CITY OF BELVEDERE

FINANCE COMMITTEE
AGENDA

March 26, 2021
Via Zoom
9:00 a.m.

Join Zoom Meeting
https://us02web.zoom.us/j/4136417003?pwd=TXB1T1pERy8rcG5Hbkdjd1Y2NFVBUT09

Meeting ID: 413 641 7003
Passcode: Belvedere

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Meeting ID: 413 641 7003
Passcode: 310801

1. Approve minutes of January 12, 2021 Finance Committee meeting.

2. Discuss the analysis performed by the Taskforce on Pensions and Other Post-Employment Benefits (OPEB). Receive the Taskforce's recommendation and proposed reforms to reduce the City's unfunded pension and OPEB liabilities. Consider a recommendation on the same to the City Council.

3. Other business.

4. Adjourn.

Attachments:

1. Taskforce Update to Finance Committee
2. Note to the Finance Committee on Section 115 Investment Trust Management
3. Proposed revisions to Administrative Policy Manual:
    a. Policy 2.2 Fund Balance and Reserve Policies
    b. Policy 2.3 Pension OPEB Funding
    c. Policy 2.5 Investments
4. Proposed language around the 115 Pension Reserve funding methodology to be included in the City's annual budget document.

Date posted: March 23, 2021

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NOTICE

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Date posted: March 23, 2021

REGULAR MEETING
FINANCE COMMITTEE
Wednesday, January 12, 2021
3:00 PM
on Zoom remote platform

MINUTES

COMMITTEE PRESENT:	Justin Faggioli, Bob McCaskill, Greg Ostroff, David Walker, Sally Wilkinson, Steve Block
COMMITTEE ABSENT:	John Wilton
OTHERS PRESENT:	City Manager – Craig Middleton, Admin. Services Manager – Amber Johnson

CALL TO ORDER OF REGULAR MEETING

The meeting was called to order at 3:00 p.m.

SCHEDULED ITEMS

1. The Committee approved the minutes of the January 6, 2021 meeting.

2. The Committee discussed the draft Charter of the City of Belvedere's Taskforce on Pension and OPEB. It was unanimously agreed to approve the Charter as amended.

ADJOURN

The meeting was adjourned at 3:30 p.m.

THE FOREGOING MINUTES were approved at a regular meeting of the Finance Committee on March 26, 2021 by the following vote:

AYES: _
NOES: _
ABSENT: _
ABSTAIN: _

APPROVED ____________________
Bob McCaskill, Chair

ATTEST ________________________________
Amber Johnson, Admin. Services Manager

Taskforce on Pensions & OPEB Interim Report to Belvedere Finance Committee

Date: March 16, 2021

Background

On January 12, 2021, the City of Belvedere's Finance Committee established a Taskforce on Pensions & OPEBs ("taskforce"), comprising four of its seven members. The taskforce was assigned the job of recommending a package of reforms to reduce the City's unfunded pension and other post-employment benefit (OPEB) obligations, to ensure the City's ongoing fiscal sustainability. The taskforce was asked to report back to the full Finance Committee when it had made substantive progress. The taskforce has met six times in the past nine weeks and is ready to recommend a package of measures to reduce the City's pension risk. Policy ideas on OPEBs are still being developed.

Pension Funding Tenets

The taskforce suggests the City adopt the following five tenets as the basis of its pension funding policy:

1. The cost of employee benefits should be paid by the generation of taxpayers who receives services.
2. Actuarial assumptions should be prudential to ensure that promised benefits can be paid.
3. Funding shortfalls should be closed expeditiously. The goal is full funding.
4. Large swings in employer contribution rates are undesirable. Smoothing is desirable.
5. Funding policies and underlying assumptions should be clearly delineated and regularly reviewed.

Actuarial Assumptions

The first question the taskforce sought to answer in analyzing the City's pension risk is whether the City's pension obligations are appropriately valued by CalPERS. There was broad agreement that the 7.0% discount rate used by CalPERS to discount future pension benefit payments, which is based on its expected return on plan assets, is too optimistic, thereby understating the City's pension liabilities. The taskforce set about determining a more appropriate discount rate selection methodology. It considered the merits of using a "risk-free" discount rate (based on an index of high-quality corporate bonds) or relying on analyst forecasts of future investment returns, for example those laid out in Horizon's Annual Survey of Capital Market Assumptions. It concluded that a risk-free discount rate is likely too conservative, given CalPERS actual investment mix, and that analyst forecasts are no more likely to be correct than those of CalPERS' investment office, which also consults with outside advisors. The taskforce observed that CalPERS itself is projecting a 5.67% annual return on plan assets over the next 10 years (it assumes a 7.85% return in the outer years to reach its overall 7.0% average return).

Factoring in the City's risk aversion and plan maturity, and acknowledging the unpredictability of financial markets, the taskforce agreed the City should adopt a discount rate equal to CalPERS' expected return on plan assets minus a margin of 100 basis points. This would peg the City's discount rate at 6.0% for FY21-22. Recognizing that CalPERS may reduce its own discount rate in coming years, the taskforce agreed the 6.0% rate should be maintained for a period of up to five years and then be reviewed by the Finance Committee as part of a standing review of the City's pension funding strategy (see later).

The taskforce reviewed the other economic and demographic assumptions underpinning CalPERS' model and concluded the risks are evenly balanced. The City's demographic risks are pooled, and the pooled experience has largely tracked expectations.

Annual Funding Costs

Having agreed a 6.0% discount rate assumption, the taskforce sought to understand the financial impact of this more prudent discount rate on the City's ongoing pension costs. Thanks to GASB rules, agencies are required to report the impact of a one percentage point reduction (or increase) in the discount rate on both the normal cost rate (NCR) and unfunded accrued liability (UAL). The data for fiscal year end June 30, 2019 are shown in the table below. CalPERS calculates contribution rates based on funded status two years prior, so the June 30, 2019 valuations provide the correct numbers for the upcoming 2021-22 fiscal year.

