JOINT MEETING AGENDA REPORT

Finance Department

Richmond Housing Authority (RHA) &
City of Richmond

DATE:	June 27, 2023
TO:	Mayor Martinez and Members of the City Council
FROM:	Nickie Mastay, Deputy City Manager – Internal Services Mubeen Qader, Deputy Director of Finance Gabino Arredondo, Interim Director of the Richmond Housing Authority
Subject:	Annual Review and Adoption of Financial Policies for Fiscal Year 2022-23 and Fiscal Year 2023-24 (Cash Reserve, OPEB Funding, Pension Funding, RHA – City Administrative Services Agreement)
FINANCIAL IMPACT:	The adoption of and adherence to financial policies can be measured by factors such as: •Minimizing borrowing costs; •Providing fiscal security during times of unforeseen economic downturns; and •Paying down the City's unfunded liability annually.
PREVIOUS COUNCIL ACTION:	May 2, 2023, May 16, 2023, June 2, 2023
STATEMENT OF THE ISSUE:	City Staff is requesting that City Council review and approve the City's annual Financial Policies (Cash Reserve, OPEB Funding, Pension Funding Policies, and RHA-City of Richmond Agreement).

RECOMMENDED ACTION:	REVIEW and ADOPT resolutions for the Cash Reserve Policy, OPEB Funding Policy, Pension Funding Policy, and Richmond Housing Authority/City of Richmond agreement, and resolutions for Fiscal Year 2022-2023 and Fiscal Year 2023-2024 – Finance Department (Nickie Mastay 510-620-6609/Mubeen Qader 510-412-2077/Gabino Arredondo 510-621-1300).

DISCUSSION:

On April 4, 2022, the City of Richmond was notified by the California State Auditor that it would be conducting an audit of the City as approved by the Joint Legislative Audit Committee on June 30, 2021. The State Auditor's local audit program identifies and supports local government agencies that might be at high risk based upon analysis of the City's audited financial statements. Richmond's risk assessment was conducted in February 2021 based upon the City's June 2020 financial statements.

At the conclusion of the audit, the State Auditors formalized 11 recommendations that were presented to the City Council at the December 20, 2022, City Council meeting. City staff incorporated the Auditor's recommendation into a Corrective Action Plan.

Cash Reserve Policy

The State Auditor's recommendation number 1 on the Cash Reserve Policy states:
"To help ensure that Richmond maintains appropriate reserves for times of fiscal uncertainty, city staff should, by June 2023, review Richmond's reserve policy to determine whether a higher reserve target is appropriate. As part of the review, staff should consider all the factors the Government Finance Officers' Association (GFOA) recommends for setting a reserve target. Once that review is complete, city staff should present proposals to the city council for modifying the city's policy." (California State Audit, 2021-806)

Municipal governments provide a wide range of services that have an impact on public safety and quality of life for community members. Prudent use of resources helps determine how effectively these services are provided on an ongoing basis. In addition to managing revenues and expenditures, it is also the municipal finance official's responsibility to focus on the General Fund balance and maintain cash reserves. Such focus is important to maintain operations in case of any significant event that could cause disruptions in cash flow, such as an economic downturn or natural disaster.

The Governmental Finance Officers Association (GFOA) recommends that reserve levels be directly related to the degree of uncertainty the local government faces. The following guidelines were presented to the City Council during May 2, 2023, City Council meeting:

1. The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile);
2. Its perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts);
3. The potential drain upon general fund resources from other funds, as well as the availability of resources in other funds;
4. The potential impact on the entity's bond ratings and the corresponding increased cost of borrowed funds.

Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose). Governments may deem it appropriate to exclude from consideration resources that have been committed or assigned to some other purpose and focus on unassigned fund balance, rather than on unrestricted fund balance."

City staff also presented the City Council with a Five-Year Financial Forecast with three scenarios on June 6, 2023. Under the pessimistic scenario, the City is forecasting an operational deficit of $9.6 million by the end of Fiscal Year 2028.

Figure 1: Five-Year Financial Forecast, Pessimistic Scenario, Originally presented on June 6, 2023

	2023	2024	2025	2026	2027	2028
Revenues	215,103,041	225,374,607	238,843,933	243,243,012	250,092,434	257,279,354
Expenditures	215,139,687	225,374,607	240,503,329	249,276,243	258,213,985	266,846,849
Surplus/(Deficit)	(36,647)	-	(1,659,396)	(6,033,231)	(8,121,551)	(9,567,495)
Reserve Level @ 20%	43,027,937	45,074,921	48,100,666	49,855,249	51,642,797	53,369,370
Reserve Level @ 22%	47,330,731	49,582,414	52,910,732	54,840,774	56,807,077	58,706,307

To preserve the City's services to the community through the potential volatility of revenues and uneven cash flows in the future years, the Cash Reserve Policy identifies a year-end cash balance equal to twenty-two percent (22%), slightly more than two months of General Fund total expenditures (including transfers out) as the minimum cash reserve level. Staff recommends the Cash Reserve Policy identifies an ending Cash Balance equal to 22 percent of total General Fund Expenditures budgeted in the ensuing Fiscal Year.

