



**CITY OF HEALDSBURG  
CITY COUNCIL AGENDA STAFF REPORT**

**MEETING DATE:** February 20, 2024

**SUBJECT:** General Fund Surplus and Pension Liability Funding Policy Review

**PREPARED BY:** Katie Edgar, Finance Director

**STRATEGIC INITIATIVE(S):**  
Provide Effective Governance

**RECOMMENDED ACTION(S):**

Adopt a Resolution rescinding Resolution No. 26-2022 and approving the updated Pension Liability Funding Policy.

**COMMUNITY ENGAGEMENT/OUTREACH:**

Not applicable.

**BACKGROUND:**

The Government Finance Officers Association (GFOA) best practices emphasize the importance of formally adopting financial policies to provide the foundation for long-term fiscal health. In 2016, the City Council updated the General Fund Reserve Policy to require a minimum reserve equal to 30 percent of the annual operating expenditures to protect the City's essential service programs. In accordance with California Government Code, Council adopts an Investment Policy annually to guide all investment activities. In 2019 the Council adopted a Pension Liability Funding Policy establishing a methodology for funding pension liabilities and completed the first biennial review in February 2022. In August 2022, the Council adopted the General Fund Surplus Policy to institutionalize prudent financial management by promoting long-term strategic thinking and defining categories for use of one-time funds derived from year end surplus. The Pension Liability Funding Policy and the General Fund Surplus Policy require biennial review to ensure continued alignment of the City's long-term financial goals with the current financial position.

**DISCUSSION/ANALYSIS:**

**Pension Liability Funding Policy**

The City participates in the California Public Employee Retirement System (PERS). A pension is a retirement account that an employer maintains to give employees a fixed payout when they retire. PERS is a defined benefit plan. The payout typically depends on how long the employee

works for the employer, whether the employee works in public safety, and the employee's salary. Investment income, employee contributions and employer contributions fund the total pension cost, including benefits and expenses. Employer contributions are set by actuaries using an investment return assumption (also known as the "discount rate"), and other assumptions related to salary, payroll, cost of living, mortality rate, disabilities, terminations, and retirements. CalPERS has been lowering the discount rate over the last several years, from 7.5% to 7% in 2018, and lowered again from 7% to 6.8% as of June 30, 2021. The maximum employee contribution rates are set by law. When subsequent changes are made to assumptions and actual investment earnings are available the actuaries will calculate the difference to their original annual valuation. The total of these annual differences comprises the unfunded accrued liability (UAL).

Current California law establishes that public employee retirement benefits are a form of deferred compensation and part of the employment contract. The Courts have established that the vested rights of public employees prevent not only a reduction in the benefits that have already been earned, but also a reduction in the benefits that a member is eligible to earn during future service. As such, changes to the employees' retirement benefits are considered a negotiable item and must go through the meet and confer process.

Over the years, the City has taken several steps to control pension costs – issuing pension obligation bonds in order to pay down part of the City's obligation at a fixed and favorable interest rate, establishing second tiers with reduced pension benefits for new classic members (employees transferring from other PERS agencies), implementing the Public Employees' Pension Reform Act ("PEPRA") which reduced benefits for new employees, and establishing and funding a Pension Stabilization Fund.

On February 22, 2022, the City Council updated the Pension Liability Funding Policy that is in place today. The existing policy does the following:

- Includes language that requires planned use of the Pension Stabilization Fund to be included as part of the 2-year budget planning process.
- Sets as a policy goal the City's desire to limit Pension Stabilization Trust Fund withdrawals to maximize both interest earnings and the long-term benefits of the Trust.
- In the event additional funds are available, directs staff to make additional contributions directly to CalPERS towards the outstanding UAL.

Staff have reviewed the policy and propose updating the language surrounding additional funding. In line with the previous policy update that highlighted the City's desire to maximize interest earnings and the long-term benefit of the Trust Fund, staff are proposing that if additional funding is available, staff will make additional contributions towards the Trust Fund instead of directly to CalPERS. In addition to giving the City greater control over the management of the funds, staff believes this change will result in stronger investment returns over time, thereby strengthening the City's ability to fund its pension obligations.

The other proposed change is to update the Policy to reflect our current Investment Manager. PFM Asset Management has recently acquired Highmark Capital Management and is now responsible for the investment portfolio of the Pension Stabilization Fund. Our individual advisor

has been retained through the merger, and the City has a positive existing relationship with PFM Asset Management as they provide investment management services for the City's Treasury portfolio.