Annual required contribution (ARC) = Normal cost rate (NCR) + Annual UAL payment

Table 1: Impact of 6.0% Discount Rate on Belvedere's Pension Metrics

	7.0% Discount Rate	6.0% Discount Rate	Change
Accrued Liability (US$ mn)	23.88	26.81	2.94
Market Value of Assets (US$ mn)	22.30	22.30	-
UAL (US$ mn)	**1.58**	**4.52**	**2.94**
Funded Ratio (%)	93.38%	83.15%	10.23%
Employer NCR (%)	11.63%	16.40%	4.76%
Employer NCR (US$)[1]	**249,882**	**352,208**	**102,325**

[1]Based on estimated payroll and assumes no change in employee contribution rates. Note: The sensitivity data reported in agencies' CAFR differ from those presented above (which draw from CalPERS' Annual Valuation Reports) because CAFR data are based on a higher discount rate (equal to CalPERS' discount rate plus 15 basis points of administration expenses). Source: CalPERS

Unfortunately, the GASB-required sensitivity analysis does not show how to amortize the higher UAL created by a 6.0% discount rate. The City asked CalPERS if it could assist, but it declined. The taskforce therefore reviewed various options for calculating an appropriate annual UAL payment, including relying on CalPERS' Pension Outlook tool, using an off-the-shelf tool called GovInvest, applying closed-period, dollar-flat amortization, or scaling up CalPERS suggested UAL payments in proportion to the higher UAL. All four options have shortcomings (see box on page 3) but produce broadly similar results in terms of dollar impact. The taskforce ultimately settled on using CalPERS' Pension Outlook tool and recommends that the dollar cost implied by the tool (over and above CalPERS' scheduled payments) be smoothed and fixed in nominal terms for a period of up to five years to allow sensible budget planning.

Affordability

Next the taskforce sought to establish the affordability of a 6.0% discount rate from a budgetary perspective. City staff reviewed the scope of "free funds" within the budget to allocate to pensions, over and above CalPERS' ARC payments. They identified approximately $300,000 of available funds on a recurring basis, $100,000 from terminating the annual pension fund reserve payment and $200,000 from deferring the hiring of a police officer for at least the next three years. The taskforce also reviewed the City's current financial statements, as of June 30, 2020, and identified $1.2 million of excess reserves (leaving a residual excess of $100,000) and $300,000 of pension fund reserves that could immediately be used to fund pensions and lower ongoing amortization costs.

Using CalPERS' Pension Outlook tool, the cost of amortizing the 6.0% UAL adjusted for a $1.5 million upfront payment was calculated. The additional cost in terms of UAL payment ranged from $190,000 to $220,000 p.a. over the following five years. Coupled with a $100,000 higher NCR, the total annual impact of adopting a 6.0% discount rate, adjusted for a $1.5 million extraordinary payment, stands at about $300,000, allowing the policy to be implemented with limited budgetary stress whilst honoring the City's generous reserve policy.

Box 1: UAL Amortization Methodologies

Option 1: CalPERS Pension Outlook Tool

The tool allows agencies to make changes to discount rate and investment return assumptions as well as make additional discretionary payments and model their impacts on UAL payments (and the NCR) over a 30-year period versus the current payment profile. The advantage of this tool is that it lays out the impacts over multiple years and relies on the intricacies of CalPERS plan-specific actuarial data and amortization rules. The downside is that it produces results that are one year off cycle i.e., changing inputs today (related to FY19-20) produces results that affect required contributions starting FY22-23, not FY21-22. Furthermore, it does not allow the application of a lower discount rate to "stick", so the amortization clock starts again every time the model is run.

Option 2: GovInvest Pension Tool

The GovInvest tool is a more sophisticated version of the CalPERS Pension Outlook tool, using CalPERS plan-specific inputs and amortization rules, and adding one more year of census data. Assumptions can be altered at a more granular level. Historical data can also be inputted, related to FY18-19 for example, allowing direct calculation of the appropriate UAL payment for FY21-22. The tool has other useful attributes, unrelated to calculating the UAL payment. The downside of the tool is its cost (circa $5,000 p.a.) and the unknown nature of its black box, which other cities indicate does not generate matching results to CalPERS tool.

Option 3: Ratio Formula

Application of a ratio formula involves taking the ratio of the UAL at 6.0% (less Section 115 trust assets – see later) to the UAL at 7.0% and multiplying it by the UAL payment (at 7.0%) required by CalPERS. The main downside of this methodology is that CalPERS' amortization schedule is not smooth and UAL costs tend to accelerate over time. Using a ratio formula will amplify this effect. Taking the average cost implied by the formula over a medium-term period will mitigate some of this effect.

Option 4: Dollar Flat Amortization Formula

Dollar-flat amortization involves taking the UAL at 6.0% (less Section 115 trust assets) and repaying the debt over a fixed period, say 20 years, in equal installments, using a 6.0% interest rate. A 20-year window fits with CalPERS new amortization rules (which shorten the amortization window from 30 to 20 years on new annual bases), and gels with the view of rating agencies that pension debt should be amortized over 20 years or less. To avoid the debt continuing to roll i.e., never being fully paid off, the formula would have to amortize the existing UAL over a closed 20-year period, with additional amortization rules applied to UAL bases created after implementation of the formula.

Source: Author

Investment Options

The taskforce was in broad agreement that monies set aside for pensions should not be used to make additional discretionary payments to CalPERS. The City already has a 93.4% funded ratio with CalPERS (using its 7.0% discount rate), although this will likely drop as of June 30, 2020, given CalPERS provisional 4.7% investment return for the year. The taskforce discussed using the funds to make accelerated payments on the City's $2.228 million of outstanding lease-leaseback debt (used to finance earlier discretionary payments to CalPERS) but the terms of the recent lease-leaseback refinancing preclude early repayment until at least 2026.

Interest therefore centered on establishing a Section 115 pension trust, which irrevocably ringfences funds for pension purposes. Section 115 trusts are commonplace among Marin municipalities and elsewhere. Although Section 115 pension fund assets cannot be used to reduce net pension debt for GASB financial reporting purposes, they are held on balance sheet as restricted assets, thereby improving the City's overall statement of net position. The credit rating impact is essentially the same.

