MINUTES
FINANCE COMMISSION

Wednesday, January 29, 2020 - 5:00 P.M.
City of Huntington Beach
Civic Center – Lower Level Conference Room #B-7
2000 Main Street
Huntington Beach, CA 92648-2702

Chair Sterud called the Meeting to order at 5:00 p.m. and Commissioner Van Der Mark led the Pledge of Allegiance.

MEMBERS PRESENT:	Sterud; Lo Grasso; Van Der Mark; Gledhill; Hudson; Ray; Morrow
MEMBERS ABSENT:	None
STAFF PRESENT:	Dahle Bulosan, Acting Chief Financial Officer Sunny Rief, Acting Assistant Chief Financial Officer Oliver Chi, City Manager Travis Hopkins, Assistant City Manager Joyce Zacks, Finance Manager – Treasury Paulina Flores, Acting Finance Manager – Budget Serena Bubenheim – Senior Finance Analyst Thuy Vi, Administrative Assistant, Finance Linda Wine, Administrative Assistant, Finance

ORAL COMMUNICATIONS – Ralph Taboada, Chair of the Costa Mesa Finance and Pension Advisory Committee, spoke regarding Huntington Beach's Pension Obligation Bonds.

INTRODUCTION OF NEW COMMISSIONERS

Chair Sterud introduced and welcomed newly appointed Finance Commissioners Charles "C.J." Ray and Chris Morrow.

ELECTION OF CHAIR AND VICE CHAIR

Motion: Moved by Sterud and seconded by Hudson to nominate Frank Lo Grasso as Commission Chair.

Ayes: Sterud; Lo Grasso; Van Der Mark; Gledhill; Hudson; Ray; Morrow
Noes: None
Approved: 7-0

Motion: Moved by Gledhill and seconded by Van Der Mark to nominate Ron Sterud as Commission Vice-Chair

Sterud declined the nomination and thanked the Commission.

Motion: Moved by Lo Grasso and seconded by Sterud to nominate Jay Hudson as Commission Vice-Chair

Ayes: Sterud; Lo Grasso; Van Der Mark; Gledhill; Hudson; Ray; Morrow
Noes: None
Approved: 7-0

DISTRIBUTION OF FINANCE COMMISSION PARKING PASSES

Staff distributed Beach Parking Passes to the Finance Commissioners.

MINUTES

Motion: Moved by Hudson and seconded by Van Der Mark to approve the Finance Commission Meeting Minutes dated October 30, 2019, as presented

Ayes: Sterud; Van Der Mark; Hudson
Noes: None
Abstain: Lo Grasso; Gledhill; Hudson; Ray; Morrow
Approved: 3-0-4 (Lo Grasso, Gledhill, Hudson, Ray, Morrow -Abstain)

Motion: Moved by Gledhill and seconded by Lo Grasso to approve the Finance Commission Meeting Minutes dated November 20, 2019, as presented

Ayes: Lo Grasso; Van Der Mark; Gledhill
Noes: None
Abstain: Sterud; Hudson; Ray; Morrow
Approved: 3-0-4 (Sterud, Hudson, Ray, Morrow -Abstain)

PRESENTATION

1. Year End Audit Results

Acting Chief Financial Officer Dahle Bulosan introduced Sunny Rief, Acting Assistant Chief Financial Officer and Jennifer Farr, Audit Partner from DavisFarr LLP, who will both present the Year End Audit Results.

Rief stated that auditing firm DavisFarr audited the City's financial statements and internal controls for the year ending June 30, 2019. She was pleased to report that the City's FY 2018/19 Comprehensive Annual Financial Report (CAFR) received an

Unmodified (Clean) Audit Opinion from DavisFarr. She also noted that the City's CAFR is award winning, and has received the Government Finance Officers Association's (GFOA) Excellence in Financial Reporting Award for 33 years.