### **General Fund Surplus Policy**

City finance staff complete an analysis of the City's financial condition on a quarterly basis to ensure proactive financial management. Staff update the Council on current trends and request adjustments to revenue and expenditures based on City needs, economic conditions, and overall fiscal health.

The General Fund Surplus Policy memorializes financial priorities to guide staff in recommending additional prudent expenditures when an unanticipated surplus exists. During the third quarter review staff provide estimates for remaining revenues and expenditures through the end of the fiscal year and prepare a projected ending fund balance. The policy defines a surplus as any anticipated fund balance exceeding \$250,0000 of the required reserve. At the time of the third quarter fiscal review, staff recommend allocating any available surplus funds based on the funding priorities outlined in the policy. The policy priorities focus on non-recurring expenditures that will not increase long-term operation costs or result in an expansion of the scope of City operations. The existing policy outlines the following priorities:

- Actions that reduce City debt or liabilities, including but not limited to reducing fund deficits, paying off internal or external loans, early repayment of bonds, and additional contributions to the City's unfunded pension obligations (CalPERS UAL).
- Contributions that result in investment returns or expand future revenue potential, including but not limited to contributions to the Pension Trust Fund, and Long-Range Planning Fund.
- Investments to repair, replace, or expand existing capital assets including but not limited to deferred building maintenance, vehicle replacements, streets and drainage infrastructure, water and sewer infrastructure.

Staff have reviewed the policy and have no proposed changes. The policy continues to reflect the goals of strategically investing short-term surplus to better position the City to address long term goals.

### **ENVIRONMENTAL STEWARDSHIP:**

Not applicable.

### **ALTERNATIVES:**

Council could make specific changes to the existing policies. If this direction is provided, staff would request time to update the policy and bring it back at a future meeting.

### **FISCAL IMPACT:**

The proposed action would have no immediate impact on the adopted FY 22-24 biennial budget. The Pension Liability Funding Policy will be incorporated during the FY 24-26 budget development process as we address funding for the annual UAL payments. Staff will return to Council in May to present the third quarter review of the FY 23-24 budget and implement the General Fund Surplus Policy as applicable.

**ENVIRONMENTAL ANALYSIS:**

Pursuant to Title 14, the California Code of Regulations, Section 15302(c) of the California Environmental Quality Act (“CEQA”) guidelines, the proposed action is an administrative activity of the City that will not result in direct or indirect physical changes to the environment.

**ATTACHMENT(S):**

Resolution

Exhibit A: Pension Policy

Surplus Policy

Pension Policy - Redline

CITY OF HEALDSBURG

RESOLUTION NO.

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF HEALDSBURG REPEALING RESOLUTION NO. 26-2022 AND APPROVING AN UPDATED PENSION LIABILITY FUNDING POLICY

WHEREAS, a formally articulated budget and strong fiscal policies provide the foundation for assuring the City’s long-term fiscal health; and

WHEREAS, the City Council of the City of Healdsburg adopted an updated Pension Liability Funding Policy on Resolution No. 26-2022; and

WHEREAS, the City Council of the City of Healdsburg adopted a General Fund Surplus Policy on Resolution No. 125-2022; and

WHEREAS, in accordance with both policies staff have completed a biennial review of the policies; and

WHEREAS, to further align the Pension Liability Funding Policy with the intent to maximize interest earnings and sustain long-term benefits, amendments to the Policy to direct additional payments to the Pension Stabilization Fund are desired; and

WHEREAS, PFM Asset Management has recently acquired High Mark Capital Management and assumed the role of Investment Manager for the Pension Stabilization Fund; and

WHEREAS, the City Council desires to update the policy to reflect the current Investment Manager.

NOW, THEREFORE, BE IT RESOLVED, the City Council of the City of Healdsburg rescinds Resolution No. 26-2022 and approves the updated Pension Liability Funding Policy attached as Exhibit A.