The range of Section 115 trust providers is extremely limited. The taskforce briefly explored the option of the City securing its own private letter ruling from the IRS but determined it would be cost and time prohibitive. It therefore examined the offerings of the two main 115 trust providers: CalPERS and PARS. PARS is a for-profit financial services firm that currently manages the City's modest retirement enhancement plan. CalPERS 115 pension trust, known as the California Employers' Pension Prefunding Trust Fund (CEPPT), has only been operational since October 2019 (although its OPEB trust has run for much longer). Under both structures, CalPERS/PARS acts as the trustee and partners with outside investment managers. PARS offers more investment options, but charges higher fees. Investment performance between CEPPT and PARS is similar. The taskforce is looking for guidance from the Finance Committee on its preferred investment vehicle. It recommends seeding the chosen trust with the $1.5 million of excess reserves/pension reserves, using dollar-cost averaging, and then making payments of $300,000 per annum until the next pension review (see next).

Please review the separate document for a more thorough review of investment options.

Oversight and Reporting

The taskforce discussed an appropriate oversight and reporting framework. It suggests the Finance Committee conduct a standing pension funding review at least every five years to reset the discount rate, adjust annual funding costs and fix those payments until the next review. It may also wish to move money from the 115 trust to CalPERS, depending on circumstances, and/or making additional payments to the 115 trust or CalPERS should the City have accumulated fresh excess reserves.

The taskforce discussed valuing the City's pension liabilities at a 6.0% discount rate for financial reporting purposes but concluded this would disadvantage the City vis à vis its peer cities. Instead, it suggests staff produce an annual pension funding update describing the City's pension funding policy and funded status and include it in the City's annual budget report.

Retirement Enhancement Plan Review

The taskforce reviewed the City's retirement enhancement plan, managed by PARS, which has been closed to new entrants since 2012. It determined that its total and unfunded liabilities are small and already discounted using a 6.5% discount rate and that further review, or special funding arrangements, were not necessary at this stage.

Review of City's Reserve Policy

The taskforce discussed whether the City's generous reserve policy (reserves of no less than 6 months of general fund operating expenses, debt financing costs and fire contract costs net of fire tax revenues) should be relaxed to reflect the additional financial buffer provided by the Section 115 trust i.e., in a difficult year, trust assets can be used to finance payments to CalPERS. The consensus was that reducing reserve discipline to finance greater pension discipline would be imprudent.

The taskforce also considered how transfers to the Section 115 trust and additional discretionary payments to CalPERS should be treated for the purposes of calculating the City's reserve requirements. It recommends these items be excluded from the reserve requirement calculation (denominator) because they are discretionary in nature. This is consistent with the City's existing treatment of discretionary payments to CalPERS and internal money transfers.

Employee Contribution Rates

Finally, the taskforce discussed scope for raising employee contribution rates to help share the burden of increased costs associated with CalPERS' investment underperformance versus its ambitious target. The taskforce observed that PEPRA employees already pay 50% of their NCR, which is the maximum allowed under the law. However, classic employees pay less than recommended by the Public Employees' Pension Reform Act which provides for an increase in classic employee contribution rates to 8.0% (from 7.0%) of salary for miscellaneous staff and to 12.0% (from 9.0%) of salary for safety workers, commencing 2018. The savings to the City from implementing a higher classic employee cost share are limited (circa $15,000 p.a.) given the City's current employee mix, particularly the low number of classic safety workers. Nevertheless, the taskforce recommends the City work to increase classic employee contribution rates to those suggested by the PEPRA reforms, bringing the City in line with other local agencies. The taskforce does not recommend employee cost sharing of the employer portion, as the required quid pro quo, typically a pay rise or higher COLA, can increase overall employer costs, particularly given the low rate of staff turnover in Belvedere.

Summary

- Continue to make CalPERS' ARC payments (NCR + UAL payment) according to its funding formulas.
- Continue to use CalPERS discount rate for financial reporting purposes.
- Seed a Section 115 pension trust with the $1.5 million of excess reserves and pension reserves.
- Adopt a discount rate of CalPERS minus 100 basis points for internal planning purposes.
- Fix that rate, currently 6.0%, for up to five years, commencing FY2021-22.
- Determine the NCR and UAL at 6.0%, using CalPERS latest Annual Valuation Reports.
- Calculate the annual UAL payment at 6.0% net of Section 115 fund assets.
- Calculate the difference between the ARC at 6.0% and CalPERS ARC. Fix that amount, estimated to be $300,000 in FY2021-22, in nominal terms for up to five years.
- Make an annual payment of $300,000 to the Section 115 trust, commencing FY2021-22.
- Produce an annual pension funding update to be included in the City's annual budget report.
- Implement a standing pension review at least every five years after adoption of the policy, led by the City's Finance Committee.

Note to the Belvedere Finance Committee on Section 115 Investment Trust Management

Section 115 Plans are the common vehicle used by cities to set aside funds for expected future cash needs to cover the unfunded pension liabilities at CalPERS. The Subcommittee researched the two primary providers of these IRS-approved plans (CalPERS and PARS) and the investment options offered by each. The Subcommittee suggests that the full Finance Committee conclude on the following issues:

1. Active vs passive investment management (see “Asset Selection” below).
2. Choice of an aggressive vs. conservative asset allocation (see “Allocation” below).
3. Choice of a CalPERS or PARS plan (see “Implementation” below).

Allocation

Asset allocation decisions commonly overwhelm other investment decisions with respect to risk and return. PARS offers five different asset mixes, of which only three provide meaningful diversification to the CalPERS main fund. CalPERS offers two strategies that are diversified from the asset allocation in the CalPERS main fund. Information regarding each of these strategies is included in the tables following this note. The Ad Hoc Committee has a mild preference toward the higher return funds offered by these providers (CEPPT 2 and PARS “Moderate”) but recognizes that these strategies provide less diversification and higher risk. We would like the full committee to examine the issue and state a preference.

