



City of Palo Alto

City Council Staff Report

(ID # 10784)

Report Type: Action Items

Meeting Date: 5/13/2020

Summary Title: Review, Discuss, and Recommend Establishment of a Pension Funding Policy

Title: Discussion and Direction to Staff Regarding the Establishment of a Pension Funding Policy and Approval of Amendment Number 1 to Contract Number C15159278 to Increase Compensation by \$97,675 for Additional Actuarial Consultant Services for a New Total Not-To-Exceed Amount of \$230,000

From: City Manager

Lead Department: Administrative Services

Recommendation

Staff recommends that the City Council:

- 1) Provide input and guidance to staff on elements of a Pension Funding Policy to proactively fund the City's long-term pension obligations.
- 2) Approve and authorize the City Manager or his designee to execute the attached Amendment No. 1 to Contract C15159278 with Bartel Associates to increase the funding by \$97,675 for a revised total amount Not-To-Exceed \$230,000 for additional actuarial consultant work related to long-term obligations for pension and retiree health liabilities.

Executive Summary

This report continues the City's work on Fiscal Sustainability as an organization, specifically focused on addressing the City's long-term pension obligations. The Finance Committee discussed this topic on October 15, 2019 as part of City Manager's Report (CMR) [10645](#). CMR 10645 contains critical elements necessary to inform the conversation about a Pension Funding Policy with the City Council and is included as Attachment A with this report. Through the conversation on October 15, 2019, the Finance Committee provided general guidance to staff on elements to further explore for the development of a Pension Funding Policy. This report serves as a companion document to CMR 10645 and further explores the guidance provided by the Finance Committee for discussion with the full City Council. Staff is seeking direction from City Council to refine the elements of the Pension Funding Policy and approval of contract

authority necessary for the continued analysis and modeling of potential pension impacts. Staff anticipates incorporating direction from City Council into a formal Pension Funding Policy and returning to City Council for the adoption of said policy at a later date.

In October, the Finance Committee requested more information regarding reaching different funding levels between the next ten and fifteen years. Through work with Bartel Associates, the City's outside actuarial consultant, staff analyzed the additional contributions that would be necessary to reach 90% of CalPERS' calculated funding for the Miscellaneous and Safety plans over different timeframes ranging from 15 years to 10 years. This was based on assets as of June 30, 2019 and is meant to be a framework for the discussion around additional contributions to the City's long-term pension liability. This included as Attachment B to this report.

It is noteworthy that CalPERS has experienced significant volatility in recent weeks which have significantly impacted the valuation of our assets. This volatility underscores the need for the City to pursue its own pension funding policy but was too recent to be included in the actuarial analysis that was performed to examine funding levels over the ten to fifteen year time horizon. Nonetheless, the actuarial analysis presents a model at a point in time for comparing anticipated fiscal impacts. The recent volatility of the market emphasizes the need for a flexible policy that is elastic and adaptable to the changing needs of the organization. The City has evidenced its commitment to funding its long-term liabilities through additional contributions using year-end savings each year since FY 2017.

As discussed with the Finance Committee, the overarching goal of a pension funding policy is to minimize service delivery crowd-out from escalating pension costs by balancing near-term investments with anticipated long-term needs. As discussed in the Fiscal Sustainability Workplan, [CMR 10267](#), and again with the Finance Committee in October, the development and establishment of a pension funding policy is just one element of the City's overall fiscal sustainability. The fiscal sustainability ecosystem is comprised of service delivery, resources, and the cost of doing business. As the City establishes a Pension Funding Policy, it is important to keep the ecosystem balanced. Significant impacts on one area of the ecosystem, such as the cost of doing business, will have corresponding impacts on the other areas of service delivery and resources. As such, this item is being brought forward concurrent to the discussion of the FY 2021 Budget, which will greatly impact service delivery throughout the organization.

Important to this discussion are the following attachments and a summary of the additional information provided within:

Attachment A: As discussed above, CMR 10645 is included as Attachment A for review along with this report. That CMR also includes additional information regarding the City's long-term pension obligations.

Attachment B: The additional information requested by the Finance Committee regarding additional contributions necessary to reach 90 percent of CalPERS' calculated funding over

different timeframes ranging from 15 to 10 years is discussed in Attachment B. As discussed above, this is meant to be a framework for the discussion around additional contributions to the City's long-term pension liability.

Attachment C: A sample pension funding policy is drafted and is intended to spur discussion. It is anticipated that it will be refined based on City Council feedback and staff will return to the City Council for formal adoption.

Attachment D: A scenario that shows the impact of CalPERS achieving a 0 percent rate of return for FY 2020 is included as Attachment C with a brief discussion of that scenario. This scenario was created using CalPERS Pension Navigator tool. This is meant only to offer additional context for the conversation; many other factors will also impact the City's contributions over the immediate future and long-term horizon.

Attachment E: As a result of the significant additional actuarial work associated with analyzing and developing this policy, attachment D contains an Amendment No. 1 to Contract C15159278, originally approved in September 2015 by the City Council, with Bartel Associates to serve as the City's outside actuarial consultant for long-term liabilities related to Retiree Health and Pension costs.

Background

CMR 10645 (Attachment A) contains a comprehensive summary of conversations that had been held through October 2019 with the City Council and the Finance Committee. At their meeting on October 15, 2019 the Finance Committee discussed the example Pension Funding Policies that were outlined in Table 2 of Attachment A and discussed in greater detail in that report.

There was consensus among the Finance Committee that the City should continue to make the Actuarial Determined Contributions (ADCs) as calculated by CalPERS, continue its current practice of using a more conservative discount rate to calculate the normal cost (pay-go) portion of pension obligations, and look to expand into additional funding options. Paying the ADC is the lynchpin of the City's pension funding obligations. Continuing to pay the full ADC ensures that the City does not further worsen its funding ratio. Using a lower discount rate to calculate the normal cost is also an important element of the overall strategy. That methodology has been part of the City's annual contributions to its irrevocable Section 115 Trust (PARS Trust) Fund, generating approximately \$8.2 million in contributions through FY 2020. In addition, the City has also elected to make *ad hoc* contributions totaling \$19.0 million to the PARS Trust since it was created in January 2017. This brings principal contributions to \$27.2 million through FY 2020.

Options available, as outlined in Table 2 of Attachment A, include tactics on a continuum with a variety of impacts to the long-term pension obligations and corresponding impacts on service delivery levels. One option with minimal service delivery impact would be to amend the existing BSR policy to include PARS contributions as an eligible use of excess BSR above 18.5% without City Council approval. This would enable greater discretion by the City Manager to allocate excess resources at year-end. On the other end of the spectrum are options such as a contractual 'Fresh Start' with CalPERS, which would legally obligate the City to meet a new, shorter amortization schedule. Although this would yield long-term savings by avoiding interest at the tail end of the current amortization schedule, it would have a drastic and immediate impact on service delivery levels by necessitating significant additional expenses for the annual ADC.

In October 2019, the Finance Committee expressed interest in learning what additional levels of contributions would be necessary to reach a 90% funding level over different timeframes, ranging from 10 years to 15 years, and contextualizing what service delivery trade-offs would be necessary to achieve that funding level within each timeframe. That analysis is transmitted as Attachment B to this CMR.

Discussion

As discussed in CMR 10645, it is important that the City not get too far ahead of CalPERS. Therefore it is recommended that the valuation of assets in a Pension Funding Policy be aligned with CalPERS. To do otherwise risks adverse impacts to the City's credit rating, which could limit the City's ability to borrow at favorable rates. However, given the recent volatility seen by CalPERS, largely due to the unforeseen impacts of COVID-19, it seems prudent to presume that CalPERS will not meet its 7% rate of return on an annual basis for the current year. This reinforces previous concerns voiced by the City Council regarding the optimistic rates of return presumed by CalPERS and the corresponding impacts of that optimism on the City's long-term pension liability.

Synthesizing these two concepts would mean that the City could use the 7% Discount Rate to determine its actuarial valuation but should not rely exclusively on the contribution rates specified under that projection alone to bolster its proactive pension contributions.

The City has evidenced its commitment to proactively funding the long-term pension obligations by diligently preserving *ad hoc* transfers of excess revenue and year-end savings to the PARS Trust. Additionally, the City has contributed the difference in normal cost calculations to the PARS Trust fund since receiving corresponding guidance from the City Council.

In order to institutionalize the City's current practice and address the City Council's desire to adopt a Pension Funding Policy it is recommended that a policy be adopted that codifies the City's current practice of paying the CalPERS' Actuarial Determined Contribution and confers

flexibility to the City Manager to pursue both additional contributions and potential uses of the PARS Trust as part of the annual budget process.

Elements of a Pension Funding Policy are discussed briefly below and more fully in Attachment A.

Funding Goal and Timeframe

The Pension Funding Policy should also clarify a desired funding goal to be reached in the PARS Trust and with CalPERS, and the timeframe to achieve that. The example Pension Funding Policy attached to this CMR (Attachment C) suggests a 15 year timeframe to reach a 90 percent funding level.

Funding Components

The Pension Funding Policy should include guidance and direction on funding components to achieve the funding goal within the specified timeframe. The example Pension Funding Policy attached to this CMR includes continued calculation of the Normal Cost at a lower 6.2 percent Discount Rate as well as use of excess BSR above 18.5 percent as funding components.

Additional discussion of potential funding components and their uses is included in CMR 10645 (Attachment A) as are additional options that are not recommended, such as investments in other City Reserves, Pension Obligation Bonds, and a Formal Fresh Start that would trigger an irrevocable contract amendment with CalPERS.

Allowable Uses of Funding

Another element of the Pension Funding Policy is clarifying the allowable uses of funding accumulated in the PARS Trust Fund and when those funds should be transferred to CalPERS. The example Pension Funding Policy includes the parameter that the funding components described above would be sent to the PARS Trust Fund on annual basis. The example Pension Funding Policy also clarifies that Additional Discretionary Payments (ADPs) from PARS to CalPERS would be articulated as part of the annual budget process. (In general, funding will yield a greater benefit to the City if it is invested with CalPERS since the funding does not impact the annual ADC until it is invested with CalPERS.)

Contingencies, Service Delivery Outcomes, and Fiscal Impacts

As discussed earlier in this CMR, the uncertainty that the City currently faces emphasizes the need for an elastic and flexible Pension Funding Policy. The Pension Funding Policy should clarify contingencies, service delivery outcomes, and fiscal impacts that are anticipated to allow for adaptive responses to changing circumstances.

Contingencies could be included as 'guard-rails'. Parameters for consideration could include requiring the City to continue using a lower discount rate to calculate the normal cost for pensions until a funding target of 90% is met, unless General Fund revenues decline by more than a certain percentage year-over-year. In these cases, the City Manager could be required to

identify how a year of diminished contributions could impact the funding target and timeframe element and identify strategies for 'making-up' that payment in subsequent years. COVID-19 has impacted CalPERS rate of return for the current year, but it has also disproportionately impacted the City's Fiscal Sustainability ecosystem by constraining resources as discussed with the transmission of the FY 2021 Proposed Operating and Capital Budgets on April 20, 2020 and through multiple subsequent status reports to the City Council.

Given that the City is anticipating resource constraints that have not been seen since the Great Recession, pursuing a more aggressive pension funding policy would have even greater impacts on the City's service delivery environment. Through the budget process, it is anticipated that service delivery impacts will be presented even without increased funding for additional proactive pension contributions. This environment emphasizes the importance of duly considering service delivery outcomes and fiscal impacts when developing a Pension Funding Policy.

An example Pension Funding Policy is included as Attachment B; it is meant to spur discussion and dialogue on this topic as the City works to adopt a policy in this time of heightened uncertainty. The sample Pension Funding Policy uses a 15 year timeframe to reach a 90% funding level of CalPERS calculated funding, using a lower discount rate (6.2 percent) to calculate the Normal Cost and transmitting that difference to the Section 115 PARS Pension Trust Fund on an annual basis. The sample policy would require any use of the Pension Trust Fund's accumulated funding to be approved by the City Council. The City Manager would be required to identify the impacts of any temporary changes to the practices prescribed by the policy, including temporarily diminishing contributions to the PARS Trust, on the funding goal and timeframe to the City Council through the annual Budget process.

Contract Amendment

The City has an open contract with Bartel to work on three bi-ennial Other Post-Employment Benefit valuations, the most recent of which was transmitted on April 30, 2020 for discussion with the Finance Committee on May 5, 2020. It also included authority for additional services related to pension forecasting and analysis. This contract amendment increases the contract authority to align with the significant work effort to date from Bartel Associates, which has been instrumental in the extensive discussions that have been had with the City Council and the Finance Committee regarding long-term pension obligations. It also includes contract authority for additional Government Accounting Standards Board (GASB) reporting requirements to ensure the City's compliance with those regulations. Although no budgetary adjustment is necessary for this contract amendment, staff does anticipate using salary savings to fund elements of the amended scope.

Stakeholder Engagement

The Administrative Services Department has engaged stakeholders throughout the organization, including Human Resources, the City Attorney's Office, the Public Works Department, and the Police Department for feedback on this issue. As the City Council clarifies its desired path forward for a pension funding policy, staff will work to ensure that stakeholders remain informed of developments and changes.