PASSED, APPROVED AND ADOPTED, this 20th day of February 2024, by the following vote:

AYES: Councilmembers:

NOES: Councilmembers:

ABSENT: Councilmembers:

ABSTAINING: Councilmembers:

SO ORDERED:

ATTEST:

\_\_\_\_\_  
David Hagele, Mayor

\_\_\_\_\_  
Raina Allan, City Clerk

Attachment: Resolution (4346 : Financial Policy Review)

# City of Healdsburg

## Pension Liability Funding Policy

### 1. PURPOSE

The purpose of this policy is to memorialize the methodology and process for funding current and future costs associated with the City's contractual obligations to provide pension benefits as set forth in the City's labor agreements. The policy also:

- Demonstrates prudent financial management practices;
- Promotes long-term and strategic thinking;
- Provides guidance in making annual budget decisions;
- Reassures bond rating agencies; and
- Demonstrates to employees and the public how the unfunded pension liability will be funded to ensure adequate funding for negotiated benefits.

### 2. BACKGROUND

A pension is a retirement account that an employer maintains to give employees a fixed payout when they retire. The City's plan is a defined benefit plan. The payout typically depends on how long the employee works for the employer and the employee's salary.

Investment income, employee contributions and employer contributions fund the total pension cost, including benefits and expenses. Employer contributions are set by actuaries using an investment rate assumption (also known as the "discount rate"), lowered from 7.0% to 6.8% as of July 1, 2021, and other assumptions related to salary, payroll, cost of living, mortality rate, disabilities, terminations, and retirements. The maximum employee contribution rates are set by law.

Current California law establishes that public employee retirement benefits are a form of deferred compensation and part of the employment contract. The Courts have established that the vested rights of public employees prevent not only a reduction in the benefits that have already been earned, but also a reduction in the benefits that a member is eligible to earn during future service. As such, changes to the employees' retirement benefits are considered a negotiable item and must go through the meet and confer process.

Over the years, the City has taken steps to control pension costs. In 2012 the City issued Pension Obligation Bonds to pay off CalPERS side funds at a lower interest rate and established second tiers for classic members. In 2013, the City adopted the Public Employee's Pension Retirement Act ("PEPRA"). In 2015, the City established the Pension Stabilization Fund and began making contributions to the fund. In 2019, the City adopted the initial version of this policy.

### 3. POLICY

#### 3.1 Establishment of Pension Stabilization Fund

Effective July 21, 2015 the Council adopted the PARS Public Agencies Post-Employment Benefits IRS Section 115 approved trust, also known as the Pension Stabilization Fund. The premise behind the Trust is to set-aside monies in the fund with a City determined investment policy and pull out the funds as needed to achieve a level contribution by the City's budget. The Pension Stabilization

Fund is an important tool the City can use to limit the impact of future decisions made by CalPERS on the City's finances and ensure the delivery of public services.

### **3.2 Governance and administration of the established Trust:**

The City Council established the Trust and defined the initial goals and policies for the administration of the Trust funds. The City Manager and staff have overall responsibility for the Trust and will manage the Trust in accordance with the City Council's adopted policies.

Trust Administrator, PARS, keeps plan documents current to ensure that they reflect the substantive plan and provides ongoing consulting, reporting and plan accounting records.

Trustee, currently US Bank, will be the plan's trust and custodian and will safeguard the assets in the Trust, hold the investment securities for safekeeping and make disbursement on request.

Investment Manager, currently PFM Asset Management (PFMAM), will recommend investment portfolio allocations based upon the Pension Trust Funds. PFMAM has adopted Investment Guidelines based on initial City Council input, revised to comply with existing law in November 2021 (Attachment 1), and manages City assets in accordance with the guidelines.

The Asset Allocation Investment Strategy chosen by a Council committee is rated as Moderately Conservative in regard to risk tolerance. Attachment 1 provides more detail on the asset allocation and breakdown.:

This policy recognizes that there will be future market volatility and that actual economic and demographic experience will differ from assumed experience. Accordingly, this policy is intended to provide flexibility to smooth such volatility and experience in a reasonable, systematic and financially sound manner.

### **3.3 Liability Funding Plan: Use of Pension Stabilization Fund**

The City is required to make annual UAL payments to CalPERS to cover outstanding liabilities based on the amortization schedules for those liabilities. The amount of payment is forecasted annually by CalPERS and is impacted by annual return rates, changes to the discount rate, and changes in actuarial analysis inputs and outputs.

City staff will include in the two-year budget details on projected UAL costs and anticipated use of the Trust. Given the Trust's ability to generate interest, the City will endeavor to limit trust fund withdrawals, maximizing potential for Trust Fund growth over time.