Implementation

The second most important factor impacting long term investment returns is the manager’s rebalancing strategy. In most oscillating markets and over long periods of time, a “constant mix” strategy will perform better than a “buy and hold” strategy since constant mix maximizes the value of diversification. Some managers employ tactical adjustments to the “constant mix” strategy based the manager’s short-term views of capital market prospects. Implementation is a significant area of differentiation between the PARS strategies and the CEPPT strategies. CEPPT funds are managed to reduce tracking error (i.e. variance from benchmarks and from the aggregate weighted return of such marks) while PARS strategies are intended to produce portfolio level blended alpha through tactical allocation (i.e. create a positive premium over their blended benchmarks). The Ad Hoc Committee generally prefers the CEPPT approach to implementation but would like the full committee to state a preference.

Asset Selection

Third, most investment consultants would probably agree that the least reliable factor in determining investment returns is asset selection. PARS offers a set of “active management strategies” while CalPERS does not. Because of the heightened need to screen and monitor active investment strategies, the Ad Hoc Committee recommends the full committee only consider passive strategies.

Compare CalPERS and PARS Sec. 115 Investment Performance

Rev. 3/11/21

NOTE: •CalPERS CEPPT pension plans have only existed for 1 yr. But, CalPERS CERBT (OPEB) plans have a longer history.
•Thus, data below compares PARS Funds to CalPERS CEPPT and CERBT funds with comparable fixed income target allocations.

Annualized Net Returns (as of 12/31/20)

	Fixed Income Target	1 Yr	3 Yr	5 Yr	10 Yr	
PARS Conservative - Active	80%	8.43%	5.50%	5.24%	4.15%	
PARS Conservative - Passive	80%	7.96%	5.23%	4.75%	3.83%	
PARS Mod Conservative-Active	65%	10.16%	6.46%	6.52%	5.39%	
PARS Mod Conservative-Passive	65%	9.14%	6.16%	6.16%	5.10%	
CalPERS CEPPT #2	73%	8.54%	n/a	n/a	n/a	(only 1 year of data)
PARS Moderate - Active	45%	12.32%	7.85%	8.38%	6.89%	
PARS Moderate - Passive	45%	10.63%	7.25%	7.86%	6.68%	
						No significant difference in historical performance
CalPERS CERBT #2	43%	12.21%	8.12%	8.91%	n/a	
CalPERS CERBT #3	49%	10.70%	7.27%	7.60%	n/a	
CalPERS CEPPT #1	47%	11.24%	n/a	n/a	n/a	(only 1 year of data)
PARS Balanced-Active	35%	13.46%	8.55%	9.30%	7.64%	
PARS Balanced-Passive	35%	11.47%	7.77%	8.73%	7.41%	
PARS Capital Appreciation-Active	20%	13.90%	9.16%	10.32%	8.55%	
CalPERS CERBT #1	25%	13.31%	8.62%	9.85%	7.96%	

Attachment 2

Comparison of CalPERS vs PARS Section 115 Pension Plans

Rev. 3/20/21

	CalPERS CEPPT Plans	PARS
Size of Fund: # Calif. Agencies	28 pension plans plus 578 OPEB plans	225 plans in California (pension/OPEB)
Assets under Administration	$14.5 B (Sec. 115 plans only)	$5.1 B
Asset Allocation Options	2 funds (CEPPT #1 and #2)	5 active and 5 passive funds
Active vs Passive Options	Passive only	Active or passive
Transferability to a different Sec 115 Plan?	Yes	Yes
Termination restrictions	None	30 days notice
Can reimburse city for pension expenses?	Reimbursement of current year payments	Reimburse prior and current year payments
Limit on number and amounts of pay-ins?	No	No
Limit on total amount in fund?	Yes: UAL per CalPERS + PV of future benefits	Yes: Probably the same
Who is underlyting investment manager?	State Street	HighMark
Diversified from CalPERS?	Yes	Yes
Fund custodian	State Street	US Bank
Admin + Investment Mgmt Expense	0.25% (includes 0.025% to State Street)	0.6% (includes 0.35% to HighMark)
Investment implementation strategy	Managed to reduce tracking error	Intended to produce alpha thru tactical allocation
Expected Return	CEPPT #1: 5% CEPPT #2: 4% (10 year)	PARS Conservative: 4.668% (30 year) PARS Moderately Conservative: 5.47% (30 year) PARS Moderate: 6.33% (30 year)
Expected Risk (sigma)	CEPPT #1: 8.2% CEPPT #2: 5.2% (10 year)	PARS Conservative: 3.5% (30 year) PARS Moderately Conservative: 4.8% (30 year) PARS Moderate : 7.92% (30 year)
Fund creation date	CEPPT #1: Oct. 2019 CEPPT #2: Jan. 2020	OPEB: 2005 Pension: 2015
Target Allocations	(see attached)	(see attached)
Historical Performance	(see attached)	(see attached)

CalPERS and PARS Sec. 115 Plan Investment Targets

	Equity	Fixed	TIPS	REITS	Liquidity	Policy Ranges (plus or minus)
CalPERS CEPPT #1	40%	47%	5%	8%	0%	5% for Equity & Fixed ; 3% for TIPS
CalPERS CEPPT #2	14%	73%	5%	8%	0%	5% for Equity & Fixed ; 3% for TIPS
PARS Conservative	15%	80%	N/A	*	5%	Equity -10%/+5%; Fixed -20%/+15%
PARS Moderately Conservative	30%	65%	N/A	*	5%	Equity -10%/+15%; Fixed -15%/+15%
PARS Moderate	50%	45%	N/A	*	5%	Equity -10%/+10%; Fixed -5%/+15%
PARS Balanced	60%	35%	N/A	*	5%	Equity -10%/+10%; Fixed -5%/+15%
PARS Capital Appreciation	75%	20%	N/A	*	5%	Equity -10%/+10%; Fixed -10%/+10%

* included under Equity

CalPERS Benchmarks:

Equity	MSCI All Country World Index IMI (net)
Fixed Income	Bloomberg Barclays U.S. Aggregate Bond Index
TIPS	Bloombert Barclays U.S. TIPS Index
REITS	FTSE EPRA/NAREIT Developed Index (net)
Cash	91 Day Treasury Bill

PARS Blended Benchmark:

32% S&P 500
6% Russell Mid Cap
9% Russell 2000
4% MCI EM (net)
27% BBG Barclays US Agg
6.75% ICE BofA 1-3 Yr US Corp/Gov't
1.25% ICE BofA US High Yield Master II
2% Wilshire REIT
5% FTSE 1 Mth US T-Bill

POLICY 2.2
FUND BALANCE AND RESERVE POLICIES

2.2.1 FUND BALANCE – CLASSIFICATIONS

The City has adopted the provisions of GASB Statement No. 54, Fund Balance and Governmental Fund Type Definitions. GASB 54 establishes Fund Balance classifications based largely upon the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The Governmental Fund statements conform to this new classification.

