



FINANCE COMMITTEE SUMMARY MINUTES

Special Meeting
December 6, 2022

The Finance Committee of the City of Palo Alto met on this date in the Community Meeting Room and by virtual teleconference at 5:30 P.M.

Present In-Person: Filseth, Kou

Present Virtually: DuBois (Chair)

Absent:

Oral Communications

Neilson Buchanan remarked on Item 4 on the agenda and being impressed with the report. He suggested the header on Page 26 be worded as "Risks Not Included in the Forecast," to rank order the priorities, consider adding additional risks of sea rise and the levees, changes to office space and commuters due to work-from-home, and specific area plans of two downtowns associated with commercial centers.

Agenda Items

1. FY 2023 Finance Committee Referrals Update

Assistant City Manager Kiely Nose commented the annual December Information Report regarding referrals and status would be used to prepare for the Council Retreat in 2023.

Assistant Director of Administrative Services Christine Paras spoke of four referrals dating back to 2020 that were in progress or pending.

Chair DuBois commented the Summary of the JMZ focused on raising prices and should include managing demand.

NO ACTION TAKEN

2. Pension Policy and Retiree Healthcare Review and Update

SUMMARY MINUTES

Budget Manager Jessie Deschamps provided slides and details of the Council-adopted Pension Policy. Staff had several meetings with the Finance Committee scheduled, including review of CalPERS actuarial analysis as of June 30, 2021; review of the status of Pension and OPEB Trusts with plan providers, which was completed with the Finance Committee in October 2022; and this evening's meeting of the review of the status of pension plans with alternative actuary assumptions and potential policy revisions for City Council consideration. Potential policy revisions were presented for feedback and action regarding adding proactive planning for OPEB and retiree healthcare, which would formalize actions and was consistent with City Council direction. There were recommendations to reduce the discount rate for supplemental contributions, which was outlined, and also approved by City Council; add language for investment strategy of Pension and OPEB Trusts, which was consistent with recommendations at the October 18 Finance Committee meeting, which would not require budgetary action; identify areas of focus for accumulated savings, which options were furnished; and modify the actuary reporting from three to four years. The action was to review and accept the revised Actuarial Pension Analysis using the alternative assumptions and recommend City Council adopt modifications to the Pension Funding Policy used to guide financial planning of the benefits.

Foster & Foster, Inc., Mary Beth Redding, furnished definitions of the terms that would be used. Slides were supplied related to investment return; CalPERS changes from the November 2021 Board meeting; and CalPERS valuation reports of June 30, 2021, published in August 2022, including demographics, plans, funded ratios, and contribution projections.

Discussion ensued with regard to contribution projection rates.

Foster & Foster, Inc., Redding discussed and provided slides in reference to the City's funding policy, which included Section 115 Trust balances, contributions, and projections.

Discussion arose concerning the contribution numbers being from the ALM Study, the City's policy related to using the 115 Trust, and modeling of the ADPs. The Committee decided to discuss modeling of the ADPs later in the meeting.

Foster & Foster, Inc., Redding continued discussing CalPERS and 115 Trust contributions and projections. Slides were presented as to estimated savings assuming payments to the Section 115 Trust and transfers to CalPERS stopping when CalPERS plans were 90% funded.

SUMMARY MINUTES

Discussion occurred regarding savings related to the funding policy and unfunded liability payment and comparisons of other cities' investment strategy with the 115 Trust and the ADP and strategy of investing at the bottom of the market.

Chair DuBois asked if Palo Alto's unfunded liabilities were large compared to other cities in California.

Foster & Foster, Inc., Redding responded Palo Alto was much less funded than most other agencies, and contribution rates were on the high side, but it was not due to doing anything wrong but due to being in existence a long time.

Bianca Lin noted that in the past two years many agencies issued pension obligation bonds that increased their funding status.

Discussion commenced regarding pension obligation bonds, debt service payments, and CalPERS payments.

Chair DuBois questioned if there was going to be discussion or presentation concerning OPEB.

Assistant City Manager Kiely Nose indicated the OPEB piece was to true up the actions the Council took on the OPEB plan that was reviewed by the Finance Committee in May. The same actuarial studies were reviewed in May and synced the OPEB proactive funding contributions with the policies of the pension proactive contributions. Part of aligning the pension funding policy as adopted by Council was to incorporate both sets of policies in one document incorporating all directions given by the Council and Finance Committee over last few years. The Committee was to review policy tenets related to cost assumptions for the normal cost contributions and how to allocate resources from the 115.

Chair DuBois inquired about aligning the investment strategies in the 115 to be a little more moderate or tiering it and splitting the 115 so part would be more short term and conservative but the bulk of it being a more moderate investment.

Assistant City Manager Nose commented Packet Page 62 listed recommended policy revisions, which addressed investment strategy of the Pension and OPEB Trusts. In the PARS account, there were five to seven investment strategies, and Palo Alto was in a moderately conservative portfolio and could move to a slightly more aggressive portfolio.

SUMMARY MINUTES

Chair BuBois stated this decision was also tied to the ADP payment strategy and questioned if it would make sense to bunch payments up and make a larger payment in a loan frequency to have a longer investment horizon versus the current policy of investing the excess of one year's worth of payment.

