Legislation Details (With Text)

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On agenda:	5/4/2017	**Final action:**	
Title:	Presentation of Updated Pension Forecast; Options for Addressing Unfunded Pension Liabilities and Rising Pension Contributions; Establishment of a Pension Stabilization Trust Fund (Finance Director Moe). RECEIVE REPORTS; ADOPT RESOLUTION		
Sponsors:			
Indexes:			
Code sections:			
Attachments:	1. Resolution No. 17-0062, 2. Bartel & Associates Pension Projections - May 2017, 3. Amortization Schedule - Miscellaneous Plan, 4. Amortization Schedule - Police Plan, 5. Amortization Schedule - Fire Plan, 6. Amortization Bases - Miscellaneous Plan, 7. Amortization Bases - Police Plan, 8. Amortization Bases - Fire Plan, 9. Highmark Investment Options, 10. Unfunded Liabilities for Comparator Agencies, 11. PARS Client List for Pension Rate Stabilization Program, 12. Pension Trust Fund PowerPoint, 13. City Council Staff Report (Attachment only available online)		

Date	Ver.	Action By	Action	Result

TO:
Honorable Mayor and Members of the City Council

THROUGH:
Mark Danaj, City Manager

FROM:
Bruce Moe, Finance Director
Henry Mitzner, Controller
Libby Bretthauer-Long, Financial Analyst

SUBJECT:
Presentation of Updated Pension Forecast; Options for Addressing Unfunded Pension Liabilities and Rising Pension Contributions; Establishment of a Pension Stabilization Trust Fund (Finance Director Moe).
RECEIVE REPORTS; ADOPT RESOLUTION

RECOMMENDATION:
Staff recommends that the City Council receive reports on: a) updated pension forecasts from the independent actuary, and b) options available for addressing unfunded pension liabilities and rising contribution rates.

After receiving the reports, staff recommends that the City Council: a) adopt Resolution No. 17-0062 establishing a Pension Rate Stabilization Trust Fund Administered by Public Agency Retirement

Services (PARS) ; b) Appoint the City Manager as the City's Plan Administrator; c) Authorize the City Manager to negotiate and execute the final documents of the Trust; d) authorize the transfer of $500,000 in budgeted General Funds to the Pension Rate Stabilization Trust Fund, and e) assign responsibility and authority to the Finance Subcommittee to develop an investment policy and guidelines, and direct investments in the trust.

EXECUTIVE SUMMARY

Due to a number of factors, including changes in actuarial assumptions and inconsistent/substandard investment returns, the City is facing rapid growth in unfunded pension liabilities and required pension contributions. In an effort to proactively address these issues, the City Council requested information on options that may be available to go beyond the minimum funding requirements for pensions. Staff has identified such options that include: 1) establishing a Pension Rate Stabilization Trust, 2) accelerating amortization of existing unfunded liabilities, 3) paying down select liabilities, and 4) using a lower discount rate than currently utilized by CalPERS to set internal funding levels. Staff is recommending option #1, the trust fund, which may then be used in conjunction with the other three options if desired.

FISCAL IMPLICATIONS:

The City's FY 2017-2018 total pension contributions are estimated to be $6.9 million, an increase of $674,000 over FY 2016-2017 budget. Those contributions include the Normal Cost (e.g., contributions for current service provided by current employees) as well as contributions for unfunded liabilities (past service for which full funding for retirement has not been achieved).

As of the last CalPERS valuation report (dated June 30, 2015) the City's unfunded accrued pension liabilities totaled $55,158,732:

Police	$26,056,225	47.2%
Non-Sworn	$17,626,012	32.0%
Fire	$11,476,495	20.8%

Given revised CalPERS assumptions for the expected rate of return adopted in December 2016 (which lower the rate from 7.5% to 7% over three years), coupled with lower than expected earnings by CalPERS, the City's unfunded accrued liabilities are estimated to rise to $117 million by June 30, 2022. With this change, City contributions are also expected to rise to $12.0 million by FY 2021-2022, an increase over FY 17-18 contributions of $5.1 million.

These pension rates are built into the City's updated Five Year Forecast presented with the FY 2017-2018 budget update.

The recommended initial funding for the Pension Rate Stabilization Fund is $500,000 from budgeted funds in FY 2016-2017.