The Fund Financial Statements consist of Nonspendable, Restricted, Committed, Assigned and Unassigned amounts as described below:

Nonspendable: Items that cannot be spent because they are not in spendable form, such as prepaid items, or items that are legally or contractually required to be maintained intact, such as principal of an endowment or revolving loan fund.

Restricted: Restricted fund balances encompass the portion of net fund resources subject to externally enforceable legal restrictions. This includes externally imposed restrictions by creditors (such as through debt covenants), grantors, contributors, laws or regulations of other governments, as well as restrictions imposed by law through constitutional provisions or enabling legislation.

Committed: Committed fund balances encompass the portion of net fund resources, the use of which is constrained by limitations that the government imposes upon itself at its highest level of decision making (normally the governing body) and that remain binding unless removed in the same manner. The City Council is considered the highest authority for the City and can commit funds through resolutions.

Assigned: Assigned fund balances encompass the portion of net fund resources reflecting the government's intended use of resources. Assignment of resources can be done by the highest level of decision making or by a committee or official designated for that purpose. The City Council has the authority to assign funds in Belvedere and can assign funds through the budgetary process.

Unassigned: This category is for any balances that have no restrictions placed upon them. The general fund is the only fund that reports a positive unassigned fund balance amount. In other governmental funds it is not appropriate to report a positive unassigned fund balance amount. However, in governmental funds other than the general fund, if expenditures incurred for specific purposes exceed the amounts that are restricted, committed, or assigned to those purposes, it may be necessary to report a negative unassigned fund balance in that fund.

2.2.2 FUND RESERVES

The City Council may elect to establish General Fund Reserve Policy/Guidelines. These Policy/Guidelines may be updated, modified and revised as determined by the Council. At the time of adoption of this Finance Policy, there are three such Policies/Guidelines: General Fund Reserve, 115 Pension Trust Reserve, and Insurance Reserve.

A. General Fund Reserve:

- Target: The City shall endeavor to achieve at year end a General Fund Reserve that totals one half of the current fiscal year's General Fund expenditures, plus one half of the current fiscal year's General Fund transfer to the Fire Fund, plus one half of pension-related debt payments. Transfers to the City's 115 Pension Trust and Additional Discretionary Payments made to CalPERS are excluded from the reserve requirement calculation (denominator) because they are discretionary in nature.

- Purpose: Funds reserved under this category shall be used in case of catastrophic events, for budget stabilization purposes, or for capital and special projects:

  - Catastrophic events: Funds reserved shall be used to mitigate costs associated with unforeseen emergencies, including natural disasters or catastrophic events. Should unforeseen and unavoidable events occur that require the expenditure of City resources beyond those provided for in the annual budget, the City Manager or designee shall have authority to approve Catastrophic General Fund Reserve appropriations. The City Manager or designee shall then present to the City Council a budget amendment confirming the nature of the emergency and authorizing the appropriation of reserve funds.

  - Budget stabilization: Funds reserved shall be used to mitigate, should they occur, annual budget revenue shortfalls (actual revenues less than projected revenues) due to changes in the economic environment and/or one-time expenditures that will result in future efficiencies and/or budgetary savings. Examples of "economic triggers" and one-time uses include, but are not limited to:

    - Significant decrease in property tax, or other economically sensitive revenues;
    - Reductions in revenue due to actions by the state/federal government;
    - Workflow/technical system improvements to reduce ongoing, personnel costs and enhance customer service;
    - One-time maintenance of service levels due to significant economic/budget constraints; and
    - One-time transitional costs associated with organizational restructuring to secure long-term personnel cost savings.

  - Capital and Special Projects: Funds reserved may be designated by the City Council for key infrastructure and capital/special projects as identified in the

City 5-year Capital Improvement Plan, as there is no ongoing funding source to support the City's capital needs.

- Classification: The General Fund Reserve is classified as "Assigned" in the City's financial statements.

B. 115 Pension Trust Reserve:

- Target: ~~It is the practice of the City to set aside up to $100,000 per year in the Pension Reserve Fund for current or future unfunded pension liability and/or other post-employment benefit (OPEB) liability payments~~. An annual amount as determined by the funding calculation prescribed in Policy 2.3.5.

- Purpose: ~~The Council may decide as part of its annual budget process to expend some or all of the accumulated Pensions Reserve Fund balance to pay down accrued unfunded pension or OPEB liability~~. The purpose of the 115 Pension Trust is to set aside an appropriate level of funds to fully fund accrued pension obligations at a more prudential rate. City Council approval is required for use of accumulated funds in the 115 Pension Trust to CalPERS as an additional discretionary payment or to offset a portion of the actuarially determined contribution.

- Classification: The 115 Pension Trust Reserve Fund is classified as "~~Assigned~~Restricted" in the City's financial statements.

C. Insurance Reserve:

- Target: Reserves shall be maintained between $50,000 and $100,000 to allow for emergencies and numerous or large claims. Reserves shall be replenished through subsequent charges to the appropriate user departments.

- Purpose: This Fund is designed to cover claims and deductibles related to property and casualty insurance claims.

- Classification: The Insurance Reserve Fund is classified as "Assigned" in the City's financial statements.

Administrative Policy Manual Amendment [DRAFT]

Policy 2.3 (Pensions and OPEB) is amended by deleting the section and replacing it with the following:

2.3 "PENSION/OPEB FUNDING

2.3.1 PENSIONS

2.3.1.1 Purpose and Goals

The City of Belvedere is committed to fiscal sustainability. In keeping with this principle, it maintains minimal debt and generous reserves to cope with exogenous shocks. The City is also committed to honoring its pension obligations. One of the biggest threats to the City's ongoing fiscal sustainability is its rising pension costs. The overarching goal of this Policy is to avoid the risk of crowding out vital public services in future years, and to provide balance sheet space to finance essential infrastructure projects in the years ahead, by funding its accrued pension obligations at a more prudential rate. This Policy also formalizes a past practice of using excess reserves to make discretionary payments to CalPERS whenever affordable.