Additionally, the City's interest in meeting its pension funding obligations necessitates ongoing engagement with the State Legislature to give cities more tools for managing those obligations. The State could choose to give cities tools such as defined contribution plans, which could significantly limit long-term obligations compared to the current system of defined-benefit plans.

Resource Impact

The FY 2021 Proposed Budget included the CalPERS required pension payments as well as additional proactive pension funding, calculated by taking the difference in Normal Cost annual payments between CalPER's 7.0% Discount Rate and a 6.2% Discount Rate. If the City Council chooses to pursue additional funding, there will be corresponding changes necessary to the budget with resulting adverse service delivery impacts. Conversely, if the City Council decides to pare down or scale back contributions to the long-term pension obligations given the current financial outlook, it may allow for some positive service delivery impacts.

No Budget Amendment is necessary for Amendment No. 1 to the contract with Bartel Associates. Staff will need to reallocate salary savings in the Administrative Services Department to fund elements of the amended scope.

Environmental Review

This report is not a project for the purposes of the California Environmental Quality Act. Environmental Review is not required.

Attachments:

- Attachment A: CMR 10645 - Direction to Staff on Pension Funding Policy
- Attachment B: Finance Committee Request for Information
- Attachment C: Example Pension Funding Policy
- Attachment D: Impact of 0% Investment Return for CalPERS for FY 2020
- Attachment E: Amendment No. 1 to C15159278 Bartel Associates LLC



City of Palo Alto

Finance Committee Staff Report

(ID # 10645)

Report Type: Action Items

Meeting Date: 10/15/2019

Council Priority: Fiscal Sustainability

Summary Title: Review, Discuss, and Recommend Establishment of a Pension Funding Policy

Title: Discussion and Direction to Staff Regarding the Establishment of a Pension Funding Policy

From: City Manager

Lead Department: Administrative Services

Recommendation

Staff recommends that the Finance Committee review and discuss the options for a Pension Funding Policy and recommends elements to include in the establishment of a Pension Funding Policy to be reviewed and adopted by the City Council.

Executive Summary

This report continues the City's work on the City Council's Fiscal Sustainability priority and corresponding workplan through the development of a pension funding policy. Four example policies, including a CalPERS example as a baseline, **are outlined for discussion by the Finance Committee and refinement prior to returning to the City Council for adoption.** A brief analysis of each example policy is included to inform the conversation and discussion regarding the impacts and outcomes of each. Also included is a list of the funding components and levers that the City can use to address its long-term pension liability.

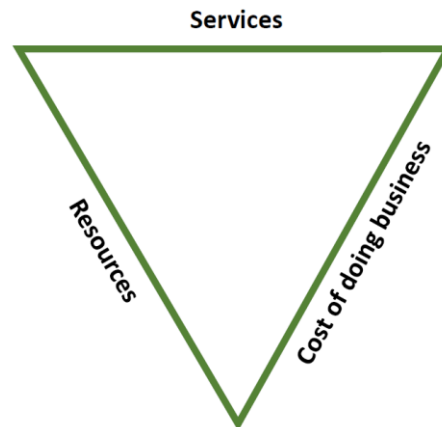
The development and establishment of a pension funding policy is just one element of City's overall fiscal sustainability workplan. As discussed in CMR [10267](#), the City's fiscal sustainability ecosystem is comprised of service delivery, resources, and the cost of doing business. As the City works to develop a pension funding policy, it is important to keep in mind that the goal is to keep the ecosystem balanced; significant impacts on one area of the ecosystem, such as reducing the cost of doing business, will have a corresponding impact on the other areas of service delivery and resources.

This report contains a brief description of the work the City has already done to proactively address its long-term pension liability before presenting draft policies for consideration and

discussion by the Finance Committee. Attachment A to this report provides additional background on the City's pension liability, including a summary of the reports and discussions with the Finance Committee and City Council to date, and variables and factors that impact the City's liability. When the CalPERS actuarial reports were transmitted to the Finance Committee on September 24th, the committee made a request to see the differences in the annual payments between the current CalPERS required payments and a "Fresh Start", which would reamortize the Unfunded Accrued Liability over a shorter horizon. Attachment B provides a table showing the Fresh Start payment schedules, as calculated by CalPERS, for the Miscellaneous and Safety Plans.

Background

The City of Palo Alto has been discussing its options for prefunding its long-term pension obligations as part of its work towards addressing the 'Fiscal Sustainability' workplan. Significant progress has been made over the past three years towards better understanding the challenges the City faces and proactively identifying and implementing tools to better position the City to address its long-term liabilities. The establishment of a pension funding policy is an important segment of the City's Fiscal Sustainability workplan and the City's continued progress towards addressing long-term pension liability. The pension funding policy is a tool to guide pension funding decisions within the context of service delivery and resources. The ecosystem is depicted in the diagram below.



It is important to remember that the City cannot work in isolation to address its pension obligations given our needs to remain a competitive employer and for our retirement benefits and costs to be understandable and relevant to the marketplace. As a part of the CalPERS system, the central actions that CalPERS takes impact our pension costs.

To date, CalPERS has taken the following actions:

- lowered their expectations for investment returns and inflation rates to better align with the rates they have experienced over the past ten years (from 7.5% to 7.0% discount rate);
- changed how they calculate the annual payment for the Unfunded Accrued Liability (UAL) from a percentage of payroll to a flat-rate dollar amount thereby guaranteeing a certain level of contributions from member agencies; and

- changed the timeline for amortizing new bases (gains/losses) from investment returns from 30 years to 20 years and eliminated the ramp-up and ramp-down of these bases beginning with the valuation reports as of June 30, 2019.

These actions have resulted in increases to the City's costs for funding the defined benefit pension plan but will better position the City on a long-term basis.

Parallel to the actions being taken centrally by CalPERS, the City of Palo Alto has also individually implemented practices to better address its long-term pension liabilities. Actions taken by the City include:

- No longer paying any portion of the employee share of pension costs (also referred to as "EPMC" or "Employer Paid Member Contribution");
- Employees now "pick-up" a percentage of the employer share of pension costs (also known as "cost sharing");
- Establishment of an irrevocable IRS Section 115 Pension Trust Fund; and,
- Adoption of a more conservative discount rate than CalPERS (currently 6.2%) that is used to calculate the normal cost of pensions for all financial planning across all funds.

These actions are described in further detail below.

A chart showing the currently approved employee pick-up of the employer share rates at the end of the current labor agreements, as well as the expiration date of the current agreement, is shown below in Table 1.

TABLE 1: Employee Pick-Up of Employer Share

| Labor Group | Employee Cost Share Rate (by the end of Current Labor Agreements) | Current Labor Agreement Expiration |
|-------------|---|---------------------------------------|
| SEIU | 2.0% | 12/31/2021 |
| UMPAPA | 1.0% | 6/30/2020 |
| MGMT | 1.0% | 6/30/2020 |
| FCA/IAFF | 4.0% | 6/30/2021 |
| PAPOA | 3.5% | 6/30/2021 |
| PAPMA | 4.0% | 6/30/2021 |

Additionally, the City Council authorized the establishment of an irrevocable Section 115 Supplemental Pension Trust Fund ("Pension Trust Fund") with the Public Agency Retirement Service (PARS) through CMR [7553](#) in January 2017. The Pension Trust Fund is irrevocable because the City can deposit funds into this fund and those contributions may only be used for paying City's pension costs. From January 2017 through FY 2020, the City will have invested more than \$22.0 million in principal contributions into the PARS Trust. Contributions were initially made on an *ad-hoc* basis, using one-time savings or excess revenues. However, the City has since incorporated a structural change to its budgeting practice and financial planning. Per

City Council direction on October 29, 2018 through CMR [9740](#), the City now calculates the normal cost, or “pay-as-you-go” cost of pensions using a lower Discount Rate than CalPERS, currently 6.2%. This change in methodology generated approximately \$6.2 million in contributions for FY 2020 across the organization and is anticipated to generate approximately \$5.0 million in ongoing contributions above those currently projected by CalPERS.

Discussion

Through staff’s work to extensively research the strategies and tools to draft and implement a policy to more proactively address growing pension costs, four guiding principles and questions have emerged. They are listed below and were used to inform the policy examples that follow.

- 1) What is the desired funding target? What is the desired timeline to achieve that target? (While 100% funding would be the presumptive goal, achieving this quickly could require drastic service reductions with corresponding workforce and community impacts. A balanced and thoughtful strategy is therefore necessary.)
- 2) The policy should be “evergreen” (similar to the Budget Stabilization Reserve (BSR) policy); it should guide staff and the Council when certain parameters are met and require action when those parameters are not met. The more conservative the policy, the more accountability will need to be included in the policy.
- 3) What can the City afford? What is the most efficient use of its funding? Based on those answers, what payment options and tools best align with those considerations?
- 4) It is important to remember that this is a state-wide issue and that CalPERS invests over a very long-term time horizon. Although the City is currently experiencing cost volatility and increases in its pension costs, it has also experienced “superfunded” status in the past. The City should position itself to take advantage of potential changes in the pension landscape over the medium- and long-terms.

Overall, staff recommends that **the goal of the City’s pension funding policy is to reach 100% of funding necessary for its pension liabilities** as calculated by CalPERS. The goal of 100% funding is based on conversations with actuarial consultants; full funding provides the most resilience to changes in the market that would impact pension costs. Using CalPERS’ calculated funding requirements ensure that the City remains aligned with the fourth guiding principle.

There are different timelines, mechanisms, and options available to pursue this goal. The purpose of a fiscal policy, which a potential pension funding policy would be effectively guiding, is to establish practices and procedures that will guide City Council and staff when certain parameters are met and require certain levels of action when those parameters have not yet been met. Staff has outlined example pension policies with variations between each based on research of other jurisdictions, conversations with actuaries, and reviews of existing best practices from industry publications.

Each of the example policies makes progress towards addressing the City’s pension liabilities; the first example models the strategies that CalPERS is implementing while the remaining examples go above and beyond what CalPERS is currently requiring. The minimum funding level and the timeline to achieve that minimum funding level vary among the examples. As a result, the tools to reach the funding level over the desired timeframe differ slightly from example to example. Each example outlines different applied uses of the funding to align with the funding level and the timeline target. Finally, each of the different policies will have a different impact on the City’s Fiscal Sustainability ecosystem and require different levels of structural adjustment, service delivery impacts, and/or the generation of new revenue in order to meet the funding goal.

These example policies are intended to prompt discussion among the Finance Committee and ultimately recommend a set of parameters for the basis of a draft policy. A brief analysis of each of the different options is detailed below Table 2. A further discussion of potential funding components follows after the analysis: some of the components are recommended, some of them are potential tools that could be used depending on the desired funding level and target, and still others are not recommended because of the disadvantages associated with them.

Table 2 outlines examples of what a potential pension funding policy may include. Reading from left to right, the first column identifies the different elements of a pension funding policy. Moving from left to right the components of each element are building in the next. For demonstration, a policy under “example 3” would be inclusive of all elements and the components of them in Examples 1, 2, and 3. The elements to be contemplated as part of the adoption and implementation of a funding policy are described below.

Funding Goal: The first element of a pension funding policy is articulating the funding goal of the policy, and staff recommends inclusion of an acceptable range as well as a target funded level (like the City’s General Fund Budget Stabilization Reserve “BSR” policy). The percent funded a plan is would be calculated by the total assets divided by the total liabilities. If the lower end of the range was not met (“floor”), the funding components section of the funding policy would be required to be invoked. In general, the higher the floor, the greater need the need for additional funding to be dedicated towards proactive pension contributions which will require structural adjustments (revenue increases, or expense reductions; the latter would have impacts on service delivery).

Timeframe: The second element is the timeframe; this represents the timeframe to meet the desired funding level in the context of the many variables used in actuarial analysis and calculations. Examples of additional variables include but are not limited to demographic changes - the shift from a workforce comprised mostly of ‘Classic’ members to PEPRAs members, mortality estimates, and workforce size and tenure. The shorter the timeframe, the greater structural adjustments would be necessary to achieve the goals.

Funding Components: These are the actions that would be required when the funding “floor” was not met. As the examples move from Example 1 to Example 2, to Example 3, and Example

4, the additional funding components are noted. As outlined above, each example includes the elements in the earlier examples. (Example 3 includes everything in Examples 1 and 2 as well as the additional components detailed in the Example 3 column.)

Allowable Uses of Funding: This element of a pension funding policy details the allowable uses of the funding generated through the funding components. Depending on the ultimate policy goals here, further refinements such as investment strategy and reporting will need to be added.

Service Delivery Outcomes: In order to implement the elements of each of the examples outlined, there will be implications on the organization. This section outlines the adjustments necessary to meet the policy elements outlined in each example; the impacts and actions needed to contribute sufficient funding to meet the goals. Any further structural adjustments will necessitate service delivery impacts.

