



FINANCE COMMITTEE MEETING FINAL MINUTES

Special Meeting
October 15, 2019

The Finance Committee of the City of Palo Alto met on this date in the Community Meeting Room at 5:38 P.M.

Present: Cormack, DuBois, Fine

Absent:

Oral Communications

Michel Poché Flaherty, Deputy City Manager noted that because of the members of the public present that Agenda Item 2 should be heard first.

Chair DuBois announced that Agenda Item 2 would be heard first.

Action Items

2. Consideration of Revenue Generating Ballot Measure and Potential Recommendation to City Council to Approve Framework and Direct Staff to Proceed With Stakeholder Outreach and Initial Polling.

Judy Kleinberg, Chamber of Commerce predicted that there was no reason to have a Business Tax because Palo Alto's (City) revenues were growing beyond current budgetary needs. The business community requested to have a fair share tax with the residents, they preferred a Special Tax, that a Business Tax should have a nexus to business benefits, and to carefully examine all impacts a tax would cause to businesses.

Chair DuBois summarized that the Agenda Item was a formal summary of the Finance Committee's (Committee) previous meeting so that the Committee could refer the item back to City Council (Council).

Kiely Nose, Chief Financial Officer and Director of Administrative confirmed that was correct.

Council Member Cormack did not recall the Committee discussing data collection of business segment demographic profiles.

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Vice Mayor Fine encouraged Staff to think about trust between the community and the City and about what the funds would be used for.

Chair DuBois noted that Staff had expressed at the last meeting that they planned to mimic the structure of the 2016 polling questionnaire.

Ms. Nose asked if the Committee wanted the recommendation to go to the Council as an Action Item.

Chair DuBois believed the Committee did want to see it as an Action Item.

Vice Mayor Fine wanted to know if Staff could still meet the timeline if the Council approved the polling questionnaire at the beginning of November 2019.

Ms. Nose concurred that was correct.

MOTION: Council Member Cormack moved, seconded by Chair Dubois to recommend the City Council approve the framework and direct Staff to begin stakeholder outreach and conduct initial polling for a potential ballot measure.

MOTION PASSED: 3-0

1. Discussion and Direction to Staff Regarding the Establishment of a Pension Funding Policy.

Steve Guagliardo, Interim Director for the Office of Management and Budget reminded the Finance Committee (Committee) that the City Council (Council) had approved the Fiscal Sustainability Work Plan in April of 2019. Three major components of the Fiscal Sustainability Work Plan that had to be in sync with each other were resources, services, and cost of doing business. The City of Palo Alto (City) had already established an ongoing budgeting mechanism and forecasting process which included a more conservative calculation of the normal cost than California Public Employees Retirement System (CalPERS) in the budgetary process. Staff was seeking guidance on how to treat critical variables in the various policy elements, the pace to reach a specified goal, the setting of goals, and the level of flexibility versus rigidity. Four Guiding Principles that Staff had asked the Committee to think about were: 1) what was the desired funding target and the desired timeline to achieve that; 2) the policy should guide Staff and the Council when certain parameters were met; 3) what can the City afford; and, 4) that the issue was State-wide. Elements of a Pension Policy included a funding goal, a timeframe, funding components, allowable uses of funding, service delivery outcomes, and fiscal

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impacts. Components that were already being addressed included funding components, allowable uses of funding, and service delivery outcomes.

Chair DuBois clarified that if the City had a higher funding target, then the City's internal numbers would be close to 100 percent, but CalPERS would see it as over 100 percent.

Mr. Guagliardo stated that was correct. In terms of a funding goal, Staff was recommending a format similar to the Budget Stabilization Reserve (BSR) Policy for both range and target percentage. Items that impacted the timeframe included Public Employees' Pension Reform Act (PEPRA) enrollment, the ratio of actives vs. retiree, and mortality rates. Staff recommended reassessing where the City was in 10 years to make sure they were on track. Items that the City leveraged to meet its chosen timeframe included the 115 Trust and/or Additional Discretionary Payments (ADPs) to CalPERS. CalPERS was calculating the normal cost at a 7 percent discount rate; their timeframe was 20 years for completion of that payment, and the Unfunded Actuarial Liability (UAL) was amortized over 30 years with a 7 percent discount rate. CalPERS was planning to move to a 20 year amortization period instead of the 30 year amortization period in 2020 for the UAL. The City was currently cost sharing with its employees and they were assuming a 6.2 percent discount rate for normal cost. One option was that the BSR Policy be amended to say 50 percent of excess funds could be allocated for pension costs from the General Fund.

