



City Council Agenda Item

City Council Meeting Date: April 7, 2020

TO: Honorable Mayor and Members of the City Council

FROM: Jim Throop, City Manager
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SUBJECT: Council Discussion Regarding Long-Term Liabilities with California Public Employees Retirement System

Recommendation:

Staff recommends the City Council open discussions, but take no actions, on options related to Unfunded Accrued Liability (UAL) with CalPERS, and receive a presentation from the City's external financial advisors on different options related to the City's UAL with CalPERS.

Background:

During the last budget cycle, covering Fiscal Years 2019-21, the City Council decided to place a sales tax measure on the March 3, 2020, election ballot. The measure was designated a 'General Tax', thus only requiring a 50% +1 vote for approval. The ballot question stated:

Lompoc Preservation of City Services Measure

To maintain and improve public services, including neighborhood police patrols, firefighter staffing, gang unit enforcement, crime and vandalism prevention, street improvements, community and recreational needs, park upgrades, reduction of long-term liabilities (which include a potential savings of \$21 million in interest payments), and other general city services, shall the measure establishing an additional maximum 1% sales tax, ending in 15 years, and estimated to generate \$4.8 million annually, be adopted?

The election was held on March 3, 2020, and the measure was approved with 68% of the vote (subject to final certification of the vote count by the County).

If the ballot measure passed, then the City Council had requested that an agenda item be brought back the first meeting immediately following the election for discussion about the long-term liabilities.

Discussion:

The City has a long-term liability with CalPERS with the outstanding liability currently estimated to be \$93 million.

This liability issue began in 1998/1999 with the approval by then Governor Davis to allow State and Local governments to increase retirement benefits immediately with no prior payments from agencies or employees. This action created the unfunded liability and it grew larger during the historic recession in 2007-2009.

This situation became more dire when CalPERS changed different assumptions on their investment policy by reducing their forecasted 'return on investment', as well as changing actuarial charts, such as their "mortality rates", which determines how long an average retirement annuitant would live. The new mortality chart increased the time a person is expected to live, thus causing a larger unfunded liability.

After reviewing the most recent City budget, the City Council, via a unanimous decision, decided to place a sales tax measure on the ballot, to provide a new revenue stream for the City that could be used to reduce or eliminate the long-term liability.

Given that the annual payments to CalPERS would need to be made regardless of other necessary City expenses, the new sales tax funding could be used to backfill department budgets that would need to be reduced in order to make the required benefit payments.

The City Council must now decide on the best plan to reduce or eliminate the UAL liability. There are different options available and range from just paying the debt for the next 30 years at the payment schedule set by CalPERS, to do a 're-set' and choose a reduced length of time for payment (similar to moving from a 30-year mortgage to a 15-year mortgage), selling Pension Obligation Bonds, which typically are running at an interest cost of approximately 3% (versus CalPERS interest at 7%), creating a 115 Trust account that is used to help fund the payments, as well as other options.

During the last budget process, the City hired the firm NHA Advisors to review staff's projections during the budget cycle. NHA Advisors presented to the City Council their confirmation of staff's projections on the outstanding UAL and schedule of benefit payments. Both the City Council and the public appreciated the presentation to such a degree that staff has engaged the firm to present to the City Council different options, and analysis on the options, at the April 7th City Council meeting.

However, since the original request to bring forth this item to City Council, both the Federal and State governments have declared emergencies due to the pandemic COVID19 virus.

The pandemic has caused worldwide financial turmoil as many countries have implemented "Shelter in Place", or "Shelter at Home" restrictions. Those unprecedented restrictions have required the closure of many businesses, or created severe reductions

in many business sectors. As an example, airline business has been reduced by an estimated 90%, due to flying restrictions.

Those unprecedented actions will also have a large potential negative impact to the City's UAL with CalPERS. The full financial impact of the restrictions is not yet known given that the situation is continuing and there is no estimate on when the emergency restrictions will be removed.

CalPERS is having a conference call on April 8, 2020, to discuss with cities and agencies how the current financial downturn could impact future UAL payments. City staff will be on the call to hear what impacts may be coming to the City.

Fiscal Impact:

A current estimate on the possible increase for the City's UAL, given what is currently happening in the financial markets, could be as much as an additional \$35 million. This is an estimated 35% increase from the previous \$95 million UAL. However, this is just an estimate as much uncertainty remains in the financial markets since no one knows how long the current situation will continue.

The fiscal impact to the City also depends upon the choices made by the City Council to pay down the City's UAL. It is recommended to first receive a presentation from the financial advisors, who have worked with more than 40 cities on this topic, before making a final decision. At that time, a calculation of potential savings can be made on the option that the City Council decides upon.

City staff had discussed during the budget cycle some options and potential savings from paying down the UAL faster than the current payment plan. Unfortunately, there is now an unknown risk for moving forward with some of the different options.

It is important to note that with the present financial downturn, the current estimate is that all General Fund reserves will be depleted by June 30, 2020. General fund reserves are a critical part of a city's financial health, and discussion should be made on how to rebuild those reserves.

Conclusion:

It is recommended that the City Council table the discussion, or take no action, on the potential options related to the UAL until the meeting of April 21st, due to the fact that CalPERS will be holding a conference call on April 8th to discuss the current financial situation. On April 8th, CalPERS will potentially let cities know what the financial meltdown means to the different agencies, or at a minimum, how cities should prepare for future payment increases to CalPERS.

If the City Council decides to move forward with a discussion, then the financial advisors, given their experience helping many other cities with their UAL, should be able to offer

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options for the City Council to select from. They will also suggest the best path to follow given the current situation with the financial markets, the City's current financial health, and prospects of what CalPERS may do to future payment requirements for cities.

Respectfully submitted,

Jim Throop, City Manager