Fiscal Impacts: Any further structural adjustments will have additional impacts on the City's fiscal sustainability; this element begins to articulate the scope or magnitude of structural adjustments necessary to achieve a funding goal.

| TABLE 2: Pension Funding Policy Examples | | | | |
|--|--|--|---|---|
| Pension Funding Policy Elements | Example 1: CalPERS (Baseline) | Example 2: Lower Funding Target (Current Practice) | Example 3: Medium Funding Target | Example 4: Higher Funding Target |
| % Funded Goal (Range) | 100%; no lower element of range | 80% - 100%; Target of 85% | 80% min - 100%; Target of 95% | 90% - 100%+; Target of 100%+ |
| Time frame | 30 years | Within 10 years | Within 10 years | Within 10 years |
| Funding Components | Normal Cost (NC) calculated at 7.0% Discount Rate | (+) Cost-sharing with employees (see table above for specific rates) | (+) Additional cost-sharing with employees | (+) Recalculate the UAL with the same lower DR (phase-in) |
| | Changes in actuarial assumptions amortized over 20 years | (+) Using a more conservative discount rate (DR) for calculation of normal cost | (+) Identify funding for the pension obligation through Budget | (+) Amend existing BSR policy, 100% excess BSR allocated for pension costs (all funds contribute a commensurate amount) |
| | UAL amortized over 30 years for gains/ losses; calculated at 7.0% Discount Rate (20 years beginning 6/30/2019) | (+) Amend existing BSR policy, 50% excess BSR can be allocated for pension costs (all funds contribute a commensurate amount) | | |
| | | (+) Reach one-year of funding for CalPERS ADC in 115 Trust Fund (invest moderately conservatively); subsequent proactive funding to CalPERS as ADP | | |
| Allowable Uses of Funding Components | NC covers pay-go portion; UAL portion pays off unfunded liability in 30 years if CalPERS investment returns met | (+) Use of 115 Trust Fund funding to be addressed through annual budget process or separate City Council approved action. Pension Rate Stabilization Program | (+) Fresh start in concept for the Safety group, beginning in a target year | (-) Contractual Partial Fresh Start for the Safety group beginning in a target year in-lieu of fresh start in concept |
| Service Delivery Outcomes | Continue services throughout the City including the ability to keep up with the cost of doing business as well as limited strategic investments. | Continue current constraints and limitations on service delivery including an inability to keep up with the cost of doing business. Prioritization would continue to be necessary annually through the budget process. | (+) City Manager to identify plan to address additional contributions to pension as part of annual budget process | (+) Significant adverse impacts on service delivery levels; additional revenue |
| | | | (+) Impacts on Service Delivery and/or structural additional revenue | |
| Fiscal Impact | Savings to the City | Continue \$5.0 million structural adjustments necessary to maintain contributions | Additional structural adjustments Estimated at ___%* of the General Fund | Significant additional structural adjustments Estimated at ___%* of the General Fund |
| <p>(+) Indicates that this is in addition to the step to the left while (-) indicates that this is instead of the step to the left. * This information is not available at the time of the printing of the report; however, staff is working to provide a metric for context.</p> | | | | |

Example 1: CalPERS Methodology

Example 1 shows the baseline elements of CalPERS methodology. CalPERS has a funding goal of 100% of the City's pension liability over the next 30 years. To meet this goal, it actuarially calculates what the City's normal cost should be given the CalPERS actuarial assumptions, as well as the Unfunded Accrued Liability annual payment for the City. In a year when CalPERS meets its investment return the UAL will shrink since the City has made its payment, it will shrink more when CalPERS exceeds its investment return. Conversely, when CalPERS fails to meet its investment return, the UAL will grow. CalPERS will be changing its amortization timeline from 30 years to 20 years beginning with the June 30, 2019 valuation which will shorten the City's horizon to pay off its UAL. If the City were to use this methodology, it would result in savings of approximately \$5.0 million compared to the City's current practice. These savings could be used for service delivery enhancements and/or to lower rates in the City's enterprise activities.

Example 2: Lower Target/More Flexibility

Example 2 provides the most flexibility of any of the policies, with the lowest funding floor, fewest restrictions on budgetary additions, the least amount of additional impacts to the City's service delivery, and the lowest additional fiscal impact of the three non-CalPERS examples. This example stipulates that the City Council has a range of between 80% and 100% funded, a target of 85%, and a minimum funding level of 80% necessary within 10 years. When the City's overall funded status is less than 80%, the tools detailed under the option would be required actions. For Example 2, this would result in continued cost-sharing with employees, calculating the Normal Cost portion of the pension at a more conservative rate than CalPERS, and transmitting half of the excess BSR above City Council's 18.5% target to either PARS or CalPERS. The recalculation of the Normal Cost portion is included under each pension funding policy Example other than the CalPERS example; it is recommended that the City Council set its desired discount rate to use in the calculation every two years to avoid excessive volatility.

In Example 2, the City would transmit the costs beyond the CalPERS annual ADC to the PARS trust until one year's worth of ADC was accumulated in the trust. In each option, the PARS Trust assets would still be invested in the PARS 'moderately conservative' portfolio. After one year of ADC funding was reached, the City would transmit the funding to CalPERS as an Additional Discretionary Payment to pay down the Unfunded Accrued Liability. Once the PARS fund reached its target, use of its accumulated funding would be discussed as part of the annual budget process or separately through a City Council approved action. This example would have a relatively low additional impact on Service Delivery, since it largely aligns with current practices, but it would maintain the ongoing structural adjustments and service delivery impacts articulated in the FY 2020 Operating Budget. As a result, although no additional restrictions would need to be enacted to restrict new services throughout the organization, they would likely need to be offset either by corresponding reductions of services that were lower priority or structural revenue changes.

Example 3: Medium Funding Target

Example 3 provides a combination of the elements seen in Examples 2 and 4. It would have a higher floor than Example 2 but have a more aggressive timeframe of 10 years. This option stipulates that the City Council has a desired range of between 80% and 100% funded, with a target funding level of 95%. As such, it would expand on the tools used in Example 2 by drawing on some of the funding components listed in Example 4. In addition to each of the tools described in Example 2, this policy would also include pursuing further cost-sharing with the labor groups through the standard negotiating process. This policy would also require the City Manager to identify additional funding for the pension obligation through the Budget process; to the extent that these were further expense reductions they would cause additional service delivery impacts.

As with Example 2, the City would transmit the costs beyond the CalPERS annual ADC to PARS until one year of ADC was accumulated before transmitting the ongoing funding generated by the tools to CalPERS to reduce the UAL. This option also includes a fresh start in concept for the Safety group in a target year, which would allow the City to re-amortize specified bases over a certain timeline with CalPERS but not contractually obligate the City to make those payments to CalPERS. (The partial Fresh Start detailed in Example 4 would be contractually required payments). Given the higher funding floor for Example 3 than Example 2, further structural adjustments to the City's revenue and expenses would be necessary. As such, it would be important for the City to carefully weigh the implications of service delivery changes against its pension obligation.

Example 4: Higher Funding Target/Less Flexibility

Example 4 provides the least flexibility of any of the policies, with the highest funding floor, most restrictions on budgetary additions, the greatest additional impacts on the City's service delivery, and the greatest additional fiscal impact of the examples. This example stipulates that the City Council has a target range of between 90% and 100%+ funded, with a target level of 100%+. When the City's overall funded status is less than 90%, the tools included in this policy would be required actions. In addition to each of the funding components included in Examples 2 and 3, this policy would also include a phase-in of calculating the City's annual UAL payment at a more conservative discount rate (this would be tied to the same discount rate used for the Normal Cost).

As with Examples 2 and 3, the City would transmit the costs beyond the CalPERS annual ADC to PARS until one year of ADC was accumulated before transmitting the ongoing funding generated by the tools to CalPERS to reduce the UAL. This option also includes a partial fresh start for the Safety group, which would require the City to re-amortize specified bases over a certain timeline with CalPERS and contractually obligate the City to make those payments. Since this option has the highest funding target, it correspondingly offers the least flexibility. It would

effectively impair the City's ability to add services and would have significant impacts on service delivery due to the further structural adjustments necessary to maintain contributions.

The example policies included in this CMR are meant to be a starting point for discussion with the Finance Committee regarding the establishment of a pension funding policy. Further description of the funding components included in the chart and examples above and some of the allowable uses of those components, as well as additional funding components that are not recommended are included below.

Pension Funding Policy Funding Components: Recommended

The City is currently using some of these funding components, including ongoing expense reductions to fund contributions to the Pension 115 Trust Fund, as well as employee cost-sharing (employee pick-up of the employer share) to help limit the City's exposure on the Unfunded Accrued Liability.

Section 115 Trust Fund: In the FY 2020 Operating Budget, \$6.2 million in contributions to the PARS Trust was included, bringing total contributions to the PARS Trust to more than \$22.0 million since its inception in 2017. It is anticipated that approximately \$5 million a year will be transmitted to the PARS Trust as a result of the City's current practice of budgeting a lower, and thereby costlier, discount rate to calculate the Normal Cost contributions than the one CalPERS uses for its actuarial modeling.

Cost share with Employees: The City has successfully negotiated employee pick-ups of the employer share of pension costs in its bargaining agreements with its pensioned employee groups. Each group in the Miscellaneous plans currently picks up 1%, while groups in the safety plan are transitioning from a 3% pick-up of the employer share to higher rates of between 3.5% and 4.0%.

Additional Discretionary Payments: Another recommended tool would be to make Additional Discretionary Payments (ADPs) to CalPERS once the PARS Trust reaches a certain funding level. CalPERS does not recognize the funding in PARS in its actuarial analysis, as such once a certain level is reached in PARS funding the additional contributions should be transmitted to CalPERS. Once it is sent to CalPERS it could be applied to a specified amortization base, in essence paying down the principal on the City's Unfunded Accrued Liability. This accomplishes two things simultaneously: 1) Transmitting the funding to CalPERS records the asset on CalPERS' balance sheet, which lowers the City's unfunded accrued liability, thereby lowering the future annual expenses as calculated by CalPERS, and 2) it limits the City's exposure to future investment return volatility since the principal amount is lower.

Fresh Start in Concept: The City could use the ADPs discussed above to either pay down specific bases (removing a specific liability from CalPERS completely) as discussed above or to re-amortize over a shorter time period. This latter option is what is referred to as a "Fresh Start in Concept" because it mirrors the action taken by a Fresh Start. However, a formal Fresh Start, as

discussed below, requires a contract amendment and handcuffs the City to that new amortization schedule. A “Fresh Start in Concept” would confer many of the benefits of reducing the UAL without the disadvantages and risk.

One-time Funding (Additional Revenues/Expense Savings): In certain instances, one-time funding may emerge that has not been appropriated for ongoing commitments. In such instances, whether from expense savings or Revenue windfalls, funding could be used to partially address the City’s long-term pension liability.

Amend Existing Policies: The City Council has the authority to amend existing policies, such as the Budget Stabilization Reserve Policy. If it chose to amend that policy, the City Council could include pension pre-funding as an eligible item that excess BSR (above City Council’s target of 18.5%) could be spent on instead of Capital Infrastructure. Currently, Capital Infrastructure is the only allowable use of excess BSR. The revised policy could even be narrowed further to say that half of excess BSR remaining at year-end could be used for pension pre-funding and half could be used for Capital Infrastructure purposes.

Pension Funding Policy Funding Components: Other Options

There are other funding components that the City could choose to pursue to address its long-term pension liability. These tools are listed below along with a brief description.

Partial Fresh Start (Formal): The City could choose to enter a partial Fresh Start with CalPERS. This would re-amortize certain specified bases over a shorter time period. However, it would be contractually binding and would be irreversible. If the City chose to pursue this instead of a “Fresh Start in Concept” it would be a significant work effort to identify which bases to include in a partial fresh start.

Further Cost Sharing with Employees: Each employee bargaining unit currently includes an employee pick-up of the employer share in its bargaining agreement. If the City chose to continue to expand this tool it would need to negotiate in good faith with its bargaining units in order to develop the rate of the pick-up as well as the timeline.

Revenue Generation: The City could choose to pursue the generation of additional revenue in order to fund some of the strategies discussed above. Options could include a parcel tax or other mechanism to generate additional income which could be earmarked specifically for addressing the City’s long-term pension liability.

Further Expense Reduction: The City has taken steps to contain costs over the past few years. Any further reduction would have a corresponding impact on service delivery. However, if the City Council chose to prioritize additional pension pre-funding over current service levels then expenses could be reduced, and those reductions could be used to partially address the City’s long-term pension liability.

Pension Funding Policy Funding Components: Not Recommended

A brief explanation of the other pension funding policy funding components that are not recommended, including why they are not recommended, follows below.

Investments in Other City Reserves: The City could choose to bolster its reserves and use them to address the City's long-term pension liability. This action is not recommended because of the City's investment policies, which could limit the growth of an asset when compared to a Section 115 Trust Fund administered by PARS, and because the investment in the City's reserves is revocable. The funding put into a reserve could be repurposed for something else depending on the reserve policies. In contrast, funding paid into the Section 115 Trust Fund is irrevocable and cannot be used for any purpose other than addressing the City's pension liability.