Farr stated that her office issued a number of audit reports, which included a two-page audit opinion in the City's CAFR. DavisFarr issued an "unmodified" audit opinion on December 17, 2019, which is the highest level rating that you can receive. Also in the audit package is the Auditor Communications Letter to those in governance regarding any significant audit findings, Appropriations Limit Agreed-Upon Procedures, AQMD Report, and Single Audit Report, which is in progress, and not due until March 31, 2020.

Farr discussed Internal Controls. Auditors are not engaged to express an opinion on internal controls, but do evaluate the City's controls to determine if they are adequate to ensure that there are no material errors in their financial statements. The internal control areas that were reviewed include: Billing and Cash Receipting; Purchasing and Cash Disbursements; Payroll; Banking and Investing; Grant Management; and Information Systems. As a result of the testing performed, Farr indicated that she was happy to report that there were no material weaknesses or significant deficiencies in internal controls. The City's controls are adequate to protect the City's assets, and there were no instances of noncompliance of laws and regulations that auditors believe are direct and material to the financial statements.

Chair Lo Grasso asked if the purchase of the Navigation Center was reviewed as an audit of Purchasing. Farr stated that it was, and passed inspection as the terms of the purchase were made in compliance with the City's Purchasing Policies and Federal Grant Guidelines. Farr noted auditors do not express an opinion or evaluate whether the guidelines are good or appropriate, and only determine if the guidelines were followed.

With regard to the purchase of the Navigation Center, Commissioner Sterud asked if it was an acceptable practice in the purchasing process of the City's Purchasing Policy for the seller to represent both the buyer and seller. Farr stated that it would not have been expressed in the Purchasing Policy. Sterud noted that we have a City Councilmember whose brother is a high level executive with said company who represented both buyer and seller. Sterud said that he wanted to state this for the record.

Bulosan noted that since the purchase of the Navigation Center, the process is being reviewed for improvements and recommendations, and will be discussed at the next Finance Commission meeting.

Farr gave an overview of the Areas of the Audit Focus in FY 18/19, which included Pension Obligations and OPEB (Other Post-Employee Benefits). DavisFarr also included testing of the following: Police Department offsite cash receipting; claims payable calculations; capital asset activities; and a Single Audit testing of the CDBG Grant. Farr noted that their Audit, which focused on a high threshold of 65% of the

City's Purchasing Policies and Federal Grant Guidelines, included the Navigation Center purchase.

Farr also discussed upcoming Auditing Standards. These included FY 19/20 GASB 84: Fiduciary activities; FY 20/21 GASB 87: changes accounting for capital and operating leases; FY 21/22 GASB 91: Conduit Debt Obligation disclosure changes. She noted that a change in the government financial reporting model is on the horizon. Commissioner Gledhill inquired about the changes to leases and if this will increase our assets and liabilities. Farr said that we would be recording a right to use an asset that we are not currently recording in our financial statements.

Rief gave a summary of the FY 18/19 Performance (Audited). She noted that the City's Current and Other Assets and Capital Assets total $1,177,879,000, with Deferred Outflows for Pensions totaling $70,702,000. She said that the City's Current and Other Liabilities and Long-Term Obligations* total $552,239,000 with Deferred Inflows for Pensions totaling $13,401,000. The City's Total Net Position is $682,944,000.
*This number reflects GASB 68 Recording of Net Pension Liability of $421.0 million and GASB 75 recording of Net OPEB Liability of $6.6 million.

Rief also discussed the FY 18/19 General Fund (Audited). She noted that the Excess of Revenue over Expenditures was $21,162,000, and the Net Change in the General Fund Balance is $10,379,000. She noted that we had strong revenues this year and included one-time revenues totaling $4.5 million, which consisted of sales tax back payments from 2018 totaling $2.23 million, settlements of $616,000 Fire Strike Team Revenues of $1.12 million, and other State, county and developer revenues totaling $534,000.

