FINANCE COMMITTEE SUMMARY MINUTES

Special Meeting
June 7, 2022

The Finance Committee of the City of Palo Alto met on this date at the Community Meeting Room and via virtual teleconference at 5:34 P.M.

Present: DuBois (Chair), Filseth, Kou

Absent: None

ORAL COMMUNICATIONS
None

ACTION ITEMS

1. Fiscal Year 2022 Third Quarter Financial Status Report

Vice Mayor Lydia Kou asked for additional information regarding the Governor's Budget Trailer May Revise for Excess Educational Revenue Augmentation Fund (ERAF).

Assistant Director Christine Paras advised that the Trailer Bill would set a limit on ERAF disbursements to local agencies, but the proposal was rejected.

Assistant City Manager Kiely Nose informed the Committee that Staff have been in contact with Townsend Public Affairs and a letter of opposition was submitted.

Chair DuBois asked whether the 42% decrease in water was due to drought conditions or if fewer individuals were in the City during the day. Such a decrease seems significant for only drought-related savings.

Ms. Paras clarified she was referring primarily to electric.

Chair DuBois reiterated that 42% savings appeared to be substantial compared to the usual drought savings.

Ms. Paras believed it was primarily driven by residential sales and reduced water consumption among residents due to the drought.

Chair DuBois indicated 15 to 20 percent was the typical amount suggested to be conserved. He inquired if the 200% swing in the hydro rate was a long-term structural concern.

Ms. Nose explained that projections and activities in this fiscal year (FY) through quarter three (Q3) were included as part of the forecasts brought forward to the Committee. Systemic changes versus one-time changes in Q3 have already been matriculated through the financial forecasts.

MOTION: Chair DuBois moved, seconded by Vice Mayor Kou to accept the Third Quarter Financial Report, and forward it to the City Council.

MOTION PASSES 3-0

2. Review and Approval of the Fiscal Year 2023 Investment Policy

Assistant Director Christine Paras reported that Staff is presenting the Committee with the 2023 Investment Policy, which must be adopted annually. The proposed policy has no changes.

Chair DuBois asked when the policy was last changed.

Manager of Treasury, Debt & Investment Tarun Narayan indicated some changes were made within the last two years to reduce the agency proportion of the portfolio by increasing the municipal bond investments. Staff is on the precipice of getting the agencies between 30-40% of the portfolio, while increasing municipal securities to up to 40%.

Vice Mayor Lydia Kou asked whether the dates on page twenty-three of the packet were related to policy.

Ms. Nose answered yes and even if the policy is not amended, it is reviewed and approved annually based on its guidance.

Chair DuBois asked if there was any reason the City would or would not want to be certified.

Mr. Narayan indicated that there is no direct value to certification, but green environmentally friendly or social investments are desired.

Chair DuBois asked if an environmental, social, and governance (ESG) classified portfolio would be a financial benefit to the City.

Mr. Narayan answered not necessarily, it is a competitive item, and the yield may be lower because there is a low supply relative to demand.

Chair DuBois asked how the actual allocations are decided and how actively it is managed.

Mr. Narayan replied it is very actively managed. There is a balancing act between supply to buy and capacity within policy limits. Typically, there is no need for short-term investments.

Vice Mayor Kou asked for the approximate minimum amount of one month’s net cash needs.

Mr. Narayan answered between a positive of $10-$15 million dollars to a negative of $10-$15 million dollars in a particular given month.

Vice Mayor Kou asked for an example of a Reverse Repurchase Agreement (Reverse REPO).

Mr. Narayan informed that Reverse REPOS are not used by the agency.

Vice Mayor Kou inquired about balancing the interest rate risk with long-term bonds.

Mr. Narayan explained that one way to increase safety would be to have a higher rate of bonds to purchase, but the return rate would be lower. Negotiable CDs are only bought under the Federal Deposit Insurance Corporation (FDIC) or Credit Union’s Insurance Umbrella, which is $250,000 dollars or less.

