.

Mr. Perez: I think given the unfunded liability that we have, it'd be good for us to work on potential options for you to consider. One of the goals for us would be to at least, one, understand the issue as a community. Second, understand our options in light of everything else that we have, all our other obligations, infrastructure and so on. We believe that there are options for you to consider on how to address it. It's a matter of having that talk and education about what the options are, what the pros and cons are. It could be something that could go to the Finance Committee. I'll look to Jim as well to give you more of his opinion. We can work out some of the details and then bring it back with more concrete information as to what it would mean. If we go to a trust, how would we fund it? What ideas do we have? What potential methodologies we could use to explore. John mentioned that some other agencies have a three-legged stool approach when there's excess revenues. We've been fortunate the last few years that we've had some excess revenues, and we purposely, through Jim's recommendations

to you, directed them all to infrastructure. Rightfully so because of the great need. At some point, you could have options on maybe you direct some to the other unfunded liabilities from those potential dollars. You heard about borrowing from the General Fund. There could be discussions for us to borrow from the Enterprise Funds and make it worth their while, if we're carrying reserves that we believe are healthy enough. We believe there are points of discussion for you to consider and make informed decisions.

Mr. Keene: Thanks. If I could add to that. I mean, for me both thinking about the briefing purpose that we had for bringing this forward to the Council, then listening to John. I mean you take away two things. One which is what strategies do we want to explore, as Lalo was saying, to deal with our unfunded liability. That's not a fast conversation, unless we're going to write a $300 million check all at once. We don't have the capacity to do that even if we were willing to risk it. I think that it is an ongoing kind of conversation. Even if we establish a strategy and policy, I would imagine it'll be something that will unfold over years that will have to be routinely revisited. The second piece, though, which I think is more near term and immediate, was to get a good look at what the increased pension cost requirements are going to be in the very near term. They can help inform, I would think even with today's snapshot, the conversations we have as we go into labor negotiations about what the obligations and the costs that the City and our employees are facing in the future. I think that there's an immediate return on that and that information. I think it's helpful. This other piece is I do think a conversation that will take some time. That being said, I think it's something that is of interest to the whole Council, so I think you want to think about what's the right mixture; even if you refer it to a Committee, that the whole Council has a little bit of chance to chew on this a little bit.

Vice Mayor Schmid: To follow up with Suzanne's comment right up front of this is an important step on moving toward the long-term financial forecast, which is the basis of the budget discussions that come up quickly. I think the long-term financial forecast is due in December, so it would seem to make sense to go to the Finance Committee to have a detailed discussion, come back to the Council with issues, but be ready by September for that long-term financial forecast to have a point of view on the issues that are addressed here.

Mayor Holman: I haven't had a turn yet. Before I go to Council Member Burt and Council Member DuBois, I can see the advantage of this going to Finance, if the point there is to chew on the issues and bring to Council some options that have been digested there. I agree with City Manager that this is an issue that is such a large issue for the whole Council, I would really

want to have Mr. Bartel accessible to the whole Council as well. I don't see how we're going to do that by Vice Mayor mentioned September. This is September.

Mr. Keene: He meant (inaudible).

Mayor Holman: December, okay. That's very different then, yeah. Also, I had mentioned to the Vice Mayor earlier, I feel a bit like we're in the briar patch. I kept looking for like, okay, we'll find our way out of here. Surely there are better answers than not, but it is hard to disseminate those. I'm splitting the baby here of, yes, Finance is fine, but I don't want there to just be then a minimal report to Council. We need to all understand this very fully and have access to Mr. Bartel.

Mr. Perez: That's a excellent point. If you recall, some of you that were here, that's exactly what we did with the retiree medical. It is a big, meaty issue. It worked well because we worked out some of the nuts and bolts at Finance, and we brought it back. It was a little more focused of a discussion instead of this big, wide picture. Good comments taken well.