Rief noted that the General Fund Balance(s) (Audited) were $61,180,000 in FY 16/17, $68,634,000 in FY 17/18, and $79,013,000 in FY 18/19. Gledhill asked why the City did not use the excess revenue to pay down Pension Debt. Bulosan noted that targeting $15-$16 million of the excess revenue is under consideration, and will go before the City Council. Commissioner Morrow questioned the amount, and Bulosan noted that the amount will be finalized at the Fiscal Year End. Commissioner Hudson asked Farr about the 65% Audit ceiling. Farr noted that 65% is a high threshold for an audit, and focused on 25 random sample selections to confirm their compliance with Federal Guidelines.

Lo Grasso thanked Farr and Rief for the presentation.

DISCUSSION ITEMS AND POTENTIAL RECOMMENDATIONS

1. CalPERS Divestment Policy Presentation by Jason Perez, CalPERS Board Member and Michael Cohen, CalPERS Chief Financial Officer

Bulosan introduced Michael Cohen and Jason Perez of CalPERS.

Perez noted that the views expressed tonight are his views, and not the view of CalPERS.

Cohen stated that CalPERS is the largest public pension system in the country. City of Huntington Beach employees are members of the system. Cohen gave an overview of CalPERS' (or PERS') Basic Financials. He noted that PERS has a market value of $400 billion, two million members, and pays out $24.2 billion in benefits annually. Cohen noted that PERS' goal is to be 100% funded. PERS has enough assets on hand that over the next 30 years, there will be enough to pay off the accrued liabilities from the existing employees in the system. Currently, PERS is approximately 71% funded and increasing slowly. Several years ago, PERS lowered its discount rate from 7.5% to 7%, which is what it expects to receive on investment return over the long term.

Cohen discussed the challenges that PERS is expecting over the next ten years in achieving the 7% rate to improve and increase funding status. The challenges include: 1) declining interest rates with increasing profit margins less likely to repeat; 2) current valuations are high; 3) slower global economic growth; 4) few opportunities to generate excess returns; 5) underfunded status limits options; and 6) PEPRA (Public Employees' Pension Reform Act) – impacts not materially relieving costs.

Cohen stated that we are currently in a low interest rate environment. It is much easier to make the 7% interest rate if interest rates are 5%-6%, because there is less risk in reaching 7%. Given that rates are down at the 2% range, higher levels of risk have to be undertaken to achieve a 7% return by investing in the stock market and private equity, which leads to some volatility within the system. Some years will see double digit returns, other years will not see the 7%, and in the case of the Great Recession over a decade ago, PERS lost 24% of their assets. Cohen stated that the current environment is challenging for PERS' investment professionals to hit the 7%. Lo Grasso asked if the PERS Discount Rate of 7% was realistic. Cohen stated that it is a challenging number to achieve, and the Board will make this decision. Based on the information given to the Board, there is no reason for them to change it. Cohen noted that every four years, PERS reviews its asset management process to reconcile its investment policies and actuarial policies, so this percentage will be revisited in 2021.

Lo Grasso asked if it was wise to have this much volatility in a pension system like this, and said PERS could further lower its discount rate. Perez stated that there is no other option, and risk in the fund is needed to make the return in investments that is needed. He noted that Huntington Beach may be in a good position where it is over 80% funded, but there are over 2,000 PERS agencies that are not at the City's level and lowering the discount rate would negatively impact agencies across the State, including the State. Perez stated that he is confident that PERS can achieve their 7%-7.3% predicted rate. Lo Grasso asked if the City may be exposed to financial loss similar to that of ten years ago when PERS lost 24% of its assets. Cohen stated that there is volatility in the stock market, but we are not at the same risk level as during the Great Recession. Perez stated that PERS has an operations plan in place to deal with any downturns.

Gledhill asked how the 7% rate compares with other large pension funds. Cohen stated that PERS was one of the first pension funds to go towards 7%, but now there are other systems that are somewhat lower. He noted that 7% is on the lower end of where pension funds are nationally, but the trend is coming down. Cohen acknowledged that reaching the 7% rate involves taking risks.

