Written materials relating to an item on this agenda that are distributed to the legislative bodies within 72 hours before the item is to be considered at its regularly scheduled meeting will be made available for public inspection at the City Clerk's Office, 300 West Third Street 4th Floor during customary business hours. Agenda reports are also on the City of Oxnard web site at www.oxnard.org.

CITY OF OXNARD CALIFORNIA

AGENDA
OXNARD CITY COUNCIL
FINANCE AND GOVERNANCE COMMITTEE

Council Chambers, 305 West Third Street

May 14, 2019

Regular Meeting - 9:30 to 10:45 AM

A. ROLL CALL/POSTING OF AGENDA

B. PUBLIC COMMENTS ON ITEMS NOT ON THE AGENDA

At this time, the legislative body will consider public comments for a maximum of fifteen minutes. A person may address the legislative body only on matters not appearing on the agenda and within the subject matter jurisdiction of the legislative body. Speaker cards will not be accepted after the beginning of the general public comment period. Based on the number of speaker cards submitted, the presiding officer may impose time limits per speaker. Typically, speakers are limited to two minutes, but shorter time may be established as deemed necessary. A person not able to address the legislative body at this time because the fifteen minutes expires may do so just prior to adjournment of the meeting. The legislative body cannot enter into a detailed discussion or take action on any items presented during public comments at this time. Such items may only be referred to the City Manager for administrative action or scheduled on a subsequent agenda for discussion.

C. CONSENT AGENDA

1. City Clerk Department

   SUBJECT: Approval of Minutes.

   RECOMMENDATION: That the Finance and Governance Committee approve the minutes of the April 23, 2019 regular meeting as presented.

   Contact: Michelle Ascencion, (805) 385-7805

D. REPORTS

In compliance with the Americans with Disabilities Act, if you require special assistance to participate in a meeting, please contact the City Clerk's Office at 385-7803. Notice at least 72 hours prior to the meeting will enable the City to reasonably arrange for your accessibility to the meeting.

Agenda Item time estimates: (Staff Presentation / Committee Discussion / Public Comment)

1. Finance Department

   SUBJECT: Update on Potential Strategies to Address Rising Pension Costs. (20/10/5)

   RECOMMENDATION: That the Finance and Governance Committee:
   1. Receive a presentation from the City's municipal advisor on the current status and projections for the CalPERS pension program, and a discussion regarding various strategies to address rising pension costs;
   2. Provide feedback to staff and the municipal advisor as to whether more due diligence should be completed on the pension bond option; and
   3. If "yes" on #2 above, direct staff to return to the Committee with more information in the Summer or Fall of 2019. If "no" on #2 above, proceed to the full City Council with this presentation and accompanying Committee recommendation.

   Contact: Kevin Riper, (805) 385-7475

E. ITEMS FOR FUTURE AGENDAS

F. ADJOURNMENT

M I N U T E S
OXNARD CITY COUNCIL
FINANCE AND GOVERNANCE COMMITTEE
Regular Meeting
April 23, 2019

A. ROLL CALL / POSTING OF AGENDA

At 9:32 a.m., Chair Flynn called to order the regular meeting of the Oxnard City Council Finance and Governance Committee in the City Hall Council Chambers, 305 W. Third Street, Oxnard, California. The City Clerk called the roll and announced the posting of the agenda. Members Gabriela Basua, Bert Perello, and Chair Tim Flynn were present.

Staff members present were Shiri Klima, Deputy City Manager; Stephen Fischer, City Attorney; Alexander Nguyen, City Manager; Kevin Riper, Chief Financial Officer; Donna Ventura, Assistant Chief Financial Officer; and Michelle Ascencion, City Clerk.

B. PUBLIC COMMENTS ON ITEMS NOT ON THE AGENDA

Public comments were received from Ray Blattel (budget balancing, outsourcing).

C. CONSENT AGENDA

City Clerk Department

1. SUBJECT: Approval of Minutes.
   RECOMMENDATION: That the Finance and Governance Committee approve the minutes of the April 9, 2019 Regular Meeting as presented.

It was moved by Member Basua, seconded by Member Perello, to approve the minutes as presented. VOTE: Basua, Flynn, and Perello voted in favor; the motion carried 3-0.

D. REPORTS

Finance Department

1. SUBJECT: Status Update of Internal Audit Projects Memo.
   RECOMMENDATION: That the Finance and Governance Committee receive an update from the Internal Auditors on the status of the current projects in progress related to the Internal Audit Department and authorize the Internal Auditors to present the item to the City Council.

Henry Oum of Price Paige & Company gave a report. Public comments were received from Jim Lavery. Discussion ensued among the Committee, staff, and Mr. Oum. No action was required.

2. SUBJECT: Internal Audit Department Protocol For Investigation of City Management Personnel.
   RECOMMENDATION: That the Finance and Governance Committee receive an update

from the Internal Auditors on the appropriate protocol for investigating members of the City of Oxnard's management and authorize the Internal Auditors to present the item to the City Council.

Mr. Oum gave a report. Public comments were received from Alicia Percell. Discussion ensued among the Committee and staff. No action was taken.

3. SUBJECT: Presentation on Corrective Action Plan.
   RECOMMENDATION: That the Finance and Governance Committee receives an update on the Corrective Action Plan (CAP) and gives authorization for staff to present the item to the City Council.

Eden Casareno of Eadie & Payne LLP and the Assistant Chief Financial Officer gave reports. Public comments were received from Alicia Percell, Phil Molina, and Jim Lavery. Discussion ensued among the Committee and staff. No action was taken.

E. ITEMS FOR FUTURE AGENDAS (No requests were made.)

F. ADJOURNMENT

There being no further business on the agenda, and without objection, Chair Flynn adjourned the meeting at 11:04 a.m.

MICHELLE ASCENCION, CMC City Clerk	TIM FLYNN Chair

CITY OF OXNARD CALIFORNIA

FINANCE AND GOVERNENCE COMMITTEE
AGENDA REPORT

REPORTS
AGENDA ITEM NO. D.1.

