



CITY COUNCIL STAFF REPORT



May 28, 2024

ITEM TITLE

Reserve Policy: Consolidate Various Council Policies into a Citywide Reserve Policy and Repeal Various City Council Policies Related to Reserves

Report Number: 24-0089

Location: No specific geographic location

Department: Finance

G.C. § 84308: No

Environmental Notice: The activity is not a “Project” as defined under Section 15378 of the California Environmental Quality Act State Guidelines. Therefore, pursuant to State Guidelines Section 15060(c)(3) no environmental review is required.

Recommended Action

Adopt a resolution repealing various City Council Policies related to reserves, amending City Council Policy 220-03 to serve as a consolidated citywide reserve policy, and renaming City Council Policy 220-03 to Citywide Reserve Policy – Fiscal Health Plan.

SUMMARY

The City currently has several policies that set reserve levels in various funds, City staff recommends consolidation of the various reserve policies into a single Citywide Reserve Policy. In addition, City staff has explored potential revisions to the City’s existing Pension & OPEB (Other Post-Employment Benefits) Reserve Fund Policy to support several objectives, including: (1) long-term management of the City’s ongoing pension liabilities; (2) effective allocation of budgeted surplus savings; (3) adequate funding of various reserves and (4) mitigation of future pension and OPEB cost increases. City staff recommends consideration of these policy adjustments and related analysis.

ENVIRONMENTAL REVIEW

The Director of Development Services has reviewed the proposed activity for compliance with the California Environmental Quality Act (CEQA) and has determined that the activity is not a “Project” as defined under Section 15378 of the State CEQA Guidelines because the proposed activity consists of a governmental

fiscal/administrative activity which does not result in a physical change in the environment. Therefore, pursuant to Section 15060(c)(3) of the State CEQA Guidelines, the activity is not subject to CEQA.

BOARD/COMMISSION/COMMITTEE RECOMMENDATION

Not Applicable

DISCUSSION

The City currently has several policies that address reserves in various funds. City staff would like to consolidate the various reserve policies into a single policy. This will standardize the existing policies, streamline review and future updates to the policy.

Citywide Reserve Policy updates:

Establish a Citywide Reserve Policy to consolidate existing separate policies into a single, standalone policy through the following actions:

- Rename: 220-03 General Fund Reserves – Fiscal Health Plan to Citywide Reserve Policy– Fiscal Health Plan
- Combine the following existing policies into the new Citywide Reserve Policy:
 - 220-04 Sewer Service Revenue Fund Reserve Policy
 - 220-09 Pension & OPEB Reserve Fund
 - 220-10 Measure A Reserve Fund Policy
 - 220-11 Ambulance Transport System Enterprise Fund Reserve Policy
- Repeal the existing reserve policies that have been consolidated into the new Citywide Reserve Policy:
 - 220-04 Sewer Service Revenue Fund Reserve Policy
 - 220-09 Pension & OPEB Reserve Fund
 - 220-10 Measure A Reserve Fund Policy
 - 220-11 Ambulance Transport System Enterprise Fund Reserve Policy

Proposed General Fund Reserve Policy Updates

In November 2020, the City Council amended Council Policy 220-03 General Fund Reserves – Fiscal Health Plan, with the adoption of Pension & OPEB Reserve Fund Policy No. 220-09. Staff has reviewed the current policy and is recommending two changes.

Modify Catastrophic Event Reserve: Establish a minimum reserve level of 3% as compared to a recommended reserve level of 3%.

Modify Calculation of General Fund Reserve Level: Replace the following year’s Adopted Budget with the prior year’s Adopted Budget as the basis for calculation of General Fund Reserve level. This change will allow the City to calculate and include the contribution necessary to maintain minimum reserve levels in the annual operating budget, ensuring the General Fund reserve levels are maintained once the minimum levels are achieved.

