The Pension Problem and What the City Is Doing About It
Why Are We Here Today?

INFORM

Inform all stakeholders of the problem and the process to develop a plan

PLAN

Lay out process to develop a Fiscal Health Response Plan to reach the ongoing budget reduction target

Q & A

Answer questions and receive suggestions
Agenda

6:00 p.m. – 6:20 p.m. Staff available for questions and background information at informal stations

6:20 p.m. – 6:40 p.m. How We Got Here & Where We’re Going – Mary Beth Redding, Bartel Associates

6:40 p.m. – 7:00 p.m. Developing a Fiscal Health Response Plan – Derek Johnson, City Manager

7:00 p.m. – 7:30 p.m. Question & Answer Panel

7:30 p.m. – 8:00 p.m. Staff available for questions and background information at informal stations
Multiple Ways to Engage

✓ Talk with staff members at informal stations
✓ Write questions on yellow question cards and submit for Q&A panel discussion
✓ Write suggestions on green cards and submit for consideration as Council and staff prepare plans after this session.
✓ Submit additional comments and ideas at www.slocity.org/opencityhall
✓ Attend the Council meetings on November 7 (process for plan) and December 12 (direction)
CALPERS

HOW WE GOT HERE AND WHERE WE’RE GOING

Mary Beth Redding,
Vice President & Actuary

Bartel Associates, LLC

October 5, 2017

mbredding@bartel-associates.com
Agenda

Topic

Definitions

How We Got Here

CalPERS Changes

Contribution Rates & Projections - Miscellaneous

Contribution Rates & Projections - Safety

CalPERS Termination

Options
DEFINITIONS

■ Present Value:
  ● The value now of amounts due to be paid in the future

■ PVB - Present Value of all Projected Benefits:
  ● Discounted value (at valuation date - 6/30/15), of all future expected benefit payments based on various (actuarial) assumptions

■ Actuarial Liability:
  ● Discounted value (at valuation date) of benefits earned through valuation date [value of past service benefit]
  ● Portion of PVB “earned” at measurement

■ Current Normal Cost:
  ● Portion of PVB allocated to (or “earned” during) current year
  ● Value of employee and employer current service benefit
**DEFINITIONS**

- **Target:** Have money in the bank to cover Actuarial Liability (past service)
- **Unfunded Liability:** Money short of target at valuation date
- **Excess Assets / Surplus:**
  - Money over and above target at that point in time
  - Doesn’t mean you’re done contributing
- **Super Funded:**
  - Assets cover whole pie (PVB)
  - If everything goes exactly like PERS calculated, you’ll never have to put another (employer or employee) dime in
HOW WE GOT HERE

- Investment Losses
- Enhanced Benefits
- CalPERS Contribution Policy
- Demographics
Above assumes contributions, payments, etc. received evenly throughout year.
Estimated June 30, 2017 based on CalPERS actual return through 6/30/17.
HOW WE GOT HERE – INVESTMENT RETURN

Historical Funded Status (Miscellaneous Plan)

6/30/16 & 6/30/17 funded status estimated
HOW WE GOT HERE – INVESTMENT RETURN

Historical Actuarial Liabilities and Assets (Miscellaneous)

6/30/16 & 6/30/17 funded status estimated
HOW WE GOT HERE – INVESTMENT RETURN

Historical Contribution Rates % of Payroll
(Miscellaneous Plan)
At CalPERS, Enhanced Benefits implemented using all (future & prior) service

- Typically not negotiated with cost sharing
HOW WE GOT HERE – OLD CONTRIBUTION POLICY

- Effective with 2003 valuations:
  - Slow (15 year) recognition of investment losses into funded status
  - Rolling 30 year amortization of all (primarily investment) losses

- Designed to:
  - First smooth rates and
  - Second pay off UAL

- Mitigated contribution volatility
HOW WE GOT HERE – DEMOGRAPHICS

- Around the State
  - Large retiree liability compared to actives
  - Declining active population
CALPERS CHANGES