DATE: May 14, 2019

TO: Finance & Governance Committee

FROM: Kevin Riper, Chief Financial Officer, (805) 385-7475, kevin.riper@oxnard.org

SUBJECT: Update on Potential Strategies to Address Rising Pension Costs. (20/10/5)

RECOMMENDATION

That the Finance and Governance Committee:
1. Receive a presentation from the City's municipal advisor on the current status and projections for the CalPERS pension program, and a discussion regarding various strategies to address rising pension costs;
2. Provide feedback to staff and the municipal advisor as to whether more due diligence should be completed on the pension bond option; and
3. If "yes" on #2 above, direct staff to return to the Committee with more information in the Summer or Fall of 2019. If "no" on #2 above, proceed to the full City Council with this presentation and accompanying Committee recommendation.

BACKGROUND

NHA Advisors, LLC ("NHA"), the City's municipal advisor, will be making a presentation (attached) regarding the City's historical pension costs, recent assumption changes and projections for the CalPERS program. This review is not intended to be an actuarial study, typically completed by the City's actuary, but a high-level overview of the City's pension cost projections. NHA Advisors made a similar presentation to the Fiscal Policy Task Force in February 2018, to City Council in March 2018, and to the Finance & Governance Committee (the "Committee") in February of 2019. After the last meeting, the Committee directed staff and NHA to evaluate in more detail the various cost management strategies that were introduced, which are included in this report and the attached presentation.

Rising pension costs are a widespread issue facing all municipalities nationally, with unfunded accrued liabilities (UAL) having grown nearly 50 percent in the last few years. For many cities, annual payments may double over the next decade. The City's UAL has grown from $181 million in June 2014 to a projected $270 million in June 2019. Relative to the City's other post-employment benefits (OPEB) liability ($36 million) and its outstanding General Fund-backed bonds ($86 million), the CalPERS UAL is the City's largest liability.

Based on the CalPERS 11.2 percent investment return in FY 2016-17, the City's UAL was reduced to $270 million for the June 2019 estimates. Next year's annual valuation report (to be released by CalPERS in Fall of 2019) will include the 8.6 percent investment returns for FY 2017-18, which should reduce the UAL. However, it is also the last year of discount rate phasing (from 7.25 percent to 7.00 percent), which will increase the City's UAL. It is expected that the net effect of these two impacts will be an increase to the City's

UAL.

Annual CalPERS pension costs have continued to climb and are projected to continue. Contributions totaled approximately $20 million in FY 2013-14, $31 million for FY 2018-19 and are estimated to grow to $45 million by FY 2024-25. Relative to FY 2018-19 levels, the City's cumulative amount of pension cost increases over the next decade are estimated at $115 million.

While these cost increases are significant and need to be addressed strategically, the City is in a favorable position relative to most other California cities. The City's voter-approved Property Tax Override (which currently covers about 72% of the Safety Fire and Safety Police Plan costs), is projected to generate about $15 million in revenue for FY 2019-20 to be used for eligible costs, which otherwise would be covered by the General Fund. The City is one of only 24 cities in the State that collects a property tax override for pension costs.

While the Property Tax Override significantly reduces the burden of pension costs on the City's General Fund, the total contribution to CalPERS is expected to grow as contributions are likely to increase at a faster pace than that of the Property Tax Override (limited at the maximum tax rate, $.076637 per $100 of assessed valuation). Thus, the General Fund will be required to fund an increasing share of these costs moving forward.

OTHER PENSION/OPEB LIABILITIES - PARS AND OPEB

Based on the review of the City's CAFR, the City also has a $36 million OPEB UAL with CalPERS and a $21 million net pension liability with Public Agency Retirement System (PARS). Based on the City's CAFR, annual OPEB expenses were about $2.8 million last year, and the City's contribution to the PARS plan was about $4.5 million.

It should be noted that the attached presentation and the projections found within are solely focused on City's CalPERS pension plans and do not include estimates for these OPEB and PARS plans.

STRATEGIES TO ADDRESS RISING COSTS

Understanding the pension cost increases, and specifically the increasing burden to the City's General Fund, are critical pieces to the City's financial forecasting efforts and budget. There are also various strategies that other cities have employed to assist in addressing rising pension costs and developing alternative repayment strategies. Details on these strategies are discussed in the attached presentation, with a brief summary of each provided below:

(1) New UAL Amortization Schedules with CalPERS – there are two options for requesting a new amortization period with CalPERS: A Fresh Start option which shortens the repayment period, and a Financial Necessity option that extends the repayment period.

(a) Fresh Start Option – The City can request a new amortization schedule with CalPERS, but it must amortize the liability over a shorter period than the current amortization schedule. Less interest would be paid over time under the new schedule; however, annual payments in the near-term would likely be higher. Additionally, once the City requests this fresh start, the new payments would be locked in and would not be able to be re-modified.

(b) Financial Necessity Option – While no other agency has implemented this option, CalPERS does offer the opportunity to apply for a "Financial Necessity" option, which could extend the UAL repayment period up to either 25 or 30 years. Irrespective of the ability (likelihood) to even qualify for such an option, preliminary analysis shows that even with the extension, annual payments in the next two fiscal years would be even higher than currently scheduled. Due to the higher payments and lack of flexibility, neither of these options is recommended at this time.

(2) Use Cash to Set Up a Section 115 Trust and/or Pay Down UAL Directly with CalPERS – Both of these options aim to increase the earnings potential of the City's reserves but differ in their mechanics of doing so. ***Based on the fact that the City is projecting reduced reserve levels, which are below minimum targets, neither of these are likely feasible at this time, but should be considered if the City's financial position improves in the future.***

(a) Section 115 Trust – A Section 115 Trust is managed by a third party (not CalPERS). Funds held in such an account are dedicated to pension and OPEB expenses only. Many agencies prefer this option as it diversifies investments away from CalPERS, provides various investment portfolio options, and offers flexibility year to year to utilize these funds when needed. Funds in a Section 115 Trust do not directly reduce the City's UAL with CalPERS unless they are at some point transferred to CalPERS to buy down the UAL.

(b) Pay-Down UAL – The City can apply reserves to pay down its UAL. Funds are submitted to CalPERS, with the UAL directly reduced by the pay-down amount and the funded status of the City's plans increased. CalPERS will eliminate the future payments associated with that UAL component and give the City credit for 7.0 percent interest earnings on that amount.