Sterud asked what type of investment vehicles would be utilized in the downturn plan. Cohen stated that this information is not shared in open session because others will make money from PERS' thought process. Cohen noted that PERS has a top notch Chief Investment Officer (CIO) whose focus is on liquidity in investing.

Commissioner Ray discussed PERS' focus on managing Climate Risk. He cited the November 2018 Wilshire Investment Group's Financial Analysis of PERS' Divestment Programs. Ray said he had concerns that PERS had "pet projects" and special interest issues, which do not meet the requirements and needs for the program, and asked about PERS' recommendations for the City. Cohen noted that PERS has a new 13-Member Board, who is providing a different perspective on PERS' goals and investment strategies. He noted that investing in diverse use projects can make more money, while protecting PERS members and that the risk factor would be integrated into PERS' investment strategy. Cohen said that ESG is a long term sustainable investment path. He also noted that the Wilshire Investment report was a "look back" that locks in place policies that the current PERS Board will not pursue.

Lo Grasso asked if PERS' ESG initiatives were in effect last year, and if we could attribute the 8% loss to ESG initiatives. Cohen said no, ESG was not the cause.

Perez noted that the goal of the new Board is to not divest, which was reiterated by Board Member and State Controller Yee. The primary duty of the 13-Member PERS Board is to make the returns. Ray said that PERS' priorities to meet obligations have taken second to social issues and are out of line. Cohen noted that with the new PERS Board, the investment priorities have changed. Gledhill asked if there were new policies and procedures in place to address what had happened, and whether personal interests interfere with the Board's decisions. Perez responded no. Cohen stated that the investment decisions are not made by the PERS' Board, but by Investment Professionals. Perez also noted that the new CIO is making changes regarding investments and looking through the lens of profit. Gledhill asked about the difference in performance rates between PERS and the market. Cohen said that given how big PERS is, PERS drives the averages and it is hard to exceed them. He said the new CIO is focusing on passive investment of following the trend. PERS' investment office is within a few basis points of other large investors, and last year's rate was 6.7%, while the teacher's system was 6.8%. Perez said that focus is now on conservative investments.

Commissioner Hudson noted that Perez was elected to the PERS Board specifically because he did not agree with the investment direction of the Board at the time, and thanked Perez for his work. Hudson urged PERS to pay competitive salaries to its fund managers to ensure that the best and brightest will be managing the single largest pension fund in the country. Perez agreed with Hudson regarding competitive salaries and noted the CEO, CIO and the entire Board are focused on getting the returns to lessen the burden on the agencies and to make sure that defined benefit systems stay around.

Morrow asked if PERS ever met its 7% return after lowering the rate from 7.5%. Cohen stated that looking back 30 years, PERS has achieved 8%. PERS uses outside consultants, like Wilshire Consulting, to make financial projections and capital market assumptions to form the basis of asset allocations. Morrow asked if there is a completely new PERS Board. Cohen stated that the consensus view of the Board has moderated in terms of divestment, partly based on the Wilshire Report, their experience and changeover in some of the Board members. This combination has led to the Board being more proactive in saying that divestment is not the answer. The Board believes that if you want to change the way a company is behaving, or a country is behaving, it is better to engage with them as a major investor.

Ray asked if the Board is still looking to invest in social agenda projects or market needs across the board. Cohen discussed how the PERS investment team is addressing climate risk. ESG should not be considered a social cause, but a long term view of where the markets are going. Long term, ESG will evolve and be thought of as good business sense, of what risk and opportunities are in the market due to the global change, which changes the way everyone does business and makes money. Cohen said that 20 years from now, there will no longer be an ESG unit within PERS and people will have just integrated into their common sense thinking about how to make money for the system.