OPEB Funding Policy

The State Auditor's recommendation number 5 on Other Post-Employment Benefits("OPEB") states:

“To improve the city's ability to pay other post-employment benefits, Richmond should, by June 2023 and annually thereafter, implement a policy identifying funds, such as surpluses or one-time revenues that should be contributed to the OPEB trust fund. Staff should conduct an annual analysis to determine whether any funds available to the city are applicable under the city's policy and should present a proposal to the city council to apply those funds to the trust fund.” (California State Audit, 2021-806)

The City provides medical benefits to retirees. The benefit is paid monthly to the retiree, subject to proof of coverage and attestation of premium payment, and generally ceases upon death of the retiree. Unlike the expenses associated with pension benefits, the City has historically chosen to pay its OPEB expenses as they come due (the monthly reimbursements to retirees) rather than as they are earned. These annual “pay-as-you-go” benefit expenses have increased over the years and are expected to continue growing as more active employees retire and as healthcare costs increase.
Payment of OPEB expenses as they come due, rather than as they are earned, results in the accumulation of unfunded liability for the future benefit. To estimate that liability, and to calculate the annual contribution required to pay down that liability over a specified amortization period (the Actuarial Determined Contribution, ADC), the City’s actuary prepares an OPEB valuation annually.

As of July 1, 2021, the City’s OPEB Funding valuations estimates an Unfunded Actuarial Accrued Liability (UAAL) of $85.41 million, $76.48 million for City OPEB plan (administered by PARS) and $8.93 million for Richmond Police Officers Association (RPOA) OPEB plan (administered by CalPERS). In December 2022, the City’s Actuary projected an ADC of $10.29 million consisting of $8.73 million for the City Plan and $1.56 million for the RPOA plan for FY22-23 and projected an ADC of $10.36 million consisting of $8.78 million for the City Plan and $1.58 million for the RPOA plan for FY23-24.

The City staff recommend that the City Council continue pre-funding the City’s OPEB liabilities by directing the City Manager to continue contributing the ADC minus the pay-as-you-go costs into the Trusts to pay down the City’s unfunded liability annually. Additionally, staff is recommending contributing 10 percent of each year-end operating surplus in the General Fund in excess of the City’s Cash Reserve Policy into the Trusts. The prior OPEB Funding Policy that was discontinued by the City Council in September 2022 had a contribution rate of 50 percent of each year-end General Fund operating surplus. This additional contribution shows that the City is addressing its OPEB UAAL.

Pension Funding Policy

The State Auditor’s recommendation number 4 on retirement-related costs states:
“To ensure that Richmond is able to fund its retirement-related costs, city staff should, by June 2023, propose to the city council a specific policy regarding funding of its pension trust fund for this purpose. Staff should report to the city council on estimated long-term savings from increasing its direct payments to Cal PERS compared to investing the same amounts in its pension trust fund. Staff members should use this information to inform

their recommendations related to funding targets for the pension trust fund and should consider recommending that the council increase the city's payments directly to CalPERS." (California State Audit, 2021-806)

The City of Richmond's Unfunded Accrued Liability ("UAL"), also known as the Net Pension Liability ("NPL"), has grown from $263 million as of fiscal year end 2015, to a projected $381 million, as of fiscal year end 2022. Annual costs to amortize this debt with CalPERS have risen from $14 million, to $29 million, over the last 6 years and are projected to grow another 46 percent (46%) by fiscal year 2031. Rising pension costs are one of the largest financial challenges facing agencies state-wide and are projected to impact the City's budget significantly, potentially crowding out other critical priorities and projects.

The City of Richmond, like most cities in California, has a UAL associated with its CalPERS pension plans for Safety and Non-Safety employees. A UAL occurs when current pension plan assets are not projected to be sufficient to pay projected pension costs in future years. As of June 30, 2021 (the most recent CalPERS valuation), the City's UAL was $249 million. However, CalPERS reported an investment return of -7.5 percent for fiscal year 2022, which is projected to increase the City's UAL to approximately $381 million.

