March 16, 2017

**TO:** Honorable Mayor and City Council

**FROM:** Edward C. Starr, City Manager

**SUBJECT:** CITY MANAGER'S WEEKLY REPORT: March 10-16, 2017

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## CITY MANAGER/ADMINISTRATIVE SERVICES DEPARTMENTS

- Earlier this month, Finance Director Don Parker, Personnel Officer Gary Charleston, Senior Management Analyst Mikey Fuentes, Benefits Coordinator Leslie Phillips, Junior Accountant Liz Lew, and I attended the annual Public Retirement Seminar. Speakers were Bill Slaton, California Public Employee Retirement System (CalPERS) Board of Administration's local government representative, and Randall Dziubek, Senior Pension Actuary, Valuation Services, CalPERS Actuarial Office.

  During the course of presentations, City staff posed a number of questions to CalPERS representatives regarding (1) the health of the pension fund; (2) policies employed by CalPERS to achieve full funding of liabilities within 30 years; (3) apparent disparities in calculations between pool rates and non-pool rates, as well as apparent disparities between agencies within pools; (4) pool-related valuation studies that fail to recognize the unique pension experiences related to individual cities within pools; and (5) what is often viewed as an apparent indifference by CalPERS to the financial plight of cities as they face mounting and excessively high pension costs.

  In 2010, one year after a nearly $100 billion loss to its financial portfolio, from a high of $258 billion down to a low of $163 billion, CalPERS began a process of re-evaluation and re-positioning of its investments and administrative practices. This process ultimately placed CalPERS on a 30-year path (2015 to 2045) to achieve full-funding of pension obligations, shifting much of its focus to fully capture liability values on to member agencies—a path that now threatens the ability of many cities to maintain services to their respective communities, improve infrastructure, expand programs, hire employees, and provide employee wage and benefit adjustments.

Prior to the decision to achieve full funding by a certain date, full funding of pension liabilities was always a "theoretical" objective, with a rolling target date that moved forward from year-to-year. In some years, CalPERS approached or achieved full-funded status; but generally, the pension fund's holdings typically equated to 80 percent to 90 percent of total liabilities.

Historically, CalPERS relies on a mix of investments and contributions to fund the pension system; however, in recent decades, a number of failed investments, recessions, and real estate and Wall Street downturns combined to negatively impact the fund's investment earnings, pushing CalPERS to increasingly rely on member agencies and employees to fund a larger percentage of pension liabilities.

Today, CalPERS controls $303 billion in assets, equal to approximately 67 percent of total liabilities—estimated to be $455 billion. The CalPERS Administrative Board views the fund's current $303 billion fund status as a significant improvement over the 2009 decline to $163 billion. However, in relative terms, the pension fund is well below historical averages. In early 2009, the fund's pre-decline balance of $258 billion represented an estimated 84 percent funded status—at that time, there was little, if any discussion regarding the need to achieve full-funded status. In relative terms, CalPERS' fund balance should be at approximately $382 billion, if it is to be equivalent to its pre-decline funded status of approximately 84 percent.

For many local government agencies, the effort by CalPERS to achieve full-funded status has developed into a serious financial hardship. Montclair, through careful management and wise decisions by elected representatives, has achieved post-recession fiscal stability and growth; and, through bond funding, the City has embarked on an expansive infrastructure improvement program. Despite these efforts, however, a significant share of Montclair's annual revenue improvements is directed toward meeting annual increases in the CalPERS employer rate.

In addressing the City's pension concerns with CalPERS representatives, City staff made the point that the pension fund's goal of achieving 100 percent funding of liabilities is not functionally viable if it harms the fiscal integrity of the contributing agencies. Rather, CalPERS needs to recognize that an improved fund balance will come long-term based on achievement of the following conditions:

1. There will be a transition in the membership base as the Public Employee Pension Reform Act (PEPRA) employee population replaces the pre-PEPRA annuitant (retiree) population over the next 30 years—the same time frame targeted by CalPERS to achieve full funding of pension liabilities through massive member agency increases. As the annuitant and active employee populations transition to a predominant PEPRA base, with pension payments based on lower pension formulas, pension costs will eventually realize a progressive relaxation.

2. Repositioning its investment portfolio to control risk and improve/stabilize performance—a process already initiated by CalPERS—will provide the pension fund with greater reliability in two critical areas vital to its employer and employee contribution-based calculations: investment portfolio performance and projecting earnings.

