PLAN PURPOSE

The purpose of this plan is to establish a three-year framework to respond to the long-term fiscal impacts of the significant increases in required pension contributions to the CalPERS retirement system. This plan is a specific deliverable and is structured in a manner to provide guidance for budgetary actions in the 2018-2019 Fiscal Year as well as to provide broad strategic budget direction for the 2019-2021 Financial Plan.

THE PROBLEM

The City of San Luis Obispo and the other 3,000-member agencies in the California Public Employees Retirement System (CalPERS), are facing significant increases in required pension contributions. The City's annual CalPERS costs are projected to more than double in ten years; growing from $7.8 million in 2014-15 to $19 million in 2024-25 for the General Fund. These costs will continue to grow through 2031-32 and affect all funds including the City's Enterprise Funds (Water, Waste Water, Transit, and Parking).

To address these rapidly rising costs, the City must address an $8.9 million ($7.5 million from the General Fund and $1.4 million from the Enterprise Funds) budget gap over the next three fiscal years (2018-19, 2019-20, and 2020-21). The size of the problem has been informed using fiscal forecasting supported by third party economic models, as well as the City's outside sales tax advisor and a separate actuary who specializes in pensions.

The City’s fiscal forecasting is based on assumptions such as:

1. Continuing current levels of service.
2. Continuing the commitment to capital investment including a slight increase due to ongoing maintenance needs.
4. Continuing Local Revenue Measure (Measure G) funds.
5. Enterprise Funds revenue projections based on approved and historic rates and revenue growth trends.

The City must continue to utilize CalPERS as its retirement system as it is not feasible for the City to leave without incurring significant costs. To exit CalPERS, the City would have 30 days to meet its projected (worst case) financial obligations estimated to be from $377 to $495 million at the time of separation. Furthermore, the current legal framework in California restricts cities ability to reduce retirement benefits for current employees, as well as retirees. Lastly, CalPERS forbids offering alternative retirement benefits for new employees, different from those reduced benefits that already have been legislatively authorized.
GENERAL FUND FOCUS; ENTERPRISE FUND PARTICIPATION

This Plan is primarily focused on guiding the General Fund closure of the ongoing budget gap over the next three fiscal years.

The Enterprise Funds (Water, Sewer, Parking, and Transit) are also participating because the problem of rising pension costs also affects employees of the Enterprise Funds as they participate in the same CalPERS retirement system as General Fund employees. Each fund, however, will solve the problem based on the fund type and its unique situation, as discussed later in this report.

KEY CITY POLICIES AND GUIDING PRINCIPLES FOR THIS PLAN

- The City’s existing financial policies provide the foundation for this Plan and include a balanced, sustainable budget based on conservative investment practices and diversified revenues.
- Specific policies which support this Plan include: the 2001 Fiscal Health Contingency Plan, the 2014 Financial Responsibility Philosophy, the Compensation Philosophy and the 2017 Long-Term Liabilities and Maintenance of Infrastructure.
- Ongoing Fiscal Health Monitoring including modeling of economic trends and incorporation of new data will occur through the budgetary process and three years of this Plan.
- Budgetary changes in response to the Plan will minimize service level impacts.
INTEGRATION OF THE PLAN WITH THE FINANCIAL PLANNING PROCESS

The Fiscal Health Response Plan will be applied to the 2018-19 Budget Supplement as well as the 2019-21 Financial Plan process. The 2019-21 Financial Plan will include Major City Goals informed by public participation. However, the Fiscal Health Response Plan sets forth the framework by which the 2019-21 will need to close the structural budget gap of $8.9 million over the term of this Plan.

For ease of use, and so that Council and the community can review the implementation of this Plan with respect to solving this problem, this document will be updated with a record of Council meetings regarding the Plan’s implementation.

<table>
<thead>
<tr>
<th>Council Meeting Date</th>
<th>Action Related to FHRP Taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 17, 2018</td>
<td>1. Adoption of FHRP</td>
</tr>
<tr>
<td></td>
<td>2. Strategic Budget Direction for 2018-19 Budget Supplement</td>
</tr>
<tr>
<td>To be completed as meetings occur.</td>
<td>Scheduled meetings include June 5 and 19, 2018 Council meetings on the 2018-19 Budget Supplement and primary options to address unfunded liabilities.</td>
</tr>
</tbody>
</table>

ELEMENTS OF THIS PLAN

There are three key components to this Plan. These components create savings and revenue necessary to address the unfunded liability. In addition, there are two primary options for reducing the increased costs of the City’s unfunded liability.