MOTION: Chair DuBois moved, seconded by Council Member Filseth to recommend the City Council approve the City’s Investment Policy.

MOTION PASSES 3-0

3. Accept June 30, 2021, Actuarial Valuation of Palo Alto's Retiree Healthcare and Other Post Employment Benefits, Approve Annual Actuarially Determined Contributions for Fiscal Years 2023 and

2024, and Affirm Additional Payments to Employers' Benefit Trust Fund

Vice Mayor Lydia Kou inquired about changes to the Supplemental Memorandum.

Assistant City Manager Kiely Nose advised there was a redlined supplemental that corrected language in the Staff report. The item was a Bi-Annual Actuary Report to be reviewed and approved, and direction was requested regarding the funding assumptions for use in FY 2023-24.

Consultant Deanna Van Valer presented an overview to the valuation of the retiree medical that the City pays for its retirees. Assets of the trust are invested with CalPERS and the CERBT Trust since March 2008. The City chose Strategy 1, which is the allocation that most closely matches the allocation in the Pension Fund. Actuarially Determined Contribution (ADC) to be contributed is composed of a Normal Cost and an Amortization of the Unfunded Liability (UAL). The total ADC dollar amount is reduced by City-paid benefits. Each biennial valuations produce two years of ADC. June 30, 2021, valuation calculates contributions for FY 2022-23 and FY 2023-24. Generally, benefits provided by the City cover most of the medical premium for retirees and dependents. Participant counts for Group 1 and Group 2 are decreasing as they become deceased or decide to no longer be covered by the City’s medical plan. Group 3 benefits mirror the benefits paid for active members. Group 4 is referred to as the Vesting Schedule and is based on overall CalPERS service. Total Actuarial Accrued Liability (AAL) of the plan this year is approximately $244 million dollars.

Consultant Mary Beth Redding reported the Unfunded Actuarial Accrued Liability (UAAL) is approximately $47 million dollars less than expected. Significant changes to UAAL included a $28 million dollar decrease due to gain on plan assets, $19 million dollar decrease from premiums less than expected, and $8 million net increase from inflation decrease, reducing discount rate, and future health costs, lowering the discount rate to 6.25%. Additionally, new CalPERS demographic assumptions lowered the liability by $4 million dollars, and extra City contributions resulted in an additional decrease of $3 million dollars. Future contributions are expected to increase by about 2.75% annually, and the UAAL should be liquidated by the early 2040’s. Most employees are projected to take coverage at retirement. UAAL valuation decreased from $150 million dollars in 2017 to $80 million dollars in 2021, and the ADC valuation for FY 2022-23 is $11.5 million dollars.

Ms. Van Valer explained the baseline funding option ADC cost is $11.4 million dollars for FY 2023. Staff recommended excluding additional contributions from the rest of plan assets, assuming 0% earnings to be more realistic, exploring a 5.75% discount rate, and using a 15-year amortization for a cost increase of $15.9 million dollars for FY 2023. Staff also suggested an additional cost of approximately $400,000 dollars for proposed new hires.

Assistant City Manager Kiely Nose noted that City contributions would be lower than in 2012 if it used the baseline assumptions.

Chair DuBois asked if the Committee was establishing direction for two years.

Ms. Nose answered essentially yes, but it was determined in the Resource Impact section that the study could be conducted more frequently. Consultant costs are associated and is open for discussion.

Chair DuBois felt that going to a 0% return for two years was a lot.

Ms. Nose advised it would only be a zero return for this year and every other year thereafter would return to the assumptions of 6.25%.

Chair DuBois wanted to understand the rationale for picking the market for one year only.

Ms. Redding explained that Staff was calculating the contributions to be paid by the City in FY 2023-24, which requires a one-year roll forward. By doing so, it became apparent that 6.25% would not be achieved.

Council Member Eric Filseth asked if there is a different strategy than Strategy 1 for pensions versus other post-employment benefits (OPEB).