### **3.4 Additional Contribution: Expansion of Pension Stabilization Fund**

The City will annually review its ability to make additional contributions to the Pension Stabilization Fund. Making additional contributions when funds are available will maximize interest earnings, extend the long-term benefits of the Trust, and provide further flexibility for future UAL funding. Actions to budget additional contributions will be proposed to Council as appropriate.

### **3.5 Transparency and Reporting**

Funding of the City's pension benefit should be transparent to all parties including City employees, retirees, recognized employee organizations, the City Council and City residents. To achieve this level of transparency, the following information shall be available:

- a. Copies of the actuarial valuations for the City's pension plans shall be published on the City's website.
- b. The City's Annual Financial Statements shall be published on the City's website. The financial statements include information on the City's pension plans, contributions to the Trust, and the funded status of the plans.
- c. The City's annual operating budget shall include appropriations for contributions to the Trust, to CalPERS and the annual pension costs.

### **3.6 Review of Funding Policy**

Funding pension liability requires a long-term plan. The City will review this policy at a minimum biennially, coincident with preparation of the actuarial valuations, to determine if changes to this policy are necessary to ensure adequate resources are being accumulated to fund pension benefits.

# City of Healdsburg

## General Fund Surplus Policy

### 1. PURPOSE

The purpose of this policy is to establish a framework for allocating unanticipated annual surplus in the General Fund. This policy establishes a framework for identifying a surplus and the categories of expenditures in which staff will recommend surplus funds be allocated. The policy institutionalizes prudent financial management practices by promoting long-term strategic thinking and defining boundaries for use of one-time funds.

### 2. BACKGROUND

The City adopts a biennial budget with the goal of balancing the cost of providing services with the amount of revenues received. These planned expenditures and revenues can be further classified as recurring or non-recurring. Recurring expenditures are those that are included in the budget each year to maintain current service levels. Recurring revenues are those that can be reasonably expected to continue every year with some degree of predictability (property taxes, for example). A structurally balanced budget supports financial sustainability for multiple years into the future by balancing recurring revenues with recurring expenses.

The amount of money available after subtracting the total amount of expenditures made from the total amount of revenues received is the fund balance. The City has adopted a general fund reserve policy that requires maintenance of an unrestricted fund balance equal to at least 30% of the annual operating expenditures. The purpose of the reserve policy is to mitigate risks that could disrupt City services. If unforeseen economic conditions result in a reduction of expected revenues or catastrophic events require exorbitant one-time expenses the reserve is available to continue supporting essential recurring expenditures.

In addition to the budget process, the City prepares a long-term forecasting model that provides the opportunity to plan for longer term needs outside of the typical two-year budget cycle. The forecast provides a mechanism to understand the impacts of volatility on recurring revenues like Transient Occupancy Tax and Sales Taxes as well as growth trends associated with pension costs and other recurring expenditures. The forecast model is an important tool for identifying funding shortfalls and understanding the impacts of additional contributions.

### 3. POLICY

#### 3.1 Definition of Surplus

For this policy, any anticipated remaining fund balance in the general fund that exceeds the reserve by \$250,000 is defined as surplus. The \$250,000 excess allows for reasonable variances within the estimated closing figures.

#### 3.2 Financial Analysis and Review

A budget is a financial plan. Prudent fiscal management practices require ongoing analysis and updating of the City budget. Staff analyze the Cities financial condition and bring updates to Council for review on a quarterly basis. During these reviews staff recommend adjustments to revenues and expenditures to align budgeted expectations with current trends and reduce or

increase expenditures based on City needs and the overall fiscal health of the organization. During the third quarter budget review staff have a good understanding of the remaining revenues to be received and expenditures that will be incurred. During this review staff will provide closing estimates and determine if unanticipated revenues or budgetary savings will result in a surplus in the general fund. If a surplus is present staff will propose additional budgetary appropriations to allocate the surplus consistent with this policy.

### 3.3 Allocation of Surplus

Identified surplus funds will only be allocated for use on non-recurring expenditures to maintain a structurally balanced budget. Allocations of surplus funds are meant to improve the long-term fiscal health and prosperity of the City. Surplus funds will not increase long-term operational costs or expand the scope of operations. City staff will present surplus funding options consistent with the following categories.

