

**LODI CITY COUNCIL
SHIRTSLEEVE SESSION
CARNEGIE FORUM, 305 WEST PINE STREET
TUESDAY, FEBRUARY 2, 2016**

A. Roll Call by City Clerk

An Informal Informational Meeting ("Shirtsleeve" Session) of the Lodi City Council was held Tuesday, February 2, 2016, commencing at 7:00 a.m.

Present: Council Member Johnson, Council Member Mounce, Council Member Nakanishi, Mayor Pro Tempore Kuehne, and Mayor Chandler

Absent: None

Also Present: City Manager Schwabauer, City Attorney Magdich, and City Clerk Ferraiolo

NOTE: Mayor Pro Tempore Kuehne arrived at 7:01 a.m. and left at 8:11 a.m.

B. Topic(s)

B-1 Discuss Framework for Operating Budget and Reserve Policies (CM)

Deputy City Manager Jordan Ayers provided a PowerPoint presentation regarding the Operating Budget and Reserve Policies. Specific topics of discussion included goal, operating budgets, basic guidelines, reserves - Governmental Accounting Standards Board (GASB) reporting, reserves - General Fund, reserves - Special Revenue Funds, reserves - Enterprise Funds, and Reserves - Internal Service Funds.

Council Member Mounce questioned if having such policies would tie the hands of Council and make it more difficult to deviate from the strategy, using the energy cost adjustment as an example. City Manager Schwabauer stated that Council would set the policy and plan as a concept on how the budget will be structured going forward and how to reach this goal. It is a difficult task, but without a plan, it will be challenging to achieve the ultimate purpose. He added that Council would have the ability to change or deviate from a plan. In further response, Mr. Schwabauer explained that there are a number of reserves that are unfunded, as well as operations without reserves. Council Member Mounce stated that a policy would prevent councils from spending money on less important issues and help build up funds for building replacements, roof repairs, and vehicle replacements, but it would also limit Council. In further response, Mr. Ayers stated that at next week's Shirtsleeve Session he will review GASB's new standard for reporting other post-employment benefits (OPEB). He stated that the formula has changed and staff is currently in the process of compiling the actuarial. Based on the last numbers, the unfunded amount for the OPEB liability is roughly \$17 million split evenly between the dedicated employees and the \$130 per month the City pays for each employee's post-employment retirement and medical coverage. He stated that he did not believe the City should fund that at a 100 percent level, but it should begin funding the liability now. Mr. Ayers further confirmed that OPEB will be required to be reported on the balance sheet beginning with the June 30, 2016 financials.

In response to Council Member Nakanishi, Mr. Ayers stated that GASB requirements apply to all state and local government agencies.

Mr. Schwabauer reported that staff is expecting \$1 million more in California Public Employees Retirement System (Cal-PERS) costs than what was budgeted and stated that pension stabilization funds provide councils with flexibility when extraordinary costs arise. Cal-PERS would like cities to invest their funds with it, but if Cal-PERS loses the money, it is gone. With a pension stabilization fund, Council would maintain control over its level of risks on investments and use those dollars to subsidize unpredicted expenses in the budget.

In response to Council Member Nakanishi, Mr. Schwabauer stated that many other cities are going with pension stabilization funds and there are several companies who can provide that service. Mr. Ayers further explained that the City could give money to Cal-PERS in a regular fund or a side fund, but there are also third-party investment agents who can set up qualified trust funds. Cal-PERS is not guaranteed; it is an investment that will fluctuate up and down. A third-party investor can more aggressively invest the City's money and keep it local, depending on the level of comfort. Those funds would be available to the City if it experienced an unexpected spike over budgeted amounts instead of paying out of local funds. In further response, Mr. Schwabauer explained that the only OPEB issue for Lodi is the sick leave conversion to health care for employees hired before 1994 and the Cal-PERS post-retirement health care benefit of \$130 per employee per month.

Council Member Mounce questioned the difference between investing through Cal-PERS and a third-party investor because the risks and lack of guarantees would be similar. Mr. Ayers stated that the City could not direct Cal-PERS on which investments to pursue; however, the City would have greater control on its investments with a third-party investor. Mr. Schwabauer added that Council would set the investment level.

