



City Council Agenda

City of Campbell, 70 N. First St., Campbell, California

NOTE: To protect our constituents, City officials, and City staff, the City requests all members of the public follow the guidance of the California Department of Health Services', and the County of Santa Clara Health Officer Order, to help control the spread of COVID-19. Additional information regarding COVID-19 is available on the City's website at www.campbellca.gov.

This City Council Special meeting will be conducted in person as well as telecommunication and is compliant with provisions of the Brown Act.

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Those members of the public wishing to provide public comment virtually are asked to register in advance at: <https://www.campbellca.gov/signup>. After registering, you will receive a confirmation email containing information about joining the meeting. Members of the public may attend the meeting in person at Campbell City Hall - Council Chambers.

Public comment will also be accepted via email at ClerksOffice@campbellca.gov prior to the start of the meeting. Written comments will be posted on the website and distributed to the Council. If you choose to email your comments, please indicate in the subject line "FOR PUBLIC COMMENT" and indicate the item number.

STUDY SESSION OF THE CAMPBELL CITY COUNCIL

Tuesday, November 21, 2023 – 6:00 p.m.

City Hall Council Chamber

70 N. First St., Campbell, California

CALL TO ORDER

PUBLIC COMMENT

NEW BUSINESS

1. **Understanding and Addressing Unfunded Pension Liabilities**
Recommended Action: That the City Council receive an update on unfunded pension liabilities

ADJOURN

IMPORTANT NOTICE: Materials related to an item on this agenda submitted to the City Council after distribution of the agenda packet are available for public inspection with the agenda packet in the lobby of City Clerk's Office, 70 N. First Street, Campbell, CA 95008, during normal business hours. These materials will also be available on the City website at <https://www.ci.campbell.ca.us/agendacenter> with the agenda packet following the last item of the agenda, subject to staff's ability to post the documents prior to the meeting. All documents not posted prior to the meeting will be posted the next business day.

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*City
Council
Report*

Item: 1
Category: NEW BUSINESS
Meeting Date: November 21, 2023

TITLE: Understanding and Addressing Unfunded Pension Liabilities

RECOMMENDED ACTION

That the City Council receive an update on unfunded pension liabilities

BACKGROUND

Like most public agencies within California, the City of Campbell contracts with the California Public Employees' Retirement System (CalPERS) for pension benefits on behalf of its employees. The amount that public agencies must pay CalPERS annually for these benefits is based upon actuarial valuations that factor in employees' salaries, pension pool investment returns, pension tier formulas, and actuarial assumptions relating to mortality, salary growth, and other factors. These valuations are also based on a number of estimates that can turn out to be true or not true; leading to overfunding or underfunding of pension plans. For most public agencies, underfunding of pension plans occurs, which result in the accrual of unfunded pension liabilities. This is true for the City of Campbell and as of the fiscal year ending June, 30 2022, the City had **\$79.59 million** in unfunded pension liabilities for its employees. In the course of a normal year, a portion of these unfunded pension liabilities along with a continual accrual of pension costs for current employees is paid down on a scheduled basis to CalPERS with interest; similar to the pay down of a mortgage. However, unfunded pension liabilities can also increase beyond the scheduled payments based on a number of factors outside the City's control such as pension pool investment returns falling short of expectations or changes in actuarial assumptions. Thus, in order to get ahead of these costs, the following Workplan item was assigned to the Finance Department in FY 2024:

Develop strategies to systematically address Unfunded Pension Liabilities in the short- and long-term [Council Priority – Financial Stability]

To achieve this Workplan objective, the City has partnered with GovInvest, a California based consulting firm that has created pension management software and through its team of experienced actuarial professionals and seasoned public agency experts, assists public agencies in developing strategies to address unfunded pension liabilities. For reference, the City paid **\$8.1 million** for CalPERS pension premiums in FY 2022-23 and is expected to pay **\$8.6 million** in FY 2023-24 and **\$9.3 million** in FY 2024-25. For FY 2023-24; these payments represent **12.45%** of the City's General Fund budget and limit the City's financial flexibility in addressing other operational or capital objectives.