Proposed Pension & OPEB Reserve Fund Policy Updates

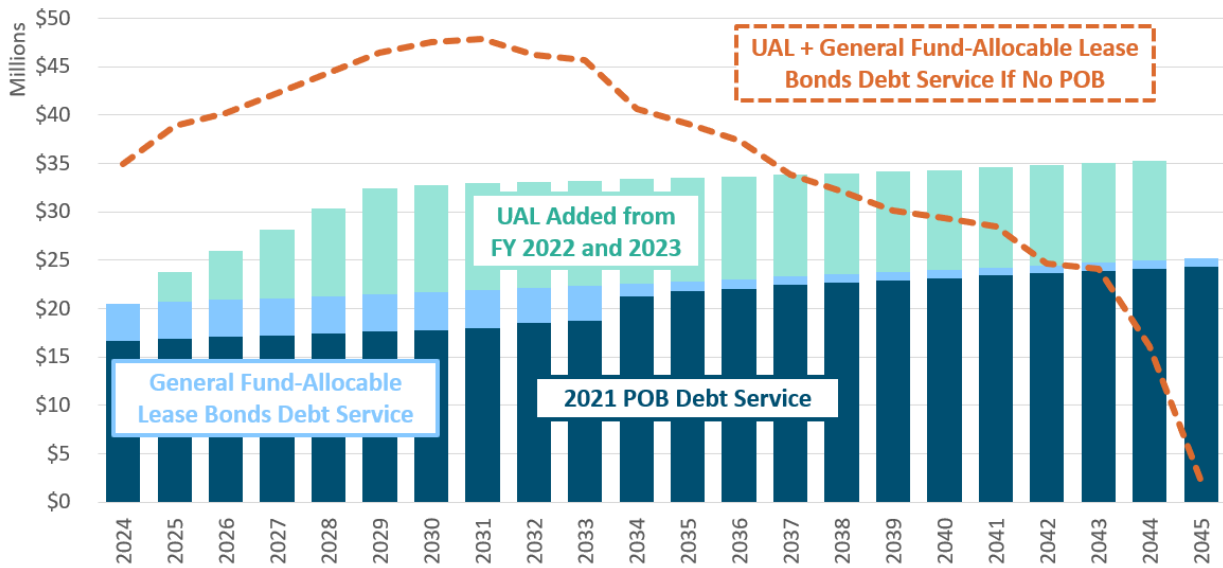
The City entered into an agreement with NHA Advisors LLC (NHA), who served as the City's Financial Advisor for the issuance of the 2021 pension obligation bonds (POB), to evaluate the City's pension related policies and other fiscal considerations. As a result of NHA's analysis and consultation, staff is recommending several updates to the Pension & OPEB Reserve Policy that are expected to result in financial savings, thereby reducing ongoing operating costs of the City.

In November 2020, the City adopted a Pension & OPEB Reserve Fund Policy, prior to the issuance of \$350 million of POBs in February 2021. The policy established guidelines for managing the City's Section 115 Trust, POB Bond Call, Other Post-Employment Benefits (OPEB) reserves, including those related to the allocation of portions of future savings from a POB issuance. These guidelines were intended to facilitate the management and mitigation of future pension cost increases.

As a result of the 2021 POB low interest rates of 2.54%, the City programmed significant annual savings from the bond issue toward numerous reserves, in alignment with the policies. However, as CalPERS investment returns have seen volatility in recent years, the City is currently managing a new \$85 million unfunded accrued liability (UAL) as of the most recent CalPERS valuation estimates for June 30, 2022. This was the result of a negative 7.5% CalPERS investment return in fiscal year 2021-22. The City's UAL is projected to increase further to approximately \$100 million based on the fiscal year 2022-23 6.1% CalPERS investment returns.