- Actions that reduce City debt or liabilities, including but not limited to reducing fund deficits, paying off internal or external loans, early repayment of bonds, and additional contributions to the City's unfunded pension obligations (CalPERS UAL).
- Contributions that result in investment returns or expand future revenue potential, including but not limited to contributions to the Pension Trust Fund, and Long-Range Planning Fund.
- Investments to repair, replace, or expand existing capital assets including but not limited to deferred building maintenance, vehicle replacements, streets and drainage infrastructure, water and sewer infrastructure.

The ultimate responsibility for determining the allocation of surplus funds, consistent with this policy, rests with the City Council. The third quarter fiscal review will include appropriation adjustments to accommodate the approved allocations, but no expenditures will be incurred until the closing of the fiscal year. Staff will report back to council at the next quarterly financial update if for any reason approved surplus expenditures are not completed.

### 3.6 Review of Surplus Policy

Maintaining a structurally balanced budget that promotes sustainability of essential services requires a long-term plan. The City will review this policy at a minimum biennially, concurrent with preparation of the budget, to determine if changes to this policy are necessary to ensure resources are being allocated to priorities pertinent in the current financial landscape.

# City of Healdsburg

## Pension Liability Funding Policy

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### **3.2 Governance and administration of the established Trust:**

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Investment Manager, currently ~~Highmark-Capital~~ PFM Asset Management (PFMAM), will recommend investment portfolio allocations based upon the Pension Trust Funds. ~~High-PFMAM Mark~~ has adopted Investment Guidelines based on initial City Council input, revised to comply with existing law in November 2021 (Attachment 1), and manages City assets in accordance with the guidelines.

The Asset Allocation Investment Strategy chosen by a Council committee is rated as Moderately Conservative in regard to risk tolerance. Attachment 1 provides more detail on the asset allocation and breakdown.:

This policy recognizes that there will be future market volatility and that actual economic and demographic experience will differ from assumed experience. Accordingly, this policy is intended to provide flexibility to smooth such volatility and experience in a reasonable, systematic and financially sound manner.

### **3.3 Liability Funding Plan: Use of Pension Stabilization Fund**

The City is required to make annual UAL payments to CalPERS to cover outstanding liabilities based on the amortization schedules for those liabilities. The amount of payment is forecasted annually by CalPERS and is impacted by annual return rates, changes to the discount rate, and changes in actuarial analysis inputs and outputs.

City staff will include in the two-year budget details on projected UAL costs and anticipated use of the Trust. Given the Trust's ability to generate interest, the City will endeavor to limit trust fund withdrawals, maximizing potential for Trust Fund growth over time.

### **3.4 Additional Contribution: Expansion of Pension Stabilization Fund**

The City will annually review its ability to make additional contributions to the Pension Stabilization Fund. Making additional contributions when funds are available will maximize interest earnings, extend the long-term benefits of the Trust, and provide further flexibility for future UAL funding. Actions to budget additional contributions will be proposed to Council as appropriate.

### **~~3.4 Additional Contribution paid directly to CalPERS~~**

~~The City will annually review its ability to make additional contributions to CalPERS to further reduce unfunded liabilities and propose budget action to Council as appropriate. When making additional contributions, the City will seek maximum interest savings. Additional contributions paid to CalPERS will be applied to pay down the following amortization bases (in order):~~

- ~~• Miscellaneous: Pre-2013 Share of UAL Pool (maturity 2036), 2014 Assumption Change (maturity 2036), and 2016 Assumption Change (maturity 2038)~~
- ~~• Safety: 2014 Assumption Change (maturity 2036), Pre-2013 Share of UAL Pool (maturity 2037), 2016 Assumption Change (maturity 2038), and 2017 Assumption Change (maturity 2039)~~

### **3.5 Transparency and Reporting**

Funding of the City's pension benefit should be transparent to all parties including City employees, retirees, recognized employee organizations, the City Council and City residents. To achieve this level of transparency, the following information shall be available:

- a. Copies of the actuarial valuations for the City's pension plans shall be published on the City's website.
- b. The City's Annual Financial Statements shall be published on the City's website. The financial statements include information on the City's pension plans, contributions to the Trust, and the funded status of the plans.
- c. The City's annual operating budget shall include appropriations for contributions to the Trust, to CalPERS and the annual pension costs.

### **3.6 Review of Funding Policy**

Funding pension liability requires a long-term plan. The City will review this policy at a minimum biennially, coincident with preparation of the actuarial valuations, to determine if changes to this policy are necessary to ensure adequate resources are being accumulated to fund pension benefits.