Hypothetical examples of each option quantifying the benefit of a $5 million deposit are provided in the presentation. It should be noted that while the City increased General Fund reserve levels to the minimum target amount of 18 percent in 2017, current reserve levels are only at about 13 percent of expenditures, due to FY 2017-18 General Fund expenditures plus transfers-out having exceeded revenues plus transfers-in by $5.8 million. The preliminary budget projects additional reductions to reserve levels. Drawing down reserves permanently under either the Section 115 or Pay Down option could potentially put downward pressure on the City's credit rating, increase the cost of accessing the capital markets and negatively impact operations and capital projects.

- **Debt Funding** – Many agencies have issued debt (bonds to investors or loan from bank) and used the proceeds to pay off all or a portion of its UAL with CalPERS. Benefits include: (1) Lower interest rate – recent debt issuances were between 4% and 5% versus the 7% CalPERs charges; (2) Higher funding ratios and (3) Ability to "re-shape" overall payments to achieve near term savings and a more predictable payment structure.

It should be clearly noted that the Government Finance Officers Association (GFOA) does not recommend pension bonds as a best practice, primarily due to the market/re-investment risk and the possibility that liabilities will actually grow larger. In other words, present value (PV) savings are only generated if CalPERS' actual future investment earnings turn out to be greater than the interest rate paid on the pension bond, which is impossible to predict at the time of issuance.

Recent City Pension Bond Issuance: While pension bonds were historically commonplace, recent municipal bankruptcies and lack of credit enhancement from bond insurers have reduced the amount of POBs issued by cities over the last several years given lack of investor appetite. Below is a list of a few cities that have recently issued pension bonds, most of which are rated in the "AA" category, and some of which are cities that also collect a pension tax override. This list is not exhaustive and is focused on California cities that recently issued “unsecured” pension bonds. There have also been other pension bonds issued secured by assets (lease bonds) and net revenues (like those of an enterprise system).

$54M Baldwin Park (2019): “AA-” rated; no tax override
$10.5M Chowchilla (2019): “A+” rated; no tax override
$54M La Verne (2018): “AA+” rated; no tax override
$112M Monrovia (2017): “AA” rated; has tax override
$53M Inglewood (2017): “AA” insured; has tax override

In NHA’s opinion, the ability to “smooth” overall payments through a restructuring to enhance budget predictability and create near term cash flow savings is the most important consideration and should be considered above the speculative nature of potential interest savings.

In addition to the complexity and risks already inherent for pension bonds, the City’s property tax override adds a separate layer of complexity. If tasked by the Committee to compile more information on this idea, thorough legal and financial due diligence, and a cost-benefit analysis of various options/structures is recommended in order for the Committee to properly evaluate this strategy. This due diligence would be completed in order to assess the extent to which the City’s key objectives could be met through a pension bond. These key objectives include: (1) Mitigate Financial Risk; (2) Maximize the Property Tax Override Revenue in Near and Long Term; (3) Create Meaningful Cash Flow Savings and Enhance Budget Predictability; (4) Pay Less in Interest Costs.

STRATEGIC PRIORITIES

This agenda item supports the Organizational Effectiveness strategy. The purpose of the Organizational Effectiveness strategy is to strengthen and stabilize the organizational foundation of the City in the areas of Finance, Information Technology, and Human Resources, and to improve workforce quality while increasing transparency to the public. This item supports the following goals and objectives:

Goal 2. Increase transparency with Council, community and staff related to the City’s budget and financial management processes.

FINANCIAL IMPACT

None directly.

Prepared by: NHA Advisors

ATTACHMENTS

1. City of Oxnard Pension Update (FGC Presentation May 14 2019)

City of Oxnard
Update on Potential Strategies to Address Rising Pension Costs

PRESENTATION TO FINANCE AND GOVERNANCE COMMITTEE

MAY 14, 2019

NHA | ADVISORS
Financial & Policy Strategies. Delivered.

Table of Contents

Notes

- NHA is not an actuary and all figures should be considered "best estimates"

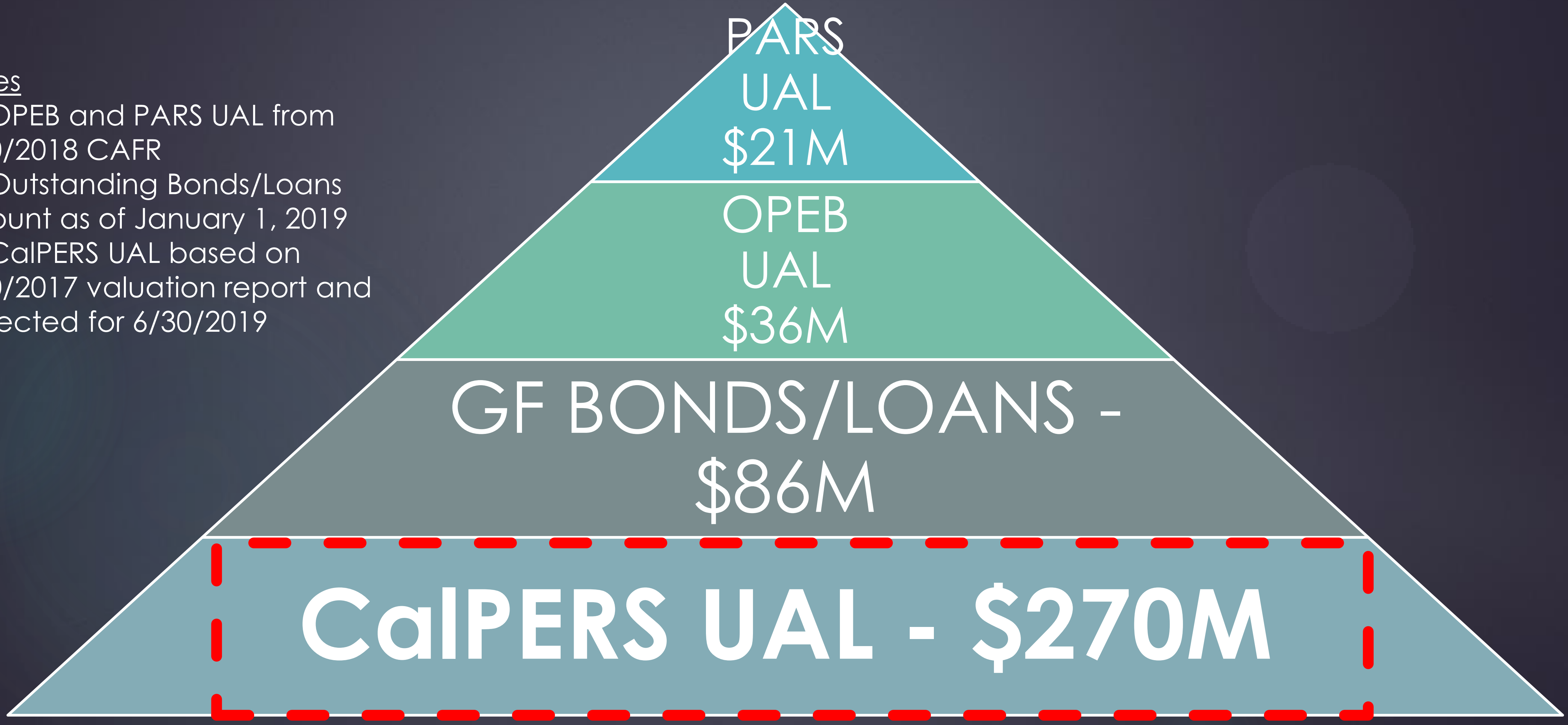
- CalPERS focused; Does not include costs for PARS retirement plan or OPEB