BACKGROUND:

Over the past two years, staff has obtained the services of an independent actuary to assist in the analysis and forecasting of CalPERS pension data. This has proved beneficial during a time when CalPERS has changed actuarial assumptions, investments have performed inconsistently and alternative methods of funding pensions have been discussed.

At the May 4th Budget Study Session, John Bartel (Bartel Associates) will present an update to the

City's pension forecast. This update will incorporate the reduction in the discount rate approved by the CalPERS board in December 2016. That change will lower the discount rate from 7.5% to 7.0% over the course of three years. The rates associated with the change will affect the City beginning in FY 2018-2019, and are projected to add on average $1 million per year to City contributions over the next five years.

During FY 2016-2017 budget deliberations, the City Council directed that $500,000 be set aside in the budget for the creation of a Pension Rate Stabilization Fund (PRSF), the purpose for which is to assist in smoothing annual pension contributions so as to balance rising rates against other important needs and services. In September 2016, City Council, upon consideration of the actual implementation of the PRSF, requested staff explore an alternative to the PRSF of reducing the amortization period of the existing unfunded liabilities in order to pay-off liabilities sooner, thereby reducing cost. This report provides information on that alternative, as well as others for Council consideration.

DISCUSSION:

Pension Actuary Report

Attachment #2 to this staff report is an update on the City's pension data prepared and provided by Bartel and Associates. This information will be the basis for discussion at the Budget Study Session. It includes data on the City's three CalPERS pension plans for Police, Fire and non-sworn employees, including demographics, plan funding status, contribution rates and unfunded liabilities. It also includes options for addressing rising pension costs.

Addressing Unfunded Pension Liabilities and Rising Pension Contributions

This report provides several options for addressing pension costs. As a basis for developing the following options, several objectives were identified:

1. Reduce unfunded pension liabilities
2. Maintain budget flexibility
3. Reduce the carrying costs of unfunded pension liabilities

Each option listed below supports one or more of these criteria.

Option #1 - Pension Rate Stabilization Fund
Until recently, the only option available for the City to reduce unfunded pension liabilities was to submit additional discretionary payments to CalPERS above and beyond the required contributions (required contributions include funding for current employees as well as unfunded liabilities for past service). However, those funds, once on deposit, are subject to the same market volatility risk as the other funds invested with CalPERS. There is an alternative in the form of depositing funds into an irrevocable trust established specifically for pension rate stabilization purposes.

A Pension Rate Stabilization Fund (PRSF) has several benefits:

- The City maintains oversight of investment management and control over the risk tolerance level of the portfolio
- Assets can be accessed to offset unexpected rate increases thereby stabilizing on-going

pension expenditures
- Assets held in the fund allow for greater investment flexibility and risk diversification compared to the City's general investments
- Pending Governmental Accounting Standards Board (GASB) approval, funds deposited into the trust may address the City's Net Pension Liability which is now reported on the City's balance sheet in accordance with Government Accounting Standards Board (GASB) Statement No. 68
- Depositing assets in a trust will be a positive development to Moody's and Standard and Poor's in the City maintaining Triple-A credit ratings from both of these entities

It is important to note that any funds deposited in the trust fund may only be used for pension costs and cannot be recaptured for other uses. However, use of funds may reduce reliance on existing unrestricted funds freeing those moneys for other uses.

The concept of the account is that the City would deposit funds into the account and invest those moneys in instruments that have the potential to earn greater returns than can be achieved under the City's existing investment policies and State law for general public funds. State law provides the framework for public funds investment in such trust funds. The principal and earnings may then be contributed to any one of the City's three CalPERS plans (Police, Fire, Miscellaneous) at the City's discretion. For example, the funds can be used as a buffer to reduce the impacts of large rate fluctuations in Employer rates from substandard investment returns.

While the PRSF has the potential to reduce net pension costs, actual earnings on those funds will most likely not approximate the carrying cost of the unfunded liabilities at CalPERS (unless riskier investments are selected in an attempt to achieve high returns). The discount rate has the effect of being the interest rate charged by CalPERS on any unfunded liabilities. As a result, the City is, in essence, currently paying 7.5% interest on the unfunded liabilities (lowering to 7% over the next three years). For example, $55,158,732 in unfunded liabilities cost the City $4,136,905 annually in carrying costs with CalPERS.