Council Member Burt: My thoughts are along the same lines as yours and what Lalo described of what we did when we did the retiree medical. If it was to have the Finance Committee help flush out various options and have them have more meat on the bone when they come back to the Council for full consideration, that would be reasonable in my mind. If it was the Finance Committee making a recommendation or determination on behalf of the whole Council, I would not go along with that. This conversation got into this process. We still have the question of whether we're going to ask some additional questions tonight. I'll set that aside until we make this determination.

Mayor Holman: Yes, please and thank you.

Council Member DuBois: That was actually where I wanted to go. I think we should maybe use this time to ask some more questions of Staff, and we get ideas from all of us out on the table. Maybe we each get five minutes. Let's cap the amount of time we spend, but let's continue the Study Session, and then send it to the Finance Committee.

Mayor Holman: I'm good with that. I just want to also establish where we're going to go going forward. Council Member DuBois, would you care to start us off.

Council Member DuBois: Sure. I had some quick questions.

Mayor Holman: Then to be fair, Vice Mayor and Council Member Berman and Council Member Burt did not get to ask any questions at all. Maybe to be fair a little bit, you might defer your questions to those.

Council Member DuBois: Yeah. If you come back to me, I have a few more questions.

Mayor Holman: The order was Vice Mayor, Council Member Burt and Council Member Berman. If we go in that order and each have five minutes, that would be good. Then I'll come back to you, Council Member DuBois. Is that agreeable?

Council Member DuBois: Yeah.

Vice Mayor Schmid: Two questions as a follow up. This is a great study. It was good to have, but I note that the data we're dealing with is Fiscal Year 2013. All the charts and the figures we have going into the future reflect what was taking place 2 1/2 years ago. It is important to note that two years ago we talked about moving the rate down from 7.5 to 7. Here we are two years later. I guess I note that if you take the last 13 years of return at CalPERS, the rate of return averages 7 percent. If you look at the real economy, there's some dramatic changes that have taken place between the earlier period and the last 15 years. Between 1980 and 2000, the real economy grew 3.1 percent per year. Since then, it's grown 1.9 percent per year, about 36 percent less. The workforce participation rates have actually declined of the working age population. Productivity rates are down from what they were in that earlier period. The median wage has not gained. There are a lot of real indicators in the economy that rates of return aren't going to return to where they were in the '70s and the '80s and the '90s. These historic rates of return seem to me to be unrealistic. It's important we confront that issue. Should we be pushing with Bartel's recommend to us to go to a 7 percent rate of return? We need to take a realistic rate about paying for the liabilities we have rather than pushing it off to the future. Another very important factor is if you take the last two years, 2015 and what we know about 2016 Fiscal Year, rates of return are likely to be close to zero. That means we are returning to where we were in '08 and '09, not quite as bad but to two poor years in a row. I think Mr. Bartel made the case that the reason we are having these escalating rates now is we're trying to make up for the shortcomings in '08 and '09. What happens if we have another shortfall that we need to make up over the next five years? There's some real fundamental questions about where are we, what assumptions should we make. The second point I'd like to make is just the rate of return, especially in our Safety. When we look at money wage issues there, we have so many of those people are close to retirement, will be

retiring quickly. The impact of a rate of increase in the salary will have a long-term and immediate impact on our liabilities out front. It's important to keep that in mind as we look to our future.