Recap of 2/26/2019 F&GC Meeting

- CalPERS pension costs are escalating rapidly, primarily due to below average investment performance and assumptions changes
- City's voter-approved Property Tax Override has historically provided significant support to the City's General Fund to cover allocable costs
- High level introduction of cost management & alternative repayment strategies

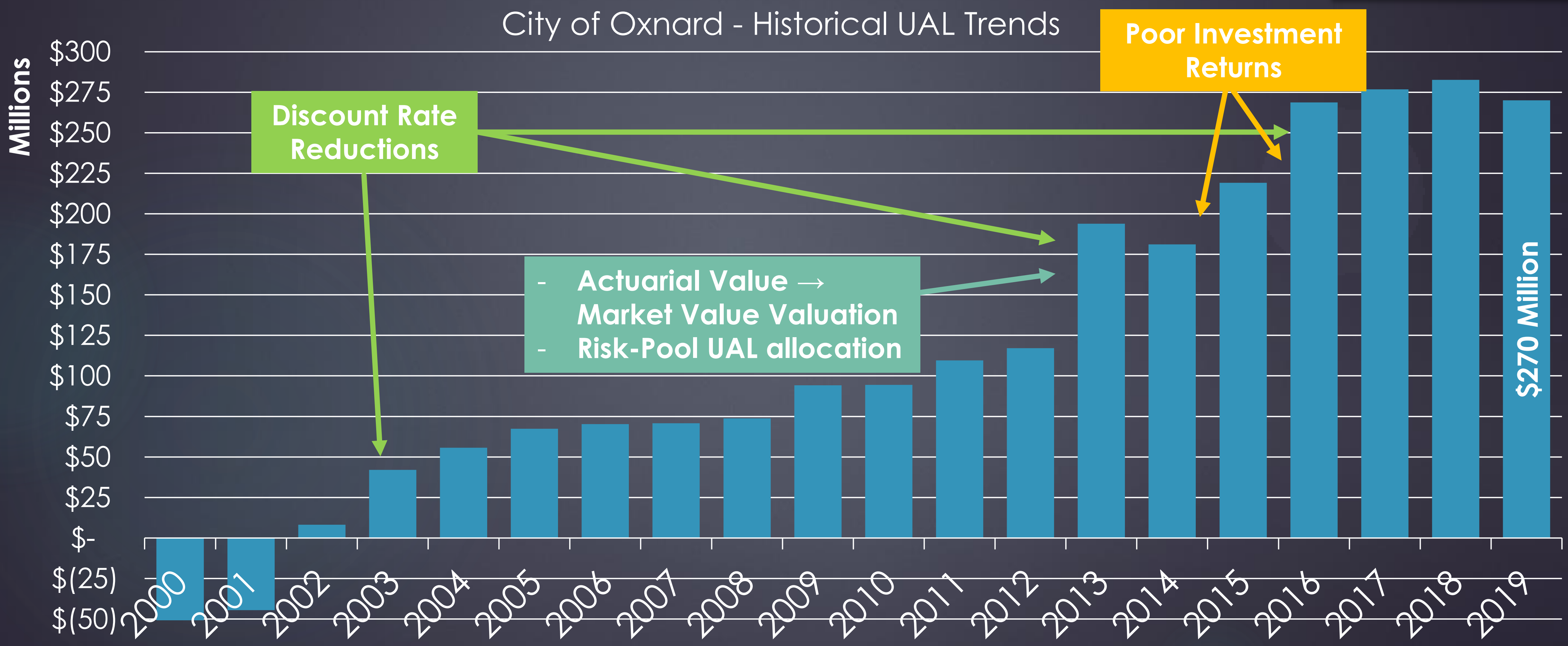
Long-Term General Fund Liabilities

<u>Notes</u>
(1) OPEB and PARS UAL from 6/30/2018 CAFR
(2) Outstanding Bonds/Loans amount as of January 1, 2019
(3) CalPERS UAL based on 6/30/2017 valuation report and projected for 6/30/2019