3. Over the 30-year time frame established by CalPERS to achieve full funding (2015 to 2045), CalPERS should establish a minimum funding threshold of 80 percent through a mix of investments and employee/employer contributions. This practice would return CalPERS to a full-funding objective that rolls over from year-to-year and will minimize and control annual contribution increases and their impact on member agencies.

Minimally maintaining an 80 percent pension fund threshold (plus an investment reserve equal to 5 percent to 10 percent of portfolio value for greater risk investments) is generally considered a safe funding zone for pension systems. Member agency and employee contributions should be driven by maintenance of the minimum 80 percent threshold. Fund improvements above the 80 percent threshold may be achieved through an investment reserve fund within the fund's portfolio that may be used to invest in greater-risk instruments that allow for higher-yield returns. This reserved investment fund sector for greater risk investments would only be available from accrued pension assets above the minimum 80 percent threshold. The 80 percent threshold may adjust upward over time to guarantee balance between inflows and outflows and to maintain investment instruments that produce receipts targeted to achieve and maintain fund assets up to the minimum threshold level. Investment funds drawn from assets above the threshold would be used to improve value in the total fund, guarantee positive cash flow, limit employer and employee contributions, and provide additional funds for investment.

When overall investments fall short in performance, member agency contributions may rise, but only to (1) maintain the fund's minimum threshold, or (2) to ensure adequate inflows to meet outflows, maintain safer investment instruments that produce a stable inflow of receipts into the fund to meet the minimum threshold target, and provide for a reserve investment fund sector for greater-risk investments.

Achieving an 80 percent threshold of funding of liabilities would substantially approximate historic CalPERS fund levels, and would maintain the pension system in a relatively safe and healthy zone without unnecessarily overburdening member agencies (cities) with the threat of fiscal insolvency from a CalPERS trek to achieve 100 percent funding by 2045.

Why does an 80 percent threshold work? One hundred percent funding represents total liability for the entire CalPERS member population—both active employees and annuitants (retirees). There are 1.6 active employees for every CalPERS annuitant. This means that at any given point, more members are paying into the system than are receiving from the system. Even in the current negative cash flow situation that stems from the 67 percent fund level, the pension system is not in danger of collapse—fund assets are sufficient to meet annuitant obligations well into the future. However, it is important for CalPERS to minimally achieve a balance between receipts and disbursements. In the near-term, a minimum 80 percent fund threshold (plus 5 percent to 10 percent of portfolio value for greater-risk investments) is sufficient to pay annuitants, provide for positive cash flow, and allow for targeted investment strategies that incorporate safe and greater-risk investments, with the long-term objective of achieving and maintaining 100 percent funding of liabilities.

While it may be necessary, long-term, to gradually increase the pension fund threshold level above 80 percent to provide positive cash flow for both outflow and investment purposes, particularly in view of the long-term gradual population shift between active and retired members, the immediate effort to target a 100 percent fund base over 30 years may prove detrimental to contributing members and endanger the pension fund's long-term viability as it represents a threat to the fiscal integrity of member agencies.

The gradual impact of PEPRA changes to pension formulas and how they relate to the annuitant population and changes to the active employee-annuitant population ratio may ultimately impact the fund's long-term health. Long-term, pension formula changes will produce a lower overall cost impact to the pension fund; however, CalPERS will need to balance this change with a projected gradual decline in the active employee population versus a corollary increase in the annuitant population. Over the next 20 years, CalPERS' actuaries project the active employee population will decline to 0.6 versus 1.0 annuitants. This population change would ultimately shift a larger burden for pension liabilities to employers and employees if the fund's investment portfolio fails to produce positive, long-term results. At the current 100 percent pension fund target, the cost impact of this dynamic change in the active employee to annuitant population ratio could prove catastrophic to member agencies, particularly in light of upcoming, projected increases as indicated in the following table provided by CalPERS:

**Table 1**

**Estimating Public Agency Contribution Increases**

| | | **Normal Cost Range** | | **Unfunded Liability Payments** | |
|---|---|---|---|---|---|
| **Valuation Date** | FY Impact | Miscellaneous Plans | Safety Plans | Miscellaneous Plans | Safety Plans |
| **6/2016** | 2018–19 | 0.25% – 0.75% | 0.5% – 1.25% | 2% – 3% | 2% – 3% |
| **6/2017** | 2019–20 | 0.5% – 1.5% | 1.0% – 2.5% | 4% – 5% | 4% – 6% |
| **6/2018** | 2020–21 | 1.0% – 3.0% | 2.0% – 5.0% | 10% – 15% | 10% – 15% |
| **6/2019** | 2021–22 | 1.0% – 3.0% | 2.0% – 5.0% | 15% – 20% | 15% – 20% |
| **6/2020** | 2022–23 | 1.0% – 3.0% | 2.0% – 5.0% | 20% – 25% | 20% – 25% |
| **6/2021** | 2023–24 | 1.0% – 3.0% | 2.0% – 5.0% | 25% – 30% | 25% – 30% |
| **6/2022** | 2024–25 | 1.0% – 3.0% | 2.0% – 5.0% | 30% – 40% | 30% – 40% |

Ultimately, the concept of full-funding is a misnomer and an elusive goal due to the dynamic nature of investment strategies, fluctuations in the economy, transitional changes to the population cohort served, and year-to-year as well as generational changes in actuaries and mortality tables. Of particular note is the transitional shift in the active versus annuitant populations—a condition that will only stabilize long-term when, and if, equity is re-established between the two populations. Intricately connected to this latter concern, however, is a local dynamic occurring in many member agencies: In the aftermath of the Great Recession and in the face of annual and significant CalPERS rate increases, many member agencies are controlling costs by (1) restricting growth in their respective employee populations or implementing workforce reductions; and/or (2) limiting wage adjustments. These scenarios, while designed to establish or maintain local financial stability, have become major contributors to the transitional change in the population cohort and CalPERS' negative cash-flow concerns.

In the near-term, CalPERS needs to implement revised investment objectives; gradually revise projected investment earnings to reflect real performance; introduce measures that address a declining active employee population vis–à–vis an increasing retiree population; reconsider its long-term objective to achieve full funding of liabilities as opposed to a strategy to achieve balance between inflow and outflow with sufficient reserves to provide for a mix of investment choices; separate its investment strategy to include a mix of investments and contributions that minimally maintain an 80 percent funding threshold; divide its investment portfolio to (1) provide for safer investments that, when combined with employer and employee contributions, achieve and maintain a minimum 80 percent funding threshold, and (2) provide for a strategically defined investment strategy that invests available funds above the required minimum threshold into riskier, higher-yielding investments designed to increase funding above 80 percent; and pursue a constitutional amendment that reconstitutes the Administrative Board to reflect a mix of experts from the financial, banking, investment, insurance, and auditing industries whose sole charter is to achieve and maintain a healthy pension system, long-term, for the benefit of taxpayers and California's public employees.

Upon conclusion of the seminar, City staff spoke individually with CalPERS representatives to press Montclair's concerns. City staff was advised that expressed concerns would be discussed with the Board. In addition, a letter conveying Montclair's recommendations will be transmitted to the Board.

- Cities across the nation are preparing to cope with a plan being floated by Washington D.C. to eliminate the Community Development Block Grant (CDBG) program starting in Fiscal Year 2018. Reduction or elimination of CDBG funds would be directly tied to a plan to reduce Housing and Urban Development (HUD) funding by more than $6 billion in order to offset an estimated $54 billion increase in defense spending. The proposed reduction to HUD would be equal to 14 percent of the agency's budget. Reductions would also target $2 billion for public housing assistance.

  CDBG funds are used in Montclair for graffiti abatement, alleyway improvements, support for senior citizen programs, and other community projects.

  The CDBG program is a companion program to the former General Revenue Sharing (GRS) grant program that provided unrestricted funds to each of the 50 states and to cities, towns, and counties under the State and Local Fiscal Assistance Act of 1972. The program expired in 1987.

  GRS funds could be used for any purpose by the recipient governments. In contrast, to receive CDBG funds, applicant agencies must identify urgent needs and solicit project ideas and plans from citizens and local organizations that address those needs. The program is specifically designed to support affordable housing, anti-poverty programs, and infrastructure development.

  Eliminating or cutting CDBG funds would risk ending or harming community-based programs designed to make environments safer. City staff will ask congressional representatives to oppose elimination of CDBG funding.

# COMMUNITY DEVELOPMENT DEPARTMENT/ ECONOMIC DEVELOPMENT

- Montclair Housing Corporation (MHC) staff is conducting its Annual Income Certification of existing tenants. The MHC is required by state law to annually certify that tenants continue to income-qualify for their affordable rental units. Tenants are required to submit a copy of their 2016 Federal Income Tax Returns, as well as copies of current pay stubs. Tenants found to exceed the income limits for their family size are provided a courtesy notice advising them they will need to vacate the unit within six months.