Council Member Burt: One thing that we didn't hear about was as we're looking at setting up something that might be this new supplemental pension trust. If we did something like that, I wanted to think through and understand the impact of contributions to that trust and when and how those would occur. It wasn't mentioned that what we face and government faces in general is that our contribution rates go up as a result of diminished returns on investment during downturns, which is the same time our revenues have shrunk. It's a double wham-o. There's often a bit of a lag between when our revenues go down and we have the contribution rates go up, but that's now being contracted, that lag as well. This is what goes on all the time. What happened in the dot-com boom era was we were getting these phenomenal rates of return and at the same time cities and other governments were flush, we had a reduction in the contribution that we had to make. I think we have to acknowledge that pattern and make sure, if we're setting up a new supplemental approach, that it anticipates that; that when we get hit, we're going to get hit twice at once or pretty close one punch after another. Whether we would look at maybe a hybrid approach to contribution, if it's permissible, is something I'd be interested in. That we have a certain minimum amount of either our General Fund revenue or a percentage of all labor-related compensation or some amount that we would pay every year, and then a supplemental amount that we would pay in on a discretionary basis when we do have surpluses. The way it was set up on some of those alternatives, it was kind of either/or. I thought it might be more appropriate to look at a hybrid. We have a base level and then, in flush years, we supplement it. That would help even out this whiplash that we get. Also, one of the things that came up and others brought up tonight is what will happen if we—if and when, I should say—likely have a further reduction in anticipated CalPERS returns, because these graphs get off kilter even worse when that happens. Whatever decision we make has to be in that context. It sounds like the rate of return is going to go down at least to 7 percent—that's what Mr. Bartel indicated, and it could go lower—and over what timeframe would that reduced rate of return be factored in at CalPERS. Clearly if CalPERS is looking at 20 years to bring down their rate of return, it's not because the rate of return will decline in actuality over that period. It's because they're trying to soften the blow to everybody. Right? Is that basically correct?

Mr. Perez: Correct. They're looking at a couple of options. Just got an update today that I've got to work with the City Manager's Office on. Apparently through the League we're being asked to provide input for

CalPERS. They're calling them, the flexible glide path option is one. With this option, it would occur during a period of above-average returns, i.e., the 7 1/2, if there was a return above that. Reduce the discount rates based on how far the return is above the expected rate, so anything excess. Part of those excess earnings then would go towards risk mitigation of the future volatility. They're trying to do some of the stuff we're talking about, but CalPERS taking the initiative. This would only occur during the good years. That's one option. The second option they're talking about is similar to the first one, but it would be based on what they're calling checkpoints. Every four years there would be a reduction in the rate of return assumption of, for example, 15 basis points. No matter what was going on in the market, good or bad, they would automatically have that reduction. These are the two options that the Board is going to consider in September. We're being asked to provide input. I just got that update today, so we've got to scramble here pretty quickly to figure out how do we provide some input into that. It is something that the Board is trying to tackle this year.

Council Member Burt: Thanks.

Council Member Berman: Thanks. Just to follow up with that. You said that the CalPERS Board is going to be considering that in September?

Mr. Perez: That is my understanding. I haven't had a chance to flush it all out. I just got the update this afternoon from our (crosstalk).

Council Member Berman: I know I saw somewhere that Governor Brown's kind of pushing them to take a much more aggressive strategy on these issues, whether or not ...

Mr. Perez: It is a tough issue for the Board, because obviously labor has a lot of say and pressure. This would mean that our rates are already going up as a result of the demographic adjustment, the shorter amortization period, the 30-year closed amortization. This on top of all of that. Some of the cities that are more constrained are obviously ...

Council Member Berman: Asking them to kind of slow down a little bit.

Mr. Perez: ... saying, "No thank you, not right now."

Council Member Berman: Then the question becomes if they don't do what we feel was the fiscally prudent thing to do, what can we do in addition to that, whether it's these Section 115 trusts or what have you, to take those extra steps that we think are responsible. A couple of questions on—I guess a couple of question that we've had from Mr. Bartel are—he showed us a graph that compared us to other cities on certain metrics, just from what

he's seen in terms of where we are. On the whole, I'd be curious to know how he thinks we're doing, should huge alarm bells be going off, and should we be taking remarkably aggressive measures or should we kind of realize that we're definitely not in the place that we want to be but the sky isn't quite falling yet, just where on the spectrum do we fall. I'd also love to see some of those graphs, those future projection graphs, using that 7 percent as an average as opposed to 7 1/2 and just be curious to know what those would look like versus the 7 1/2 percent rate of return that was used. Some questions just in the Council packet. Like packet page 12, the summary of demographic information for Miscellaneous. We've got average annual City provided benefit for service disability, service retirements in last five years. Then in 2013, the different amounts, $34,000, $13,000, 44,000. Is that just—so I'm understanding this correctly—is that saying that the average annual City provided benefit to our Miscellaneous employees in the service category is $35,000 a year? Is that ...