DISCUSSION

Given the high level of ongoing annual pension payments to CalPERS, which are likely to increase for the next several fiscal years, as well as large unfunded pension liabilities, which may grow due to factors outside the City's control, the City is faced with a significant problem that would be beneficial to fully understand and then take actions to properly address. As such, the purpose of the November 21, 2023 Study Session with City Council is to:

- Provide background information on what drives pension costs and options in which public agencies have to manage unfunded pension liabilities; and
- Understand potential goals, policies, funding sources, and pension management tools to develop and utilize in addressing unfunded pension liabilities
- Discuss a plan for future meetings with City Council in which policy and other direction will be provided to staff

Staff anticipates that this will be the first of several meetings with City Council on the topic of unfunded pension liabilities and follow up meetings with Council will more fully develop and select detailed goals, policies, funding sources, and pension management tool to incorporate into the FY 2025 budget and beyond. The GovInvest team will partner with City staff in making a presentation at the November 21 Study Session; with both being available to answer questions.

So as to start the discussion and provide areas for Council to consider between the November 21 Study Session and the next meeting (TBD), staff has developed the following questions:

- **What pension funding goals are most important to the Council?**
- **What pension management tools are Council most comfortable utilizing?**
- **What potential funding sources would Council like to explore?**

Staff does not expect Council to provide answers to these questions at the November 21, Study Session, but will schedule a follow up discussion with Council in January or February 2024 and near the beginning of the FY 2025 budget development process to receive guidance. There may also be several other discussions after this.

In regard to pension funding goals, there are several for Council to consider which will assist staff in developing appropriate funding policies, funding sources, and pension management tools. These potential goals to be discussed at the November 21 Study Session include the following. Council may wish to address one or more of these goals in the future as it looks to address unfunded pension liabilities:

- **Preservation of Liquidity & Budget Flexibility** – having enough reserves and resources to provide continuity of services to the community
- **Being Financially Strategic** – maximizing interest savings on unfunded pension liability payments made to CalPERS annually
- **Ensuring Good Governance** – having regular review of unfunded pension liabilities and transparent disclosure of information
- **Solvency** – maximizing the reduction of pension payments to CalPERS

In regard to pension management tools, there are several which Council may wish to consider and which will be discussed in greater detail at the November 21 Study Session. Council may wish to utilize one of more of these tools as it looks to address unfunded pension liabilities:

- **Additional Discretionary Payments to CalPERS**
- **Full or Partial Restructuring of Unfunded Actuarial Liability (UAL) Payment Schedule with CalPERS**
- **Expanding Upon the City's Current Pension Reserve**
- **Establishing a Section 115 Pension Trust to Earn Investment Returns Outside of CalPERS Pooled Funds**
- **Establishing Other Pension Funding and Reserve Policies**

And lastly, in regard to funding sources, the City's current financial resources to address unfunded pension liabilities are currently very limited, with most of the City's resources already programmed towards ongoing operational expenses and one-time capital projects. Nevertheless, the City Council previously established a Pension Reserve within the General Fund at a level of **\$2.2 million**. While this was a good initial step to address unfunded pension liabilities, policies regarding the acceptable usage of the Pension Reserve have not been developed as of yet nor has there been funding sources established for ongoing buildup and replenishment of the Pension Reserve. The following funding sources are potential ways to address unfunded pension liabilities that Council may wish to consider in the future. Some of these options may also be ways to fund ongoing operational expenses and/or one-time capital projects:

- **Additional Employee Contributions towards Pension Expenses/Liabilities**
- **Reducing Operating and/or Capital Expenditures**
- **Placing Tax Measures on the Ballot**

- **Restructuring Other Existing City Reserves such as the Pension Reserve or Emergency Reserve**

As it relates to the last option, the City again has a \$2.2 million Pension Reserve under its General Fund. But it also has a \$1.0 million Operating Reserve for cash flow purposes, a \$3.2 million Emergency Reserve that is set by Council Policy at 10% of revenues, and a \$10.0 million Economic Fluctuations Reserve that is set by Council Policy at 16.67% of expenditures. Since some of these reserves may be duplicative in purpose and since best financial practice is to establish a General Fund Reserve of at least 16.67% of expenditures, Council may wish to consider shifting some existing reserves towards the pension reserve or other purposes such as infrastructure maintenance and repair. Having adequate reserves is always fiscally responsible and ensures that the City is able to meet its long-term financial obligations, but reserves should be set at levels which are not too high or too low. Setting reserves too low diminishes the City's ability to meet its long-term financial obligations, but setting reserves too high decreases the City's ability to respond to current operational and capital needs.

FISCAL IMPACT

There is no fiscal impact associated with the November 21 Study Session. However, based upon Council direction received at future meetings, policies could be developed which have fiscal impact on future budgets; starting with FY 2025. Staff will return to Council with added detail on fiscal impacts once appropriate funding policies, funding sources, and pension management tools have been more fully developed. It is anticipated that these follow up discussions will occur in tandem with the FY 2025 budget development process.

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