Ms. Redding advised that CalPERS was releasing less information on Asset Liability Management (ALM) contents underneath the different strategies, but they show their same capital market assumptions. If a short-term return was provided, it would be lower than 6.25% for Strategy 1. The 6.25% assumption is with consideration to higher long-term inflation, but that balances with healthcare costs using the same long-term inflation.

Ms. Nose noted the report includes scenarios anywhere from twenty-two years from an amortization period to fourteen years. Fourteen years would sync the City with the pension plan, to be 90% funded.

Chair DuBois requested clarification that any new employee would be automatically placed in Group 4.

Ms. Redding answered yes. Group 4 currently has few retirees and predictions are more difficult.

Chair DuBois asked whether an individual must pick one of the plans the City offers.

Ms. Valer clarified that an individual must select a plan offered by CalPERS, and the City contracts with CalPERS for medical.

Chair DuBois inquired about a potential future scenario where Covered California or Obamacare was more attractive than the Group 4 benefit, so that the percentage of individuals opting in would significantly decrease.

Ms. Redding explained that Group 4 pays its benefits looking at an individual's entire career while covered by CalPERS. Most who approach retirement age and retire from the City tend to have the full twenty years and most of the benefits are paid by the City. The City could negotiate different coverage with its employee groups in the future, which may lead to fewer individuals taking the plans.

Chair DuBois inquired about the PayGo Group.

Ms. Van Valer advised it was the benefits the City pays to retirees in a particular year for retiree cash benefits. A portion is paid directly for premiums, and a portion is the implied subsidy.

Ms. Redding added that CalPERS issues retirement checks, and with OPEB, the City pays directly.

Council Member Filseth pointed out the number of actives was around 874-employees, but the City has 1,050 employees. He inquired if 200 individuals on payroll were not enrolled in the CalPERS Health Plan and why.

Ms. Van Valer explained that seasonal and part-time employees are not eligible to enroll.

Chair DuBois asked if there was a trend of individuals leaving public service and pay into CalPERS, but do not retire.

Ms. Redding answered not often, individuals who venture in and out of public service tend to do so earlier in their career.

Council Member Filseth asked what Return on Investment (ROI) assumption was used to calculate the normal cost this year.

Ms. Redding indicated that 6.25% was being used for ADC every year. The assumed 0% related to projecting the assets in the fund forward one year. Staff's recommended alternative of 5.75% is being used..

Chair DuBois requested an explanation of the comparison to other agencies.

Ms. Redding explained that Bartel and Associates conducts around two-hundred-fifty valuations every other year and loads the results into a database to make comparisons and normalize the assumptions between valuations. Under the current Group 4 plan, Palo Alto is in the 75th percentile for benefits paid to employees, spouses, and dependents. Agencies paying more will be ranked higher.

Chair DuBois asked whether there was any benefit to having the extra $2 million dollars.

Ms. Nose advised that Staff recommended it go into the fund balance.

Chair DuBois asked if the motion changed with the supplemental report.

Ms. Nose answered yes, one number that was quoted in it.

Chair DuBois inquired whether there would be additional discretionary payments.

Ms. Nose stated yes, number three because the baseline assumption would be 6.25%, and payments would be made equivalent to the difference between 6.25% and 5.75%.

MOTION: Council Member Filseth moved, seconded by Chair DuBois to recommend the City Council:

1. Review and accept the June 30, 2021, actuarial valuation of Palo Alto's Retiree Healthcare Plan;
2. Approve full funding of the annual Actuarial Determined Contribution (ADC) for Fiscal Year 2023 and Fiscal Year 2024 using the staff recommended adjusted assumptions; and

3. Affirm the continued practice of transmitting amounts at a lower discount rate, 5.75%, as an additional discretionary payment to the City's California Employers' Retiree Benefit Trust (CERBT) Fund.

MOTION PASSES 3-0

FUTURE MEETINGS AND AGENDAS

ADJOURNMENT The meeting was adjourned at 6:56 PM