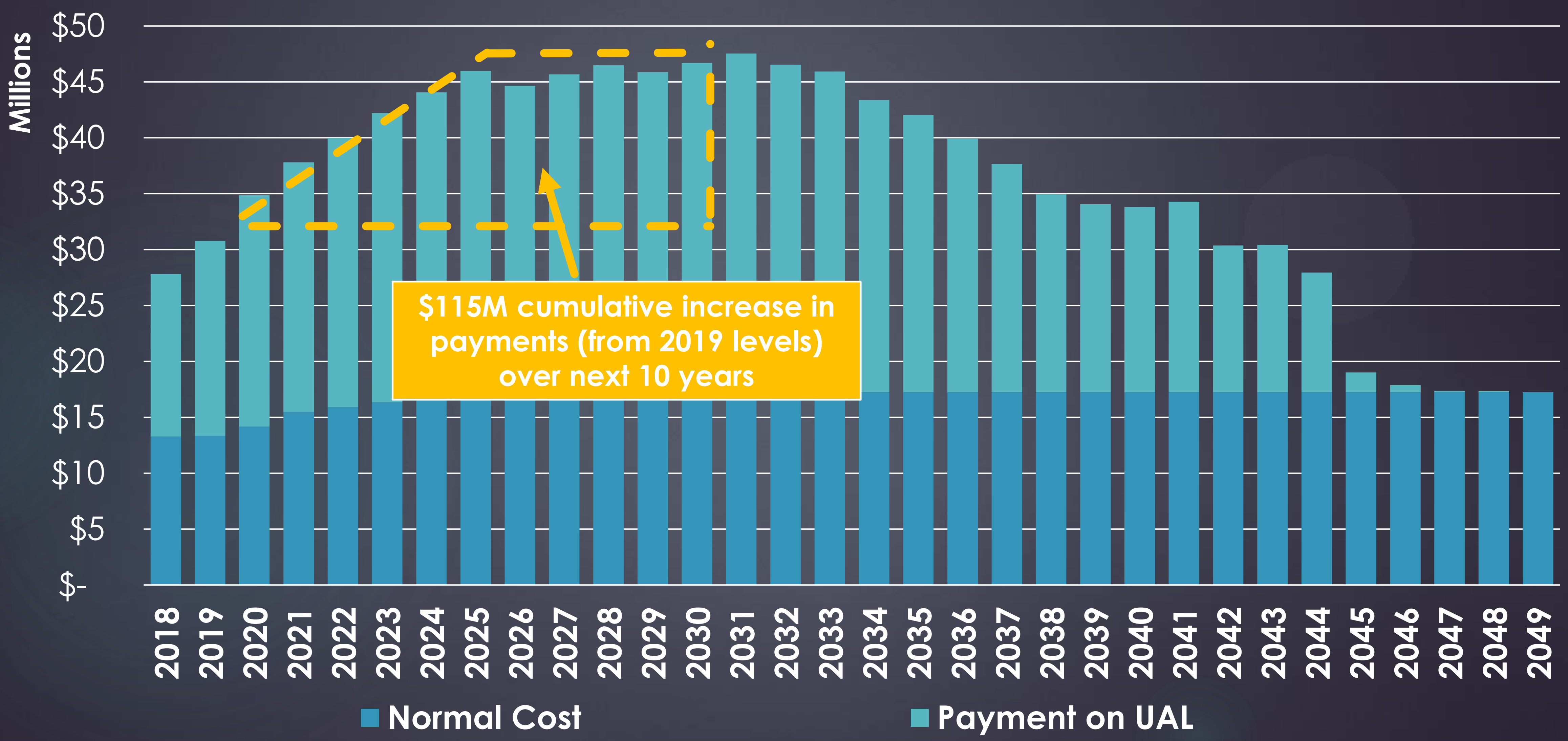


RECAP: UAL Trends

Historical PERS Returns
5-Year: 8.8%
10-Year: 4.4%
20-Year: 6.6%



RECAP: 30-Year Payment Projections

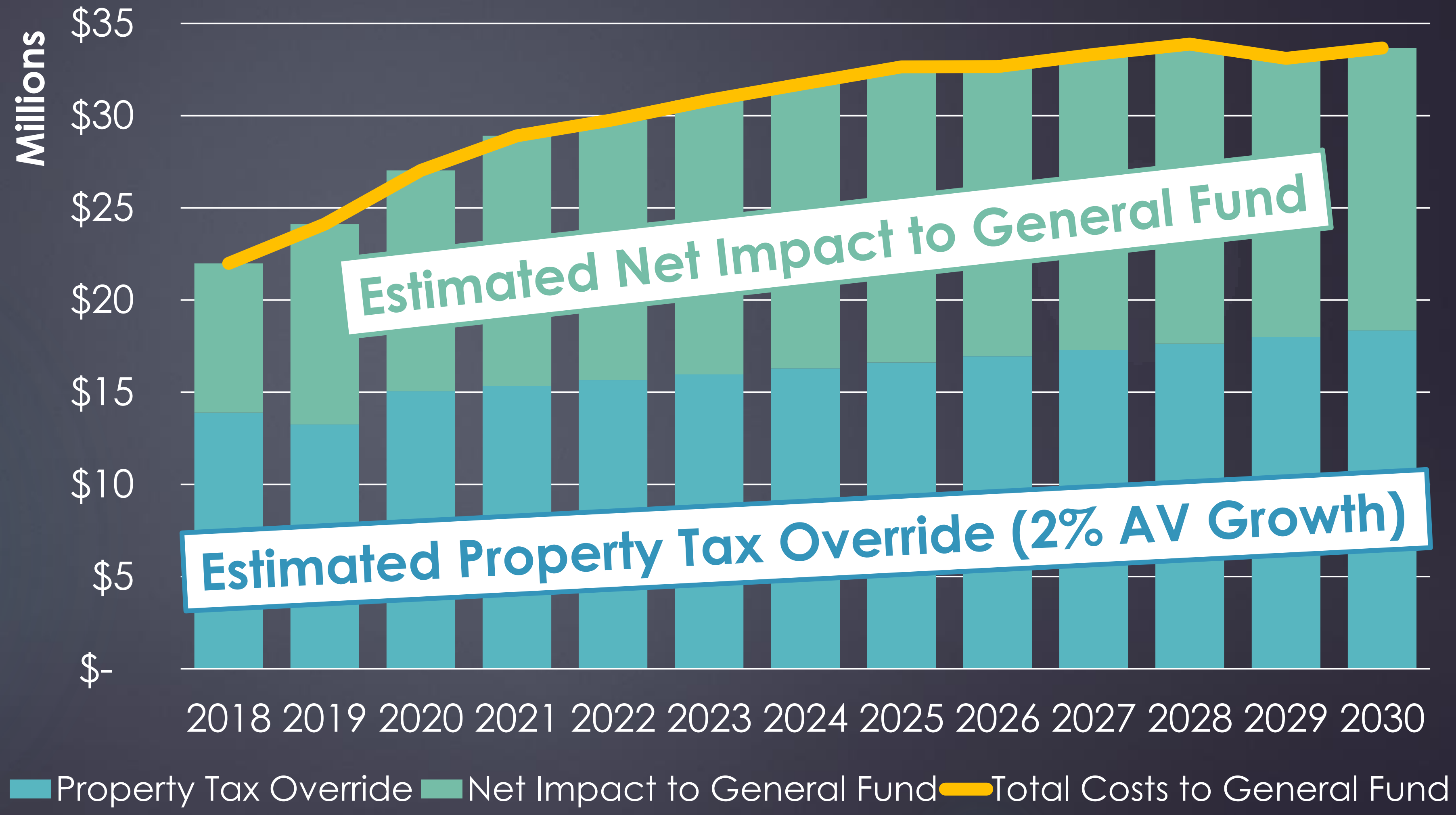


RECAP: Impact to General Fund

- 40%-45% of Miscellaneous Plan costs paid by the General Fund
- 100% of Safety Police and Safety Fire is paid by General Fund
- **<u>Property Tax Override:</u>** Can **<u>only</u>** be used to cover a portion of Safety Police and Safety Fire
  - Currently covers about 72% of total safety costs ($15M of $21M for FY 2020)
- Limitations on how much Property Tax Override the City can collect