- Contribution policy changes:
  - No asset smoothing
  - No rolling amortization
  - 5-year ramp up
  - First impact 15/16 rates; full impact 19/20

- Assumption changes:
  - Anticipate future mortality improvement
  - First impact 16/17 rates; full impact 20/21

- Risk Pool changes
  - All Risk Pools combined into one Miscellaneous & one Safety
  - Collect payment on UAL as dollar amount, not as % of pay
  - Impacts 15/16 rates
CalPERS Changes

- CalPERS Board will change their discount rate:

<table>
<thead>
<tr>
<th>Rate</th>
<th>Initial</th>
<th>Full</th>
</tr>
</thead>
<tbody>
<tr>
<td>6/30/16 valuation</td>
<td>7.375%</td>
<td>18/19</td>
</tr>
<tr>
<td>6/30/17 valuation</td>
<td>7.25%</td>
<td>19/20</td>
</tr>
<tr>
<td>6/30/18 valuation</td>
<td>7.00%</td>
<td>20/21</td>
</tr>
</tbody>
</table>
- Risk mitigation suspended until 6/30/18 valuation

- CalPERS Board reviewing their Capital Market Assumptions

- Likely no further changes to discount rate

Risk Mitigation Strategy

- Move to more conservative investments over time
- Only when investment return is better than expected
- Lower discount rate in concert
- Essentially use ≈50% of investment gains to pay for cost increases
- Likely get to 6.0% over 20+ years
CONTRIBUTION RATES - MISCELLANEOUS

<table>
<thead>
<tr>
<th></th>
<th>6/30/14</th>
<th>6/30/15</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2016/2017</td>
<td>2017/2018</td>
</tr>
<tr>
<td>Total Normal Cost</td>
<td>18.7%</td>
<td>18.0%</td>
</tr>
<tr>
<td>Employee Normal Cost</td>
<td>7.8%</td>
<td>7.6%</td>
</tr>
<tr>
<td>Employer Normal Cost</td>
<td>10.9%</td>
<td>10.4%</td>
</tr>
<tr>
<td>Amortization Bases</td>
<td>18.7%</td>
<td>20.0%</td>
</tr>
<tr>
<td>Total Employer Contribution Rate</td>
<td>29.6%</td>
<td>30.4%</td>
</tr>
</tbody>
</table>

What Happened from 6/30/14 to 6/30/15:

- 2016/17 Rate: 29.6%
- Asset Method Change (3rd Year): 1.0%
- Assumption Change (2nd Year): 0.9%
- 6/30/14 (Gains)/Losses (2nd Year): (0.9%)
- Payroll Increased More (Less) Than Expected: (0.2%)
- 6/30/15 (Gains)/Losses (1st Year): 0.0%
- 2017/18 Rate: 30.4%
## Contribution Projections

- **Market Value Investment Return:**
  - June 30, 2016: 0.6%
  - June 30, 2017: 8.2%
  - Future returns based on stochastic analysis using 1,000 trials

<table>
<thead>
<tr>
<th>Single Year Returns at</th>
<th>25th Percentile</th>
<th>50th Percentile</th>
<th>75th Percentile</th>
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</thead>
<tbody>
<tr>
<td>7.0% Investment Mix</td>
<td>0.1%</td>
<td>7.0%</td>
<td>14.8%</td>
</tr>
<tr>
<td>6.0% Investment Mix</td>
<td>0.8%</td>
<td>6.0%</td>
<td>11.4%</td>
</tr>
</tbody>
</table>

- Assumes investment returns will, generally be 6.5% (as compared to 7.0%) over the next 10 years and higher beyond that.