Although risks exist with advanced funding with CalPERS, paying down liabilities more rapidly is the most cost effective way to reduce costs.

Objectives Met: 1, 2, 3

Option #2 - Accelerated Amortization
Another option is to reduce the existing amortization period for unfunded liabilities from the current 30 -years to either 15-years or 20-years (see attachments #3, #4 and #5). Please note that these figures are based on the most recent valuation report dated June 30, 2015 and do not include the FY 2015-2016 investment results of 0.61% or the change in the discount rate from 7.5% to 7.0%, both of which will increase these estimates:

15-Year Amortization

Plan	Savings	1st Year Payment Increase
Police	$13.8 MM	$1,054,900
Fire	$6.1 MM	$488,000

Miscellaneous	$8.3 MM	$658,930
Total	$28.2 MM	$2,201,830

20-Year Amortization

Plan	Savings	1st Year Payment Increase
Police	$4.8 MM	$605,200
Fire	$2.1 MM	$288,050
Miscellaneous	$2.3 MM	$359,590
Total	$9.2 MM	$1,252,840

It is important to note that once the City selects a reduced amortization period it cannot be revised. This inflexibility does not allow for payment adjustments in the event of financial or economic hardship. However, the savings are significant.

Objectives Met: 1, 3

Option #3 - Payoff of Selected Liabilities

This option allows the City to specifically select an unfunded liability and payoff that amount (see Attachments #6, #7, and #8). For example, utilizing the Fire Safety Plan (Attachment #8), if the City were to pay-off the “Share of Pre-2013 Pool UAL” of $4.8 million, the annual payment for that liability would be reduced by $360,907 in FY 17-18. On the other hand, it reduces budget flexibility by reducing available funds by $4.8 million that could be utilized elsewhere.

Objectives Met: 1, 3

Option #4 - Establish an Internal Discount Rate Upon Which to Base Contributions

This option involves setting the City’s CalPERS contributions to a discount rate below what is used by CalPERS (currently 7.5% being adjusted to 7.0% over three years), with the effect being contributions in excess of the minimum required. This can be used in conjunction with Option #1 (Trust Fund) and/or with the other options listed. For example, if the City were to use a 6.5% discount rate, using FY 2022-2023 contribution rates as the basis (after the phase-in of the new 7% discount rate), additional contributions of $2.5 million per year would be necessary to fund at that level (this would equate to $15.7 million being allocated to pensions that year). Those funds could then be deposited in the trust fund and invested to achieve higher returns than achievable outside the trust. It also provides budget flexibility in that there is no legal obligation to set those funds aside (although once in a trust fund,limitations on use apply) which may then be reallocated in the event the funds are needed for other purposes.

Objectives Met: 1, 2, 3

Based on the options listed above, staff recommends Option #1 - Establishment of a Pension Rate Stabilization Fund. This recommendation provides the following benefits:

1. The City maintains oversight of investment management and control over the risk tolerance level of the portfolio
2. Assets can be accessed to offset unexpected rate increases thereby stabilizing on-going pension expenditures
3. Assets held in the fund allow for greater investment flexibility and risk diversification compared to the City's general investments
4. Pending Governmental Accounting Standards Board (GASB) approval, funds deposited into the trust may address the City's Net Pension Liability which is now reported on the City's balance sheet in accordance with Government Accounting Standards Board (GASB) Statement No. 68
5. Depositing assets in a trust will be a positive development to Moody's and Standard and Poor's in the City maintaining Triple-A credit ratings from both of these entities
6. Maintains budget flexibility and adapts to changes in the City's economics from one year to the next
7. Can utilize the trust to accelerate payoff of selected liabilities (Option #2) by accumulating moneys and paying off those liabilities once sufficient funding has been achieved

Funding

The adopted FY 2016-2017 budget includes $500,000 in the General Fund to be deposited into the trust account once it is established. Aside from the $500,000 annual contribution now in place, additional future contributions will be directed by the City Council, and may include year-end surpluses and other one-time receipts. For FY 2017-2018, staff is recommending a $250,000 contribution to the trust.

Staff, in coordination with the Finance Subcommittee, will return to City Council in the future with a discussion on amending the City's Financial Policies in order to include guidelines on funding this pension trust.