Pension Obligation Bonds: The City Council could choose to issue Pension Obligation Bonds (POBs). POBs are taxable bonds that would be issued by the City, which would then invest the proceeds from the issuance and hope to achieve a greater rate of return on the investment than promised by the bonds. This is not recommended due to the inherent risk in such an investment and due to the increase, it would have on the City's bonded debt burden and potential impacts on the City's credit rating.

Formal Fresh Start: The City could choose to formally alter its contract with CalPERS to enter into a "Fresh Start". This would re-amortize the entire obligation for either the City's miscellaneous plan or safety plan (or both) over a shortened time period. This is not recommended because once the contract with CalPERS is altered it cannot be rescinded. This could significantly impact costs and service delivery since the City would be obligated to pay according to the new schedule. Many of the benefits of the formal fresh start could be realized by a "Fresh Start in Concept" without the adverse impacts.

Next Steps

After discussing the potential draft policies with the Finance Committee, Staff hopes to refine a formal pension funding policy for consideration and adoption by the full City Council. Feedback on the example policies will be incorporated into the drafting and presentation of a formal pension funding policy.

Engagement

As staff incorporates feedback from the Finance Committee into the development of a pension funding policy, engagement will occur with both the workforce and the community to inform them of developments and solicit additional feedback. Additionally, the City's interest in meeting its pension funding obligations necessitates ongoing engagement with the State legislature to give cities more tools such as the ability to change benefits prospectively for current employees, and/or defined contribution plans.

Staff examined pension prefunding policies from other jurisdictions and confirmed that the City

of Palo Alto is among very few cities with sustained contributions to Section 115 Trust Funds built into their budgeting practice and their operations. Many other cities in California that are proactively funding pensions continue to do so on an *ad hoc* basis, using fund balance at year-end, or a certain portion of remaining fund balance above a minimum amount to generate their contributions. Some examples of other California cities that have ongoing contributions include Fountain Valley, which earmarked a portion of a local sales tax measure for unfunded pension liabilities, Sausalito, which uses a lower discount rate to calculate its pension obligation and transmits the difference to its Section 115 Trust Fund, and Pasadena, which transmits the savings from paying the UAL as a lump sum at the beginning of the year to its 115 Trust. Additionally, Staff consulted with its outside actuarial consultant, Bartel and Associates, as well as its pension modeling software vendor (GovInvest) regarding implications of various strategies. Staff also consulted with CalPERS to learn more about pension prefunding options. Industry groups for government finance, including the Government Finance Officers Association (GFOA) and the California Society of Municipal Finance Officers (CSMFO), were used as sources of emerging best practices for proactively funding long-term pension obligations. Each of these engagements informed the guiding principles and questions, which were placed into context for the City of Palo Alto to inform the creation of the different pension funding policy options.

Resource Impact

The resource impact from the development of a pension funding policy would be directly correlated to the parameters and requirements of the policy itself. To the extent changes to the City's current budgeting practice (using a more conservative 6.2% Discount Rate for the calculation of the normal cost) are included in the policy corresponding changes would need to be included in the development of the City's annual Long Range Financial Forecast and annual Operating Budget. It is anticipated that the establishment of a formal pension funding policy, including parameters for the use of funds beyond the CalPERS ADC, would have a beneficial impact on the long-term financial sustainability of the organization by limiting our risk from CalPERS long-term investment returns.

Environmental Review

This report is not a project for the purposes of the California Environmental Quality Act. Environmental review is not required.

Attachments:

- ATTACHMENT A: Additional Information and Background Regarding the City of Palo Alto's Pension Obligations
- ATTACHMENT B: CalPERS Fresh Start Amortization Tables

Attachment A: Additional Information and Background
Regarding the City of Palo Alto's Pension Obligations

As discussed in the body of CMR 10645 the City of Palo Alto has been discussing its options to address its long-term pension liability. A brief timeline of the CMRs and discussions with the Finance Committee and the City Council over the past few years is included below to offer additional context. After the timeline, a few of the more critical inputs that impact the City's long-term pension liability are discussed for further background on the subject.

Timeline:

- 9/2017 Finance Committee, "Review and Discuss CalPERS Pension Annual Valuation Reports as of June 30, 2016 Including Assumptions, Financial Disclosures and Next Steps" [8509](#)
- 10/2017 Finance Committee, "Review and Recommend Strategies to Address the City's Pension Liability" [8579](#)
- 12/2017 Finance Committee "FY2019 - FY2028 Long Range Financial Forecast & City Pension Liabilities" [8676](#)
- 1/2018 City Council, "Approval of the FY 2017 Comprehensive Annual Financial Report (CAFR) and Approval of Conforming Amendments to FY 2017 Budget in Various Funds; Acceptance of the FY2019 - FY2028 Long Range Financial Forecast; and Discussion and Potential Direction Regarding Budgeting for City Pension Liabilities" [8754](#)
- 9/2018 Finance Committee, "Accept CalPERS Pension Annual Valuation Reports as of June 30, 2017 and Review and Confirm Pension Funding and Reporting Policy Guidelines" [9604](#)
- 10/2018 City Council, "CalPERS Pension Annual Valuation Reports as of June 30, 2017 and Pension Funding and Reporting Policy Guidelines" [9708](#)
- 10/2018 City Council, "Direct Staff to Amend Budget Assumptions for Pension Benefit Costs and Complete the Workplans to Address the City Council FY 2019 Adopted Budget Referral to Identify \$4 Million in General Fund Savings" [9740](#)
- 9/2019 Finance Committee, "Accept CalPERS Pension Annual Valuation Reports as of June 30, 2018" [10641](#)

Through the various discussions, the City has been able to better understand and analyze many of the inputs and factors that impact the City's pension liability. A few of the most important inputs are detailed below to offer additional context regarding the City's long-term pension obligations.

Inputs –

Discount Rate: The CalPERS pension plan is built on the assumption that assets will generate a certain rate of return over the career of an individual; these returns make up the bulk of an individual's pension benefit. The long-term investment assumption is called the Discount Rate. As a result, the assumptions for the discount rate have a significant impact on the City's pension liability. If a higher investment return is assumed, the City's contributions can be lessened compared to a lower investment return. The Discount Rate is comprised of both the "real" investment returns as well as inflation assumptions. If the inflation assumption changes, then there would also be an impact on the City's liability.

Salary Growth: The salary growth of the City is another important variable; to the extent that the City's salary growth is higher or lower than CalPERS' projections the City's contributions would need to be higher or lower to ensure adequate funding.

Mortality Rates: The mortality rates also impact the City's long-term pension liability. This is because as individuals live longer, they draw on their pension for a longer period, thereby increasing the cost of the benefit. As CalPERS refines mortality rates to reflect people living longer, the changes adversely impact the City's long-term liability.

Maturity Measures: As pension plans mature, they become more susceptible to risk than less mature plans. One of the methods to show the maturity level of a CalPERS plan is to examine the ratio of actives to retirees. A pension plan that is just beginning will have a very high ratio of active to retired members. As the plan continues and members retire the ratio starts declining. CalPERS consider a plan to be mature when the ratio is near or below 1.0. The average support ratio for CalPERS public agency plans is 1.25, meaning that 1.25 active employees are supporting each retiree. For the City of Palo Alto, as an institution that was founded 125 years ago, the active:retiree ratio is 0.72 for Miscellaneous, and is .39 for the Safety group.

PEPRA: The Public Employee Pension Reform Act (PEPRA) will have an impact on the City's long-term pension liability because it mandates a different retirement formula to employees in the PEPRA tier and limits the maximum annual compensation eligible for pension calculations for employees in the PEPRA tier. Employees fall into the PEPRA tier if their first date of employment was after January 1, 2013 and they had no prior membership in another California Public Retirement System, or they have a break-in service of more than 6 months. As the City's workforce continues to shift demographically from "Classic" members to PEPRA members, the City's long-term liability will likely contract accordingly.

Other: Other elements also impact the City's long-term pension liability, including the upcoming change in CalPERS' amortization policy. They will be shifting from a 30-year amortization with a 5-year 'ramp-up' at the beginning and a 5-year 'ramp-down' at the end to a 20-year amortization with a 5-year 'ramp-up' and no 'ramp-down'. This will have an impact on the City's annual Actuarial Determined Contributions (ADC) and the pension liability that will vary depending on whether it is a gain or a loss that is being amortized.

City of Palo Alto Unfunded Pension Liability - Safety
As of June 30 2018

| Date | Current Amortization | | 20 Year Amortization | | | 15 Year Amortization | | |
|-----------|----------------------|--------------------|----------------------|--------------------|-------------------------|----------------------|--------------------|-------------------------|
| | Unfunded Balance | Payment | Unfunded Balance | Payment | Difference From Current | Unfunded Balance | Payment | Difference From Current |
| 6/30/2020 | 176,810,640 | 11,210,740 | 176,810,640 | 13,079,551 | 1,868,811 | 176,810,640 | 15,947,209 | 4,736,469 |
| 6/30/2021 | 177,590,903 | 12,598,401 | 175,657,792 | 13,439,239 | 840,838 | 172,691,464 | 16,385,757 | 3,787,356 |
| 6/30/2022 | 176,990,378 | 13,825,697 | 174,052,181 | 13,808,818 | (16,879) | 167,830,308 | 16,836,365 | 3,010,668 |
| 6/30/2023 | 175,078,292 | 14,694,686 | 171,951,881 | 14,188,560 | (506,126) | 162,162,758 | 17,299,365 | 2,604,679 |
| 6/30/2024 | 172,133,468 | 15,421,340 | 169,311,752 | 14,578,746 | (842,594) | 155,619,549 | 17,775,098 | 2,353,758 |
| 6/30/2025 | 168,230,853 | 15,845,427 | 166,083,203 | 14,979,661 | (865,766) | 148,126,213 | 18,263,913 | 2,418,486 |
| 6/30/2026 | 163,616,378 | 16,258,249 | 162,213,945 | 15,391,602 | (866,647) | 139,602,709 | 18,766,170 | 2,507,921 |
| 6/30/2027 | 158,251,858 | 16,705,350 | 157,647,725 | 15,814,871 | (890,479) | 129,963,021 | 19,282,240 | 2,576,890 |
| 6/30/2028 | 152,049,340 | 17,164,748 | 152,324,036 | 16,249,780 | (914,968) | 119,114,729 | 19,812,502 | 2,647,754 |
| 6/30/2029 | 144,937,439 | 17,636,782 | 146,177,815 | 16,696,649 | (940,133) | 106,958,548 | 20,357,346 | 2,720,564 |
| 6/30/2030 | 136,839,428 | 18,121,791 | 139,139,115 | 17,155,807 | (965,984) | 93,387,845 | 20,917,173 | 2,795,382 |
| 6/30/2031 | 127,672,863 | 17,622,496 | 131,132,748 | 17,627,591 | 5,095 | 78,288,102 | 21,492,395 | 3,869,899 |
| 6/30/2032 | 118,381,115 | 17,537,542 | 122,077,918 | 18,112,350 | 574,808 | 61,536,364 | 22,083,436 | 4,545,894 |
| 6/30/2033 | 108,526,816 | 16,625,803 | 111,887,812 | 18,610,440 | 1,984,637 | 43,000,626 | 22,690,730 | 6,064,927 |
| 6/30/2034 | 98,925,829 | 16,285,453 | 100,469,170 | 19,122,227 | 2,836,774 | 22,539,196 | 23,314,725 | 7,029,272 |
| 6/30/2035 | 89,004,832 | 15,649,262 | 87,721,827 | 19,648,088 | 3,998,826 | | | (15,649,262) |
| 6/30/2036 | 79,047,446 | 14,573,328 | 73,538,215 | 20,188,410 | 5,615,082 | | | (14,573,328) |
| 6/30/2037 | 69,505,998 | 13,957,164 | 57,802,836 | 20,743,592 | 6,786,428 | | | (13,957,164) |
| 6/30/2038 | 59,934,015 | 13,296,089 | 40,391,696 | 21,314,041 | 8,017,952 | | | (13,296,089) |
| 6/30/2039 | 50,375,812 | 12,812,833 | 21,171,700 | 21,900,177 | 9,087,344 | | | (12,812,833) |
| 6/30/2040 | 40,648,424 | 12,595,936 | | | (12,595,936) | | | (12,595,936) |
| 6/30/2041 | 30,464,477 | 10,720,552 | | | (10,720,552) | | | (10,720,552) |
| 6/30/2042 | 21,507,566 | 10,084,590 | | | (10,084,590) | | | (10,084,590) |
| 6/30/2043 | 12,581,512 | 9,249,935 | | | (9,249,935) | | | (9,249,935) |
| 6/30/2044 | 3,894,010 | 2,256,558 | | | (2,256,558) | | | (2,256,558) |
| 6/30/2045 | 1,832,389 | 1,008,317 | | | (1,008,317) | | | (1,008,317) |
| 6/30/2046 | 917,644 | 949,218 | | | (949,218) | | | (949,218) |
| | | 354,708,287 | | 342,650,200 | (12,058,087) | | 291,224,424 | (63,483,863) |

