

DRAFT MOTIONS RECEIVED

Draft Motion #1: 115 Pension Trust

I move that the Finance Commission recommend that the Town Council direct staff in June 2026 to use the full current balance of the Town's Pension Section 115 Trust, estimated at approximately \$3.8 million, subject to staff verification, to make one or more Additional Discretionary Payments to CalPERS for the purpose of reducing the Town's unfunded accrued pension liabilities.

The Commission further recommends that this payment not be allocated mechanically or pro rata across all unfunded liabilities, but instead be targeted, in consultation with the Town's actuary and CalPERS as appropriate to the amortization bases, plans, or unfunded commitments where the payment is expected to produce the greatest fiscal benefit to the Town.

In determining the allocation of the ADP, staff should evaluate, at minimum:

- the projected reduction in total UAL principal;
- the net present value of avoided future UAL payments;
- the reduction in future required employer contributions;
- the impact on contribution volatility across the Safety and Miscellaneous plans;
- the shortening or elimination of higher-cost amortization bases; and
- the consistency of the payment with the Town's reserve, liquidity, and long-term financial policies.

The Finance Commission recommends that staff return to the Town Council with a concise implementation analysis before execution or as part of the Council action, including the recommended target allocation, projected annual savings, estimated net present value savings, impact on future CalPERS contribution schedules, and confirmation that use of the Pension 115 Trust balance does not impair the Town's operating reserves or near-term fiscal flexibility.

Background

The Pension 115 Trust provides valuable fiscal flexibility, but flexibility has value only if it is governed by a clear policy. The Town should not treat all available reserves and surplus funds the same. Some funds are needed for near-term operations, legally restricted purposes, adopted reserves, or capital commitments. Some funds should be preserved for plausible adverse scenarios identified through the Town's Asset Liability Management work. Other funds may be genuinely excess to the Town's current and reasonably foreseeable needs.

Once funds are identified as available beyond near-term needs, adopted reserve policies, legal restrictions, capital plans, and stress scenarios, the Town should have a disciplined process for determining whether those funds can be put to better use by reducing CalPERS unfunded accrued liabilities. A clearer framework for categorizing available resources would preserve fiscal resilience while reducing the risk that the Town carries avoidable pension costs simply because it has not adopted a formal definition of deployable surplus.

I move that the Finance Commission recommend that the Town Council direct staff, as part of the Town's Asset Liability Management work stream and long-term financial planning process, to reassess the Town's policy for use of the Pension Section 115 Trust and broader available reserves.

The Commission recommends that this reassessment be grounded in two principles: first, that the Town should preserve appropriate fiscal flexibility; and second, that the Town should avoid unnecessarily retaining funds that could be used to reduce high-cost CalPERS unfunded pension liabilities.

To support this policy, the Commission recommends that the Town develop a formal framework that classifies available funds into three categories:

Bucket 1: Near-Term Required Funds

Funds needed for operating liquidity, adopted budget commitments, legally or contractually restricted purposes, emergency reserves, near-term capital needs, and other obligations that should remain readily available.

Bucket 2: Flexible Contingency and Scenario-Based Funds

Funds not immediately required, but prudently retained because they may be needed under reasonably foreseeable adverse scenarios, including recession, revenue shortfalls, capital cost escalation, litigation, disaster response, pension contribution increases, labor cost pressures, or other fiscal risks identified through the ALM process.

Bucket 3: Deployable Surplus Available for Pension Liability Reduction

Funds that are not required for near-term operations, are not legally restricted, are not needed to satisfy adopted reserve policies or capital plans, and are not needed under the Town's adopted stress scenarios. The Commission recommends that the Town formally define this third category and establish a policy presumption that such funds should be evaluated for deployment to CalPERS through targeted Additional Discretionary Payments.

The Commission further recommends that staff evaluate whether Bucket 2 funds should remain in traditional liquid reserves, be invested according to their expected time horizon and liquidity needs, be held in the Pension 115 Trust where legally and fiscally appropriate, or be reserved for future pension-cost stabilization. Funds in Bucket 3 should be evaluated primarily against the expected fiscal benefit of reducing CalPERS UAL, including projected avoided interest costs, reduced future required contributions, improved funded status, and improved long-term budget resilience.

The Commission recommends that staff return to the Town Council with a proposed policy defining these three categories, the metrics used to identify deployable surplus, and an annual process for determining whether additional targeted ADPs to CalPERS are warranted.