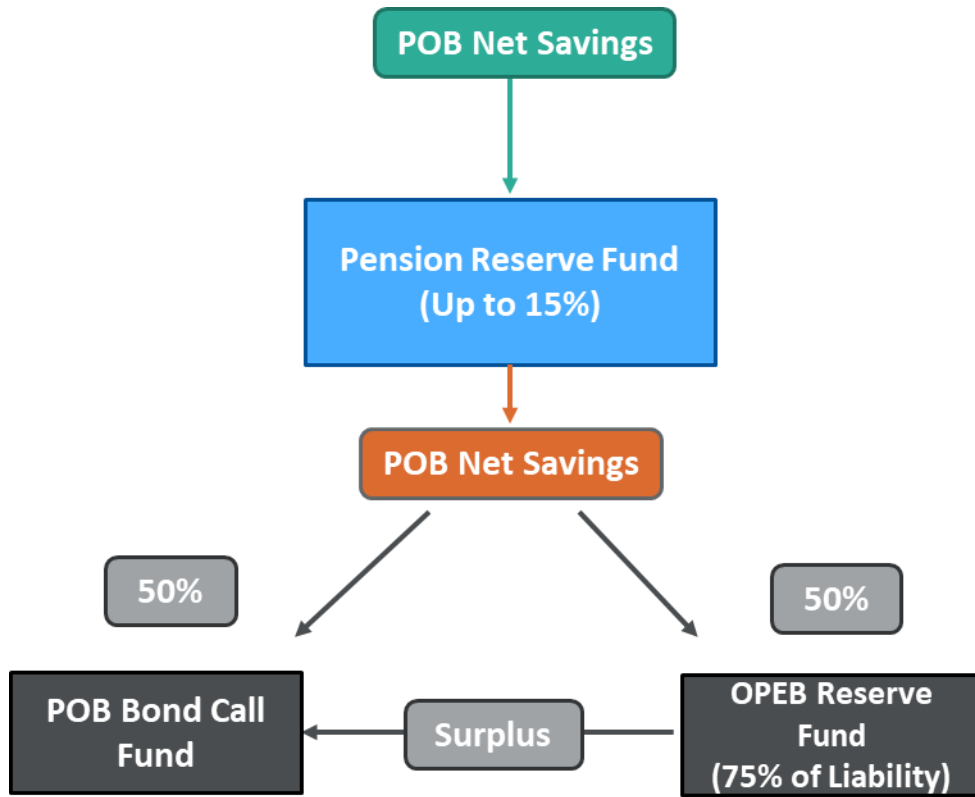
The UAL represents the shortfall/gap between what is needed to pay retiree benefits versus the value of current assets the City maintains with CalPERS. Annual payments made to CalPERS to amortize the UAL are forecast to increase rapidly over the next 5 years: from \$3.1 million in fiscal year 2024-25 to \$11.4 million in fiscal year 2028-29. The approximate \$100 million UAL is not required to be repaid all at once but is amortized over a period (about 20 years, currently) at an interest rate of 6.8%. Pension cost increases are the largest financial challenge facing most cities throughout California and are primarily due to factors outside of the cities' control, namely assumption changes made by CalPERS and below average investment returns.

In addition to the UAL, the City also pays debt service on the 2021 POB. While the City still projects significant financial benefit from issuing the 2021 POB, the City will need to prepare to manage the annual payments associated with new UAL balances moving forward. The chart below provides a current snapshot of the City's projected UAL, POB and General Fund-allocable debt payments in relation to estimated total UAL & General Fund debt payments had the City not issued the POB (depicted in the orange, dotted line).



The City's current Pension & OPEB Reserve Fund policy establishes funding mechanisms and priority of flows of funds for multiple distinct reserve accounts, as shown in the graphic below.

Current Pension & OPEB Reserve Fund Policy: Funding Mechanism for POB Net Savings