City of Palo Alto Unfunded Pension Liability - Miscellaneous
As of June 30 2018

| Date | Current Amortization | | 15 Year Amortization | | | 10 Year Amortization | | |
|-----------|----------------------|--------------------|----------------------|--------------------|-------------------------|----------------------|--------------------|-------------------------|
| | Unfunded Balance | Payment | Unfunded Balance | Payment | Difference From Current | Unfunded Balance | Payment | Difference From Current |
| 6/30/2020 | 286,363,666 | 23,432,860 | 286,363,666 | 25,828,203 | 2,395,343 | 286,363,666 | 35,308,545 | 11,875,685 |
| 6/30/2021 | 282,169,983 | 25,768,686 | 279,692,222 | 26,538,479 | 769,793 | 269,885,680 | 36,279,530 | 10,510,844 |
| 6/30/2022 | 275,266,546 | 27,775,842 | 271,819,062 | 27,268,287 | (507,555) | 251,249,840 | 37,277,217 | 9,501,375 |
| 6/30/2023 | 265,803,649 | 29,093,334 | 262,639,861 | 28,018,165 | (1,075,169) | 230,277,476 | 38,302,340 | 9,209,006 |
| 6/30/2024 | 254,315,525 | 30,450,533 | 252,042,436 | 28,788,664 | (1,661,869) | 206,776,650 | 39,355,655 | 8,905,122 |
| 6/30/2025 | 240,619,337 | 28,631,100 | 239,906,181 | 29,580,352 | 949,252 | 180,541,209 | 40,437,935 | 11,806,835 |
| 6/30/2026 | 227,846,449 | 25,356,875 | 226,101,459 | 30,393,812 | 5,036,937 | 151,349,768 | 41,549,979 | 16,193,104 |
| 6/30/2027 | 217,566,346 | 26,054,188 | 210,488,957 | 31,229,642 | 5,175,454 | 118,964,620 | 42,692,603 | 16,638,415 |
| 6/30/2028 | 205,845,327 | 26,770,680 | 192,918,992 | 32,088,457 | 5,317,777 | 83,130,572 | 43,866,650 | 17,095,970 |
| 6/30/2029 | 192,562,693 | 27,506,872 | 173,230,763 | 32,970,890 | 5,464,018 | 43,573,697 | 45,072,982 | 17,566,110 |
| 6/30/2030 | 177,588,753 | 28,263,313 | 151,251,563 | 33,877,589 | 5,614,276 | | | (28,263,313) |
| 6/30/2031 | 160,784,169 | 25,566,093 | 126,795,922 | 34,809,223 | 9,243,130 | | | (25,566,093) |
| 6/30/2032 | 145,593,290 | 25,078,301 | 99,664,696 | 35,766,476 | 10,688,175 | | | (25,078,301) |
| 6/30/2033 | 129,843,622 | 22,968,475 | 69,644,094 | 36,750,055 | 13,781,580 | | | (22,968,475) |
| 6/30/2034 | 115,173,901 | 21,972,705 | 36,504,628 | 37,760,681 | 15,787,976 | | | (21,972,705) |
| 6/30/2035 | 100,507,333 | 20,503,251 | | | (20,503,251) | | | (20,503,251) |
| 6/30/2036 | 86,334,117 | 18,042,492 | | | (18,042,492) | | | (18,042,492) |
| 6/30/2037 | 73,714,206 | 16,794,746 | | | (16,794,746) | | | (16,794,746) |
| 6/30/2038 | 61,501,581 | 15,464,725 | | | (15,464,725) | | | (15,464,725) |
| 6/30/2039 | 49,809,855 | 14,472,775 | | | (14,472,775) | | | (14,472,775) |
| 6/30/2040 | 38,325,790 | 13,874,452 | | | (13,874,452) | | | (13,874,452) |
| 6/30/2041 | 26,656,752 | 10,174,002 | | | (10,174,002) | | | (10,174,002) |
| 6/30/2042 | 17,998,655 | 9,509,422 | | | (9,509,422) | | | (9,509,422) |
| 6/30/2043 | 9,421,939 | 8,211,777 | | | (8,211,777) | | | (8,211,777) |
| 6/30/2044 | 1,587,145 | 1,641,756 | | | (1,641,756) | | | (1,641,756) |
| | | 523,379,255 | | 471,668,975 | (51,710,280) | | 400,143,436 | (123,235,819) |

Discussion of Finance Committee Request for Information

The City consulted with its outside actuarial consultant, Bartel Associates, to analyze what additional level of contributions would be necessary to reach a 90% funding level for the Miscellaneous plan and the Safety plan over different timeframes, ranging from 15 years to 10 years. This analysis was conducted using both a methodology consistent with CalPERS (presuming a 7.0% discount rate) and using a more conservative Risk Mitigation methodology where the discount rate would be lowered by 5 basis points each year beginning in FY 2023.

As part of the conversation around a Pension Funding Policy, it is crucial to remember that CalPERS itself is the largest public pension fund in the United States. CalPERS is striving to reduce risk in its portfolio, balance the competing interests of its various constituencies, and maintain returns over a time horizon that spans decades. Thus, although CalPERS has begun de-risking by shifting its investment portfolio, lowering its discount rate from 7.5% to 7.0%, and shortening its amortization period for new gains/losses from 30 years to 20 years, the City likely still has an interest in additional proactive contributions to further mitigate its long-term pension liabilities.

Table 1, below, shows the additional contributions, above the CalPERS Actuarially Determined Contribution, necessary to reach a funding level of 90% in the Miscellaneous plan using a methodology consistent with CalPERS current calculations. The table incorporates the PARS trust fund into the consideration of total funding level and includes the cost of paying the difference in Normal Cost Rates (between 7.0% and 6.2%) as its own row of data. As the timeframe for reaching 90% funding shortens, the **marginal** cost of additional contributions necessary to reach 90% within that timeframe is shown. As seen in the table below, based on the actuarial assets as of June 30, 2018, and presuming that CalPERS met its 7.0% investment return in each year, the City would have reached 90% of funding within 11 years for the Miscellaneous plan if it continued paying the difference in Normal Cost rates each year. This means that no additional contribution would be necessary unless the City wanted to reach a 90% funding level within 10 years. The marginal cost to reach it within 10 years is reflected on that row.

As seen in Figure 1, which follows the table, the largest component of the City's contributions remains the CalPERS calculated contributions. Thus, paying the CalPERS ADC remains a critical component of the City's pension funding strategy.

Attachment B

Table 1. Additional Contributions to reach 90% Funding in Miscellaneous Plan – 7% DR (\$000s)

| | FY 2021 | FY 2022 | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 | FY 2028 | FY 2029 | FY 2030 | FY 2031 | FY 2032 | FY 2033 | FY 2034 |
|-------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| 6.2% DR NC Margin | 2,729 | 2,686 | 2,668 | 2,648 | 2,624 | 2,603 | 2,583 | 2,566 | 2,550 | 2,535 | 2,520 | 2,505 | 2,490 | 2,476 |
| 14 Years | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 13 Years | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 12 Years | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 11 Years | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 10 Years | 368 | 378 | 389 | 399 | 410 | 421 | 433 | 445 | 457 | 470 | | | | |

Figure 1. Graph of Additional Contributions to reach 90% in Miscellaneous Plan – 7% DR (\$000s)

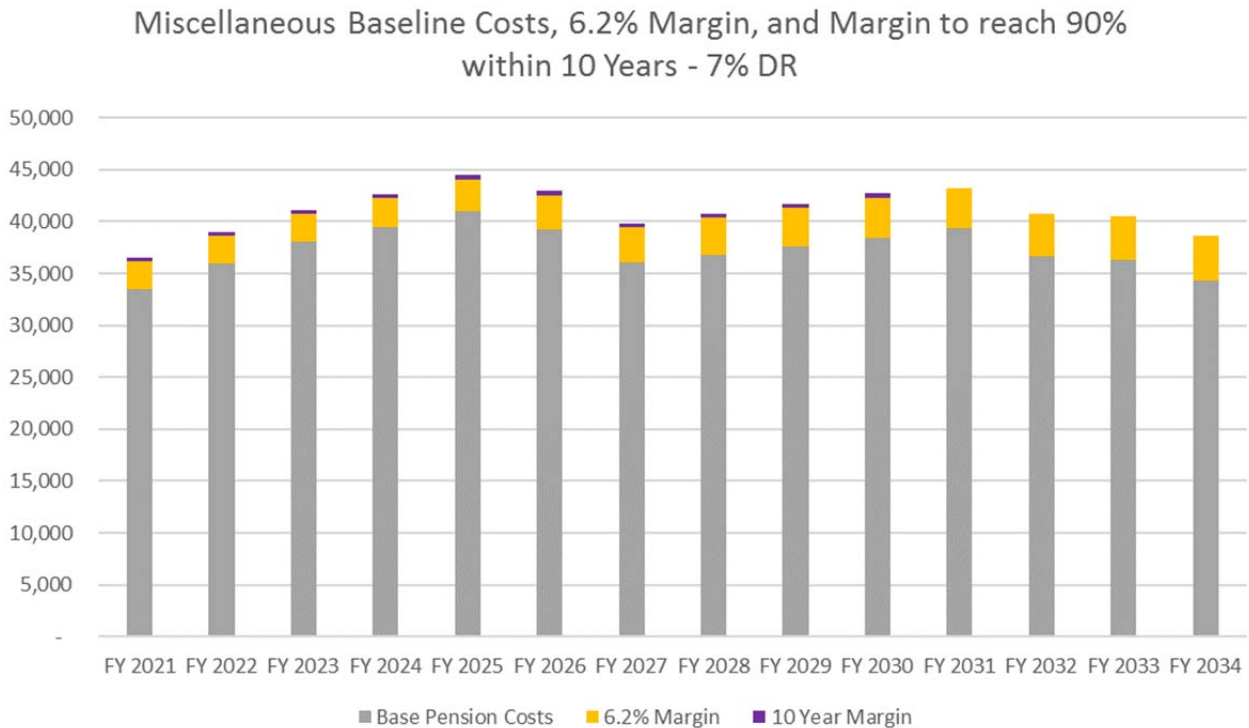


Table 2, below, shows the same information for the Safety Plan. In the Safety Plan, additional funding would be needed for each year of the timeframe in order to reach a funding level of 90% of CalPERS’ assets. As seen in the table and figure below, \$165,000 in additional funding would be needed in the first year to reach 90% funding in 14 years, and an additional \$539,000 would be needed to reach 90% funding in 13 years, with increased contributions necessary for the shorter timeframes.

Attachment B

Table 2. Additional Contributions to reach 90% Funding in Safety Plan – 7% DR (\$000s)

| | FY 2021 | FY 2022 | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 | FY 2028 | FY 2029 | FY 2030 | FY 2031 | FY 2032 | FY 2033 | FY 2034 |
|-------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| 6.2% DR NC Margin | 1,337 | 1,369 | 1,365 | 1,363 | 1,361 | 1,359 | 1,357 | 1,356 | 1,354 | 1,348 | 1,334 | 1,322 | 1,308 | 1,291 |
| 14 Years | 165 | 170 | 174 | 179 | 184 | 189 | 194 | 200 | 205 | 211 | 216 | 222 | 228 | 235 |
| 13 Years | 539 | 554 | 569 | 585 | 601 | 617 | 634 | 652 | 670 | 688 | 707 | 726 | 746 | |
| 12 Years | 695 | 714 | 734 | 754 | 775 | 796 | 818 | 840 | 863 | 887 | 912 | 937 | | |
| 11 Years | 854 | 877 | 902 | 926 | 952 | 978 | 1,005 | 1,033 | 1,061 | 1,090 | 1,120 | | | |
| 10 Years | 1,088 | 1,118 | 1,149 | 1,180 | 1,213 | 1,246 | 1,280 | 1,316 | 1,352 | 1,389 | | | | |

Figure 2. Graph of Additional Contributions to reach 90% Funding in Safety Plan – 7% DR (\$000s)