Staff Response: Staff agree the Council should consider use of these fund given the opportunity to reduce long-term costs and result in a better return on investment than leaving the funds in the 115. However, Council direction to staff has been to wait to act on the 115 funds until the asset, liability study is completed. Staff agree that waiting for a few more months until the ALM study is completed would be prudent, ensuring all financial information is available before deciding to transfer funds. This is because the Town retaining the funds provides flexibility to use these funds to offset pension costs as available to offset any potential budget shortfall that would otherwise result in the use of fund balance/reserves.

Draft Motion #2 : Vacancy Savings Factor and Monthly Reporting

Labor costs are the most significant expense category in the operating budget and effective methods to accurately plan, track and manage this expense category is critical. The Finance Commission recognizes efforts being made to better understand labor costs and believes these efforts should remain highest priority. Completing and maintaining monthly labor reporting that provides insight to each of the significant subcategories will allow the Town to identify variances from the intended plan and either take corrective action or utilize funds for other high priority items.

This planning and reporting should clearly delineate the following:

Labor hours/FTEs - the plan should be based on the intended to deployment of human capital to achieve the intended service level. This should include planned hires.

Direct Labor Dollars - the planned salary/wages that includes contract requirements and planned Step increases. The existing salary levels and planned salary levels for hires/vacancy replacements are one variable that should be well understood given the lack of flexibility for a

significant portion of salary wage escalation. Hiring is one of the few avenues the Town has to affect the overall salary and wages costs.

Pension/benefits - the costs of these items should be broken out from salary/wages.

Overtime - the Finance Commission recognizes the need and at times the benefit of utilizing overtime as a tool to manage vacancies, emergencies and other events not part of normal business. However, it can be an expensive method to provide services and should be closely tracked and managed. Maintaining overtime tracking in context of the other labor costs sub categories will help control costs and provide insight to the relationships like vacancy and need for OT.

Several years ago the Town adopted a vacancy rate applied to labor to reflect the persistent trend of significantly under running labor budgets. This method was a stop gap method to allow expected under runs to be redeployed for other Town needs. The lack of insight to the actual FTE's being charged meant the planned headcount and actual headcount were not known until after the close of the budget year with a significant surplus. The Commission believes this vacancy rate has served its purpose but the better method would be budget plans that include planned hires and tracking to those plans by monthly FTEs. As the Town implements those improved reporting methods we encourage a transition away from the brute force method of a vacancy rate to the real labor plan that supports the Town intended service levels. It is understood there will be unexpected vacancies throughout the years which will potentially result in temporary underruns - but by identifying those as variances on a monthly basis those variances will be understood and allow identification of trends or concerns to the Town. The decision to move away from a vacancy rate approach could be considered as the management tools are put into place and would improve the understanding and control of labor costs.

The above recommendations are a reflection of the good work that staff has accomplished and represents the next step forward in the ability to effectively plan and manage the largest cost category in Town Operating Expenses. As noted by staff, labor costs are expected to escalate at a higher rate than revenue so continuing to improve this expense category is appropriate.

Staff Response: Staff agree that more timely reporting would assist in calculating vacancy savings in the future. Additionally, staff agree that the Town should have a set number of staff to complete services at a certain level. However, because the root cause of the vacancies is do to attrition, employees leaving town service and then the lag time between filling the role, and potentially any change in compensation and benefits costs from the new hire, staff believe the current number of staff is the correct number. Under the current budget structure, the Council

approved the budget at the fund level and also approves the number of authorized positions. The Town Manager then manages both those numbers, using various tools including justification memos, use of part-time staff to backfill vacancies and overtime. Staff do not believe we will be ready to recommend a change in methodology to remove the vacancy savings factor until FY 2027-28 or beyond. As new reporting becomes available in July 2026, staff will consider potential replacement to the vacancy savings factor based on those report and within the budget approval structure of the Town.

Motion # 3: NHA Advisors Reports

Given the significance of long-term financial planning assumptions and the potential policy implications tied to analyses prepared by NHA Advisors, the Finance Commission recommends that any formal analyses, forecasts, or advisory recommendations produced by NHA first be presented to the Finance Commission for review and discussion prior to Council consideration or implementation.

This process would strengthen transparency, provide an opportunity for independent financial review, and allow the Commission to evaluate underlying assumptions, methodology, fiscal impacts, and consistency with the Town's broader long-term financial strategy before recommendations advance further in the decision-making process.

Staff Response: Staff agrees that the Finance Commission should view final reports prior to those reports coming to Council for approval. The Commission has been integral so far in making recommendations to NHA Advisors' work and we believe the Council and community would benefit from their continued input.