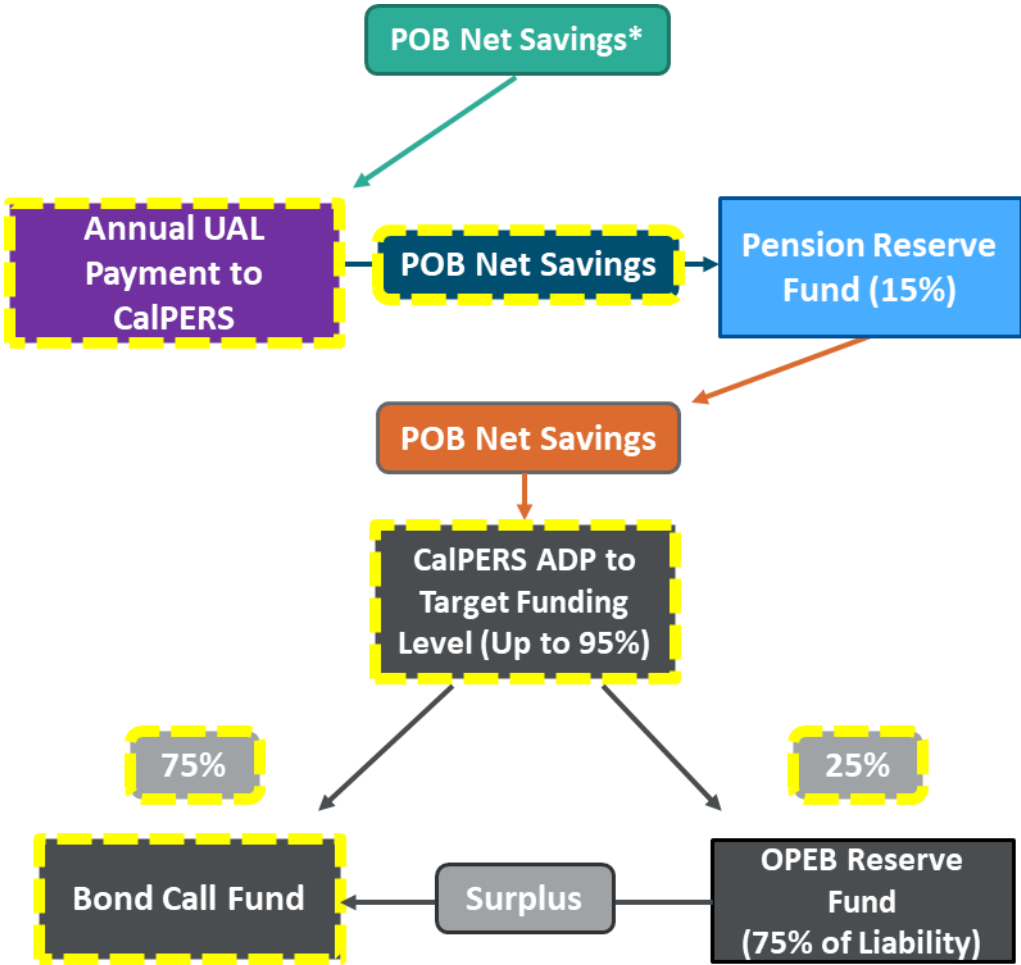


*POB Net Savings is defined as 75% of the net annual savings generated by the issuance of the POBs.

Chula Vista's Proposed Pension & OPEB Reserve Fund Policy Adjustments:

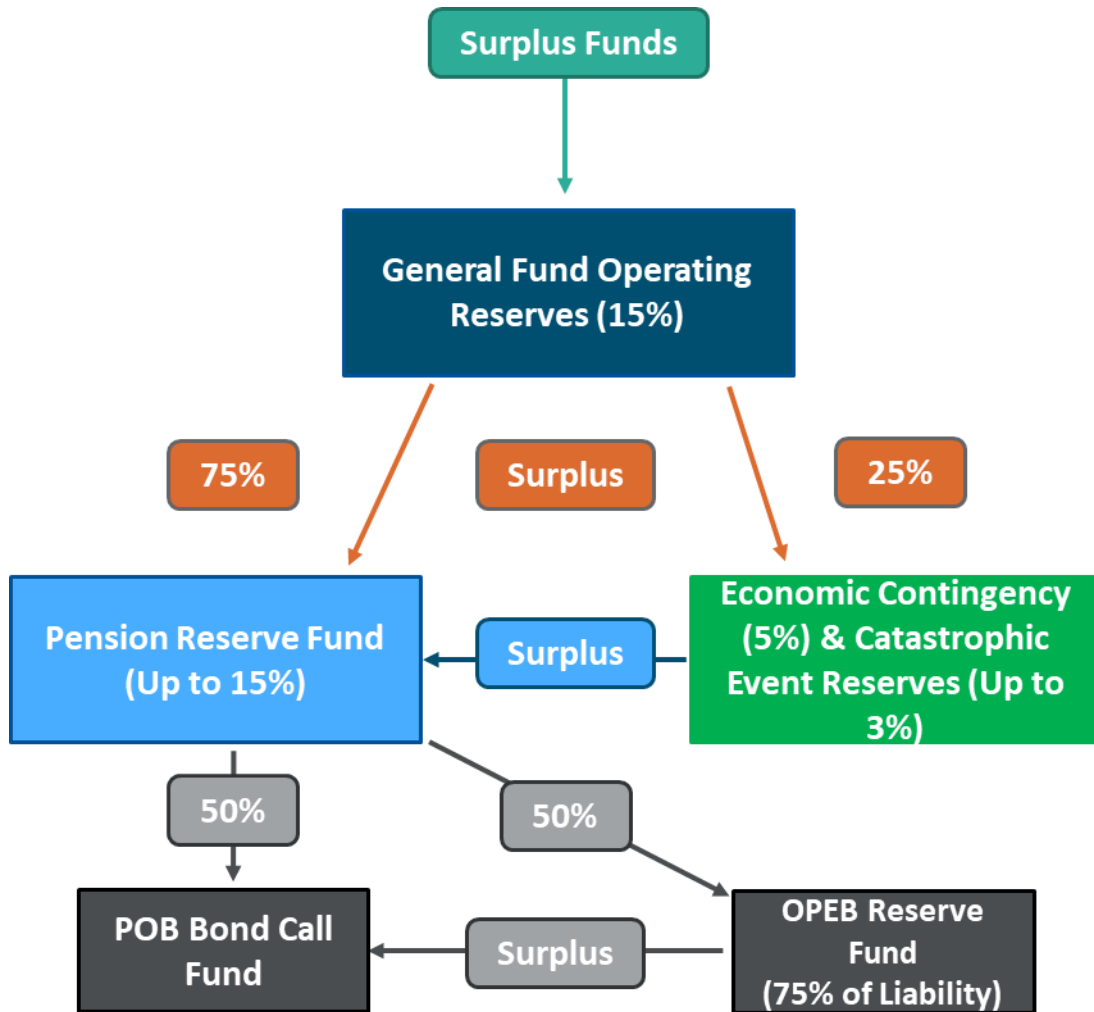
- **Modify Pension Reserve Fund Calculation:** Utilize the same calculation methodology for the Pension Reserve Fund that is used for the General Fund Operating Reserve (15% of the General Fund's Operating Expenditures).
- **Authorized Use of Pension Reserve Fund, Bond Call Fund, and OPEB Reserves:** Reserve usage will require approval of four/fifths (4/5) vote of the City Council.
- **Update funding allocation of POB Net Savings as follows:**
 - ▶ **Annual UAL Payment to CalPERS:** First allocate POB Net Savings to the City's annual UAL payment to CalPERS to minimize the fiscal impact of the annual increases in pension costs.
 - ▶ **Maintain Pension Reserve Fund Level:** Remaining POB Net Savings will be used to maintain the minimum reserve level of the Pension Reserve Fund.
 - ▶ **Implement Annual Additional Discretionary Payments (ADPs) to CalPERS from POB Net Savings:** After fully funding the Pension Reserve Fund, the City should consider utilizing remaining POB Net Savings to make ADPs to CalPERS to reduce the UAL balance. This has the benefits of 1) mitigating the projected annual increase in UAL payments, 2) achieving greater cash flow savings than redeeming a portion of the 2021 POB, and 3) increasing the City's pension plans' funded ratios to target levels (i.e., up to 95%). Additional POB Net Savings would flow through to the Bond Call Fund as currently structured.
 - ▶ **Expand Scope of Bond Call Fund:** Given the low interest rates achieved by the 2021 POB, it is not necessarily the City's most economical debt to refinance or pay down. Expanding the scope of the reserve to encompass higher interest rate City/General-Fund debt, and other General Fund debt may allow the City to 1) increase financial benefit from intended interest cost savings, and 2) pay down outstanding debt sooner than allowable for the 2021 POB (i.e., 2031 par call).
 - ▶ **Allocate 75% of all remaining POB Net Savings funds to Bond Call Fund:** Deposit remaining POB Net Savings earnings after funding ADP to CalPERS to the Bond Call Fund.
 - ▶ **Allocate 25% of all remaining POB Net Savings funds to OPEB Reserve Fund:** Deposit remaining POB Net Savings earnings after funding ADP to CalPERS to the OPEB Reserve Fund. Once 75% funding of outstanding OPEB liability is achieved, all remaining Net Annual Savings funds will be deposited into the Bond Call Fund.