<table>
<thead>
<tr>
<th>THREE KEY COMPONENTS</th>
<th>PRIMARY OPTIONS TO ADDRESS THE UNFUNDED LIABILITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. New Revenues</td>
<td>1. Prepayment of both normal and unfunded PERS Costs</td>
</tr>
<tr>
<td>2. Operating Reductions and New Ways of Doing Business</td>
<td>2. Section 115 Pension Trust Formation</td>
</tr>
<tr>
<td>3. Employee Concessions</td>
<td></td>
</tr>
</tbody>
</table>

Last Updated: April 9, 2018
The City must address an $8.9 million ($7.5 million from the General Fund and $1.4 million from the Enterprise Funds) budget gap over the next three fiscal years (2018-19, 2019-20, and 2020-21). There are three key components that have been identified to accomplish this Plan: 1) new revenues, 2) operating reductions and new ways of doing business, and 3) employee concessions. These will be apportioned as follows for the General Fund:

### NEW REVENUES

30-40% of the solution is proposed through new revenues. **Only the General Fund will participate in this component.**

- **A General Fund Cannabis Tax.** The General Fund's primary sources of funding are taxes and fees for services. A general-purpose tax on Cannabis sales, requiring voter approval of a simple majority, will be evaluated for placement on the November 2018 ballot.

  **Should a Cannabis Tax be Unsuccessful?** Should a Cannabis Tax be unsuccessful, either by not receiving voter approval or by underperforming in projected revenues, other new sources of revenue will be evaluated, such as consideration of increased Transient Occupancy Tax (TOT) or a Stormwater Tax. Additional revenue from taxes and any recommended would require further direction from Council prior to implementation.

- **The Enterprise Funds will not propose new revenues to solve this problem.** The Enterprise Funds are funded by rates and/or fees for the services provided. TransIt is primarily funded through Federal and State grants and programs in combination with a 20% match from fares. Increases to rates and/or fees will not be made to close this budget gap in the Enterprise Funds. Any changes to those rates and/or fees in the Enterprise Funds during the fiscal period of this Plan will be due to other cost increases or a result of enhanced fee recovery unrelated to unfunded pension liability cost increases.
OPERATING REDUCTIONS AND NEW WAYS OF DOING BUSINESS.

30 to 40% of the solution is proposed from operating reductions and/or new ways of doing business. All Funds and Departments will participate in this component to varying degrees.

OPERATING REDUCTIONS

1. Proactive Fiscal Management.
   a. Refinance City Bonds. Eligible City bonds will be refinanced to reduce debt rates.
   b. Pay CalPERS Required Contribution in One-Lump Sum Once A Year. Based upon the City’s cashflow analysis, the City will exercise the option to pay contributions to CalPERS in one lump sum resulting in ongoing savings. CalPERS offers two options of payment, annual and one-lump sum.
   c. Evaluate other Fiscal Efficiencies. For instance, credit card bank charges will be evaluated so that any cost reductions which do not diminish customer service are implemented. Other fiscal management efficiencies will be explored for cost savings.

2. Pursue Energy Efficiencies and Consumption Reductions. Departments will evaluate budgets to identify energy efficiencies which could save both costs and energy. Fuel and other consumables usage will be reduced through fuel efficiency vehicles and/or use pattern improvements.

3. Consultant services agreements. When possible, consultant services agreements will be renegotiated for better value and/or budgeted amounts will be adjusted to reflect service levels needed.

4. Other Agreements. The City has multiple agreements for a myriad of purposes ranging from the purchases of goods to the provision of City services and/or use of City facilities. Those agreements subject to renewal will be evaluated for the opportunities to decrease costs or to increase cost recovery while at the same time balancing the value of community partnerships.

5. Tax and Fee Enforcement. The City will continue to proactively seek compliance with business license, Transient Occupancy Tax (TOT) Homestay, Code Enforcement, and other activities which could result in more accurate revenue collections.

6. Long-term liabilities. Consistent with the City’s fiscal policies, the City will continue to utilize one-time funds to pay down unfunded liabilities and to invest in infrastructure.

7. Risk Management. The City will continue to actively implement its “30% in 3” risk management program to reduce liability and worker’s compensation expenditures.
NEW WAYS OF DOING BUSINESS

1. Sustainability.
The City will pursue increased investment in sustainable infrastructure with positive and short-term paybacks on investment.

2. Enhanced Efficiency & Effectiveness.
   a. Energy Efficiency.
      Including the use of solar power will be explored and implemented when possible for short and long-term cost savings. Other energy efficiencies will be evaluated as well.
      The Motion project, consisting of business process re-engineering and implementation of an Enterprise Resource System, will result in decommissioning of several older systems and will create opportunities for employee efficiencies and effectiveness.
   c. Equipment Replacement.
      Equipment replacement will result in energy savings, more accurate data collection, and more accurate revenues will be identified.