Cohen discussed PERS' strong foundation for the future. He noted the goal of lowering the discount rate from 7.5% to 7.0% over three years. He also discussed PERS' new asset allocations, with 50% in Global Equity, 28% in Fixed Income, 13% in Real Assets, 8% in Private Equity and 7% in Liquidity. He discussed the shorter amortization goal for employers to pay their unfunded liability, smoothing the term from 30 years to 20 years, and noted the Capital Injection from State and school pension obligations, with $9 billion from the State and $904 million to the schools.

Cohen talked about active investments versus passive investments. Cohen noted that the long term goals of the new Board are to make more money for the system. Morrow noted that PERS has hit all its targets, but is still underfunded by 30%. He asked if that was due to members living longer. Cohen said that it was a combination of factors: life expectancies, the demographic side and investment returns. Morrow also asked if accrued liability is calculated by city or profession. Cohen said that every city has their own dedicated plan in the system. Huntington Beach has two plans, safety and miscellaneous; the plans are city specific, separate from other cities.

Gledhill asked about the shorter amortization goal and what the new policy was on smoothing. Cohen noted that moving forward, any new loss or gain will be smoothed over 20 years rather than 30 years. He also said that PERS recalculates on a yearly basis. Perez stated that with the Risk Mitigation Policy, if PERS reaches a 9% rate or above, a portion of that will go towards the unfunded liability, spread equally among the plans, and the other portion would go to the discount rate, buying down the excess percentage. Cohen noted that this policy is in place, was suspended for a couple of years, and will be revisited in 2021.

Gledhill asked if other cities were pursuing Pension Obligation Bonds (POB). Cohen responded that there was height in POBs in 2002-2006, but after the Recession, everyone stopped. There have been more recent conversations and more cities are looking at POBs. Sterud asked if our POBs are approved by Council, and Huntington Beach becomes 100% funded, will we go to 105% if there is a 5% allocation, or would our account be credited. Cohen stated yes. He noted that one rate is paid for a combination of the normal cost - the annual employee service rate, and the unfunded liability. Huntington Beach would still pay the normal cost after issuing POBs. Cohen noted that not paying PERS is illegal, as pension reform laws are now in place. Lo Grasso asked for an opinion on POBs. Cohen believes that Huntington Beach has had good discussion and understands the risks associated with the POBs. Cohen noted that if the City locks in at a 3% rate, and PERS earns a 4% rate, it will be fine. If the stock market crashes the day after PERS is paid, there is a possibility that it will not work out great. Sterud noted that Huntington Beach owes PERS $436 million. General discussion ensued regarding overfunding. Sterud said the choice comes down to the 3.5% POB rate versus the PERS' 7% rate.

Hudson said that City Manager Chi gave a great presentation regarding the UAL at the Finance Commission meeting on October 30, 2019. Chi noted that the City has a contract to be a member of PERS and as part of that contract, PERS determines the payment schedules pursuant to formulas that the State legislature puts together. For every year that PERS earns less than 7%, we grow UAL which is paid back over 30 years. We currently have 25 years left to pay back $436 million. That number shrinks every year based on the payment that we make. We took on this obligation when we agreed to give enhanced benefits, and it is an obligation that we have to pay to make sure that the fund does not default. Chi stated that the City is faced with the investment risk challenge. Every year, our UAL payment increases by a couple of million before it tops out in a decade, which will be $21 million more. That number will only shrink if PERS earns consistently more than 7%. Chi believes that it is not likely that PERS will over perform, and he is concerned that the PERS' rate will drop to 6% or lower based on their investment policy. At a refinance rate of 3%-3.5% which is at historic lows, there is cost certainty and the City can pay back faster over 25 years. Chi stated that if we do issue the POBs, we will be paying $5 million less in UAL payments and see a savings. His recommends a UAL policy where 100% of savings would be put away to pay for any UAL growth and accelerate the payback schedule. Chi stated that this is most thoughtful, fiscally conservative method. Cohen and Perez predicted that PERS will hit 7%.

Cohen commended everyone for discussing pensions, and trying to understand PERS' policies, local budgets, where the money is going and what risks and opportunities are involved.