Mr. Perez: That is exactly correct. Now, keep in mind that John mentioned we've been in CalPERS for a long time, so there's members that have been retired for, some (inaudible) of 30 years that are in here.

Council Member Berman: That will probably have lower amounts because their wages were lower and ...

Mr. Perez: Yeah, exactly.

Council Member Berman: That's the purpose of the service retirements in the last five years is meant to give a better kind of indication of the retirements benefits that, pension that people are getting right now?

Mr. Perez: Yeah. The main point we wanted to show you here was the significant increase in the number of retirees and how the number has grown. As he mentioned, that's the bulk of our unfunded liability. Then the rate of return fiasco of 2008, it just made it worse.

Council Member Berman: That's just a comment that I—I mean following up on that. These graphs that were on the presentation slides, like 11 and 12, were kind of the most striking for me. Tell me if I'm misinterpreting this. This means that 60 percent of the money that we're putting into CalPERS right now is going towards retirees. I mean the pension benefits for retirees. Is that correct?

Mr. Perez: Yeah. That's why he was saying in his report that there's not a lot you can do from the current employees to deal with the unfunded portion, because you're really talking about people that are no longer here. For those of you that recall the conversation on retiree medical, it's the

same exact discussion. We have the same situation; we have more retirees on medical than we have in active.

Council Member Berman: Thanks.

Council Member DuBois: Hopefully a couple of quick questions. These charges, like on page 20, what happens in like the year 2026/2027, where kind of regardless of investment strategy our contributions start to drop?

Mr. Perez: He prepared it, but my recollection of the discussion is that the closing of the amortization period is the answer to that.

Council Member DuBois: The closing of what?

Mr. Perez: The 30-year amortization period closes. CalPERS used to have an open amortization period. To put it in other terms and you may know what it is, but just for somebody that's listening, it used to be an open period. I call it the refinancing your house every year, your 30-year loan. You're never really dealing with that; you're just starting over. That's what we used to have with CalPERS. Now, they've said, "You're going to close it." The purpose of the closing is it's intended to pay the unfunded liability with everything being equal and assumptions coming through. Your payment goes down significantly because you're only going to be paying for the active employees. You would have paid for all the retirees that were unfunded. We're looking at 20, Slide 20?

Council Member DuBois: Yeah. Basically they're saying every city in California will have caught up by that year? Or just us or ...

Mr. Perez: This is just us. This is just the Miscellaneous by the way. The Safety is the other.

Council Member DuBois: It's close on the other one, a couple of years later maybe. Maybe you guys can just tell me, like when CalPERS has an investment target, 7 1/2 percent or if they lower it, how do they actually invest their money? Do they actually aim for that 7 1/2 and take less risky investments if they're on course? Are they trying to maximize return?

Mr. Perez: We believe they try to maximize their returns. We haven't reported that; I don't think we put it in the report. We got their rate of return for the last fiscal year and it was 2.4, so it was nowhere near the 7 1/2. What we're hearing is that it's real estate driven, and then obviously the equity markets and global ...

Council Member DuBois: Their charter is not to like hit the target and remove risk. It's ...

Mr. Perez: I think they're changing. That's part of the discussion they're having, that they want to have a revisit. They've done a couple of things. They're revisiting the aggressiveness of that. Second, they're also removing some of the middle companies, I'll call them. They think they're going to save about 1 percent on the rate of return by removing the middleman, I guess they call it. The investment managers.

Council Member DuBois: The fees will ...

Mr. Perez: Those are the two strategies that we're hearing that they're working on.

Council Member DuBois: Just so I got it right. If they exceed their target, we still pay the normal contribution rate. Like in the dot-com years, they hit 22 1/2 percent. If they do that, we still are ...