Public Agency Retirement Services (PARS)

Section 115 Irrevocable Trusts have been in existence for many years. In the past several years, they have they been adopted as a mechanism for pre-funding public agencies' OPEB liabilities (which the City did in 2008 through a CalPERS sponsored plan). Most recently, they have become a popular tool for pre-funding pension liabilities as a method to address unfunded liabilities and large variances in annual pension contribution rates.

The number of administrators offering Pension Rate Stabilization Trusts is limited since this is a fairly new financial adaptation of Section 115 irrevocable trusts. Two main entities have entered the marketplace: Public Agency Retirement Services (PARS) and Public Financial Management (PFM).

While both are clearly capable and experienced in Section 115 trust administration, staff believes PARS is best suited to meet the City's needs for the following reasons:

- PARS is the leader in this marketplace having established 75 public agency PRSF trusts (up from 41 when Council discussed in September 2016), including 30 cities (up from 18)
- PARS has a track record of being a leading provider of public retirement services. For example, the City has received excellent service from PARS in providing part time employees with the legally required retirement plan (this is an acceptable and lower cost alternative to Social Security)
- PARS's asset management costs are marginally lower than PFM's (all-in costs for administration, management, trustee and advisory fees of .60% versus .715%)
- The PARS program has been established as a multiple employer trust so that public agencies regardless of size can join the program to receive the necessary economies of scale to minimize administrative fees.

Portfolio Management

PARS has partnered with US Bank to serve as Trustee, and with its sub-advisor High Mark Capital Management to provide investment management services for the program.
Under the PARS Pension Rate Stabilization fund, the City maintains oversight of the investment manager and the portfolio's risk level to mitigate undue risk. Several options exist for the portfolio management:

1. The City can utilize the Administrator's (PARS) subadvisor, High Mark, to handle the investments on a preset basis. The City would select one of five preset options (Attachment #9) from active or passive (i.e., index funds) investments with High Mark determining the actual investments utilized. With this scenario, the City has the ability to influence the risk level and investment approach, but do not select specific investments (e.g., investing in a specific equity). For new plans that have not accumulated much by way of assets, this is generally the preferred route.

2. Once the asset levels are larger (e.g., over $ 5 million), it would be possible to work with High Mark on a more customized basis (for example, The City may guide High Mark to purchase individual bonds rather than bond mutual funds). Also, once customized, the City can develop a strategy that is different than the 5 preset options which could include more alternative investments.

3. As a third approach, the City could hire a separate investment advisor. In this capacity, US Bank would serve as Directed Trustee and would be custodian of the assets. High Mark would not be involved at all. The City's investment advisor would manage the investments based on City direction and would be separately compensated. The issue to note is that at small asset levels, investment advisors may not be that interested until assets reach a more sizable level. As a result, some PARS agencies are taking the approach of working with High Mark until assets reach a more significant level and then may decide at a later point in time whether or not to use a different manager.

Staff recommends that the City Council assign responsibility and authority to the Finance Subcommittee to develop an investment policy for the trust, and direct investment decisions for the fund (e.g., Conservative, Moderately Conservative, Moderate, etc.) or another alternative listed above as deemed appropriate by the Finance Subcommittee. This is similar to the role of the Finance

Subcommittee with regard to the City's other investments. Further, staff will recommend to the Finance Subcommittee that initially the City utilize High Mark as the investment advisor utilizing one of the five preset options. However, advisory services for these investments may be changed at any time as deemed desirable.

Council Questions

When this item was previously discussed last summer, City Council had a number of questions regarding the pension fund program. Those questions, and associated answers, are provided below:

1. Describe the trust fund for retiree medical and how it works

In 2008, the City established a Section 115 Trust Fund for the purpose of prefunding the City's "Other Post Employment Benefits" (OPEB). The OPEB trust is administered by the CalPERS' California Employers' Benefit Trust (CERBT). The funds are invested in one of three options available; the Finance Subcommittee selected the mid-level risk option (as opposed to the lowest risk or highest risk).