A five minute break was called. The meeting reconvened at 6:55 p.m.

Bulosan stated that the Fiscal Impacts of CalPERS' Divestment Policy is basically the same information that the Finance Commission Sub-Committee presented at the November 20, 2019 meeting that outlines the effects of the PERS Divestment Policy and its fiscal impact on Huntington Beach based on the Wilshire Report. The subcommittee consisted of Commissioners Gledhill, Van Der Mark and Hudson. The Wilshire Report stated that because of the Divestment Policy, PERS lost an estimated \$8.5 billion. We used the same methodology to apply the same proportionate share to Huntington Beach and that equated to \$22 million. Bulosan said that a draft memo to the City Council was prepared with a summary of the findings, and asked that the Finance Commission review the memo and provide feedback.

Hudson noted that the Sub Committee was tasked by the City Council to take a look at what impact the PERS' Divestment Policy had on the City's pension fund gap. The Committee also researched the City's loss of \$22.1 million in pension liability, and whether or not PERS' Investment Policy was the cause of that loss. The Sub Committee used the Wilshire Group memo to quantify the results of the PERS' Investment Policy. Hudson said it could not be determined with certainty that the Divestment Policy was the single most contributing factor to the loss.

Bulosan noted that the Wilshire Group was hired to quantify the financial impacts of the Divestment Policy from inception in 2000, and since that time, Wilshire Group provides an annual report that summarizes the findings. Bulosan noted that the actuaries for the City and PERS both agree that this methodology is reasonable, but is susceptible to timing and change in Huntington Beach's proportionate share of the investment pool.

Morrow noted that the loss was greater than \$22 million due to lost opportunity to invest in the rest of the fund that produced 8% and incurred revenue. Sterud noted that it is difficult to quantify opportunity to cost. Ray said that if we cannot draw a correlation or eliminate that ESG was the cause, we need to do further research.

General discussion ensued regarding the City's loss and a potential lawsuit against PERS. Sterud noted that the City cannot sue PERS for the \$22.1 million loss. Chi stated there is no debate that we lost 2% when PERS invested in the divestment ESG funds compared with what they could have earned. He noted that the Commission is considering whether to pursue a lawsuit against PERS for underperformance. Chi suggested that Sub-Committee look into our contract with PERS to see if there is a provision that limits the City from doing so.

Lo Grasso stated that it is not the Finance Commission's purview to discuss or pursue potential legal matters. Sterud concurred and recommended asking the City Attorney's Office to review the issue. He stated that the Finance Commission was tasked with determining the fiscal impact of ESG on Huntington Beach's pension liability, they have completed their task and thanked the Sub-Committee. Hudson thanked City staff for their assistance.

Motion: Moved by Sterud and seconded by Hudson to send the Memo regarding the Fiscal Impacts of CalPERS' Divestment Policy to the City Council and the City Attorney with the Draft Minutes of the January 29, 2020 Finance Commission meeting

Ayes: Lo Grasso; Sterud; Hudson; Van Der Mark; Gledhill; Morrow
Noes: Ray
Abstain: None
Approved: 6-1-0

2. CalPERS UAL Funding Policy and Refinancing Update

Bulosan introduced consultant Mark Alvarado who assisted in drafting the Unfunded Accrued Liability (UAL) Policy and with the Pension Obligation Bond (POB). They presented the City of Huntington Beach Unfunded Pension Liability Policy. Bulosan stated that the purpose of the UAL Policy is to provide guidance on the development and adoption of a funding plan for any UAL that is calculated annually by PERS, or for any unfunded liabilities remaining immediately after the issuance of a POB.

Bulosan reviewed the City's Fiscally Prudent Policy, noting the following objectives: maintain the City's sound financial position; ensure the City has the flexibility to respond to changes in future services priorities, revenue levels, and operating expenditures; to protect the City's creditworthiness; ensure that all pension decisions are structured to protect both current and future taxpayers, ratepayers, employees, and residents of the City; and ensure that the structure of the City's POB and future UAL amortization is consistent with the City's strategic goals, objectives, capital improvement program, budget, and/or debt policy.