Est. Impact to General Fund

- Annual "GF costs" growing from $22M to $34M
- At 2% AV growth, property override tax expected to grow from $15M to $18M
- **Net Impact to General Fund increasing:**
  - **2018: $8M**
  - **2019: $11M**
  - **2020: $12M**
  - **2022: $14M**
  - **2023-28: $16M**



8 Estimated - a more precise analysis should include consultation with Actuary

Other Updates Since February

- Current CalPERS returns are underperforming (≈ 3.0% through first 10 months of FY 2019)
  - Increase in UAL would be seen in Fall 2020 actuarial report with cost increases hitting budget in FY 2021-22
- City's preliminary budget projects reduced General Fund reserve levels

Cost Management Strategies

Prepay Annual UAL Payment Upfront

- 3.5% discount for paying in beginning of Fiscal Year
- $725,000 potential savings for FY 2020
- **City implemented strategy for FY 2019**

City Currently Using Strategy

New Amortization Options with CalPERS

- **Fresh Start** – lower interest costs over time, but higher payments
- **25 or 30-year "Financial Necessity" Amortization** – extends payment period if application accepted

Not Recommended (see next slide)

Use Cash Reserves to:

- **Set-Up Section 115 Trust** - Separate trust solely dedicated to pension/OPEB
- **Lump Sum Direct Pay Down of UAL** – Reduce UAL with PERS and annual payments

Recommended; but not currently feasible (see slide 12-13)

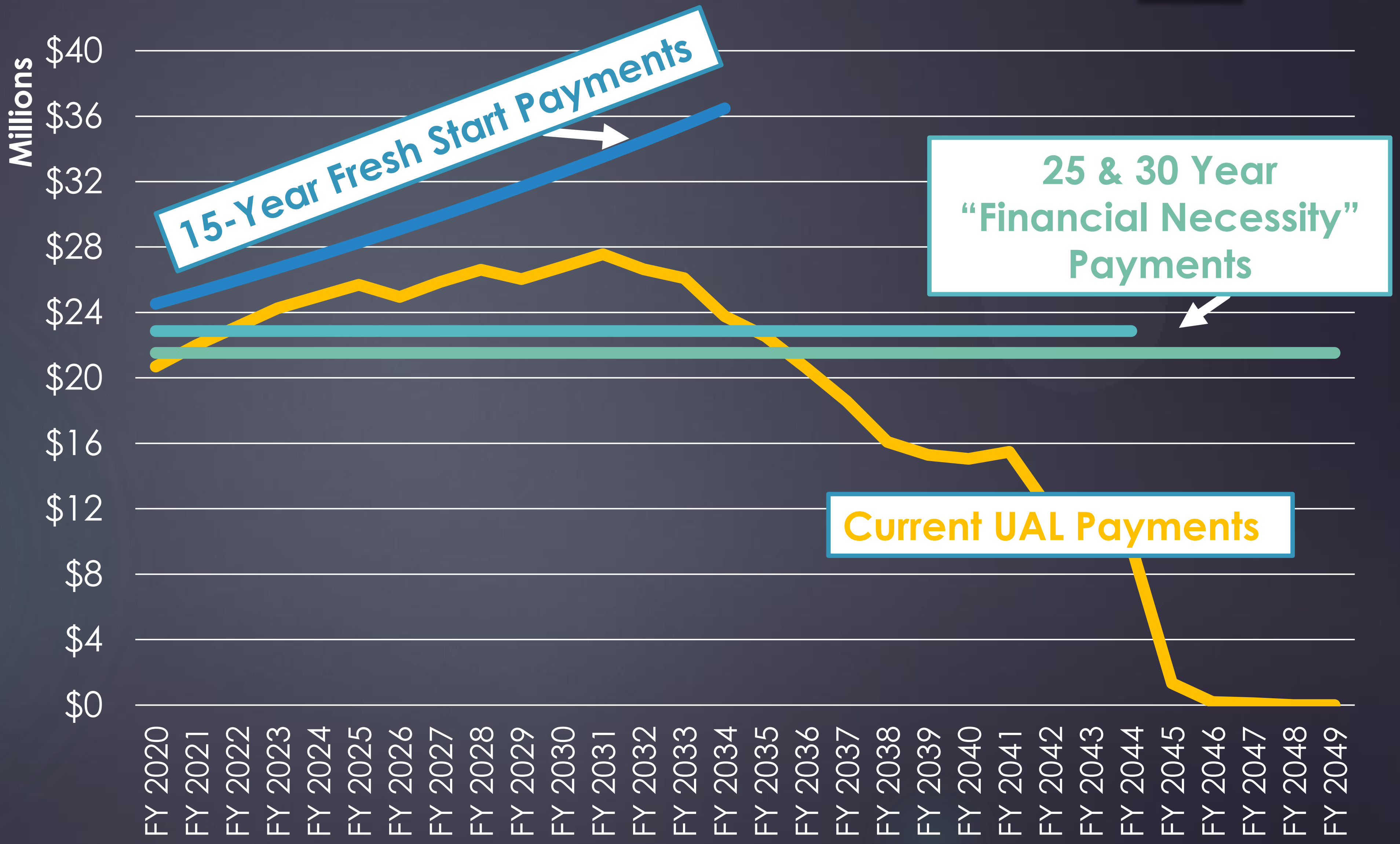
Debt Funding

- Use bond/loan proceeds to restructure payment shape
- **Most potential cash flow savings, but increased <u>complexity</u> and <u>risks</u>**

? More Due Diligence would be required (info on Slide 14-16)