Mr. Perez: They smooth it just like a loss would be, so it would be smoothed. One of the things that we could do, let's say all of a sudden they start having these fabulous rate of returns. Do exactly what PERS was saying and do it ourselves, that we send some of the money to a third party and put it there for volatility swings in the future for future payments. We could do it ourselves. When Council Member Burt talked about in the early 2000s when we were super funded, meaning we were fully funding the obligation, internally we charged ourselves like we were not. We charged ourselves the rate of two years before that. With that, we built up about $32 million for retiree medical, and that's how we seeded that. We've done that in the past as an organization.

Council Member DuBois: How does Staff look at long-term interest rates, I guess? It seems like the cost of money right now is historically low. Are you guys thinking, I mean you mentioned Enterprise Funds. We also have our investment portfolio. Are you thinking of leveraging that at kind of today's rates with the assumption that interest rates will go up and returns will go up?

Mr. Perez: We're looking at it very strongly, because our rate of returns are a little bit better than what John assumed, because what he's talking about is just about every neighbor that we have. Because we have the Enterprise Funds and longer obligations, therefore, reserves set out longer, we can invest a little bit longer. We're about a 1.9 rate of return right now. What we've got to look at is if we can send it to a third party, and let's say even if they earn 4, we're still ahead of the game. Right? It's a matter of the risk

tolerance and the confidence that we feel with those managers. We're doing the same thing. We talked with the Finance Committee at the last meeting about maybe refinancing our own debt that we may have including the Enterprise Funds. If we're paying 3, 4 percent and we're earning 2, maybe we need to look at that.

Council Member DuBois: A quick last one. Would one option be to—would the difference in that return be significant enough to pay down? If you're getting 1.9 and you now get 4, do you just take that 2 percent additional return?

Mr. Perez: Right. That's the idea, that you're building up those funds. That's what John was talking about. You seed it and you start growing that, so when the negative swings come, then hopefully you have enough to buy you time. That's the way I would look at it from a beginning for us. When we experience a significant downturn, we kind of scramble and put a freeze on the organization. We froze every position that became vacant. Operationally, that's not necessarily the best thing, because you're not picking and choosing necessarily. We kind of did, but we were pretty desperate and we blocked everything. If we had that money set aside, maybe it allows us to be more selective on what positions we freeze. It gives us maybe a year, let's say that we have a year or two years of funding, to make the hard decisions with more time.

Council Member DuBois: Thank you.

Mayor Holman: Just a couple of things. I think looking at this is, of course, important. I think also looking at it perhaps in context to the extent that it make sense would be a good thing to do too. I thought Council Member Filseth asked a really good question about how much X percent, Y percent, of raises would impact this. Also, last year the City Council instituted Public Safety impact fees. I think those were fully loaded, but I'm not sure.

Mr. Perez: Yes, with the numbers that we had at that point.

Mayor Holman: They were fully loaded, so I don't know if it makes enough difference to look at that in terms of what happens to the part that is the load, we'll call it, should that be put into this to help keep pace. We should be adjusting our impact fees regularly anyway.

Mr. Perez: Yeah. I mean Walter could probably speak to the adjustments of the fees. That's part of the review he does on an annual basis with the departments and how we come to you with recommendations on adjustments. At times, very few. Walter can correct me; we had a couple

where we had to adjust down because we were exceeding the recovery level.

Mayor Holman: Yeah. I guess the question—you don't need to answer it now—but the question is the impact fees that we collect, where are they directed? Are they split too? Are they ...

Mr. Perez: They're directed to the purpose that they're collected for.

Mayor Holman: No, I understand. If they're fully loaded, are the impact fees directed towards being able to pay salary or are they directed towards ...

Mr. Perez: The impact fees, they're predominantly used for capital. They're not used for salary and benefits, if I'm understanding your question.

Mayor Holman: I thought we instituted a Public Safety impact fee that was for staffing, because the commercial sector—I mean we have a much larger daytime demand than we do in nighttime demand. I thought that one of the impact fees that we instituted was for staffing. Am I misremembering that? I know we did capital as well.

Mr. Perez: Yeah, it was mostly capital. Yeah, yeah, yeah.