Proposed Pension & OPEB Reserve Fund Policy: Funding Mechanism for POB Net Savings.



**POB Net Savings is defined as 75% of the net annual savings generated by the issuance of the POBs.*

Current Pension & OPEB Reserve Fund Policy: Funding Mechanism for Surplus Funds



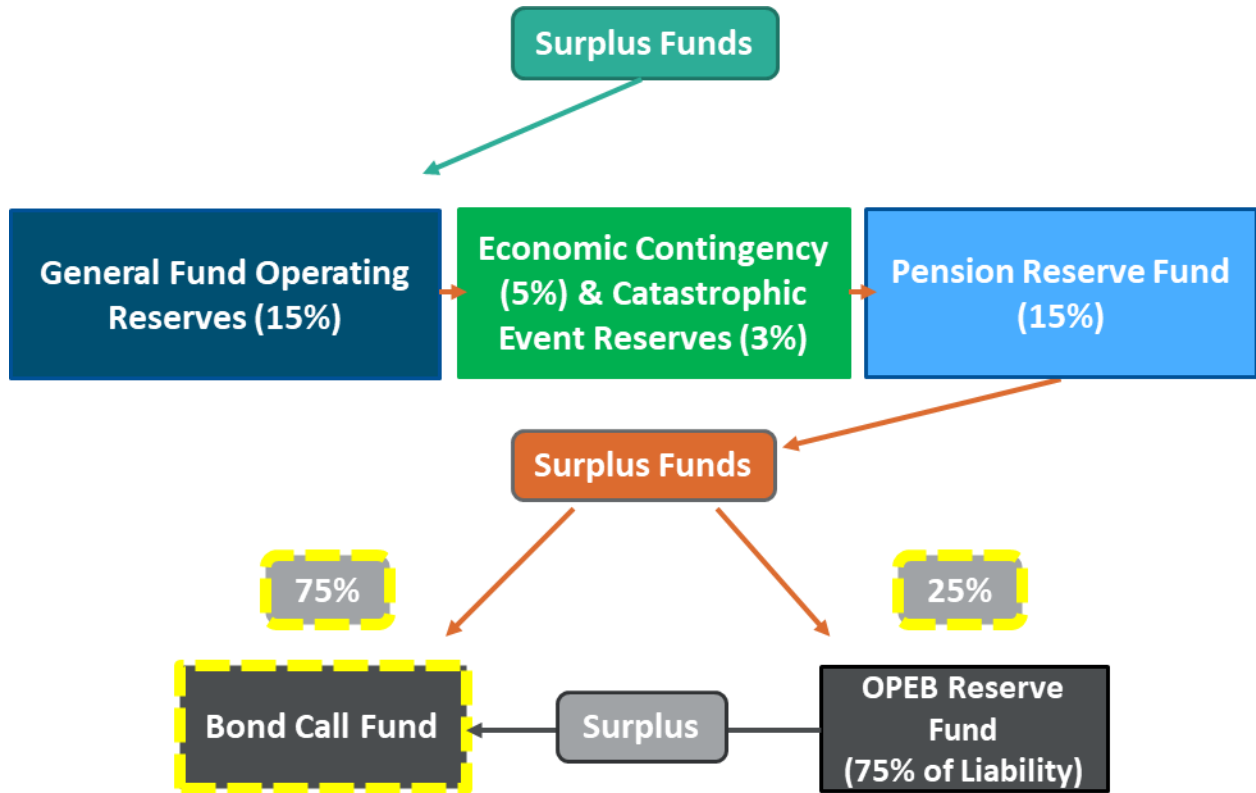
• **Update funding allocation of year-end Surplus Funds as follows:**