CalPERS investment earnings for fiscal year 2023 were not meeting its target as of the end of March, which, if unchanged, may increase the UAL to more than $409 million at the plan's June 30, 2023, valuation. CalPERS charges the City of Richmond a 6.8 percent interest rate on this debt and requires a repayment schedule that escalates quickly over the next decade. Payments to amortize this debt have risen from $14 million in fiscal year 2018, to $29 million in fiscal year 2023, and are projected to rise to close to $43 million by the end of the decade. In addition to the City's $29 million in UAL costs, other pension costs include $12 million for CalPERS Normal Costs and $6 million for the 2022 Pension Obligation Bonds ("POB"), bringing overall pension costs for FY 2023 to approximately $47 million.

Unique to the City of Richmond, and approximately 20 other public agencies statewide, is a Property Tax Override (PTO) levied to cover a portion of pension costs. This provides the City of Richmond a tool to assist with managing rising pension costs. Based on the most recent independent actuarial report, approximately 82 percent of overall (UAL, Normal Cost and POB) pension costs can legally be paid for by the Pension Tax Override Revenues (PTOR). However, the City of Richmond also has a constraint on the PTOR levy of 0.14 percent of assessed valuation, which currently generates approximately $25 million of revenue (covering approximately 53 percent of the total $47 million of annual pension costs). Additionally, secured annual debt service on the City's 2022 Pension Refunding Bonds have a first lien on PTOR received by the City. As such, the City will want to consider all available cost management options for addressing the UAL.

The City has taken some proactive steps to control pension costs. In July 2022, the City approved the establishment of a Section 115 Trust with PARS. Benefits of a Section 115 Trust include (1) the ability to use the funds in the future to pay down the plan's UAL or help smooth required CalPERS expenses; (2) enhanced budgetary flexibility; (3) investment diversification of pension assets away from CalPERS; and (4) increased investment earnings vs. other City reserves.

The City has also historically taken advantage of the prepayment discount offered by CalPERS by making a lump sum UAL payment at the beginning of each fiscal year. Currently, the prepayment discount is approximately 3.3 percent. Additionally, the City issued Pension Refunding Bonds in August 2022, to strategically restructure prior pension obligation bonds and eliminate the City's exposure to interest rate swaps. By matching the term of the bonds with the UAL, the City was able to restructure a portion of its pension expenses to better align with projected PTO revenues, generating significant savings to the General Fund over the next decade. However, with pension costs increasing significantly due to poor CalPERS investment performance, in conjunction with PTORs being limited by the 0.14 percent levy cap, it is imperative that the City continue to evaluate ways to manage growing expenses and implement cost management strategies to help stabilize future pension cost volatility.

City staff recommends that the City Council place the savings from prepayment of the CalPERS UAL into the 115 trust. Additionally, staff recommends contributing 10 percent of each year-end operating surplus in the General Fund in excess of the City's Cash Reserve Policy into the Trust, proactively preparing for imminent cost increases.

City of Richmond and Richmond Housing Authority Agreement

At the conclusion of audit, the State Auditor formalized eleven recommendations that the City has grouped into three broad areas: Budget Strategy, Housing Authority Administration, and Operations. In response to the State Auditor's report, the City developed a Corrective Action Plan. The recommendation pertaining to the RHA and the City addressed in the recommended action is Recommendation Number 8 pertaining in particular to the development of an Administration Agreement:

> *"To define Richmond's responsibility related to the housing authority, Richmond should immediately enter into a written agreement with the housing authority defining each entity's financial responsibilities and draft plans to resolve past tax liabilities and prevent unnecessary new liabilities."*

The draft Administrative Agreement will be entered by the City and RHA outlining each entity's financial responsibilities and addressing the State Auditor's recommendation conclusion to immediately enter into a written agreement. (California State Audit, 2021-806)

Next Steps

City staff recommend that the City Council adopt the resolutions to approve the attached policies and approve the agreement with RHA to implement the subject State Audit recommendations.

DOCUMENTS ATTACHED:

Attachment 1 – Resolution Adopting Fiscal Year 2022-23 & Fiscal Year 2023-24 Cash Reserve Policy
Attachment 2 – Fiscal Year 2022-23 & Fiscal Year 2023-24 Cash Reserve Policy
Attachment 3 – Resolution Adopting Fiscal Year 2022-23 & Fiscal Year 2023-24 OPEB Funding Policy
Attachment 4 – Fiscal Year 2022-23 & Fiscal Year 2023-24 OPEB Funding Policy
Attachment 5 – Resolution Adopting Fiscal Year 2022-23 & Fiscal Year 2023-24 Pension Funding Policy
Attachment 6 – Fiscal Year 2022-23 & Fiscal Year 2023-24 Pension Funding Policy
Attachment 7 – RHA - City Administrative Services Agreement