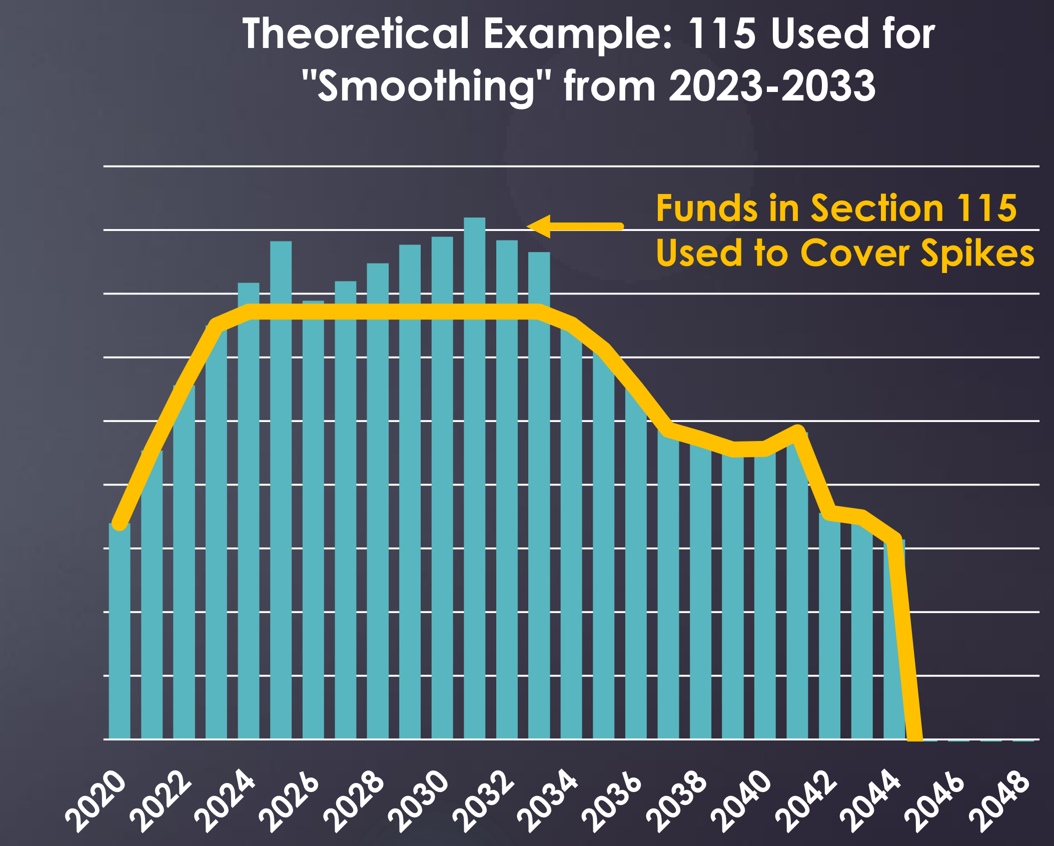
New Amortization With CalPERS

- **Fresh Start:** Increased payments not ideal; also are "locked-in"
- **Financial Necessity**: Even with 25 to 30 year amortization, FY 2021 and FY 2022 payments would be higher
  - No other CalPERS members have executed "financial necessity" option
  - Perhaps re-evaluate in two years



Section 115 Trust

- **What is it? -** Separate trust managed by 3rd party (not CalPERS)
  - Dedicated to pension and/or OPEB costs
- **Benefits**
  - Increased investment returns vs. current GF reserves
  - Flexibility – more investment options than CalPERS and can decide when and how to use
    - Longer-Term: Let grow over time and pay off full UAL with CalPERS in the future
    - Shorter-Term: Use during challenging budget years or to “smooth” payment spikes
- For every $5M, $2.4M of increased investment earnings expected over 10 year period*

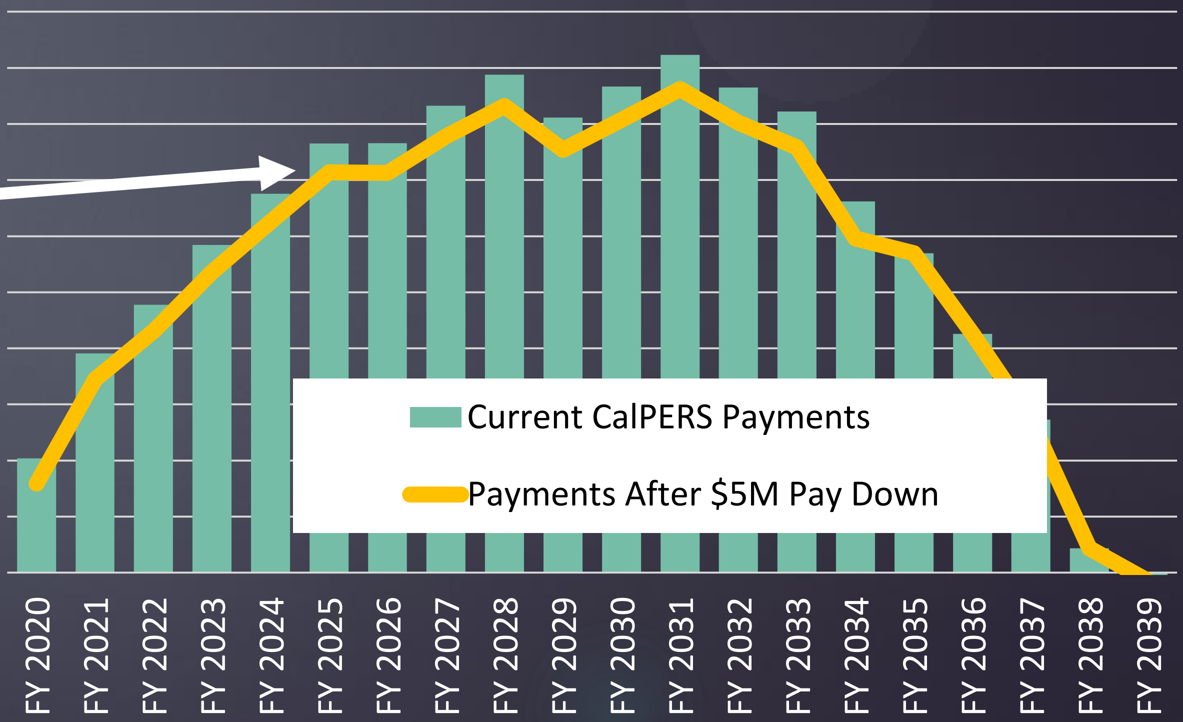


* Assumes funds aren’t drawn down and a 4% earnings differential vs. expected GF reserves earnings rates