Mayor Holman: Okay. I'm misremembering. I thought we did both. You mentioned also borrowing from Enterprise Funds. There's if it's legally permissible, and then there's also the community perception of that. Keeping that in mind ...

Mr. Perez: Absolutely.

Mr. Keene: If I might follow up on that. I think it raises a point we shouldn't lose sight of. It goes a little bit back to the points that Council Member Burt was making about revenue stream volatility. While we have economic impacts if there's a downturn, we do have more flexibility and discretion in the Enterprise Funds and the ability to set rates to match the full costs that we have. If say close to a third of our employees are funded through Enterprise Funds, we might want to be thinking about is there a different schedule or approach that we use with Enterprise Funds as one paying down their share of the unfunded liability. They obviously can't fund Public Safety or other employees' share, but certainly all of the Utility employees and folks involved in refuse and those other facilities. That liability, we have more potential control over. As Lalo said, we have some larger reserves there that might give us some flexibility to think about how we buy this down a little bit differently. Additionally on the other side, if we

choose not to buy it down, we have again a little bit more control on the fact that we're carrying a liability, while we always have the ability to set rates that will be part of the cost to be able to cover those costs. It's a little bit different when we're really constricted in a revenue stream, where we're really then faced if we have some rising costs that are so significant that we really have to cut services or eliminate other things that we want to do. That's where the liability really starts to put pressure on us for the long term. It's just something to be thinking about, that we have a little more flexibility in thinking of how we buy down the Enterprise liability probably than in some of the General Funded areas.

Mayor Holman: Great. Thank you for that. I don't see any other Council Member lights. I think the general consensus seemed to be that we would take this to Finance Committee for some fleshing out, but then it would come back to the Council for discussion including with Mr. Bartel.

Mr. Keene: We're happy to take that as the Council's direction.

Mayor Holman: I'm seeing nodding heads, so I think that's what the Council indication is. That will conclude this item.

Closed Session

Mayor Holman: We have Items Number 2 and 3, two Closed Sessions, two items in Closed Session. I need Council consideration of whether we would enter closed Session.

Council Member Burt: So moved.

Council Member Wolbach: Second.

Mayor Holman: Council Member Burt has moved, seconded by Council Member Wolbach, to enter into Closed Session on two items. One is conference with the labor negotiators, and one is conference with the City Attorney over existing litigation.

MOTION: Council Member Burt moved, seconded by Council Member Wolbach to go into Closed Session.

Mayor Holman: Is there any discussion? Seeing no lights, vote on the board please. That's about to pass on an 8-0—Liz, you want to vote? Do you want to vote?

Council Member Kniss: (inaudible)

Mayor Holman: That. That passes unanimously on an 8-0-1 vote with Council Member Scharff absent.

MOTION PASSED: 8-0 Scharff absent

Council went into Closed Session at 7:35 P.M.

2. CONFERENCE WITH CITY LABOR NEGOTIATORS
   City Designated Representatives: City Manager and his designees pursuant to Merit System Rules and Regulations (James Keene, Suzanne Mason, Kathy Shen, Dania Torres Wong, Alison Hauk, Molly Stump)
   Employee Organizations: Palo Alto Police Officers Association (PAPOA); Palo Alto Police Manager's Association (PAPMA): Palo Alto Fire Chiefs' Association (FCA); International Association of Fire Fighters (IAFF), Local 1319; Service Employees International Union, (SEIU) Local 521; Management, Professional and Confidential Employees; Utilities Management and Professional Association of Palo Alto (UMPAPA)
   Authority: Government Code Section 54957.6(a).

3. CONFERENCE WITH CITY ATTORNEY—EXISTING LITIGATION
   Subject: Buena Vista MHP Residents Association v. City of Palo Alto, Santa Clara County Superior Court, Case No. 115-CV-284763
   Subject Authority: Government Code Section 54956.9(d)(1).

Council Member Kniss left the meeting at 10:05 P.M.

Council returned from Closed Session at 10:13 P.M.

Mayor Holman announced no reportable action.

Adjournment: The meeting was adjourned at 10:35 P.M.