- No Other: Gains/Losses, Method/Assumption Changes, Benefit Improvements
- Excludes Employer Paid Member Contributions (EPMC)

---

1. Based on CalPERS CAFR.
2. June 30, 2017 return based on CalPERS return of 5.4% through 1/31/17 and assumed returns for 5 months.
3. N\textsuperscript{th} percentile means N percentage of our trials result in returns lower than the indicated rates.
CONTRIBUTION PROJECTIONS

- Includes discount rate change to 7.0%
- Includes Risk Mitigation Policy (future discount rate changes, to 6%)
- Includes Classic employees leaving and being replaced with Tier 2 or PEPRA:
  - New hire assumptions:
    - Miscellaneous includes Tier 2 (2%@60) effective December 6, 2012
    - Safety includes Tier 2 (Police 2%@50 effective December 6, 2012 and Fire 3%@55 effective August 30, 2012)
    - Assumes 50% of 2013 new hires will be Classic Tier 2 Members and 50% will be New Members with PEPRA benefits
    - Assumes Classic Members will decrease from 50% to 0% of new hires over 20 years for Miscellaneous and over 10 years for Safety.
    - Assumes Classic Members will decrease from 50% to 0% of new hires over 10 years
CONTRIBUTION PROJECTIONS - MISCELLANEOUS

Discount Rate Reduced from 7.5% to 7% over 3 Years

- 25th Percentile
- 50th Percentile
- 75th Percentile

- 2016/17: 29.6%
- 2017/18: 30.4%
- 2018/19: 32.7%
- 2019/20: 35.0%
- 2020/21: 35.2%
- 2021/22: 36.8%
- 2022/23: 38.0%
- 2023/24: 38.9%
- 2024/25: 39.0%
- 2025/26: 38.8%
- 2026/27: 38.2%
- 2027/28: 37.9%

- 2016/17: 29.6%
- 2017/18: 30.4%
- 2018/19: 32.7%
- 2019/20: 35.0%
- 2020/21: 35.2%
- 2021/22: 36.8%
- 2022/23: 38.0%
- 2023/24: 38.9%
- 2024/25: 39.0%
- 2025/26: 38.8%
- 2026/27: 38.2%
- 2027/28: 37.9%

October 5, 2017
 CONTRIBUTION PROJECTIONS - MISCELLANEOUS

Discount Rate Reduced from 7.5% to 7% over 3 Years

- 25th Percentile
- 50th Percentile
- 75th Percentile

Oct 5, 2017
Discount Rate Reduced from 7.5% to 7% over 3 Years

- Total
- Normal Cost
- UAL Payment

Year 16/17: 6,204, 6,601, 7,325, 8,130, 8,920, 9,648, 10,374, 10,957, 11,510, 11,881, 12,436, 12,878
Year 17/18: 6,601, 7,325, 8,130, 8,920, 9,648, 10,374, 10,957, 11,510, 11,881, 12,436, 12,878
Year 18/19: 7,325, 8,130, 8,920, 9,648, 10,374, 10,957, 11,510, 11,881, 12,436, 12,878
Year 19/20: 8,130, 8,920, 9,648, 10,374, 10,957, 11,510, 11,881, 12,436, 12,878
Year 20/21: 8,920, 9,648, 10,374, 10,957, 11,510, 11,881, 12,436, 12,878
Year 21/22: 9,648, 10,374, 10,957, 11,510, 11,881, 12,436, 12,878
Year 22/23: 10,374, 10,957, 11,510, 11,881, 12,436, 12,878
Year 23/24: 10,957, 11,510, 11,881, 12,436, 12,878
Year 24/25: 11,510, 11,881, 12,436, 12,878
Year 25/26: 11,881, 12,436
Year 26/27: 12,436
Year 27/28: 12,878

October 5, 2017
Funded Status
Discount Rate Reduced from 7.5% to 7% over 3 Years
Discount Rate Reduced from 7.5% to 7% over 3 Years

- 75th Percentile
- 50th Percentile
- 25th Percentile
CONTRIBUTION PROJECTIONS - SAFETY

Discount Rate Reduced from 7.5% to 7% over 3 Years

- 75th Percentile
- 50th Percentile
- 25th Percentile
CONTRIBUTION PROJECTIONS - SAFETY