Chair DuBois asked Staff if all their examples were based on meeting the targets in 10 years.

Mr. Guagliardo stated that was correct.

Chair DuBois wanted to know how sensitive that 10 year timeframe was to the length of time.

Mr. Guagliardo specified that the compound interest was a powerful intervening factor.

Chair DuBois questioned whether the Liability grew slower than the assets.

Mr. Guagliardo disclosed that it depended on how aggressive the City was choosing to fund it.

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Vice Mayor Fine requested to know if in the four examples Staff had provided to the Committee, if the discount rate was influencing the target or if the target was influencing the discount rate.

Mr. Guagliardo clarified that when looking at the target, Staff was using CalPERS numbers. If the City continued its current course, there was going to be a contribution to CalPERS of \$7.7 million. There was a possibility to increase that up to approximately \$21.2 million, if the City chose the most aggressive timeline. Next steps were to refine costs and implications of a Pension Policy, engage the organization and the community for feedback on a policy, and send the recommendations to City Council for possible adoption.

Council Member Cormack asked how long it took the City to arrive at its current situation.

Chair DuBois expressed there was no liability between 2000-2001.

Ed Shikada, City Manager corrected it was 2001-2002.

Council Member Cormack requested to know how sensitive the four example timeframes were in terms of any reduced revenues.

Mr. Guagliardo noted that the examples did not contemplate that. Some mechanism needed to be put in place if there was a decrease in revenue but that service delivery would be prioritized as number one.

Council Member Cormack acknowledged that should be something to consider.

Kiely Nose, Chief Financial Officer and Director of Administrative Services added that the policy could be written where the Committee or Council did not have to accept a plan that was identified by the City Manager to address additional contributions to the pension as part of the annual budget process. Once a fresh start was initiated with CalPERS the City was contractually locked into that payment plan.

Council Member Cormack wanted to know how Staff came up with a 10 year plan, as opposed to a 20 year plan.

Mr. Guagliardo expressed that Staff was trying to hit the floor threshold.

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Council Member Cormack asked how often in the past 5 to 10 years there was an excess of funds in the BSR.

Ms. Nose answered every year there was excess and it had been roughly \$40 million over the past 5 years.

Council Member Cormack believed splitting the excess by 50 percent and applying those funds to CalPERS was an interesting idea; as well as a full 1 year contribution to CalPERS.

Vice Mayor Fine declared that if the City followed CalPERS's 30 year amortization schedule, without contributions from the 115 Trust, in 10 years the City would be 83 percent funded.

Mr. Guagliardo clarified that would be the case if CalPERS were to meet its target every year.

Vice Mayor Fine was leaning toward something between Examples 2 and 3, in terms of timeframe. He believed a 10 year timeframe was a bit short. All the funding component options were able to work but he wanted to see what the downsides were to each of those. He did not believe that the community would be on board with doing a contractual fresh start. He requested more information on what Staff was expecting the City's revenue increases to be over the next 10 years in dollar amounts.

Chair DuBois asked what percent of the General Fund went to the pension currently.

Ms. Nose declared that the City had been in the 60 percent range of funding since 2009. In the early 2000's to 2009 the City was 180 percent funded.

Council Member Cormack questioned how the City started in a downward spiral.

Ms. Nose declared it was the great recession as well as rebounding from it and benefit changes.

Council Member Cormack advised that a paragraph or chart be included explaining how the City arrived at its current position.

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Chair DuBois questioned if the Other Post Employee Benefit (OPEB) account was in the negative as well.

Ms. Nose claimed there was a trust fund for OPEB and within the next decade, Staff was going to be recommending that the City use that trust fund. OPEB was funded by all funds and contributions were roughly \$3 to \$5 million per year.

Chair DuBois wanted to know what percentage of the General Fund would go to pensions in 10 years and when would CalPERS hit the City with a large bill.