Bulosan spoke regarding the advantages of a Funding Policy, such as providing the framework to ensure the proper management of future liabilities and to minimize the effects on operations. The adoption of a funding policy will ensure a disciplined decision making process, which will contribute to better predictability in funding. He noted that having a written summary of the funding policy that is accessible to employees and the public will help improve the transparency of funding decisions and increase the understanding of pension funding issues. He also said that the exercise of developing this funding policy improves the identification, understanding and management of the risk factors that affect the variability of funding requirements and the security of benefits to the employees and retirees.

Lo Grasso asked for assurance that future City Councils can see that we still have liabilities, and that we are not overfunded by issuing the POBs. Chi agreed and stated that we are trying to bring light to the fact that we should treat pension debt as real debt, and find out a way to manage the debt annually.

Bulosan noted that the Funding Policy Goals is to refinance 100% of the City's $443 million UAL debt through a POB at an estimated 3.4% interest rate, subject to change depending on the market. If the City issues the POB for less than 100%, the remaining UAL would be amortized over 24 years. Lo Grasso asked at what rate would we not issue the POB. Rief stated that the City Council Resolution set that rate cap at 5%. Chi stated that if interest rates are over 4%, we would re-evaluate. The POB proceeds would be deposited into PERS' general investment pool; and the goal is to fund PERS' Pension Plan to 100% to up 120% of total Pension Liability. Bulosan noted three funding options are: payment to PERS; set-aside funds in the Section 115 Trust; and Pension Rate Stabilization Reserve.

Sterud asked about the timing issue of paying our UAL. If PERS recalculates our UAL in June, is it possible to hold back until we find out what our future UAL would be and then pay PERS our new calculated UAL. Chi said that PERS usually does not publish its updated actuarials until September or October, so we would not know what the impact on our rates would be until then. The risk factor there would be what the market would look like a couple of months down the line. Alvarado said that the bond issue is structured where when the sale is completed, the proceeds go to the bank/trustee, and we do not have the flexibility to hold on to the money. Alvarado noted that the risk of waiting to issue the bonds would be interest rates going up.

Chi asked if in terms of timing, when paying PERS in advance, if we would receive credit for interest accrual for the whole year. Rief and Alvarado confirmed that that we would receive a 3% discount. Chi said that the pension literature and defined benefit plans are set up where even when you are 105% funded, you are not really super funded until you are 120% funded because PERS will not always meet their annual assumptions.

Bulosan suggested that when we are over 100% funded, we should have different funding options such as payment to PERS; Set-aside funds in the Section 115 Trust, or a Rate Stabilization Reserve. Funds in a Rate Stabilization Reserve would sit in the General Fund, allows for flexibility and is not subject to market downturn and would be considered an emergency fund.

Gledhill suggested that we pay down the POB earlier. Bulosan said that was a great idea, and we would incorporate that provision in our policy. Rief and Alvarado stated that we would have that option in ten years. Alvarado stated that our bond issue is a fixed 3.5% interest rate, if we have extra cash and new UAL at 7%, we would want to pay off the higher interest rate. Chi said that the money we would save in issuing POBs would only be used to pay down pension debt. He noted that we are proposing to structure the payments.

Bulosan reviewed New Unfunded Accrued Liability. He said that there is always a risk that we will accrue new UAL which can happen when there are changes in the following: actual assumptions and experience changes, such changes in the discount rate, changes in demographic experience; actuarial gains and losses due to asset returns being higher or lower than expected; plan benefits; and changes in the number of employees participating (Classic/PEPRA), and any employee pickup of plan contributions.