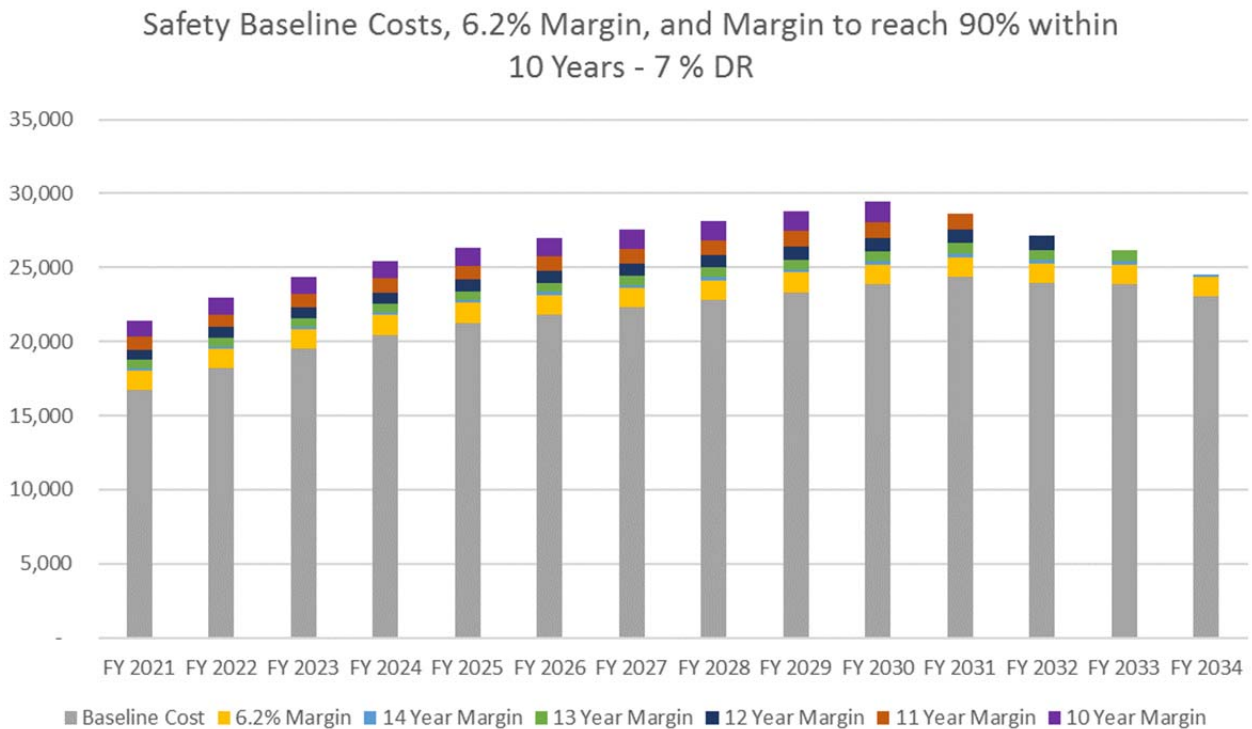


Table 3. Budgeted Additional Contributions through FY 2031 (\$000s)

| | FY 2021 | FY 2022 | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 | FY 2028 | FY 2029 | FY 2030 | FY 2031 |
|--------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Miscellaneous Plan | 3,754 | 3,865 | 3,946 | 4,030 | 3,958 | 4,051 | 4,144 | 4,237 | 4,344 | 4,422 | 4,515 |
| Safety Plan | 1,795 | 1,810 | 1,825 | 1,827 | 1,756 | 1,789 | 1,821 | 1,853 | 1,886 | 1,918 | 1,970 |

As seen from the tables and figures above, the City is currently contributing enough additional funding to reach 90% funding within 15 years for both the Miscellaneous and Safety plans if CalPERS achieved a 7.0% rate of return. However, given the historic rate of return for CalPERS and CalPERS’ stated desire to further mitigate risk by reducing the discount rate to the extent practicable and possible, Bartel Associates also calculated a projection under a “Risk Mitigation” scenario. This scenario models necessary contributions if CalPERS’ discount rate was steadily lowered by 5 basis points per year. As in the tables above, the difference in calculating the normal cost at a discount rate of 6.2% and the Risk Mitigation Rate (which lowers from 7.0% throughout the projection), is included as its separate row beginning in FY 2023. In the tables

Attachment B

below, the additional cost associated with lowering the discount rate from 7.0% to a lower rate is included as the “Costs > 7.0% DR” row.

Table 4. Additional Contributions to reach 90% Funding in Miscellaneous Plan – Risk Mitigation (\$000s)

| | FY 2021 | FY 2022 | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 | FY 2028 | FY 2029 | FY 2030 | FY 2031 | FY 2032 | FY 2033 | FY 2034 |
|-------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Costs > 7.0% DR | - | - | 331 | 1,167 | 1,964 | 2,967 | 3,831 | 4,987 | 5,735 | 6,678 | 7,377 | 8,703 | 9,268 | 9,564 |
| 6.2% DR NC Margin | 2,729 | 2,686 | 2,668 | 2,482 | 2,132 | 1,952 | 1,776 | 1,604 | 1,435 | 1,268 | 1,102 | 939 | 778 | 619 |
| 14 Years | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 13 Years | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 12 Years | 255 | 121 | 121 | 121 | 121 | 121 | 121 | 121 | 121 | 121 | 121 | 121 | | |
| 11 Years | 1,320 | 649 | 670 | 692 | 714 | 737 | 761 | 785 | 810 | 836 | 862 | | | |
| 10 Years | 1,286 | 629 | 646 | 664 | 682 | 701 | 720 | 740 | 761 | 781 | | | | |

Figure 3. Graph of Additional Contributions to reach 90% Funding in Miscellaneous Plan – Risk Mitigation (\$000s)

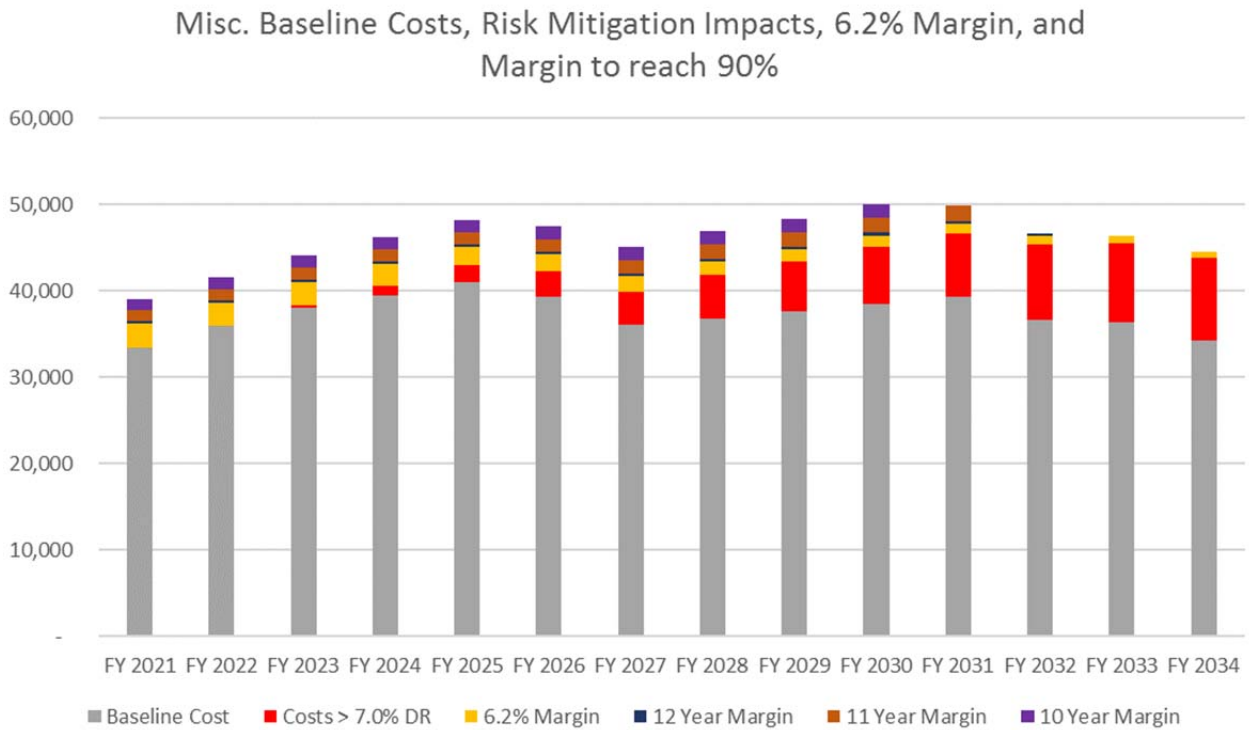
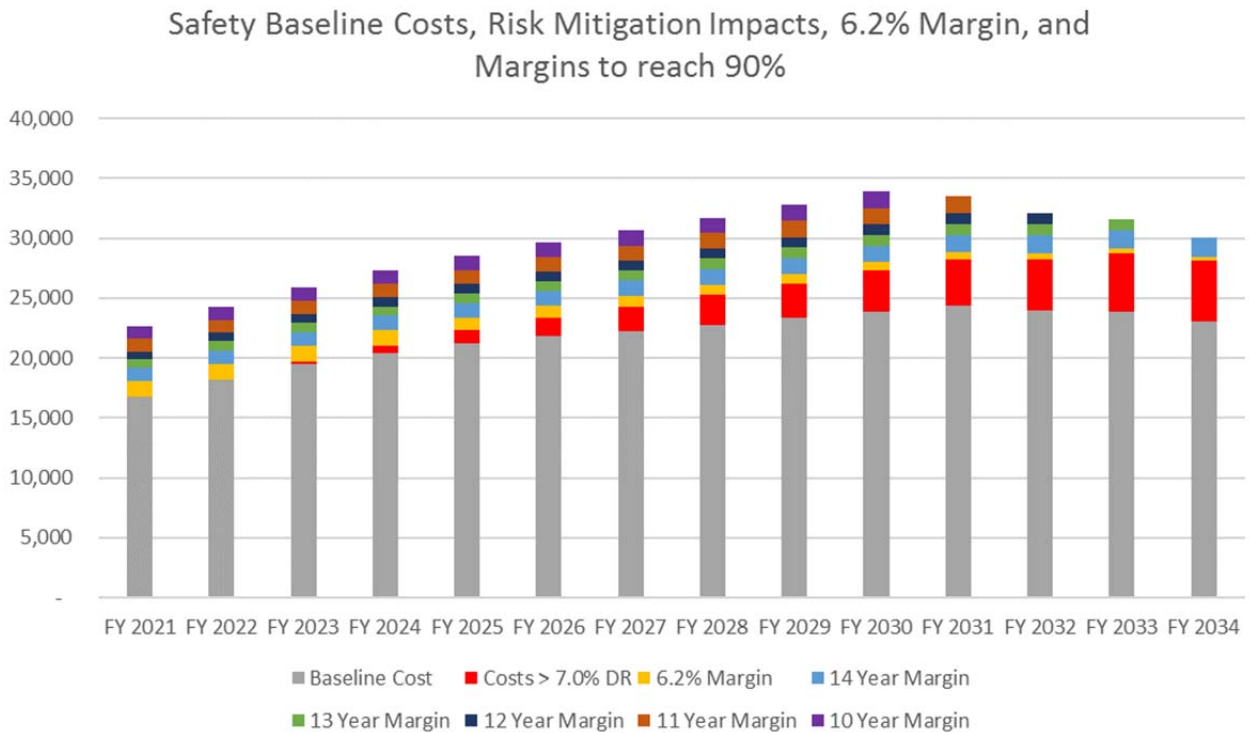


Table 5. Additional Contributions to reach 90% Funding in Safety Plan – Risk Mitigation (\$000s)

| | FY 2021 | FY 2022 | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 | FY 2028 | FY 2029 | FY 2030 | FY 2031 | FY 2032 | FY 2033 | FY 2034 |
|-------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Costs > 7.0% DR | - | - | 186 | 612 | 1,021 | 1,536 | 1,995 | 2,482 | 2,929 | 3,467 | 3,825 | 4,324 | 4,807 | 5,094 |
| 6.2% DR NC Margin | 1,337 | 1,369 | 1,365 | 1,278 | 1,106 | 1,019 | 933 | 847 | 762 | 674 | 584 | 496 | 409 | 323 |
| 14 Years | 1,088 | 1,118 | 1,149 | 1,180 | 1,213 | 1,246 | 1,280 | 1,316 | 1,352 | 1,389 | 1,427 | 1,466 | 1,507 | 1,548 |
| 13 Years | 710 | 730 | 750 | 770 | 791 | 813 | 836 | 858 | 882 | 906 | 931 | 957 | 983 | |
| 12 Years | 694 | 713 | 733 | 753 | 774 | 795 | 817 | 839 | 862 | 886 | 910 | 935 | | |
| 11 Years | 1,066 | 1,095 | 1,125 | 1,156 | 1,188 | 1,221 | 1,254 | 1,289 | 1,324 | 1,361 | 1,398 | | | |
| 10 Years | 1,068 | 1,097 | 1,128 | 1,159 | 1,190 | 1,223 | 1,257 | 1,291 | 1,327 | 1,363 | | | | |

Attachment B

Figure 4. Graph of Additional Contributions to reach 90% Funding in Safety Plan – Risk Mitigation (\$000s)



As seen by comparing the Risk Mitigation tables to Table 3. Budgeted Additional Contributions through FY 2031 (\$000s), the City would need to ramp up its contributions as the discount rate lowers beginning in FY 2023 to reach a funding level of 90% within 14 years for miscellaneous, and would need to ramp up immediately for the Safety plan to reach 90% within 14 years. Given the current and projected financial status of the organization, these additional contributions would have immediate service delivery impacts.

Example Pension Funding Policy

Determination of an appropriate level for proactive Pension Funding is a policy decision. The overarching goal of a Pension Funding Policy is to ensure that the City of Palo Alto avoids service-delivery crowd-out by increasing annual pension costs. This must be balanced against immediate impacts to service delivery in order to fund proactive contributions.