Development of the City's Pension Funding Policy was guided by the following five tenets:

- The cost of employee benefits should be paid by the generation of taxpayers who receives services.
- Actuarial assumptions should be prudential to ensure that promised benefits can be paid.
- Funding shortfalls should be closed expeditiously. The goal is full funding.
- Large swings in employer contribution rates are undesirable. Smoothing is desirable.
- Funding policies and underlying assumptions should be clearly delineated and regularly reviewed.

2.3.1.2 Policy

The City shall seek to achieve full funding, over twenty years, of its pension obligations. This means that the City shall seek to have assets to cover 100% of accrued pension liabilities valued at a prudential discount rate (CalPERS discount rate adjusted to reflect real anticipated performance) by 2031 and beyond. This calibrates with CalPERS own amortization rules, which allow losses (or gains) to be amortized over 20 years.

2.3.1.3 Establishing and Funding a Section 115 Trust

The City shall establish a Section 115 Trust ("Trust") into which it will invest funds reserved for future pension-related expenses. The City will provide an initial investment into this Trust during Fiscal Year 20/21 and will make annual contributions to the Trust in amounts determined by the Finance Committee and approved by the City Council beginning in Fiscal Year 21/22. Funds set aside by the City for this purpose will be transmitted to the Trust no less than annually. The assets will be managed conservatively, reflecting the City's general risk aversion and pension plan maturity. The City's Finance Committee will establish Trust investment parameters for approval by the City Council.

2.3.1.4 Role of the Finance Committee

The City's Finance Committee will conduct a standing pension funding review at least every five years to reset the discount rate (adjusting for CalPERS' discount rate based on latest available evidence), set annual funding costs, and fix payments until the next review. It may also recommend transferring money from the Trust to CalPERS or making a discretionary payment to the Trust or CalPERS from excess reserves if any exist at that time. The Finance Committee will send its recommendations to the City Council for its consideration.

2.3.1.5 Determination of Funding Amounts

In developing its recommendations to the City Council, the Finance Committee will review CalPERS' current discount rate (i.e. expected rate of return on its investments), CalPERS' actual investment performance during the review period, and other relevant factors. The Committee will set an adjusted discount rate that it believes to be more realistic than the discount rate set by CalPERS, and will determine the amounts that should be set aside in the Trust to ensure full funding over the requisite period.

2.3.1.6 Financial Reporting

The City recognizes the importance of ensuring that pension obligations included in the City's financial statements, particularly its Comprehensive Annual Financial Report, are consistent with CalPERS, and will continue to use CalPERS' discount rate for these purposes. This facilitates easy comparison with other agencies and avoids possible negative impacts on *perceived* credit quality. The City equally recognizes the importance of communicating its pension stewardship. It will therefore include an annual pension update, describing its pension funding policy, Trust assets and adjusted funded status in its annual budget report.

2.3.1.7 Effect on Reserve Requirements

The City maintains a robust minimum reserve policy, with reserves required to equal no less than six months of general fund operating expenses, debt financing costs and fire contract costs net of fire tax revenues. Transfers to the Trust and additional discretionary payments made to CalPERS will be excluded from the reserve requirement calculation (denominator) because they are discretionary in nature. This is consistent with the City's existing treatment of discretionary payments to CalPERS and internal money transfers.

2.3.1.8 Employee Contributions

In accordance with PEPRA guidelines and compatible with other local agencies, the City will work over time to increase Classic employee contribution rates to 8.0% of salary for Miscellaneous employees and to 12.0% of salary for Safety workers.

2.3.2 OTHER POST EMPLOYMENT BENEFIT (OPEB)

The City offers OPEB health benefits to employees who meet CalPERS vesting requirements. The benefit provided to City retirees is the minimum amount allowable under the CalPERS health plan, with the exception of certain City Manager retirees, who receive a more generous benefit. This benefit is funded on a pay-go method, with no funds set aside in a trust for this purpose."

POLICY 2.5
INVESTMENTS

2.5.1 PURPOSE

The Investment Policy provides guidelines for the prudent investment of temporary idle cash, and outlines policies for maximizing the efficiency of the cash management system. Its purpose is to enhance the economic status of the City while protecting its pooled cash.

2.5.2 OBJECTIVE

A. The investment objective is to ensure fund safety, preserve a significant amount of liquidity and achieve yields on City funds that are idle.

B. The cash management system is designed to accurately monitor and forecast expenditures and revenues, thus enabling the City to identify those funds that could be invested without adversely affecting City operations.

2.5.4 POLICY

In order to maximize interest earnings, the City pools the cash from all funds, except those funds held in trust for the City by various financial institutions in accordance with applicable trust agreements. Interest revenue derived from pooled cash is allocated monthly to the participating funds based on the relative cash balance of each fund.

2.5.5 INVESTMENT CRITERIA

Criteria for selecting investments and the order of priority are:

- Safety: The safety and risk associated with an investment refers to the potential loss of principal, interest or a combination of these amounts. The City only operates in those investments that are considered very safe and are allowable under Government Code Sections 53600 to 53610.

- Liquidity: This refers to the ability to “cash in” at any moment in time with a minimal chance of losing some portion of principal or interest. Liquidity is an important investment quality especially when the need for unexpected funds occasionally occurs.

- Yield: This is the dollar earnings an investment can provide, and sometimes is described as the rate of return.