Foster & Foster, Inc., Redding expressed she could not give investment advice, but she heard that dollar averaging was a proven strategy and timing the market almost never worked. This strategy might be closer to a dollar-averaging philosophy because it would move a little money every year.

Council Member Filseth indicated there was one Pension Savings Trust with two accounts – CalPERS and Section 115. It was important to distinguish between putting money into the aggregate trust versus moving money from Section 115 into CalPERS. He supported being more aggressive in the 115 investment strategy.

Chair BuBois agreed. The time horizon was important. The 115 was shorter term and conservative and had not had the same return as CalPERS, but if those payments were to be made less frequently, maybe more comfort would be in the balanced investment portfolio.

Discussion ensued regarding ADP payments and risk-return of the Section 115 and the CalPERS account together.

Assistant City Manager Nose noted the policy question was at what point should funds be transferred from the 115 to CalPERS.

Chair DuBois asked the risk of keeping everything in the 115 Trust in terms of unfunded liability generating negative press and impacts to financing.

Assistant City Manager Nose furnished insight related to financial reporting of the 115 versus how CalPERS was reported and presented pros and cons of the 115 Trust just growing and not being transferred to CalPERS.

Council Member Filseth asked if CalPERS provided a menu of risk versus return options for the portfolio. He provided his reasoning why it would be helpful to have future versions of the charts show ALM projections of expected returns, not CalPERS. Before discussing how much should be in the Section 115 versus CalPERS, he wanted to see the whole UAL amortization plan.

Assistant City Manager Nose stated CalPERS investments were managed by the Board.

SUMMARY MINUTES

Foster & Foster, Inc., Redding expressed future charts could show ALM projections.

Chair DuBois recommended not delaying discussion due to not having the whole UAL amortization plan and suggested Attachment B be pulled up as the best summary and discussed row by row. He asked if the City was pleased with the OPEB funding and why the discount rate was higher. He was interested in moving to the balanced portfolio for long-term 115, and long and short term needed to be defined.

Assistant City Manager Nose replied the City was satisfied with the OPEB funding. The discount rate was higher because of riskier investments and funding was at a less risky discount rate assumption, so additional payments were being made. She provided her thoughts regarding sources and uses from a financial perspective. Staff would recommend any recommended contributions of ADPs from the 115 Trust be brought forward as part of the annual budget process in alignment with this policy to allow a vehicle for discussion on the movement between accounts.

Council Member Filseth inquired if it could be stipulated X percent would be in CalPERS and X percent in Section 115 Trust. It was important the true normal cost and an adequate amortization payment be put into savings every year, and which one it was to be was important but not top priority.

Assistant City Manager Nose affirmed it could be stipulated X percent would be in CalPERS and X percent in Section 115. The Committee could choose to not change the policy but change the investment from moderately conservative to balanced.

Discussion arose regarding the alignment and differences of OPEB and Pension, the number of accounts to use, the normal cost, and what the policy specified regarding excess BSR, and ADPs.

Assistant City Manager Nose stated that putting a range on what should go in the 115 Trust with investment earnings would be appropriate, and based on circumstances, staff would work with the actuary to make determinations regarding ADPs in any given year, and that analysis could be brought forward at that time. It was important the policy guide when such things would be done. It could be like a BSR policy with a target of blank percentage between blank and blank.

Discussion occurred as to the recommendation presented being more conservative and changing it to a moderate portfolio. The Committee agreed to changing to a moderate portfolio.

SUMMARY MINUTES

Discussion occurred regarding ADPs and different accounts and cadence of payments versus amounts of payments. The Committee decided to keep it at one year.

Discussion commenced related to the CalPERS ALM Study.

MOTION: Chair DuBois moved, seconded by Council Member Filseth to recommend the City Council adoption of modifications to the Pension Funding Policy used to guide financial planning of these benefits as outlined in the staff report with the following revisions:

1. Adjusting our 115 investments to a balanced investment level

MOTION PASSED: 3-0

Council Member Filseth remarked the Committee should at some point review the UAL amortization using ALM figures as opposed to CalPERS figures.

MOTION: Council Member Filseth moved, seconded by Vice Mayor Kou to recommend the City Council refer staff to do a recalculation of the ULA amortizations schedule using ALM expected returns in the next report out of CalPERS Actuary studies and adjust the Pension Funding Policy to reflect the calculation as part of the every 4 year status check-in.

MOTION PASSED: 3-0

3. First Quarter Fiscal Year 2023 Financial Report

Finance Manager Rocelyn Fernando presented the FY2023 first quarter financial report for informational purposes only focusing on the General and Enterprise funds only. The balances were preliminary and unaudited. She highlighted the General Fund revenue and expenditures for the first two quarters and the General Fund BSR. Staff anticipated returning to Council in February 2023 with a FY2023 mid-year review and recommendations for appropriations. The Enterprise Net Position was presented.

Council Member Filseth questioned if a drop in ERAF was anticipated.

Assistant Director of Administrative Services Christine Paras commented it was still at risk due to a pending lawsuit. The latest information was that 30% of this year's distribution was at risk.