Mr. Guagliardo answered that CalPERS would require a large payment if CalPERS fell significantly short of their investment returns, but it would be amortized instead of being in the form of a lump sum.

Chair DuBois questioned if cities could choose to pay in a lump sum instead of amortizing it.

Mr. Guagliardo declared that the City could state to CalPERS that it was making a discretionary payment and wanted to pay down a specific base.

Chair DuBois suggested that a possible policy could state that the trust fund be used when CalPERS did not meet its investment returns.

Mr. Guagliardo concurred that the 115 Trust was originally set up to do exactly what the Chair was describing.

Chair DuBois advised that the Committee discuss normal cost assumptions and that there needed to be a decision made on what the City was going to manage and what the City was going to let CalPERS manage. He believed the most important question was how the City was amortizing its UAL and over what timeframe. He advised being careful when Staff was using CalPERS assumptions and when they used the City's assumptions. He suggested that Staff use the metric of what was the City's UAL and how long it would take to pay it off. He proposed that the City pay the minimum that CalPERS was requesting and never pay them more. He wished to discuss the risk and reward of paying over the minimum requirement. He added that in terms of timeframe, he wished to see the UAL recalculated to use the same discount rate of 6.2 percent. He expressed that using 50 percent of the excess was a good idea. The policy needed to include language stating that the 115 Trust would be funded every year. He mentioned that one possible goal was to realign employee contributions and have everyone contributing at the same

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rate. In terms of the 115 Trust, he asked Staff if the City should look at it as is, a fund invested on the horizon that the City picked to amortize its own UAL.

Mr. Guagliardo relayed that if the Committee set a goal to appreciate up to a certain year, that could be used to guide investment decisions.

Chair DuBois summarized that the Committee should be looking at the rate of growth of the UAL, impacts on the Enterprise Fund, and the service impacts. Other issues were growth and wages and aligning those with current numbers. He wanted to know if there was a separate trust of Miscellaneous versus Safety.

Mr. Guagliardo answered that there was not.

Chair DuBois noted that was another policy question in terms of having a separate trust for each category.

Mr. Guagliardo interjected that employee contributions were used explicitly for the normal cost. The Safety group was responsible for picking up a larger portion due to the different pension benefits that they received. In terms of tracking the funds that went to the 115 Trust, it was tracked on a fund type level.

Vice Mayor Fine requested to see projections of the recommendations before the Committee and/or Council finalized them. He announced that he wanted to see a broader goal of smoothing out the City's impacts. He did not think applying a discount rate to the UAL of 6.2 percent was manageable.

Ms. Nose explained that the 6.2 percent was chosen by an outside consultant for CalPERS. She wanted the policy to be flexible because the discount rate was always changing.

Chair DuBois commented that the discount rate was also representing a reasonable return on investment.

Ms. Nose confirmed that was correct. The discount rate was a combination of investment return and rate of inflation.

Chair DuBois asked for clarifications on the four examples that Staff had presented.

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Mr. Guagliardo declared that Example 2 was what it would look like if the City put into policy what it was currently doing.

Ms. Nose added that Example 1 was what CalPERS was currently doing.

Chair DuBois wanted to know what the large jump was from Example 2 and Example 3.

Mr. Guagliardo disclosed that the jump between the two was to meet the 95 percent target within 10 years.

Vice Mayor Fine requested another table ranging from 80 to 100 percent with a 10-30 year timeframe and seeing what that cost was.

Council Member Cormack was interested in paying CalPERS down in advance and that it should always be a high priority. She suggested that the policy not revolve around what services could be added but how much of the funds the City could put into the 115 Trust each year. She liked Vice Mayor Fine's suggestion of seeing another table with 80 to 100 percent funding. She was for phasing in any policy that the City decided to go with, and she believed anything between Examples 2 and 3 was a good approach.

Chair DuBois summarized that Council Member Cormack and himself were in consensus that the policy should be set at 80 to 100 percent with a target of 90 percent funded.

Vice Mayor Fine was not sure about the 90 percent target. He believed the ranges were more valuable.