  Staff has found the six-month notice provides families ample time to find new rental housing, as opposed to giving them a 60-day notice. Often times, however, the families end up purchasing a home. Last year, three families moved on to homeownership after being advised they exceeded the income limits for their family size.

- Macy's is morphing into a discount store. The department store chain is testing self-service systems in its shoe departments and beauty counters, meaning customers would serve themselves instead of finding a salesperson to retrieve shoes or make cosmetics recommendations.

  This model copies highly successful off-price retailers like TJ Maxx and Nordstrom Rack. Customer service once set Macy's apart from those retailers. But now, customers do not even want that level of service when they are shopping, according to Macy's chief financial officer. This is not the first time Macy's has copied discount stores, and it will not be the last.

  Macy's has added a clearance section to its department stores that it calls "Last Act." And a couple of years ago, Macy's launched an off-price brand called "Backstage" that sells Macy's brands at steeply discounted prices, up to 80 percent off. The company opened a number of stand-alone "Backstage" stores and last year started rolling them out within existing Macy's locations.

  Macy's same-store sales, or sales at stores open at least a year, fell 2.7 percent in the key holiday quarter. The company said it expects that metric to drop between 2.2 percent and 3.3 percent this year.

  Sears and JCPenney also reported dismal holiday quarters. The three chains are collectively closing nearly 400 stores in the first half of the year to slow the losses.

- Troubled electronics retailer RadioShack has filed for bankruptcy for the second time in just over two years. The Fort Worth, Texas-based retailer filed its petition in bankruptcy court in Delaware on Wednesday.

  The company says it is closing about 200 stores and evaluating options on the remaining 1,300.

  In a statement, RadioShack President and Chief Executive Officer said since the company's bankruptcy filing in 2015, the retailer had made progress in stabilizing operations, including reducing operating expenses by 23 percent.

  Analysts say several reasons, including a partnership with wireless carrier Sprint that proved not to be as profitable as expected, prompted the latest bankruptcy filing. General Wireless, part of hedge fund Standard General, acquired the RadioShack trademark and many of its stores after its 2015 bankruptcy.

  RadioShack was founded in 1921. Long known as the place to find batteries and obscure electronic parts, in recent years the company tried to remake itself as a specialist in wireless devices and accessories. That strategy largely was stymied by the advent of smartphones. RadioShack has tried to update its image, but faces formidable competition from online and discount retailers.

ECS:spa

May your thoughts be as glad as the shamrocks. May your heart be as light as a song. May each day bring you bright, happy hours that stay with you all the year long.

**~ Irish saying**

# *MARCH 2017*


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|---|---|---|
| 17 | St. Patrick's Day | |
| 20 | Happy Spring! | |
| 20 | Real Estate Committee Meeting - Canceled | |
| 20 | Code Enforcement/Public Safety Committee Meeting - Canceled | |
| 20 | Public Works Committee Meeting (special meeting)<br>City Hall Conference Room | 5:45 p.m. |
| 20 | City Council Meeting<br>Council Chambers | 7:00 p.m. |
| 27 | Planning Commission Meeting<br>Council Chambers | 7:00 p.m. |
| 28 | City Manager's Staff Meeting<br>City Hall Conference Room | 9:00 a.m. |

# *APRIL 2017*


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|---|---|---|
| 03 | City Council Meeting<br>Council Chambers | 7:00 p.m. |
| 05 | Community Action Committee Meeting<br>Council Chambers | 7:00 p.m. |
| 10 | Planning Commission Meeting<br>Council Chambers | 7:00 p.m. |
| 11 | City Manager’s Staff Meeting<br>City Hall Conference Room | 9:00 am. |
| 16 | Easter | |
| 17 | Real Estate Committee Meeting<br>City Hall Conference Room | 5:30 p.m. |
| 17 | Code Enforcement/Public Safety Committee Meeting<br>City Hall Conference Room | 6:15 p.m. |
| 17 | City Council Meeting<br>Council Chambers | 7:00 p.m. |
| 19 | Safety Committee Meeting<br>City Hall Conference Room | 10:30 a.m. |
| 20 | Public Works Committee Meeting<br>City Hall Conference Room | 4:00 p.m. |
| 24 | Planning Commission Meeting<br>Council Chambers | 7:00 p.m. |
| 25 | City Manager’s Staff Meeting<br>City Hall Conference Room | 9:00 a.m. |