Council Member Nakanishi stated that he prefers Lodi control its own investments as Cal-PERS is more politically motivated. Council Member Mounce argued that the Council is just as political, citing the example of when a past Council opted to spend all of the money during the Cal-PERS superfunding instead of saving it.

In response to Council Member Johnson, Mr. Ayers stated he will research and provide Council with the Cal-PERS objective rate of return in its general portfolio at next week's Shirtsleeve Session. Council Member Johnson stated it would be disconcerting if Cal-PERS has an unrealistic financial objective that the market would not support. Mr. Ayers stated that, at this point, staff brought up this issue to ascertain whether or not this concept should be included in a comprehensive budget policy. He summarized that, based on the discussion thus far, Council agrees it should be in the policy, but the mechanics of the policy require further dialogue.

Council Member Mounce expressed the importance of depreciating City assets and setting aside funds for asset replacement.

In response to Council Member Nakanishi, Mr. Ayers stated that these policies would be formalized in the budget document.

In response to Mayor Chandler, Mr. Ayers stated that a three-year useful life criteria for equipment and infrastructure is typical among agencies. Council Member Mounce stated that the basic accounting standards are seven years for equipment, 15 years for infrastructure, and five years for vehicles.

In response to Mayor Pro Tempore Kuehne, Mr. Ayers stated that staff decided on a three-year useful life criteria based on prior history, adding that most agencies go with a three- to five-year lifespan. Mayor Pro Tempore Kuehne stated that the useful life should be extended beyond three years. At Council Member Mounce's suggestion, Mr. Ayers stated staff would review the Federal IRS guidelines and adjust the proposed schedules.

Council Member Nakanishi stated that he believed most businesses would lease new equipment or borrow money to replace failed equipment because they do not have enough money to create a reserve fund. Mr. Ayers pointed out that Lodi already has a vehicle replacement fund, which is the only reserve fund of this type, and it is only funded at half the necessary level.

Council Member Mounce stated that this issue came to the forefront because of the struggle Parks and Recreation had in funding necessary projects. Too many cities find themselves in situations where their fleet is depleted and buildings are dilapidated and there are no funds set aside for maintenance and upkeep. She stated that having reserves for these types of matters is prudent if the budget will allow for it.

Mr. Ayers stated that staff will return with a stratified structure and breakdown on the classification of assets along with the useful lifespan and dollar value. Mayor Pro Tempore Kuehne stated it would also be helpful to know staff's priorities on funding these reserves: 1) which are emergencies; 2) which are high priority without an emergency; and 3) which are wish list items. Council Member Mounce requested that staff also survey employees to ascertain their priorities as they may have a different perspective.

In response to Council Member Nakanishi, Mr. Ayers stated that Parks, Recreation, and Cultural Services currently has a 38 percent recovery ratio and the proposed 40 percent would provide an incentive to increase revenues.

In response to Council Member Johnson, Mr. Ayers stated that department heads would evaluate their programs and whether something should be added or deleted, which would then come before Council for approval.

In response to Mayor Pro Tempore Kuehne, Parks, Recreation and Cultural Services Director Jeff Hood stated that in the last fiscal year the subsidy to Hutchins Street Square to the debt service was \$150,000. He stated that the Square has the smallest drain on the budget at this time with Recreation being the more significant burden.

In response to Council Member Mounce, Mr. Ayers stated that the policy could state that the City Manager has the authority to assign funds up to \$20,000 and anything over that amount would come to Council.

In response to Mayor Pro Tempore Kuehne, Mr. Ayers and Mr. Schwabauer confirmed there currently is no policy on the assignment of funds.

In response to Council Member Nakanishi, Mr. Ayers explained that assignment of funds is a designation to hold funds for a set purpose, but it is non-binding. As an example, there is an unassigned fund balance designated for future labor costs, but Council has not yet formally acted on it; therefore, those funds cannot go into the category of "committed" funds. Instead, it would fall in the "assigned" category. Mr. Ayers stated that if Council does not wish to provide the City Manager authority to assign funds up to \$20,000, therefore leaving Council to approve funds in both the "committed" and "assigned" categories, then it was unnecessary to have both categories.