2.5.6 INVESTMENT INSTRUMENTS

A. Eligible Securities: The City may invest in the following instruments under the guidelines as provided herein and in accordance with Sections 53601, 53635, 53637, 53638, 53651, 53652 and 53653 of the California Government Code. Percentage limitations on the purchase of securities apply at the time of purchase.

   i. LOCAL AGENCY INVESTMENT FUND (LAIF) Investment of funds in the California LAIF which allows the State Treasurer to invest through the Pooled Money Investment Account subject to the State's annual investment policy. Maximum investment is subject to State regulation.
   ii. INTERNAL REVENUE CODE SECTION 115 TRUST under investments authorized by Government Code Section 63601. The Section Trust 115 trust(s) will be irrevocable and used only to pay the City’s pension obligations.
   iii. OTHER investments that are, or may become, legal investments through the State of California Government Code and with prior approval of the City Council.

B. Prohibited Securities:

   i. Those securities not enumerated under 2.5.6. A. "Eligible Securities," as well as Inverse floaters, range notes, interest only strips derived from a pool of mortgages (collateralized mortgage obligations) and any security that could result in zero interest accrual if held to maturity as specified in Section 53601.6 of the California Government Code.
   ii. Securities lending agreements.

2.5.7 OVERSIGHT

The Finance Committee shall review investments and investment performance on an annual basis. The Committee’s findings shall be reported to the City Council through the Councilperson(s) who serve on the Committee. The Finance Committee shall also review this Investment Policy every three years and report any recommendations to the City Council through the Councilperson(s) who serve on the Committee.

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A. The investment objective is to ensure fund safety, preserve a significant amount of liquidity and achieve yields on City funds that are idle.

B. The cash management system is designed to accurately monitor and forecast expenditures and revenues, thus enabling the City to identify those funds that could be invested without adversely affecting City operations.

2.5.4 POLICY

In order to maximize interest earnings, the City pools the cash from all funds, except those funds held in trust for the City by various financial institutions in accordance with applicable trust agreements~~ related to debt issues~~. Interest revenue derived from pooled cash is allocated monthly to the participating funds based on the relative cash balance of each fund.

2.5.5 INVESTMENT CRITERIA

Criteria for selecting investments and the order of priority are:

- Safety: The safety and risk associated with an investment refers to the potential loss of principal, interest or a combination of these amounts. The City only operates in those investments that are considered very safe and are allowable under Government Code Sections 53600 to 53610.

- Liquidity: This refers to the ability to "cash in" at any moment in time with a minimal chance of losing some portion of principal or interest. Liquidity is an important investment quality especially when the need for unexpected funds occasionally occurs.

- Yield: This is the dollar earnings an investment can provide, and sometimes is described as the rate of return.

2.5.6 INVESTMENT ~~APPROACH~~INSTRUMENTS

~~It is the practice of the City to invest primarily in the Local Agency Investment Fund or in similar low-risk instruments. Longer-term investments of reserve funds or bond proceeds in other instruments may be considered and recommended by the Finance Committee to the City Manager. Any such investments should only be undertaken if the likelihood of the City needing to deploy these funds in the near term is low.~~

A. Eligible Securities: The City may invest in the following instruments under the guidelines as provided herein and in accordance with Sections 53601, 53635, 53637, 53638, 53651, 53652 and 53653 of the California Government Code. Percentage limitations on the purchase of securities apply at the time of purchase.

   i. LOCAL AGENCY INVESTMENT FUND (LAIF) Investment of funds in the California LAIF which allows the State Treasurer to invest through the Pooled Money Investment Account subject to the State's annual investment policy. Maximum investment is subject to State regulation.
   ii. INTERNAL REVENUE CODE SECTION 115 TRUST under investments authorized by Government Code Section 63601. The Section Trust 115 trust(s) will be irrevocable and used only to pay the City's pension obligations.
   iii. OTHER investments that are, or may become, legal investments through the State of California Government Code and with prior approval of the City Council.

B. Prohibited Securities:

   i. Those securities not enumerated under 2.5.6. A. "Eligible Securities," as well as Inverse floaters, range notes, interest only strips derived from a pool of mortgages (collateralized mortgage obligations) and any security that could result in zero interest accrual if held to maturity as specified in Section 53601.6 of the California Government Code.
   ii. Securities lending agreements.

2.5.7 OVERSIGHT

The Finance Committee shall review investments and investment performance on an annual basis. The Committee's findings shall be reported to the City Council through the ~~Mayor and Vice Mayor,~~Councilperson(s) who serve on the Committee. The Finance Committee shall also review this Investment Policy every three years and report any recommendations to the City Council through the ~~Mayor and Vice Mayor~~Councilperson(s) who serve on the Committee.

PROPOSED LANGUAGE FOR BUDGET SECTION ON PENSIONS

The City contracts with the California Public Employees' Retirement System (CalPERS) for its employee defined-benefit pension plans. The City is statutorily required to pay the Annual Required Contribution (ARC) to CalPERS. The ARC comprises two elements; the Normal Cost (NC), which is the annual cost of service accrual, and the Unfunded Accrued Liability (UAL) Payment, which represents the catch-up portion of costs. CalPERS calculates the NC and the UAL based on a 7.0% discount rate, which mirrors its 7.0% expected return on plan assets. The City recognizes that this 7.0% investment target is ambitious and does not align with actual experience, nor necessarily expected experience. As losses mount, annual catch-up costs accelerate. To address this shortcoming, the City's Pension Funding Policy comprises the following elements:

Discount Rate: Commencing FY21-22, the City will use a discount rate of <u>CalPERS' expected return on plan assets *minus* 100 basis points</u> to value its pension obligations. This will peg the City's discount rate at 6.0% for FY21-22. Recognizing that CalPERS may reduce its own discount rate in coming years, this 6.0% rate will be fixed until the next standing pension funding review (see later). This approach will facilitate sensible budget planning.

Funding Goal and Timeframe: The City's goal is full funding. It seeks to have assets to cover 100% of accrued pension liabilities valued at a prudential discount rate (putatively "CalPERS minus 100") within 20 years. This calibrates with CalPERS own amortization rules, which allow losses (or gains) to be amortized over 20 years.

Funding Calculation: The City will use CalPERS' Pension Outlook Tool (see "Methodology" below) to calculate what the NC and the annual UAL Payment would be if a 6.0% discount rate were applied to the City's four CalPERS' pension plans instead of CalPERS' discount rate. This additional cost will be smoothed over a five-year period and the annual cost included in the City's budget.