SUMMARY MINUTES

Chair DuBois asked if sales tax was still lagging on Cal. Ave., as the last report indicated it was. He was concerned that closing those streets limited restaurant hours. He referenced Police overtime being up over 100% and inquired if they were trying to rein that in.

Assistant City Manager Kiely Nose indicated the last analysis was the most current information. There was sales tax information because cash was received on a monthly basis, but full economics were on a quarterly basis. She would note economic development work for themselves and Assistant to the City Manager Steve Guagliardo since they were moving through the data side on that strategy. The Police Department was aware where overtime was tracking and did not expect it to abate and expected a request for additional funding mid-year. She addressed hiring and overtime needed for support and special operations.

NO ACTION TAKEN

4. Review and Forward the FY 2024 - 2033 Long Range Financial Forecast

Assistant City Manager Kiely Nose noted that many assumptions tied back to the status of the 2023 Q1 estimates and the Pension Policy assumptions.

Budget Manager Jessie Deschamps furnished slides and an overview related to the long-range financial forecast, local economy performance, 2024-2033 base case forecast, and major tax revenue projections.

Budget Manager Paul Harper highlighted some assumptions and risks not included in the forecast. The items would be more defined and brought forward as part of future budget processes. Models were displayed regarding alternative scenarios of a moderate recession and Measure K funding, which impacts were likely to occur simultaneously but were modeled separately to show the impacts compared to the base case individually. Attachment A, the FY2024 Budget Development Guidelines, was discussed. The base case and the alternative scenarios should be used to assist staff, the Finance Committee, and Council in managing the long-range economic outlook. Staff anticipated the FY2023 mid-year report would include recommendations for additions related to areas of priority or urgent needs. Next steps in the overall annual budget process were reviewing the long-range financial forecast by Council in January followed by Council's review of the mid-year report in February and release of the proposed budget in May. The recommended action for this meeting was that the Finance Committee review and recommend City Council accept the 2024 through 2033 long-

SUMMARY MINUTES

range base case and 2044 budget development guidelines and direct staff to use the forecast as a starting point for FY2024 budget process.

Council Member Filseth inquired if part of long-range financial planning should include staff and future councils looking at public safety expenses escalating. He wanted everyone to understand that long-range financial forecasts assumptions were very conservative in the outyears.

Chair DuBois mentioned the report noted not all services would be restored and questioned if it was quantified by headcount and what services had been lost and if some had been automated.

Budget Manager Harper answered it had been quantified by headcount but as far as bringing back services that were cut, they had been working with departments, and some services had been brought back in a different manner and was the idea behind reinvestment and not just restoration of what was taken away.

Chair DuBois recommended seeing a description of things that had changed rather than just headcount, such as library hours, etc., and wanted to see a list of programs and services in the longer offer. Concerning Slide 6, Major Tax Revenue Projections, he wondered if a scenario of office occupancy should be considered for ongoing property tax revenue as there could be decline due to work-from-home and a recession could be a new normal and was not modeled. He felt the Cubberley gym repair needed to be a priority. He did not know if parklets had been considered as a revenue or revenue-neutral source. He spoke of inflation of salaries and labor, pension, and medical costs needing to be carefully managed. He asked if in scenario B the \$3 million gap would be covered by the Economic Uncertainty Reserve. He suggested looking at revenue from a new fiber utility as a scenario for the 10-year forecast. He inquired if the expenses for the Climate Action Plan were in Utility and if a lot of it would be salaries already being modeled and if additional consulting, etc., would be added in.

Council Member Filseth expressed in terms of headcount that contractors needed to be factored in because declining headcount did not decrease service to the community.

Assistant City Manager Nose specified the immediate spike from large office transfers would show up in DTT. It was explained why it would be difficult to segment out office tax for commercial office only. There would be continued monitoring of emerging trends of the property taxes on a quarterly basis. The Assessor's Office provided appeals updates of assessed value, which could make changes to the property tax role. Staff expected to proactively plan for the \$3 million gap and set funds aside with that reserve. The

SUMMARY MINUTES

expenses for the Climate Action Plan were presently in Utility, but as programs were built out, it would be a shared responsibility across multiple funds. As S/CAP was built out, all funding sources would need to be looked at and was part of the Work Plan staff expected to be reviewed by the Council. The three-year work plan outlined a significant level of resources needed if all aspects of the S/CAP plan were executed and would be evaluated when the plan was evaluated and would bring forward any new resources as mid-year or the proposed in 2024.

Vice Mayor Kou, in regard to economic development, would like to see more focus on work-from-home as the Committee had been told the main source of sales tax was based on office leases, commuters, etc.

MOTION: Chair DuBois moved, seconded by Council Member Filseth to recommend the City Council accept the General Fund Long Range Financial Forecast (LRFF) for Fiscal Year 2024-2033 and the FY 2024 annual Budget Development Guiding Principles (Attachment A) and direct staff to use this forecast as the starting point for the initiation of the FY 2024 budget process.

MOTION PASSED: 3-0

Future Meetings and Agendas

Adjournment: The meeting was adjourned at 8:05 P.M.