

Date: December 1, 2019

To: Mayor and Pension and OPEB Trusts Oversight Committee Members

From: Terry Duryea, member of Town Council Finance Committee

Subject: Comments on Agenda Item 4 "Receive CALPERs Actuarial Valuations Reports as of June 30, 2018" and Item 5 "Bartel Associates OPPEB Accounting Information Report as of June 30, 2018"

For your information, at the October 14, 2019 Town Council Finance Committee meeting, the Committee reviewed and discussed extensively both Items 4 and 5

To give you greater insight into the Reports, presented in semi-outline form, are 3 key points discussed at the Finance Committee meeting

Item 4: Staff Memo Page 2 shows that the PEPRAs Safety Plan is 91.6% funded, down from 94.8%

- This funding percentage is better than the approximately 70% funded for our other plans, BUT to see the significance of the 91.6% funded ratio you need to understand history
 - The State set up a separate PEPRAs Plan in 2013 to address the high cost of pensions— i.e. it provided for reduced pension benefits for employees hired after 2012
 - So where are we 5 years after the plan was implemented?
 - During those years we have seen superior stock market performance, BUT
 - The PEPRAs pooled Safety Fund that Los Gatos participates in has an unfunded liability, i.e. it is 91.4% funded (which has declined from 94.8% in 2017)
 - One reason, although not necessarily the most significant is that CALPERs assumes a 2.75% annual payroll raise
 - Therefore, anytime the Town Council approves raises over 2.75%, they are authorizing an increase in our unfunded liability

Conclusion 1: All the information you, Town Staff, our employees, and Town residents rely on to make decisions and make judgements is based on unrealistically optimistic assumptions, methodologies, and reporting

Conclusion 2: PEPRAs will not solve our unfunded pension obligation problem as the Plan is currently managed and reported

Item 4: Observations from the 2018 Actuarial Valuation discussed at the Finance Committee meeting

- Both Misc Plan and Safety Plan are very mature plans which according to the report increases the Town's financial risk significantly
- Here is information for the Miscellaneous Plan included as Attachment 1 to Item 4:
 - Many more people are collecting their benefits than are contributing into the plan— here is the information for the Misc Plan:

▪ Collecting benefits from the plan	238
▪ Contributing to the plan	113
▪ Ratio	2.1 to 1
 - 58% of Town's total pension liability of \$121M (per CALPERs) is due to members currently receiving benefits
 - Current payout exceeds current annual contributions (\$5.9M outflow—\$3.4M inflow) in 2018

- That indicates the fund is being liquidated, and the primary reason for the high risk to the Town
- Imagine what the funding ratio will look like in the next stock market correction—pension obligations will remain fixed while assets that are being invaded to meet current payment obligations decline
- Unfortunately, that's not the worst information: Based on Los Gatos's risk metrics in the Valuation Report, the Report states our risk is expected to get even worse

Conclusion: When Staff compares our funding percentages to other communities to justify how well we are doing on a relative basis, you should ask them the question “do the comparison cities have the same risk profile as Los Gatos”? And if not, ask for comparisons with cities that have a similar risk profile

Item 4: Finance Committee discussed the conflict of interest that exists when the Town Staff negotiate for their own benefits

- The following ideas were raised to address this conflict:
 - While the Finance Committee can't be involved in labor negotiations, possibly this Committee could provide input to Town Council as you prepare for labor negotiations
 - It was stated that Palo Alto's City Council Finance Committee is involved in prepping the Palo Alto City Council
 - At the Finance Committee meeting, the Town Manager said she would talk with the Town Attorney to see if and how this can be done
 - I have not heard anything further from the Town Manager
- Budgeting at the top of the pay scale does not help this situation—it's easier to give raises if one budgets at the top of the pay scale, since you don't have accountability for salaries

Thank you for reading this. I will be at the meeting to summarize these 3 items and more importantly to answer any questions you might have.

Respectfully,
Terry Duryea