



Office of the City Manager

May 28, 2019

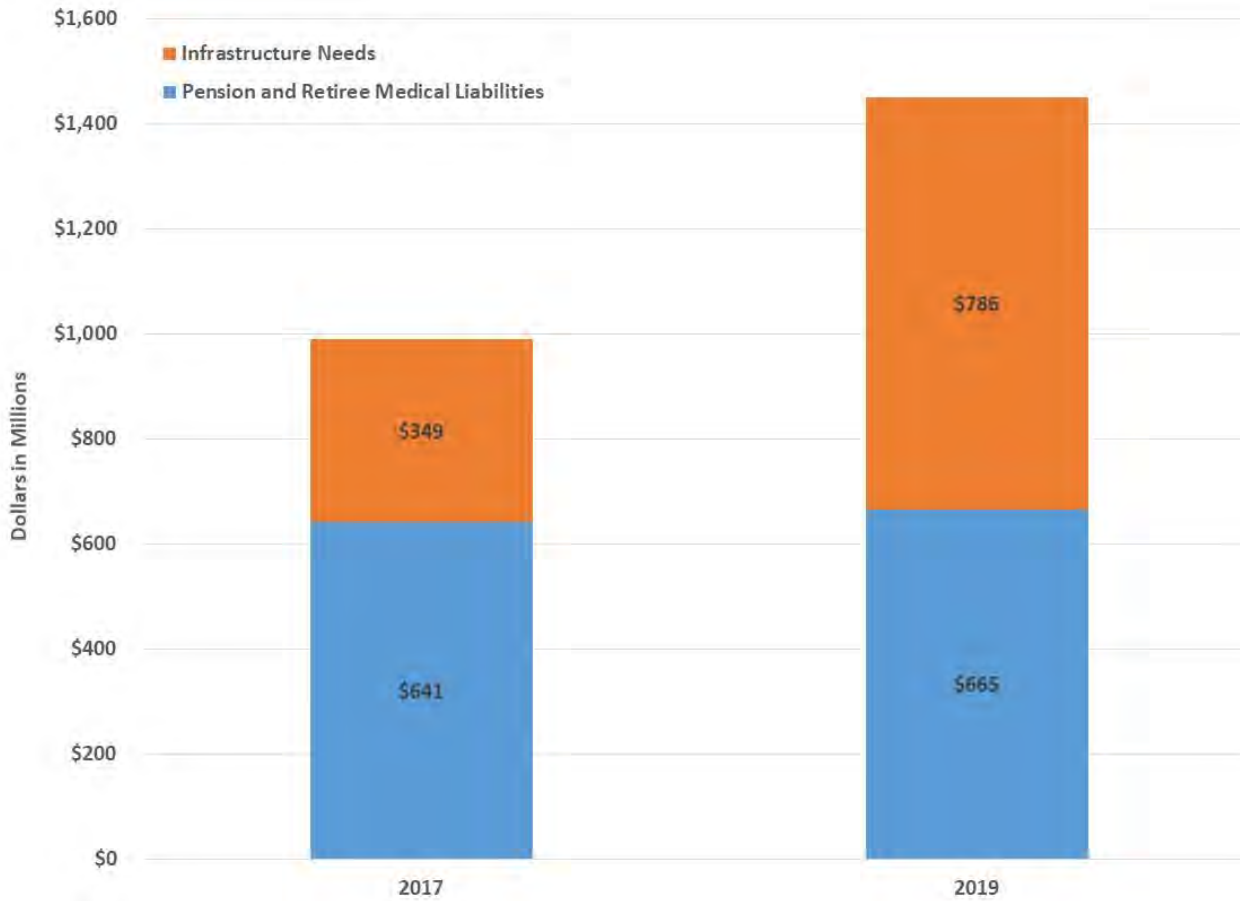
To: Honorable Mayor and Members of the City Council

From: *DWR* Dee Williams-Ridley, City Manager

Subject: Response to Questions Regarding March 19, 2019 Staff Report Regarding Projection of Future Liabilities

On May 29, 2012, the City Council adopted Resolution No. 65, 748 N.S. “Requiring that the City Manager Develop and Publish a Biennial Report of Current City Liabilities and Projections of Future Liabilities”. The March 19, 2019 staff report, Projection of Future Liabilities, was prepared in response to the resolution. The staff report summarizes the City’s liabilities and infrastructure needs. In comparison to what was presented to City Council in 2017, the City’s total liabilities and infrastructure needs increased by approximately \$460 million. As depicted in the chart on page 2, the increase is primarily the result of increased infrastructure and maintenance needs.

Comparison of Pension and Retiree Medical Liabilities and Infrastructure Needs 2017 - 2019



The purpose of this memorandum is to provide background information to respond to questions generated by the staff report regarding employee compensation, actions taken to address pension and retiree medical liabilities, and to explain the increase in liabilities and infrastructure needs that was presented to City Council.

Pension and Retiree Medical Liabilities

The City provides a defined benefit plan (pension) to employees, as well as certain post-retirement health insurance benefits. The City contracts with CalPERS to administer the pension benefit that is provided to employees and the post-retirement health benefits have been negotiated between the City and various collective bargaining units. Both of these items represent contractual obligations and the City has taken steps over the years to ensure that it can honor its commitments, while delivering the highest level of service to the community.