Motion #4: Internal Service Fund Charges

The Finance Commission moves to recommend that the Town Council direct staff to revise the FY2026-27 budget treatment of Internal Service Fund charges as follows:

1. Vehicle and Equipment Replacement Fund — Implement the Full \$1.5 Million Reduction

The Commission endorses staff's finding that a \$1.5 million reduction in Vehicle and Equipment Replacement Fund ISF charges is supportable in FY 2026-27 without creating an unfunded liability. Staff's ten-year projection confirms that ending fund balances remain healthy, averaging \$4.4 million through FY 2036, even with reduced contributions. The Commission recommends that this full \$1.5 million reduction be implemented. However, rather than redirecting any portion of those reduced charges to the Facilities Fund through an internal accounting transfer, the Commission recommends that the full \$1.5 million in savings flow

directly to the General Fund, producing a visible and reportable General Fund surplus that the Town Council can evaluate and direct. The Commission further recommends that ISF charges for the Vehicle and Equipment Replacement Fund be set going forward to recover actual and projected costs only, and not to generate structural surpluses or to compensate for prior period underspending through inflated future charges.

2. Facilities Fund — Direct Appropriation, Not ISF Reallocation

Rather than funding the Facilities Fund through a reallocation of reduced Vehicle ISF charges, the Commission recommends that staff prepare and present to the Town Council a standalone analysis of the Facilities deferred maintenance backlog, including the full assessed need in current dollars (assessed at \$3.4 million for FY 2025-26 and \$3.3 million for FY 2026-27), a prioritized list of identified repairs, a recommended multi-year funding strategy, and the annual General Fund appropriation required to address the backlog over a defined and fiscally responsible timeframe. This analysis should be presented as a direct budget request, separate from ISF mechanics, so that the Town Council can make an informed and transparent appropriation decision.

The Commission notes that the Town Council may at any time direct staff to execute a direct transfer from the General Fund to the Facilities Fund or any other Internal Service Fund when needs are clearly identified and prioritized. This direct transfer mechanism is the appropriate and transparent tool for addressing ISF funding gaps — not artificially inflated service charges embedded in departmental billing rates that accumulate quietly and are difficult to reverse.

3. ISF Charge Methodology — Comprehensive Review

The Commission recommends that staff conduct a comprehensive review of the methodology used to set charges across all Internal Service Funds, with the objective of ensuring that charges are set to recover actual and projected costs rather than to generate structural surpluses or to compensate for past underfunding through inflated future rates. Where ISFs are genuinely underfunded relative to documented future needs, staff should bring a direct funding recommendation to the Town Council through the budget process or via a specific transfer request, rather than embedding the catch-up cost in annual service charges. This review should be completed as part of the FY 2027-28 budget preparation process and presented to the Finance Commission prior to budget adoption.

The Finance Commission believes these recommendations will produce a more transparent, more accurately reported, and more fiscally resilient budget than the approach currently proposed and will better serve the Town Council's ability to make informed, visible, and deliberate decisions about the allocation of the Town's resources.

Staff Response: Staff agrees that Internal Service Fund charges for vehicles and equipment should be reduced by \$1.5 million. Staff also agree that all ISFs should be reviewed to ascertain proper fund balance and annual charges to departments. Staff will be reviewing both these items in FY 2026-27. However, staff recommends that the savings garnered by these funds be used to reduce unfunded liabilities in town facilities. Staff have recommended an alternative for Council's consideration in the staff report that recommends a transfer out of funds for identified facilities projects and still leaves the General Fund in a positive position for FY 2026-27.

Motion #5: Capital Improvement Program

- Establish an annual cash flow estimates for all capital project equal to or greater than over a million dollars so it can be tracked.
- Identify either, a PCI target specifically, or a spending capacity limit to spend on road resurfacing and repair.
- Identify a better location for the \$6.5 million carry forward from the road resurfacing and repair account for future projects, ie like the highway 17 expansion.

Staff Response: Staff will evaluate these recommendations more thoroughly in partnership with Finance, but we do agree these can be addressed.

PPW does agree that cash flow statements can be developed for the specific projects requested. The Complete Streets and Transportation recommended that the Town establish a PCI of 80 with the recommended \$3.7M per year spending level. The existing and future budget is unlikely to support spending \$3.7M per year in paving suggesting that within five years the overall PCI will be less than 80. The future of the paving program and required spending is a subject that staff believes warrants detailed discussion with Town Council.

It is important to note that the \$6.5M in carryforward does not include a \$439,706 expenditure approved by Council on April 21, and the proposed allocation of \$2.4 million from this fund proposed for action on May 19, 2026. Staff would recommend that some of the remaining \$3.6 million be set into reserve for future paving needs such as the North Santa Cruz Reconstruction.