The City is statutorily required to make the CalPERS Actuarial Determined Contribution (ADC) on an annual basis. The ADC is made up of two parts, the Normal Cost (NC), which represents the pay-as-you-go portion of costs, and the Unfunded Accrued Liability (UAL) payment, which represents the catch-up portion of costs. CalPERS currently calculates both the NC and the UAL based on a discount rate of 7.0%. CalPERS amortizes any difference between investment returns and that discount rate as part of its UAL calculation over 20 years. In a year when CalPERS does not meet its target (loss) the City has to pay more over the next 20 years. In a year when CalPERS exceeds its target (gain) the City would be able to pay less over the next 20 years. The timeframe of 20 years for amortizing gains and losses is recent; they were amortized over 30 years through the June 30, 2018 valuation).

Additionally, the City recognizes the importance of ensuring that pension obligations included in the City's financial reports, such as the Comprehensive Annual Financial Report (CAFR), are consistent with CalPERS. Reports such as the CAFR impact the City's credit rating and thereby influence areas such as bond financing that the City may seek to obtain.

However, the City also recognizes that CalPERS calculated costs are based on a discount rate, annual rates of return, and other variables that might **not** align with actual experience nor perhaps with expected experience. To address these shortcomings, the City is establishing a Pension Funding Policy to guide proactive pension contributions.

This policy provides direction to the City regarding a desired funding target in relation to CalPERS valuations, the timeframe over which to achieve that target, and actions that are required until the target is met. There are contingencies that provide an additional range of options if certain circumstances are met and some that require additional actions if other criteria are satisfied.

Funding Goal and Timeframe: Through this policy, the City's target is to fund 90% of the CalPERS determined liability by FY 2036. The City will strive to reach the target of 90% of the CalPERS determined liability within 15 years. If the City only paid the CalPERS ADC it would take at least 30 years to reach full funding of the CalPERS determined liability. CalPERS' 30-year timeframe to reach full funding is also predicated on every single one of their actuarial

assumptions materializing. Thus, a 15-year timeframe to fund 90% of the CalPERS determined liability represents a commitment from the City above and beyond the CalPERS ADC.

Funding Components: In order to achieve the target of 90% funding by FY 2036, the City will calculate what the Normal Cost portion of annual pension costs would be if a discount rate of 6.2% were used instead of the CalPERS rate for the Miscellaneous and Safety Groups across the organization. This additional cost will be included as part of the City's standard budget process and transmitted to the City's Irrevocable section 115 PARS Pension Trust Fund (PARS Trust Fund or PARS). Should the City reach its goal of 90% funding before FY 2036, the City Manager will report the status to the City Council with a recommendation on whether the practice should be continued, modified, or discontinued. *The City Manager must identify the impacts on the funding goal and timeframe to modify the transmission of the additional contributions to the PARS Trust Fund.*

In addition to the contributions required by this Pension Funding Policy, the City will examine additional opportunities for proactive contributions to the PARS Trust Fund. Furthermore, the City Manager will include recommendations on whether funding should be transmitted from PARS to CalPERS as part of the annual budget process. This may change from year-to-year depending on the circumstances and level of funding accumulated. Some years may result in accumulating additional funding in PARS, while others may result in transferring an amount greater than a single year of additional contributions, calculated through the lower discount rate, to CalPERS. *City Council approval is required for use of accumulated funds in PARS either to CalPERS as an Additional Discretionary Payment (ADP) or to offset a portion of the standard ADC.*

An additional action that will **not** require City Council approval is transfer of excess Budget Stabilization Reserve (BSR) above 18.5% to the PARS Trust Fund. The BSR Policy will be amended to confer discretion to the City Manager to make this transfer. The BSR Policy currently confers discretion to the City Manager to transfer excess BSR above 18.5% to the Infrastructure Reserve. Once amended, the BSR Policy will confer authority to the City Manager to proactively fund infrastructure and pension obligation needs through transfers to the Infrastructure Reserve and to the PARS Trust Fund. Additionally, through standard reports to the City Council (such as Year-End, Mid-Year, or another City Manager's Report) the City Manager will include actions for additional contributions from funds other than the General Fund to maintain alignment with the contributions from the General Fund via excess BSR. City Council approval is required for these contributions from funds other than the General Fund.

The City will work to proactively monitor its pension funding position through not only its CalPERS reports but also by continuing to use an outside actuary as a consultant to model different scenarios. The City will continue to transmit the CalPERS reports on an annual basis.

Attachment C

Once every three years, the City will consult with an outside actuary to provide an update on the progress the City has made towards reaching a funding goal of 90% of funding of the CalPERS determined liability by FY2036 and update the City Council. Additional actions may come out of those reports and discussions with the City Council.

Service Delivery Outcomes: The goal of the Pension Funding Policy is to prevent service delivery crowd-out by the increased costs of pension obligations. If the City's efforts to proactively contribute to the long-term pension obligations would result in service delivery impacts in the short-term, the City Manager will identify those impacts and recommendations to mitigate them, as appropriate, through the budget development process.

Fiscal Impacts: If the General Fund's revenues are projected to decline more than 7.5% year-over-year, the City Manager will return to the City Council with recommendations addressing the implications for the City's proactive funding contributions for the coming year through the budget development process.

Impact of a 0% Investment Return for CalPERS for FY 2020

Staff analyzed the impact of a 0% investment return for CalPERS for Fiscal Year 2020, spanning from June 30, 2019 through June 30, 2020. This analysis was performed using CalPERS’ Pension Navigator tool. This tool allows for forecasting changes to certain parameters to approximate the anticipated impact of changes to things like the rate of return for a given year.

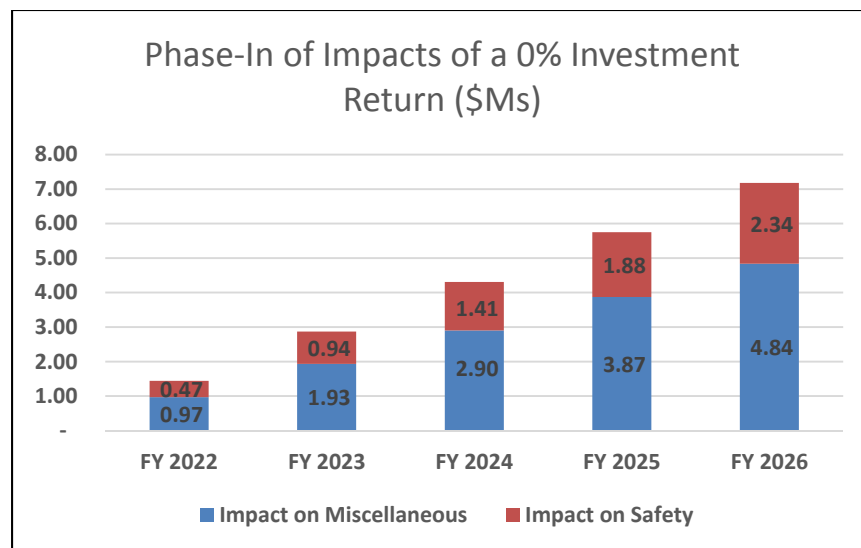
As seen in the table and graph below, the impact would be phased-in over five years, increasing by 20% each year. It begins at 20%, increases to 40% in the next year, and continues to increase through the fifth year when it reaches 100%. The cost in FY 2026 remains constant through the conclusion of the 20 year amortization period, concluding in FY 2041. Through staff’s analysis, each 1% of investment return is equivalent to approximately \$1.0 million in total impact. Thus, if CalPERS were to achieve a 1% investment return for FY 2020, the impact to the City would be approximately \$6.2 million at the end of a five-year phase-in.

Approximately 45% of the impact associated with the Miscellaneous plan would be borne by the General Fund. The entirety of the impact on the Safety Plan would be borne by the General Fund. The General Fund would accordingly bear approximately 67% of the total impact.

Table 1. Phase-In of Impacts of a 0% Investment Return (FY 2020) (\$Ms)

| | FY 2022 | FY 2023 | FY 2024 | FY 2025 | FY 2026 |
|-------------------------|-------------|-------------|-------------|-------------|-------------|
| Impact on Miscellaneous | 0.97 | 1.93 | 2.90 | 3.87 | 4.84 |
| Impact on Safety | 0.47 | 0.94 | 1.41 | 1.88 | 2.34 |
| Total Impact | 1.44 | 2.87 | 4.31 | 5.75 | 7.18 |

Figure 1. Graph showing Phase-In of Impacts of a 0% Investment Return (FY 2020) (\$Ms)



**AMENDMENT NO. 1 TO CONTRACT NO. C15159278
BETWEEN THE CITY OF PALO ALTO AND
BARTEL ASSOCIATES, LLC**

This Amendment No. 1 (this "Amendment") to Contract No. C15159278 (the "Contract" as defined below) is entered into as of September 1, 2015, by and between the CITY OF PALO ALTO, a California chartered municipal corporation ("CITY"), and BARTEL ASSOCIATES, LLC, a limited liability corporation, located at 411 Borel Avenue, Suite 620, San Mateo, CA 94402 ("CONTRACTOR"). CITY and CONTRACTOR are referred to collectively as the "Parties" in this Amendment.

RECITALS

A. The Contract (as defined below) was entered into by and between the Parties hereto for the provision of actuarial services related to the City's non-pension Other Post-Employment Benefits (OPEB) benefits, as detailed therein.

B. The Parties now wish to amend the Contract in order to include CalPERS pension valuations in the Scope of Services, replacing Exhibit "A" ("Scope of Services"), and add to the compensation amount, replacing Exhibit "C" ("Schedule of Fees"), as detailed herein.

NOW, THEREFORE, in consideration of the covenants, terms, conditions, and provisions of this Amendment, the Parties agree:

SECTION 1. Definitions. The following definitions shall apply to this Amendment:

- a. **Contract.** The term "Contract" shall mean Contract No. C15159278 between CONSULTANT and CITY, dated September 1, 2015.
- b. **Other Terms.** Capitalized terms used and not defined in this Amendment shall have the meanings assigned to such terms in the Contract.

SECTION 2. Section 5, "Compensation for Original Term", of the Contract is hereby amended to read as follows:

"5. COMPENSATION FOR ORIGINAL TERM. CITY shall pay and CONTRACTOR agrees to accept as not-to-exceed compensation for the full performance of the Services and reimbursable expenses, if any:

- The total maximum lump sum compensation of _____ dollars (\$ _____); **OR**
- The sum of _____ dollars (\$ _____) per hour, not to exceed a total maximum compensation amount of _____ dollars (\$ _____); **OR**
- For Services detailed in Exhibit A (Scope of Services), including OPEB biennial

valuations as of June 30, 2015, June 30, 2017, and June 30, 2019 and other Services, sums calculated in accordance with the fee schedule set forth at Exhibit C, not to exceed a total maximum compensation amount of Two Hundred Thirty Thousand Dollars (\$230,000).

CONTRACTOR agrees that it can perform the Services detailed in Exhibit A (Scope of Services), including OPEB biennial valuations as of June 30, 2015, June 30, 2017, and June 30, 2019; other as needed actuarial analyses; and CalPERS pension valuations for an amount not to exceed the total maximum compensation set forth above. Any hours worked or services performed by CONTRACTOR for which payment would result in a total exceeding the maximum amount of compensation set forth above for performance of the Services shall be at no cost to CITY.

- In addition, included in the total maximum compensation amount above, the CITY has set aside the sum of ten thousand dollars (\$10,000.00) for Additional Services. CONTRACTOR shall provide Additional Services only by advanced, written authorization from the City Manager or designee. CONTRACTOR, at the CITY's request, shall submit a detailed written proposal including a description of the scope of services, schedule, level of effort, and CONTRACTOR's proposed maximum compensation, including reimbursable expense, for such services. Compensation shall be based on the hourly rates set forth above or in Exhibit C (whichever is applicable), or if such rates are not applicable, a negotiated lump sum. CITY shall not authorize and CONTRACTOR shall not perform any Additional Services for which payment would exceed the amount set forth above for Additional Services. Payment for Additional Services is subject to all requirements and restrictions in this Agreement."

SECTION 3. The following exhibit(s) to the Contract is/are hereby amended or added, as indicated below, to read as set forth in the attachment(s) to this Amendment, which is/are hereby incorporated in full into this Amendment and into the Contract by this reference:

- a. Exhibit "A" entitled "SCOPE OF SERVICES", of the Contract is hereby deleted and replaced in its entirety to read as attached to this Amendment as Exhibit "A", entitled "SCOPE OF SERVICES, AMENDMENT NO. 1", AMENDED, REPLACES PREVIOUS..
- b. Exhibit "C" entitled "SCHEDULE OF FEES", of the Contract is hereby deleted and replaced in its entirety to read as attached to this Amendment as Exhibit "C", entitled "SCHEDULE OF FEES, AMENDMENT NO. 1", AMENDED, REPLACES PREVIOUS..

SECTION 4. **Legal Effect.** Except as modified by this Amendment, all other provisions of the Contract, including any exhibits thereto, shall remain in full force and effect.

SECTION 5. **Incorporation of Recitals.** The recitals set forth above are terms of this Amendment and are fully incorporated herein by this reference.

(SIGNATURE BLOCK FOLLOWS ON THE NEXT PAGE.)