Bulosan said that with any new UAL, we want to have a thoughtful approach as to how we will pay it off. He reviewed the PERS Funding Schedule, noting that PERS' pay off schedule is amortized over 20 years. Bulosan presented the City's Funding Schedule, and recommend using the City's Schedule over PERS Funding Schedule to aggressively pay off any new UAL. On the City's Funding Schedule, any new Unfunded Accrued Liability under $10 million would be paid within 1-3 years, any UAL from $10 to $20 million would be paid within 4-6 years, any UAL from $20 to $30 million would be paid with 7-9 years, any UAL from $30 to $40 million would be paid within 10-12 years and any UAL from $40 to $50 million would be paid within 13-15 years, and any UAL over $50 million would be paid within 15 to 20 years.

Chi said that he would like to pay off our UAL debt all at once so that the City is 100% funded, but the challenge is when we do not have enough money in reserves to pay it back at once. Having the Funding Schedule provides us with options to pay off our debt quicker than what PERS suggests. Lo Grasso said that if the City comes up short $20 million next year, we make cuts. Sterud recommended creating a five year expiration date for the City's Funding Schedule, or 120% funded when the City has $200 million in reserve, whichever comes first. Chi said he is supportive of this fiscally conservative goal.

Bulosan discussed the POB Savings Allocations. Savings from the POBs refinance is estimated to be $5 million, of which 85% of savings would be used to offset future UAL – approximately $4.25 million. 15% of the savings would be used to fund capital improvement projects – approximately $680,000 (General Fund Portion only). The allocations would be reviewed each year during the budgetary process with City Council to ensure proper funding of the City's Pension Pan. The UAL savings allocation shall not be reduced if City's funding level is below 100%. Alvarado stated that there may be a time when the City will be below 100% funded, and it is up to the City to decide how quickly we want to act to get back to 100%.

Chi noted that the City Charter requires that 15% of the General Fund must be used for capital improvement projects. Sterud and Hudson recommended that the City segregate the savings from the General Fund. Gledhill suggested, and Bulosan agreed, to add language in the schedule regarding utilizing reserves to get the plan with PERS to 100%, and anything beyond that can be set aside in a Section 115 and Stabilization Reserve to give us a buffer and flexibility. Sterud asked what the Stabilization Reserve will be invested in. Chi said it would be in a 115 Trust or the City's general pool. Sterud supported a second 115 Trust. Chi noted that the question is how conservatively or aggressively we want to manage that fund. The City investment policy requires us to prioritize safety and liquidity, not yield. The Section 115 prioritizes yield. Chi said we could afford to be more risky and that is why staff suggested that some funds would go into the 115 Trust and some accrued in the City's general investment pool, which earns 1%.

Chi stated that in meeting with the Finance Commission, there are changes we need to consider: 1) In the funding timeline, stronger language that states that at a certain point, we will seek to be 100% funded and the funding schedule will expire when the reserve is built and once the reserve is built, it will go away; 2) 85/15 split updated so that 100% is set aside; and 3) how to invest the savings. Sterud recommended that any possible excess funds be allocated as 60% as reserves in the City's pool with the balance allocated as 40% to Section 115. Bulosan said that we would have to check to see if we could have two Section 115 trusts.

Chi said that more staff analysis is needed and we would bring back options on how to invest the savings and to write that into the policy. He recommended adding this to the agenda for the February 2020 Finance Commission meeting.

Bulosan discussed the consideration of future pension benefits, noting that even if the City's pension plans exceed 100%, the City will still make debt payments to POB and the City will not offer any enhanced pension benefits to City employees.

3. <u>Dark Fiber Study Session Presentation by City Manager's Office to City Council</u>

Lo Grasso recommended tabling this item until the next meeting in February.

<u>COMMISSIONER COMMENTS</u> – The Finance Commission thanked staff for their presentations.

<u>ADJOURNMENT</u> – There being no further business, the meeting adjourned at 8:15 p.m.

Submitted by:

Dahle Bulosan, Acting Chief Financial Officer

By: Linda Wine, Administrative Assistant, Finance Department
Thuy Vi, Administrative Assistant, Finance Department