3. Thoughtful re-organizations.
   Staff transitions will be used to evaluate current staffing levels and service provision. The City will evaluate cross-departmental operations, service levels, and contracted services for re-organization opportunities.

EMPLOYEE CONCESSIONS.

20% to 30% would be contributions via employee concessions. All Funds, General and Enterprise, will participate in employee concessions.

- In addressing unfunded pension liability as it relates to employee concessions the City’s adopted Fiscal Sustainability Philosophy, Compensation Philosophy and Labor Relations Objectives will provide guidance.

- The City will meet and confer in good faith with its represented employee groups regarding the impacts of changes to wages, hours, and/or working conditions.

PRIMARY OPTIONS TO ADDRESS THE UNFUNDED LIABILITY

The City will evaluate each of the options in June 2018: Prepayment of unfunded liabilities by pre-paying PERS and/or funding a Section 115 Pension Trust to make future payments to PERS. The use of each method may vary by Fund.
COMMUNICATIONS STRATEGIES

The following identifies communication strategies with the Community and employees.

COMMUNITY ENGAGEMENT

As is the City’s practice the Community will be engaged consistent with the City’s Public Engagement and Noticing (PEN) Manual. There will be multiple methods of communications used to inform and educate the community as well as receive feedback and address questions and concerns. In addition to the PEN methods of communication and public engagement will include:

- Public Notification of Council Meetings on the Plan.
- What’s New in SLO and other website informational postings.
- E-notification, social media posts and press releases.
- Community forums and workshops in conjunction with the financial planning process.
- Presentations to City Advisory Bodies and interested community groups.
- Open City Hall topics.

EMPLOYEE ENGAGEMENT

As is the City’s practice all employees will be engaged in the financial planning process and the application of this Plan to that process. There will be multiple methods of communications to inform and educate employees as well as receive input and address questions and concerns.

- Briefings with City Manager, Department Heads and Budget Manager.
- Updates via emails and SLOWhat Monthly publication.
- Briefings with employee associations’ representatives.
- Surveys to Employees
- Organization-wide briefings.
IMPLEMENTATION OF THE PLAN

- The Plan will guide staff’s preparation of the 2018-19 Budget Supplement for Council’s consideration and adoption in June 2018.


EXTERNAL IMPACTS TO PLAN

This plan has been based on assumptions made in the fiscal forecast in December 2017. It is based on fiscal forecasts which have multiple inputs from multiple economic resources both external and internal to the City. However, a forecast is an estimate at a point and time and during the life of this Plan there could be significant external forces which further impact the City’s fiscal forecast. There are other fiscal policies and plans in place to help guide such a change. The following could have impact to the City’s overall budget through either expenditures or revenues and would result in staff returning to Council for further direction.

- Changes in Economic Conditions. The nation continues to be in an unprecedented economic expansion following the Great Recession. This is unlikely to continue for the entire period of this Plan. Additionally, changes in federal fiscal policy and grant funding may result in a slowing of the national and local economies.

- Diablo Closure
  The closure of Diablo Canyon presents an uncertain economic impact to the City and County of San Luis Obispo. At the time of this Plan’s creation, the mitigation of that impact is uncertain. The City will continue to have a lead role in addressing this problem and preparing an economic and financial analysis of the impacts of this closure. This analysis will be incorporated into the 2019-21 Financial Plan.

- Further CalPERS Changes. Required contributions to CalPERS are based on actuarial assumptions and further changes may occur if approved by the CalPERS Board. Examples of past significant changes in assumptions include changes to amortization periods, changes to expected rate of return, and changes to demographic assumptions. Future changes in actuarial assumptions may once again result in significant fiscal impacts to the City.

- Natural Disaster. All municipalities are vulnerable to natural disasters be it earthquake, fire, or flood. The City maintains reserves for these unfortunate circumstances but in recent years the magnitude of disasters seen in neighboring cities north and south have been at unprecedented economic levels.
SECTION D: SUMMARY OF OVERALL BUDGET SUPPLEMENT

This section provides simple charts and tables which highlight key financial relationships and summarize the overall budget document. Graphics summarizing the following areas are included:

<table>
<thead>
<tr>
<th>Changes in Financial Position</th>
<th>• Summary of Revenues and Expenditures for 2017-18 and 2018-19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Detail</td>
<td>• Revenue by Fund and Type</td>
</tr>
<tr>
<td>Expenditure Detail</td>
<td>• Expenditure by Department, Function, and Type</td>
</tr>
<tr>
<td>Operating Transfers</td>
<td>• Transfers between funds</td>
</tr>
<tr>
<td>Authorized Regular Positions</td>
<td>• Authorized positions by Department</td>
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</tbody>
</table>