Discount Rate Reduced from 7.5% to 7% over 3 Years

<table>
<thead>
<tr>
<th>Year (16/17-27/28)</th>
<th>Total</th>
<th>Normal Cost</th>
<th>UAL Payment</th>
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</thead>
<tbody>
<tr>
<td>16/17</td>
<td>3,396</td>
<td>2,372</td>
<td>1,024</td>
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<tr>
<td>17/18</td>
<td>3,792</td>
<td>2,323</td>
<td>1,469</td>
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<tr>
<td>18/19</td>
<td>4,416</td>
<td>2,474</td>
<td>1,942</td>
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<tr>
<td>19/20</td>
<td>5,127</td>
<td>2,623</td>
<td>2,504</td>
</tr>
<tr>
<td>20/21</td>
<td>5,703</td>
<td>2,882</td>
<td>2,821</td>
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<td>21/22</td>
<td>6,443</td>
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<tr>
<td>22/23</td>
<td>7,102</td>
<td>3,122</td>
<td>3,979</td>
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<td>23/24</td>
<td>7,585</td>
<td>3,195</td>
<td>4,390</td>
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<td>24/25</td>
<td>8,088</td>
<td>3,265</td>
<td>4,823</td>
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<tr>
<td>25/26</td>
<td>8,471</td>
<td>3,336</td>
<td>5,135</td>
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<td>26/27</td>
<td>8,919</td>
<td>3,407</td>
<td>5,512</td>
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<td>27/28</td>
<td>9,318</td>
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</tbody>
</table>

$0 $2,000 $4,000 $6,000 $8,000 $10,000 $12,000 $14,000

16/17 17/18 18/19 19/20 20/21 21/22 22/23 23/24 24/25 25/26 26/27 27/28

Total
Normal Cost
UAL Payment
Funded Status - Safety

Discount Rate Reduced from 7.5% to 7% over 3 Years

- 75th Percentile
- 50th Percentile
- 25th Percentile

October 5, 2017
Termination Cost ($Millions)

- Terminated Plans
  - Agencies that leave CalPERS voluntarily
    - Cannot exclude future employees only
  - Agencies that do not pay required contributions

- Must pay CalPERS the “termination liability”:
  - Risk-free interest rate
  - 7% mortality contingency load
  - Generally, must pay all at once
  - If not, benefits are reduced proportionately

- Assets & liabilities moved to the Terminated Agency Pool (TAP)
  - Assets invested very conservatively
  - No future sources of funds
  - Intent is to avoid any negative impact to ongoing plans
<table>
<thead>
<tr>
<th>Discount Rate</th>
<th>Ongoing 7.50%</th>
<th>Termination Basis 2.00%</th>
<th>Termination Basis 3.25%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Miscellaneous</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AAL</td>
<td>$185.0</td>
<td>$365.4</td>
<td>$308.1</td>
</tr>
<tr>
<td>Assets</td>
<td>118.0</td>
<td>118.0</td>
<td>118.0</td>
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<tr>
<td>UAL</td>
<td>67.0</td>
<td>247.4</td>
<td>190.1</td>
</tr>
<tr>
<td><strong>Safety Tier 1</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AAL</td>
<td>170.9</td>
<td>360.1</td>
<td>299.0</td>
</tr>
<tr>
<td>Assets</td>
<td>111.9</td>
<td>111.9</td>
<td>111.9</td>
</tr>
<tr>
<td>UAL</td>
<td>59.0</td>
<td>248.2</td>
<td>187.1</td>
</tr>
</tbody>
</table>
Options

- Where do you get the money from?
  - Employee Cost Sharing
  - Pension Obligation Bonds (POBs)
  - Borrow from General Fund
  - One time payments

- How do you use the money?
  - Give directly to CalPERS
  - Internal Service Fund
  - Irrevocable Supplemental (§115) Trust
- Discussion of Options

  - December 12th Council will provide direction on options for addressing unfunded liability
Questions?