Ms. Nose noted that Staff would use the annual benchmarks from CalPERS to formulate where the City was from those perspectives. Having a target range of 90 percent was good but she suggested having Staff run an analysis on what it would look like to get there in 10 years, 15 years, and 20 years.

Vice Mayor Fine liked that suggestion. He was worried that with a target of 90 percent that the City would be overpaying.

Council Member Cormack believed that Staff could articulate when the ups and downs were coming and come up with a plan to keep the City in line.

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Vice Mayor Fine clarified that it was not the fluctuation that he was worried about but more about coming back to the target amount.

Ms. Nose stated that the Committee could add some flexibility into the policy as they moved down the list of elements.

Mr. Shikada liked the reference to Enterprise Funds and how those funds fluctuated. He advised that Staff come back to the Committee with a more flushed out outline of how the policy would articulate the concepts the Committee was discussing.

Chair DuBois was in support of having an amortized timeline. He asked the Committee if they wanted to discuss a timeline that would pay off the UAL. The City had a contractual amount of money that was owed to CalPERS.

Mr. Shikada interjected saying that the amount was not fixed to the extent that the variability in the liability was actuary. All the other components added in caused the number to be dynamic.

Chair DuBois questioned if CalPERS used those numbers to calculate the UAL.

Mr. Shikada added that was done annually and it was adjusted on the actual, versus being estimated upon mortality, investment earnings and payroll. In terms of retirees, it was based on mortality and the Consumer Price Index (CPI).

Council Member Cormack summarized that even if the City paid off the UAL in 1 year, a new UAL would be present the next year based on employee experience. The Committee was reducing the risk to future residents, employees, and Council by setting a goal of being 90 percent funded. In terms of the timeframe, she wanted to see a chart showing 10 years and 15 years.

Chair DuBois wanted to see 20 years as well.

Vice Mayor Fine clarified that today the City was 85 percent funded.

Mr. Guagliardo confirmed the City would be 85 percent funded in 10 years.

Vice Mayor Fine wanted to know what the funding impacts would be if the City increased it every year by one percent towards the target.

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Ms. Nose advised the Committee to focus on Examples 3 and 4 when looking at the funding components.

Chair DuBois summarized the City needed to use more accurate assumptions. He wanted to see the City do all the components in Examples 3 and 4 and then have a separate line for paying CalPERS.

Vice Mayor Fine agreed with having 50 percent of the BSR going towards the Pension Policy. Additional cost-sharing with employees needed to be set as a goal. He was not sure about matching the discount rate to the UAL but agreed with identifying funding from the budget. He was not sure about paying CalPERS directly or putting the funds into a 115 Trust.

Council Member Cormack asked Staff how they chose 1 year contributions for the 115 Trust before sending money to CalPERS.

Mr. Guagliardo answered that by doing that, it would limit the exposure the City would feel when CalPERS's assumptions were incorrect.

Chair DuBois stated that the penalty was the difference between the return on the trust and the return on CalPERS.

Ms. Nose reported it was the return as well as the cost and how the trust was used. Staff was recommending a split, to keep some funds in the Trust and send some funds to CalPERS for the 1 year funding component.

Council Member Cormack was comfortable doing a split.

Vice Mayor Fine wanted to know how long it would take the City to reach 1 year of funding in the 115 Trust.

Mr. Guagliardo reported in the City's current scenario, it would take roughly 8 years.

Chair DuBois wanted to know why having a 1 year policy for payments to CalPERS was a good policy.

Ms. Nose responded that Staff had assessed what other jurisdictions were doing and was following what the original intent of the 115 Trust was.

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Mr. Shikada added that the question was how much money the City was comfortable having control over that was independent of CalPERS.

Chair DuBois asked what the risk was of having a policy that said, in the years when CalPERS was below their investment target and they requested a large sum of money, the payment be paid out of the 115 Trust.

Mr. Shikada reported in that scenario that would require the City to maintain some liquidity on the investment so that the City could be able to transfer funds quickly without a significant loss of principal.

Vice Mayor Fine added that another scenario would be in place and it could be years between normal cost and CalPERS's return. Those extra funds were able to be moved to the UAL.