In response to Council Member Mounce, Mr. Ayers stated that most cities have crafted a reserve policy that mirrors the GASB requirements, but Lodi is late in doing so. Council Member Mounce requested that staff share other cities' policies with Council. Mr. Ayers stated that, during his research, he discovered that those who adopted policies typically did so during positive financial times because it provided a framework to rely on when revenues decreased.

In response to Council Member Mounce, Mr. Ayers confirmed that Council could use the money from the economic reserve if sales tax revenue slipped dramatically and prevented the City from meeting its budget. He pointed out that the policy includes a requirement that, if the reserve dips below a certain level, the City Manager must return the funding to that level. Mr. Ayers stated that he would prefer the reserve threshold to be 24 percent of revenue instead of 8 percent, adding that the average reserve amount of 36 cities surveyed was 26 percent, with the low at 7 percent and high at 78 percent. Council Member Mounce suggested that staff review the past 25 years for the average downturn and extrapolate that into a percentage, which should produce a reasonable base reserve policy percentage.

Council Member Johnson stated it was understandable to strive for an AA+ rating, but questioned if it was worth the struggle and being tight on funds in order to maintain that level for the few times the City goes to market for financing.

In response to Mayor Pro Tempore Kuehne, Mr. Ayers stated that the catastrophic and economic reserves, each at 8 percent, equal one month each of reserves.

Council Member Mounce pointed out that the City was able to reach those 8 percent goals through employee concessions and stressed that building reserves should not be done over a short timeframe that puts a burden on those individuals who ensure continuance of operations.

In response to Council Member Mounce, Mr. Ayers stated there is value in having a positive rating when looking to borrow money, but there is a trade off of figuring out how to get to that point, increasing revenues, monitoring expenses, and paying attention to debt service. The relationship with Northern California Power Agency (NCPA) can be viewed negatively against Lodi because the rating agencies consider NCPA-related costs as debt against the City.

Council Member Johnson expressed disappointment that the NCPA relationship could be held against the City, particularly after its General Manager chastised Lodi in the past for having a poor rating.

In response to Council Member Mounce, Mr. Schwabauer stated that, if Lodi were no longer a member of NCPA, it would be challenging to purchase power on the market alone as a small city. He added that rating agencies have yet to answer why an agency is penalized for owning an asset and for paying the debt service on it. Council Member Mounce requested information from staff on what the outcome would be for Lodi if it were not members of NCPA and how others who previously broke off from NCPA are currently doing. Mr. Schwabauer pointed out that this information will be dependent upon the cities' financial situations, ratings, and sizes.

In response to Council Member Nakanishi, Mr. Schwabauer stated that a utility can and should have a reserve in order to handle a catastrophic situation, similar to any other business. In 2008 when a line collapsed at White Slough Water Pollution Control Facility, the funds to repair that situation would have been borrowed if an emergency reserve did not exist. There are no limitations in Proposition 218 on reserves, but there is also nothing in the law stating what an appropriate reserve amount should be, but he believed it should be a fiscally prudent number. Mr. Schwabauer added that the water and wastewater utilities have a reserve in place for PCE cleanup, but that is a known liability that is backed by an engineer's estimate.

In response to Council Member Mounce, Mr. Ayers stated that the concept is to create a framework with policies, but the tough decisions will be implementation, prioritizing, and how to set aside funding. Mr. Schwabauer added that it will be impossible to fund these proposed reserves within the near future, and Mr. Ayers confirmed the figures will be significant and it will take time to get the reserves fully established.

In response to Council Member Mounce, Supervising Budget Analyst Susan Bjork stated that staff will be able to implement and work within the proposed policies and this would not add a significant burden to the staff workload.

C. Comments by Public on Non-Agenda Items

None.

D. Adjournment

No action was taken by the City Council. The meeting was adjourned at 8:15 a.m.

ATTEST:

Jennifer M. Ferraiolo
City Clerk