- From 2017 to 2019, the City's total unfunded liability related to CalPERS increased by approximately \$26.6 million, while the City's unfunded liability related to retiree medical health plans increased by approximately \$1.3 million.
- The increase in the unfunded liability attributable to CalPERS over this timeframe is not surprising given the changes implemented by CalPERS over the past few years to stabilize the pension system. The most recent change implemented by CalPERS that is having a direct impact on the City's pension liability is the reduction in the discount rate (assumed rate of return on investments), which CalPERS lowered from 7.5% to 7.0%. Because the reduction in the discount rate is being phased in over a three-year timeframe, the City will continue to experience an increase in its pension liability.
- The City has taken steps to address its CalPERS pension liabilities. Most recently, the City Council authorized the City to establish a Section 115 Pension Trust, which has been initially capitalized with \$9 million. Funds set aside in the Pension Trust can be used to offset increases in pension costs when revenues are inadequate in order to maintain service levels.
- In addition to establishing the pension trust, in 2018, the City made a lump sum payment of \$30.2 million to CalPERS in lieu of spreading these payments out over 26 pay periods and paying interest to CalPERS throughout the year. This is a best practice if an agency has available resources, as the City was able to generate approximately \$1 million in savings.
- Along with the Section 115 Trust (discussed above), the City has set aside resources to ensure that it can meet its obligations under its retiree health plans.
- Finally, in 2013, the state adopted AB 340, the California Public Employees' Pension Reform Act of 2013 (PEPRA), which required employers' to implement new retirement plans that will lower costs for the City in the long run. These new retirement plans apply to employees that either have never been members of CalPERS or have been separated from a CalPERS employer for six (6) months.

Infrastructure Maintenance

Over the years, staff have worked diligently to understand and document the condition and needs of the City's infrastructure. This work has been vital in providing City Council with an accurate picture of where the City is today and what resources are needed in the future. As discussed in the March 29, 2019 Staff Report, the City's infrastructure needs increased from \$348.8 million in 2017 to \$785.6 million in 2019. The following provides an overview of some of the infrastructure categories that have contributed to the growth.

- The capital and maintenance need for Parks, Park Buildings, Waterfront, and Camps increased by approximately \$85 million. The increase is primarily driven by the costs to rehabilitate the Waterfront. A more rigorous staff analysis of waterfront needs identified \$84 million of additional costs, increasing the 2017 estimate from \$27 million to \$110 million. An Off Agenda Memo dated December 13, 2018 provides a summary of all the work that has been done to understand the investment needed to rehabilitate the Waterfront. The City has taken a number of actions to address the Waterfront, including allocating existing City resources to address immediate capital needs, identifying projects to be funded with resources from Measure T1, applying for funds to replace and reconfigure some of the failing docks, and the City Council recently approved a contract to commence a specific planning process to develop a sustainable vision for the Waterfront.
- The capital and maintenance need for public buildings increased from \$33 million to approximately \$85 million. This is largely driven by updated estimates based on current and projected construction costs. Construction costs have increased significantly since the 2017 estimates.
- The increase in capital and maintenance need for streets and roads increased from \$124.5 million in 2017 to \$170 million in 2019. The increase in deferred maintenance for streets and roads is due to the continued degradation of the street network because the City does not have the resources to adequately invest in its road network.
- The increase in capital and maintenance need for sewers increased from \$100 million to \$190 million. Our updated capital plan includes more detailed needs through 2025 to meet the City's requirements for sanitary sewer pipe rehabilitation per the consent decree.
- The increase in capital and maintenance needs for storm drains increased from \$104 million to \$241 million. This figure reflects the estimated cost of projects identified in the [2012 Watershed Management Plan](#) plus additional potential Stormwater system capital projects identified by staff that are not included in the

2017 estimate. Additionally, the Watershed Management Plan projects costs were likely understated in the Unfunded Liabilities report two years ago.

To address the significant increase in deferred infrastructure maintenance, the City has developed an aggressive capital improvement program that proposes to spend approximately \$335 million from FY 20 through FY 24. The capital improvement program reflects City Council priorities, items that require immediate attention, and mandated investment. Resources that are being deployed come from the General Fund (represents 13% of total revenue allocated to the capital improvement program from FY 20 to FY 24) and a variety of sources that are earmarked for certain uses such as Special Revenue Funds, Bond Proceeds, Enterprise Funds, Internal Service Funds, and regional tax measures. The list of projects that is being funded is extensive and is summarized in the Fiscal Years 2020 and 2021 Proposed Capital Improvement Program.

Conclusion

The City recently published its proposed operating budget and capital improvement program for Fiscal Years 2020 and 2021. These items outline a spending plan to best address the goals, objectives and community priorities set by City Council. Unfortunately, there are not enough resources to address all of the City's needs. While the City has taken prudent action to address its contractual obligations, many years of underfunding have resulted in a growing list of infrastructure needs. Moving forward, City staff look forward to working collaboratively with the City Council to identify and implement strategies that will enable the City to successfully address these challenges.

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