Funding Vehicle: The additional funds set aside by the City will be transmitted to a Section 115 pension trust no less than annually. The assets will be managed conservatively, reflecting the City's general risk aversion and pension plan maturity.

Trust Seeding: In Fiscal Year 2020/2021, the City seeded its Section 115 trust with $1.5 million of funds; $1.2 from excess reserves and $300,000 from the City's non-binding pension reserve account, which was dissolved.

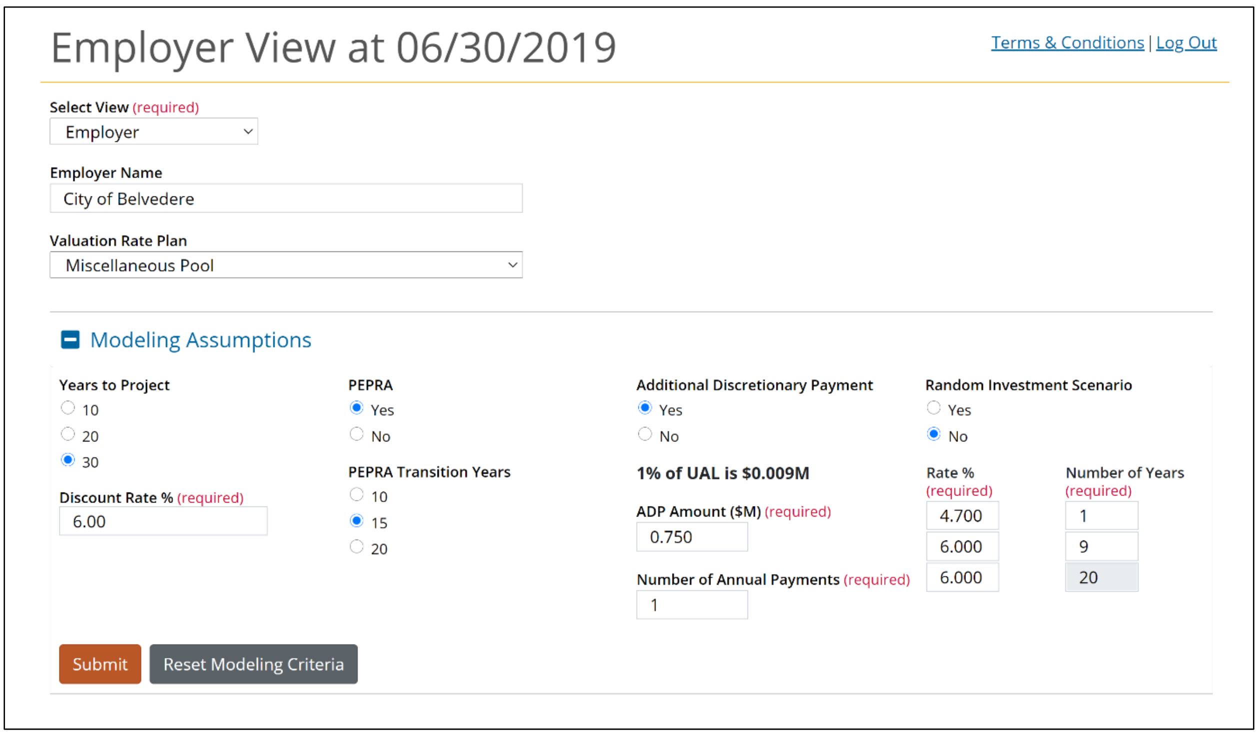
Oversight & Review: The City's Finance Committee will conduct a standing pension funding review at least every five years to reset the discount rate (at an appropriate margin to CalPERS' discount rate based on latest available evidence), adjust annual funding costs and fix payments until the next review. It may also recommend transferring money from the 115 trust to CalPERS or making a discretionary payment to the 115 trust or CalPERS from excess reserves if any exist at that time. The Finance Committee will send its recommendations to the City Council for approval.

Methodology for Calculating the Impact of a Lower Discount Rate on Annual Pension Costs

The City of Belvedere will use CalPERS' Pension Outlook Tool to estimate the additional annual pension costs associated with its lower discount rate assumption. The City recognizes the limitations of the tool, notably that outputs are one year off-cycle, and that application of a lower discount rate does not "stick", so the amortization clock restarts every time the model is run. The City is comfortable with these shortcomings, which skew towards modestly overpaying service accrual and UAL amortization costs in the short term.

The inputs outlined in Exhibit 1 were used to calculate the increase in costs commencing FY21-22 associated with the City's adoption of a 6.0% discount rate assumption, versus CalPERS' 7.0% baseline assumption. The City plans to make a $1.5 million discretionary payment to its Section 115 trust no later than June 30, 2021, which is split 50:50 between Miscellaneous and Safety Pools for modeling purposes. CalPERS generated a 4.7% preliminary investment return for the year ending June 30, 2020 which is used as the Year 1 investment return assumption in the model.

Exhibit 1: Modeling Assumptions



Source: CalPERS' Pension Outlook Tool

The outputs from the model are shown in Exhibit 2. The Normal Cost increases by an average of $90,000 and the UAL Payment by an average of $210,000 per annum over baseline for the five years commencing FY22-23. The City thus intends to transmit $300,000 per year commencing FY21-22 (one year early) to its Section 115 trust for the next five years, or until the next pension funding review, whichever is sooner. Should CalPERS lower its own discount rate between review periods, the City may transmit a portion of this $300,000 to CalPERS to compensate for the associated increase in ARC payments. All things being equal, CalPERS' Pension Outlook Tool will be used again as part of the next standing review (using a newly agreed discount rate), and payments fixed for a further multi-year period.

Exhibit 2: City of Belvedere Increase in Annual Pension Costs Associated with a 6.0% Discount Rate Assumption

$ millions	Increase in Normal Cost	Increase in UAL Payment	Total Increase
2022-23	0.10	0.19	0.29
2023-24	0.09	0.20	0.29
2024-25	0.09	0.21	0.30
2025-26	0.09	0.21	0.30
2026-27	0.08	0.22	0.30
Average of Period	0.09	0.21	0.30

Source: CalPERS' Pension Outlook Tool