SIGNATURES OF THE PARTIES

IN WITNESS WHEREOF, the Parties have by their duly authorized representatives executed this Amendment effective as of the date first above written.

CITY OF PALO ALTO

BARTEL ASSOCIATES, LLC

City Manager (Contract over \$85k)

Officer 1

DocuSigned by:
By: **Mary Elizabeth Redding**
Name: **Mary Elizabeth Redding**
Title: Vice President

APPROVED AS TO FORM:

Officer 2 (Required for Corp. or LLC)

City Attorney or designee
(Contract over \$25k)

DocuSigned by:
By: **Doug Pryor**
Name: **Doug Pryor**
Title: Vice President and Secretary

Contracts Administrator
(Checklist Approval)

Attachments:

Exhibit "A" entitled "SCOPE OF SERVICES, AMENDMENT NO. 1" (Amended – Replaces Previous)
Exhibit "C" entitled "SCHEDULE OF FEES, AMENDMENT NO. 1" (Amended – Replaces Previous)

EXHIBIT "A"
SCOPE OF SERVICES, AMENDMENT NO. 1
(Amended – Replaces Previous)

A. Project Purpose

CONTRACTOR will prepare bi-annual actuarial valuation of the City's non-pension Other Post-Employment Benefits (OPEB), as per applicable Governmental Accounting Standards Board (GASB) and actuarial requirements. The last OPEB valuation was prepared as of June 30, 2013. Additionally, the City requires as-needed actuarial services for labor negotiations, CalPERS projections, or other financial analyses.

B. Other Post-Employment Benefits Valuation

CONTRACTOR will provide an actuarial evaluation of the City's OPEB in compliance with applicable GASB and actuarial requirements. Specifically, the consultant will provide:

1. A determination of the City's retiree medical benefit actuarial liability on a biannual basis as of June 30, 2015, June 30, 2017, and June 30, 2019.
2. Within 60 days after receipt of the necessary payroll and other information from CITY, the CONTRACTOR will meet with CITY to discuss the OPEB liability and funding level options and will recommend actuarial and economic assumptions appropriate for the City based on plan benefits, anticipated funding levels, and the current economic environment.
3. The required annual total contribution amounts needed to amortize the cost over the amortization period selected.
4. A breakdown of this liability by the following:
 - Age (<65 v. >65)
 - Benefit Group (Tier)
 - Fund
 - Labor Group
 - Miscellaneous v. Safety employees
 - Normal Costs v. Unfunded Actuarial Accrued Liability (UAAL) Amortization
 - Liability and Normal Cost by Bargaining Unit (7 units)
 - Current Employees/Retired Employees and Dependents (survivors) (2 groups)
5. A description of the actuarial basis and assumptions used in the valuation.
6. A description of assumption and other changes since the last valuation.
7. A written executive summary describing the results of the valuation.
8. Sensitivity Analysis:
 - Investment return analysis using all CalPERS Trust options
 - Discount Rate
 - Amortization Period
 - Implied Subsidy
 - Other analyses suggested by proposer
9. Preparation of the California Employers' Retiree Benefit Trust (CERBT) Fund documentation and certifications needed by CITY to send to CalPERS.

CONTRACTOR shall perform the following activities to complete the bi-annual actuarial review of the City's OPEB programs:

1. Meet with City representatives including Finance Committee and Council, as well as staff, at least four to five times. The preliminary meeting will be conducted to discuss and to understand assumptions and methods before the study is undertaken. In addition, at the first meeting, a project schedule will be agreed upon. The subsequent meeting will be held to explain and to present the results of the project. CONTRACTOR will then attend Finance Committee and/or City Council meetings to present results.
2. Submit a draft report for review and approval prior to submission of final report
3. Prepare a final written report summarizing conclusions and documenting the analysis. This report may be similar in format to the one prepared for the June 30, 2013 actuarial valuation including a written executive summary, though other formats may be acceptable.
4. The report should include exhibits summarizing all appropriate results for two fiscal years (i.e. fiscal year ending June 30, 2015 and projected June 30, 2016). The report should also include information analyzing the impact of any changes in assumptions and methodology as well as plan experience relative to what would have been expected to occur during the preceding two years.

C. GASB 75 Reports

In addition to the OPEB valuation work described in Section B, annual reports providing the accounting information required under GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (GASB 75)*, which was first effective for fiscal year ending June 30, 2018. CONTRACTOR will prepare GASBS 75 reports for fiscal years 2017/18, 2018/19, 2019/20 and 20120/21. Each report will include all actuarial information required for GASBS 75:

1. Note Disclosures
2. Required Summary Information (RSI)
3. Supporting Exhibits, including the Crossover Test
4. Journal Entries
5. An allocation of OPEB amounts by Fund, and by Department within the General Fund

D. Other As-Needed Actuarial Analyses

Throughout the contract period, CITY may require additional actuarial analyses related to labor negotiations, CalPERS pension valuations, or long-term financial analyses. Additionally, CITY may require the CONTRACTOR to attend arbitration hearings, Finance Committee meetings, Council meetings, etc.

E. CalPERS Pension Valuations

In addition to the work above, CITY will require a comprehensive analysis of CalPERS Pension Valuations and impact of changes in CalPERS actuarial assumptions, including but not limited to CalPERS funding policy changes, demographic assumption changes, risk mitigation strategy changes, and the phase-in to a lower discount rate of 7.0% from 7.5%. The strategic asset

allocation of CalPERS and annual inflation assumptions will also be analyzed. The analysis of these various factors and their impact on the City's anticipated contributions to CalPERS will be discussed and used to inform a conversation about options to address the City's long-term pension obligations. This analysis will also include a discussion of using a 6.2% discount rate to calculate the City's normal cost contribution to CalPERS compared to both the 7.0% discount rate currently used by CalPERS as well as the potential for CalPERS to lower their discount rate through a risk mitigation strategy. It is anticipated that this marginal cost will aid the City in calculating its contributions to its Section 115 Pension Trust Fund and inform conversations with the City Council about a pension funding policy. Additionally, the City may ask for consultation on potential disbursement strategies to maximize the effectiveness of the Section 115 Trust Fund and ensure that proactive funding for the City's long-term pension obligations is optimally utilized.

EXHIBIT "C"
SCHEDULE OF FEES, AMENDMENT NO. 1
(Amended – Replaces Previous)

CITY shall pay CONTRACTOR according to the following rate schedule. The maximum amount of compensation to be paid to CONTRACTOR, including both payment for services and any specified reimbursable expenses, shall not exceed the amounts set forth in Section 5 of the Agreement. Any services provided or hours worked for which payment would result in a total exceeding the maximum amount of compensation set forth herein shall be at no cost to CITY.

The fee information is relevant to a determination of whether the fee is fair and reasonable in light of the services to be provided. Provision of this information assists the City in determining the firm's understanding of the project, and provides staff with tools to negotiate the cost, provide in a table.

Compensation based upon deliverables

Services in the chart below refer to services referenced in Exhibit "A" – Scope of Services, Amendment No. 1, Section B – Other Post-Employment Benefits Valuation as of the dates shown. Costs for reports that may be required as of the Measurement Date for accounting under the new GASB Statements 74 and 75 are excluded. The number and timing of any such reports are dependent on the City's selected Measurement Dates, and typically cost \$1,500 to \$3,500 each. CONSULTANT will provide an exact fee quote once the City selects its GASB 74 and 75 timing.

Hourly rates and fees below for 2017 and 2019 are based on assumed CPI of 2.5% per year.

| Scope | Labor Categories (e.g., Consultant, Sr. Consultant, etc.) | Est. Hours | Hourly Rate | Extended Rate |
|---|--|-------------------|--------------------|----------------------|
| Task 1: OPEB Biennial valuation (6/30/2015) | Partner (Bartel) | 20 | \$ 305 | \$6,100 |
| | Partner (Redding) | 25 | \$ 255 | \$6,375 |
| | Assistant Vice President | 50 | \$ 205 | \$10,250 |
| | Actuarial Analysts | 125 | \$ 130 | \$16,250 |
| Total, Not to Exceed, Task 1 | | | | \$ 38,975 |
| Task 2: Cost for attending additional meetings | Partner (Bartel) | * | \$ 305 | |
| | Partner (Redding) | * | \$ 255 | |
| | Assistant Vice President | * | \$ 205 | |
| | Actuarial Analysts | * | \$ 130 | |
| Total, Not to Exceed, Task 2 | | | | |
| Task 3: Costs for additional actuarial reports/analyses | Partner | * | \$ 305 | |
| | Partner (Bartel) | * | \$ 230 | |
| | Partner (Redding) | * | \$ 205 | |
| | Actuarial Analysts | * | \$ 130 | |
| Total, Not to Exceed, Task 3 | | | | |
| TOTAL NOT TO EXCEED (Tasks 1 - 3) | | | | \$38,975 |

* Per page 2 of RFP Attachment B, pricing for Task 2 and Task 3 is per hour.

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EXHIBIT "C" – SCHEDULE OF FEES, AMENDMENT NO. 1 (Amended – Replaces Previous)

| Scope | Labor Categories (e.g., Consultant, Sr. Consultant, etc.) | Est. Hours | Hourly Rate | Extended Rate |
|---|---|------------|-------------|---------------|
| Task 1: OPEB Biennial valuation (6/30/2017) | Partner (Bartel) | 20 | \$ 320 | \$6,400 |
| | Partner (Redding) | 25 | \$ 270 | \$6,750 |
| | Assistant Vice President | 50 | \$ 215 | \$10,750 |
| | Actuarial Analysts | 125 | \$ 135 | \$16,875 |
| Total, Not to Exceed, Task 1 | | | | \$40,775 |
| Task 2: Cost for attending additional meetings | Partner (Bartel) | * | \$ 320 | |
| | Partner (Redding) | * | \$ 270 | |
| | Assistant Vice President | * | \$ 215 | |
| | Actuarial Analysts | * | \$ 135 | |
| Total, Not to Exceed, Task 2 | | | | |
| Task 3: Costs for additional actuarial reports/analyses | Partner (Bartel) | * | \$ 320 | |
| | Partner (Redding) | * | \$ 270 | |
| | Assistant Vice President | * | \$ 215 | |
| | Actuarial Analysts | * | \$ 135 | |
| Total, Not to Exceed, Task 2 | | | | |
| TOTAL NOT TO EXCEED (Tasks 1 - 3) | | | | \$40,775 |

* Per page 2 of RFP Attachment B, pricing for Task 2 and Task 3 is per hour. Hourly rates above will depend on CPI. 2.5% annual rate used for illustration.

| Scope | Labor Categories (e.g., Consultant, Sr. Consultant, etc.) | Est. Hours | Hourly Rate | Extended Rate |
|---|---|------------|-------------|---------------|
| Task 1: Bi-annual valuation (6/30/2019) | Partner (Bartel) | 20 | \$ 335 | \$6,700 |
| | Partner (Redding) | 25 | \$ 285 | \$7,125 |
| | Assistant Vice President | 50 | \$ 225 | \$11,250 |
| | Actuarial Analysts | 125 | \$ 140 | \$17,500 |
| Total, Not to Exceed, Task 1 | | | | \$42,575 |
| Task 2: Cost for attending additional meetings | Partner (Bartel) | * | \$ 335 | |
| | Partner (Redding) | * | \$ 285 | |
| | Assistant Vice President | * | \$ 225 | |
| | Actuarial Analysts | * | \$ 140 | |
| Total, Not to Exceed, Task 2 | | | | |
| Task 3: Costs for additional actuarial reports/analyses | Partner (Bartel) | * | \$ 335 | |
| | Partner (Redding) | * | \$ 285 | |
| | Assistant Vice President | * | \$ 225 | |
| | Actuarial Analysts | * | \$ 140 | |
| Total, Not to Exceed, Task 3 | | | | |
| TOTAL NOT TO EXCEED (Tasks 1 - 3) | | | | \$42,575 |

* Per page 2 of RFP Attachment B, pricing for Task 2 and Task 3 is per hour. Hourly rates above will depend on CPI. 2.5% annual rate used for illustration.

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EXHIBIT "C" – SCHEDULE OF FEES, AMENDMENT NO. 1 (Amended – Replaces Previous)

Compensation based upon fee schedule

CITY shall pay CONTRACTOR according to the following rate schedule for work referenced in Exhibit "A" – Scope of Services, Amendment No. 1, Section C – Other As-Needed Actuarial Analyses (also referred to as Additional Services in Section 5 of the Agreement) and Section D – CalPERS Pension Valuations. The maximum amount of compensation to be paid to CONTRACTOR, including both payment for services and reimbursable expenses, shall not exceed the amounts set forth in Sections 5 of the Agreement. Any services provided or hours worked for which payment would result in a total exceeding the maximum amount of compensation set forth herein shall be at no cost to CITY.

| Position | 2020 Hourly Rate |
|---|-------------------------|
| Partner & Vice Present (Redding) | \$300 |
| Assistant Vice President (Lin, Van Valer) | \$270 |
| Associate Actuary | \$220 |
| Senior Actuarial Analyst | \$200 |
| Actuarial Analyst | \$160 |