Thank You!
Developing a Fiscal Health Response Plan

Like 3,000 other member agencies in CalPERS, the City of San Luis Obispo is facing significant financial challenges ahead due to increased pension costs.
San Luis Obispo is committed to…

**Good Fiscal Management**
Including fiscal policies to guide daily operations and long-term solutions to ensure a continued balanced budget.

**Public Engagement**
Involving the City Council, community, and staff in discussions about solutions.

**Quality Services**
Providing quality services to the community through committed employees.
What is the Problem?

- The City’s annual costs for CalPERS will more than double in 10 years.

- To address these increases, the City needs to reduce expenditures by $8.9 million in the General Fund & Enterprise Funds over the next three years.
Fiscal Forecast Assumptions

- Based on **current levels of service**.
- Continued **commitment to capital investment**.
- Modest long term **revenue growth and inflation**.
- CalPERS **required pension contributions**.
- **Informed** by Beacon Economics, HDL and the City’s third-party actuary Bartell & Associates.
- **Local Revenue Measure (Measure G) funds will continue** and be used consistent with voter directive and Council policy.
Why Are We Here Today?

**INFORM**

Inform all stakeholders of the problem and the process to develop a plan

**PLAN**

Lay out process to develop a Fiscal Health Response Plan to reach the ongoing budget reduction target

**Q & A**

Answer questions and receive suggestions
Retirement Benefits Basics

- The California Public Employees Retirement System ("CalPERS") is an agency in the state’s executive branch that manages pension and health benefits for more than 1.6 million employees, retirees and families.

- The City contracts with CalPERS to provide a “defined benefit” pension; meaning the retirement benefit is set based on years of service, final compensation, age, and a multiplier in the benefit formula.

- City employees do not participate in Social Security.

- Formulas differ between public safety employees and non-public safety employees, as well as hire date.
Retirement Benefits Basics

- Benefits to retirees are determined based on formulas that indicate the percent of final compensation and the retirement age.

- For instance, a 2% @ 60 formula means the retirement benefit is 2% of final compensation, times the years of CalPERS service.

<table>
<thead>
<tr>
<th>City</th>
<th>Tier 1</th>
<th>Tier 2</th>
<th>PEPRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miscellaneous</td>
<td>2.7% @ 55</td>
<td>2% @ 60</td>
<td>2% @ 62</td>
</tr>
<tr>
<td>Police Safety</td>
<td>3% @ 50</td>
<td>2% @ 50</td>
<td>2.7% @ 57</td>
</tr>
<tr>
<td>Fire Safety</td>
<td>3% @ 50</td>
<td>3% @ 55</td>
<td>2.7% @ 57</td>
</tr>
</tbody>
</table>
How are CalPERS pensions funded?

- Employees and the City contribute various amounts of the total payment each year into the CalPERS investment fund.
- CalPERS then invests that contribution, and the combination of the contribution and interest earned are used to pay retirement benefits that employees have accrued.
- CalPERS uses actuarial analysis to determine the funding needed to pay contractually obligated benefits.
Retirement Benefits Basics

What is the difference between Normal Costs and Unfunded Liability?

**Normal Costs**

- The amount of money based on actuarial assumptions that must be set aside, for future pensions benefits.

**Unfunded Liability**

- The amount of money by which future payment obligations exceed the present value of funds available.
Managing CalPERS Costs Through the Years

- Benefit levels
  - Enhanced in 2000
  - Reduced in 2013
- Demographic changes
  - Retirees living longer
- Investment losses during the Great Recession
  - Creating the unfunded liability
- Reduced rate of return
What Has the City Already Done to Address Costs?