Direct Pay-Down

- **What is it? –** City sends money to CalPERS; UAL is reduced and payments eliminated with the associated "amortization bases" paid off
- **Benefits**
  - Increased funded ratios
  - Increased investment returns vs. GF reserve options
  - Reduced future payments
- For every **$5M** paid down, **average annual payment reduction is about $550,000**
  - Assumes 15 year amortization base paid off

Example: Pay Down of 15-Yr Amortization Base



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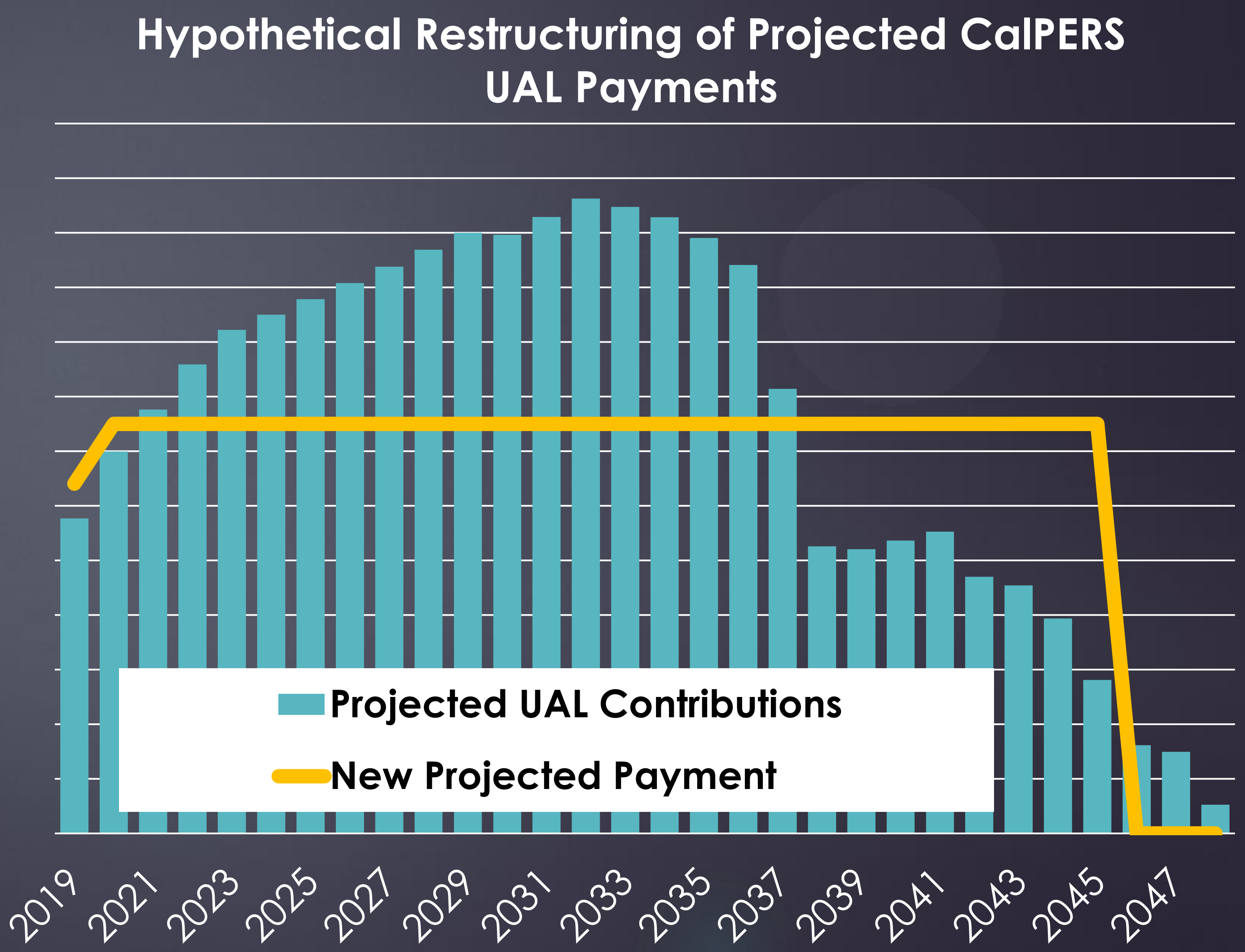
Pension Bond

- **What is it? –** City borrows money (bond to investors or loan from bank) and uses proceeds to pay off all or a portion of UAL to CalPERS
- **Key Benefits**
  - Lower interest rate than PERS (4%-5% vs. 7%)
  - Increased funding status of plans
  - Ability to "re-shape" payments for near term savings and "smoothing" (*most important benefit)*
- **Key Risks**
  - Re-investment/Market Risk: PV savings only generated if CalPERS earns more than the rate paid on the debt over life of issue
  - Increased "hard-debt" on City's balance sheet
  - Because of the above, GFOA recommends against POBs

Pension Bond – Recent City Examples

- Baldwin Park (2019)
  - "AA-"; no tax override
- Chowchilla (2019)
  - "A+"; no tax override
- La Verne (2018)
  - "AA+"; no tax override
- Monrovia (2017)
  - "AA"; has tax override
- Inglewood (2017)
  - "AA" insured; has tax override
- Many of these financings created new smoothed payment structure



More Due Diligence Needed to Assess Ability to Meet City Objectives

Mitigate Financial Risk	• Analyze options to "re-shape" payments by only taking out a fraction of full UAL (20-50%)
Maximize Tax Override Receipts in Near and Long Term	• Additional legal due diligence and more detailed actuarial projections required
Create Meaningful Cash Flow Savings and Enhance Budget Predictability	• Explore various structuring scenarios and quantify benefits/risks for City
Save on Interest Costs	• Evaluate credit, structuring options and investor interest to secure result that creates attractive solution

Next Steps

- Questions and discussion
- Committee to provide feedback to staff and NHA on whether or not more due diligence should be completed on pension bonds
- If so, direct staff and NHA to report back in Summer/Fall of 2019 with more information