Mr. Guagliardo summarized that the Committee was in consensus on the 50 percent for the BSR Policy, additional cost-sharing with employee's subject to bargaining in good faith and identifying funding for the pension obligation through the budget process. The Committee did not wish to use 100 percent of the BSR and there was no consensus of recalculating the UAL with the 6.2 percent discount rate.

Council Member Cormack wanted to see what it would look like to recalculate the UAL to the 6.2 percent discount rate. She wanted to see a fresh start concept for the Safety Group.

Vice Mayor Fine requested what the potential savings could be for a fresh start.

Mr. Guagliardo answered that it was just changing amortization.

Vice Mayor Fine reiterated that if the City paid off the fresh start payment quickly, there were a savings of funds over that amortized period. He wanted to know what the savings would look like in depreciating dollars.

Chair DuBois asked the Committee how they felt about having a separate trust for Safety and a separate trust of Miscellaneous.

Council Member Cormack looked at this as: where could the City get the biggest return on their investment. She proposed that Staff review where the City could do an initial paydown that would help the City over time.

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Ms. Nose expressed that putting too many layers on the 115 Trust in terms of where the money went would become too complicated. She needed to ask a consultant but by having two trusts, there would be fees for each trust as well.

Chair DuBois summarized that the argument to do a fresh start was about interest savings.

Ms. Nose concurred and paying down the UAL at a faster rate.

Council Member Cormack questioned if an Additional Discretionary Payment (ADP) could be given to CalPERS or if the City could decide where it went.

Ms. Nose answered both.

Chair DuBois reiterated that if the City chose to accumulate 1 year of funding and the City chose to use ADPs, what was the difference between choosing where an ADP was spent versus doing a fresh start.

Mr. Guagliardo responded that an accumulation of 1 year funding would be giving guidance and direction to Staff to pursue and implement those funds in a target year.

Council Member Cormack confirmed it would be easier to implement an accumulation of funding, rather than choosing where that money went each year.

Vice Mayor Fine affirmed that the Committee was recommending funding the 115 Trust for a year and then do ADPs. A question was whether the City wanted to do a fresh start and was there an ability to target the most expensive base years.

Ms. Nose disclosed that the policy did not have to specify how an ADPs was used.

Mr. Guagliardo commented that Staff could report out to the Council on what was being contributed and what the anticipated impact was.

Council Member Cormack liked that idea.

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Vice Mayor Fine concurred with the idea of having an Informational Memo. Using a fresh start drove future Councils to stay on the course that the current Committee and Council had set up.

Council Member Cormack was nervous about a contractual fresh start but supported the idea of the City doing one themselves.

Chair DuBois concluded there was consensus about having a 1 year payment and then the City doing ADPs, having the City choose the best use of funds and having that be addressed through the budget process.

Vice Mayor Fine added that the Committee had articulated that Staff bring back more information in terms of the investment strategy for the 115 Trust.

Chair DuBois questioned if there would be any issues with liquidation in terms of liquid assets.

Ms. Nose proposed Staff come back to the Committee with any restrictions that there might be with Public Agency Retirement Services (PARS).

Chair DuBois concluded that Council may be interested in matching the source of funds with the use of funds.

Mr. Guagliardo restated that due to the mechanism that was currently in place to generate existing ongoing contributions, Staff was tracking what was going into the fund by Safety and Miscellaneous.

Chair DuBois questioned what the ramp-up period would be in terms of Example 3, including fiscal impacts.

Mr. Guagliardo answered that it depended on the timeframe.

Chair DuBois advised that the policy would come back to the Committee one more time and then it went to Council. Also, it was going to be an Action Item, not a Consent Calendar Item.

Council Member Cormack was comfortable with it going straight to Council.

Vice Mayor Fine agreed.

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MOTION: Chair DuBois moved, seconded by Council Member Cormack to direct Staff to bring this item to Council as an Action Item.

MOTION PASSED: 3-0

Future Meetings and Agendas

Kiely Nose, Chief Financial Officer and Director of Administrative Services announced that the November 5, 2019 meeting was to be moved to November 14, 2019. Following that, there was to be another meeting on November 19, 2019, with the final Finance Committee meeting being held on December 3, 2019.

Adjournment: The meeting was adjourned at 8:04 P.M.