- ▶ **Maintain Reserve levels:** Surplus Funds will first be used to maintain the minimum reserve levels of the General Fund Reserves and Pension Reserve fund.
- ▶ **Expand Scope of Bond Call Fund:** Given the low interest rates achieved by the 2021 POB, it is not necessarily the City’s most economical debt to refinance or pay down. Expanding the scope of the reserve to encompass higher interest rate City/General-Fund debt, and other General Fund debt may allow the City to 1) increase financial benefit from intended interest cost savings, and 2) pay down outstanding debt sooner than allowable for the 2021 POB (i.e., 2031 par call).
- ▶ **Allocate 75% of all remaining Surplus Funds to Bond Call Fund:** Deposit remaining Surplus Funds earnings after funding minimum General Fund Reserves and Pension Reserve Fund to the Bond Call Fund.
- ▶ **Allocate 25% of all remaining Surplus Funds to OPEB Reserve Fund:** Deposit remaining Surplus Funds earnings after funding minimum General Fund Reserves and Pension Reserve

Fund to the OPEB Reserve Fund. Once 75% funding of outstanding OPEB liability is achieved, all remaining Surplus Funds will be deposited into the Bond Call Fund.

- ▶ **Remaining Surplus:** Remaining Surplus funds will be split 75% to the Bond Call Fund and 25% to the OPEB Reserve Fund, if both are fully funded then any surplus will be added to the General Fund Operating Reserve.

Updated Pension & OPEB Reserve Fund Policy: Funding Mechanism for Surplus Funds



Preliminary Analysis

Two funding scenarios have been prepared to illustrate the potential savings associated with the proposed reserve policy change. The first scenario reflects the status quo policy implementation and is estimated to result in savings of just under \$12 million. The second scenario reflects the implementation of ADPs to reach a funded ratio target of 95% for each plan, resulting in estimated savings of just under \$33 million, an increase in savings of more than \$21 million. Potential net savings for each scenario are summarized below.

Net Savings Comparison			
Scenario #:	#1 Status Quo	#2 Proposed	Difference
Gross Savings:	\$41,574,933	\$80,404,818	\$38,829,885
Funds Used:	(\$29,781,632)	(\$47,464,284)	(\$17,682,652)
Net Savings:	\$11,793,301	\$32,940,534	\$21,147,233

DECISION-MAKER CONFLICT

Staff has reviewed the decision contemplated by this action and has determined that it is not site-specific and consequently, the real property holdings of the City Council members do not create a disqualifying real property-related financial conflict of interest under the Political Reform Act (Cal. Gov't Code § 87100, et seq.).

Staff is not independently aware and has not been informed by any City Council member, of any other fact that may constitute a basis for a decision-maker conflict of interest in this matter.

CURRENT-YEAR FISCAL IMPACT

Implementation of the proposed policy will allow the City to fully fund and maintain adequate General Fund reserves.

ONGOING FISCAL IMPACT

Implementation of the proposed policy as outlined in Scenario #2 may reduce scheduled UAL payments beginning in fiscal year 2025-26, should any ADPs be made to CalPERS in July 2024 or future years. Any additional funds in the Bond Call Fund may be used to reduce future debt obligations thereby reducing ongoing operational expenses of the General Fund.

ATTACHMENTS

1. Redline version of Council Policy

*Staff Contact: Sarah Schoen, Director of Finance/Treasurer
Adrian Del Rio, Assistant Director of Finance.*