- New Lower Benefit Retirement Tiers established

<table>
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<td>3% @ 50</td>
<td>3% @ 55</td>
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</tbody>
</table>

- Employees pay a greater share of the total pension costs
- Retirement age increases
- Paying down unfunded retirement liabilities
How Pension Costs Grow

CalPERS Required Contribution Costs
General Fund
In thousand

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual</th>
<th>Actual</th>
<th>Budget</th>
<th>Budget</th>
<th>Revised Budget</th>
<th>Revised Budget</th>
<th>Projection</th>
<th>Projection</th>
<th>Projection</th>
<th>Projection</th>
<th>Projection</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015-16</td>
<td>$3,536</td>
<td>$5,629</td>
<td>$6,871</td>
<td>$6,517</td>
<td>$7,858</td>
<td>$9,014</td>
<td>$9,909</td>
<td>$11,054</td>
<td>$12,086</td>
<td>$12,830</td>
<td>$13,477</td>
</tr>
<tr>
<td>2016-17</td>
<td>$4,322</td>
<td>$3,612</td>
<td>$3,866</td>
<td>$4,110</td>
<td>$4,337</td>
<td>$4,414</td>
<td>$5,131</td>
<td>$5,209</td>
<td>$5,329</td>
<td>$5,451</td>
<td>$5,576</td>
</tr>
<tr>
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</tr>
</tbody>
</table>

2014-15 $7.8 M
2024-25 $19 M
What is the City Doing Now?

1. Continued implementation of the Adopted Fiscal Responsibility Philosophy which includes:
   
   Informed decision making, shared responsibility, increased transparency, aligned investments, diversified and aligned revenue sources, long-term unfunded liabilities, continued efficiency and effectiveness.

2. Activation of the Fiscal Health Contingency Plan which includes a hiring and travel “chill”.

3. Adoption of the 2017–19 Major City Goal: Fiscal Sustainability & Responsibility
If we do nothing...
If we act now...

General Fund Preliminary Forecast: Fiscal Health Response Plan

In thousands

2014-15 Actual: 5,971
2015-16 Actual: 10,063
2016-17 Budget: 3,330
2017-18 Budget: 3,642
2018-19 Budget: 6,148
2019-20 Forecast: 8,952
2020-21 Forecast: 13,813
2021-22 Forecast: 20,906
2022-23 Forecast: 21,921
2023-24 Forecast: 21,421
2024-25 Forecast: 20,854
2025-26 Forecast: 20,214
2026-27 Forecast: 19,511
2027-28 Forecast: 18,731
2028-29 Forecast: 17,871
2029-30 Forecast: 16,945
2030-31 Forecast: 15,944
How Do We Fix the Problem?

**USE AN ITERATIVE PROCESS TO DEVELOP A PLAN**
A process will be used which takes input and identifies components for a plan and how they may be apportioned.

**THE PLAN**
A plan is needed to guide the responses to the fiscal shortfall.

**COUNCIL DIRECTION**
Both strategic and specific direction will be needed from Council.
Fiscal Health Response Plan: Potential Components

- Operational Reductions
- New Ways of Doing Business
- Employee Concessions
- Revenue Options
Process for developing the Fiscal Health Response Plan

Inform public and staff, answer questions, receive feedback

Staff develops preliminary options and scenarios

Seek foundational direction from Council in December
Fiscal Health Response Plan

**OCTOBER**
Inform community & staff

**NOVEMBER**
City Council Meeting to consider process to develop plan

**DECEMBER**
City Council Meeting for direction on how plan components are to be distributed

**JAN-MAR**
Develop components of plan based on Council direction

**APRIL**
Plan adoption at Strategic Budget Direction

**JUNE**
Budget adoption consistent with plan
Why Are We Here Today?

INFORM
Inform all stakeholders of the problem and the process to develop a plan

PLAN
Lay out process to develop a Fiscal Health Response Plan to reach the ongoing budget reduction target

Q & A
Receive comments and answer questions
Thank You

- Comments or questions? Please fill out form or ask a staff member

- Participate by attending Council Meetings or online at Open City Hall (www.slocity.org/opencityhall)

- **Contact Us:** fiscalhealth@slocity.org

- [www.slocity.org/fiscalhealth](http://www.slocity.org/fiscalhealth)
Question and Answer

Receive comments and answer questions