The City's OPEB liabilities in this fund stem from two retiree medical benefit programs: a) a stipend of between $250 and $400 per month depending upon the labor group and certain minimum service years, which terminates when the retired employee reaches age 65 or Medicare eligible, and b) the CalPERS requirement that any agency participating in the Public Employee Medical and Hospital Care Act (PEMHCA) medical insurance program, as the City does, must provide employees and retirees with a certain minimum contribution. Currently, that amount of $128 per month, subject to annual adjustment. Thirty-six percent ($2.1 million) of the City's accrued liabilities relate to the City's stipend while the CalPERS PEMHCA requirement accounts for 64% ($3.8 million).

The funds in the trust may only be used for OPEB related costs. Mechanically speaking, the City pays out the stipend to retirees monthly and seeks reimbursement from the trust at the end of the fiscal year. For FY 2015-2016, the OPEB reimbursement from the trust totaled $288,888.

The OPEB trust fund is currently funded over 160% of actuarially accrued liabilities. In dollars, assets total $9.5 million while accrued liabilities total $5.9 million, leaving $3.6 million in surplus assets. This cushion will allow the City to forego the normal scheduled contributions $285,793 for FY 2016-2017 and beyond.

2. Describe how investing in the Pension Stabilization Fund reduces the pension liability and controls long-term risk

The main purpose of the Pension Stabilization Fund is to provide a cushion and smoothing against rapidly rising pension contribution rates. By design, the City deposits funds into the trust, invests at returns greater than achievable for General investments the City makes under State law, and then uses the program funds to reduce outgoing cash flow for pension costs, allowing City funds to be used for other needs as appropriate or desirable. This reduces pension costs through the ability to achieve greater investment results compared to the standard investments the City makes.

The annual total pension payments to CalPERS include a component that is applied to unfunded liabilities. As a result, any trust funds we use to pay pension costs also help address unfunded liabilities. Further, if deemed financially prudent, trust funds may be used to accelerate pay down of unfunded liabilities with CalPERS. However, it is important to note that once additional unfunded liability payments are sent to CalPERS, they are comingled with standard Pension Fund investments, and thus are subject to the same risk as the entire CalPERS investment pool since the funds are no longer in the City's control. This may result in gains or losses which mirror the risk the City is already exposed to through the pension plan.

Because the stabilization program funds are controlled by the City, long term risk may be improved compared to the CalPERS portfolio. This will be dependent upon the investment policies and risk profile the City selects. Investment choices will include lower risk Money Market and Conservative options to more aggressive Moderate and Capital Appreciation growth oriented portfolios, each with varying risk factors and corresponding expectations for rates of return.

3. What are the thoughts regarding guidelines and a distribution plan for the fund? Will there be benchmarks? What are we trying to accomplish for each department?

The recommendation is that the City Council assign responsibility to the Finance Subcommittee to develop policies on investment, sources and uses of funding. The policies may be reviewed and approved by the full City Council if so directed.

Other cities have varying funding policies. For example, Solana Beach contributes 50% of year-end surpluses to the pension stabilization fund. City of Sausalito contributes the difference between the required CalPERS contributions utilizing the current 7.5% discount rate, and a 2.8% discount rate. Finally, the City of Healdsburg set a maximum employer rate for the groups (Miscellaneous, Police, Fire) with the pension fund being utilized when employer contribution costs exceed stated levels.

Benchmarks may be established as a barometer of success. The options provided by High Mark (the initial recommended investment management advisory service) include benchmarks in their materials (Attachment #2), as do most advisory firms.

The goals for this fund are not set by department. Rather, the objective is to smooth impacts of rising pension contributions so as to not cause rapid negative impacts to other services. This would be done on a citywide basis.

4. How are other jurisdictions using similar funds?

In addition to the smoothing described above, other public agencies are using the funds to primarily accomplish the following:

- Help create new revenue sources from Trust Investment earnings to provide structural balance (i.e., helps revenue growth rate equal expenditure growth rate). (Town of Colma)
- Trust Assets act as a direct offset to Net Pension Liabilities under GASB 68 (City of Brea)
- Trust Assets act as a hedge against PERS investment risk (City of Upland)

5. How are other jurisdictions addressing the same problem? Do they have a similar fund? How has it worked for them?

Seventy-five public agencies in the state of California have established similar Section 115 trusts with PARS. These other public agencies include counties, school districts, a community college district and special districts in addition to the 30 cities that have already adopted the same trust program under consideration by the City. The same benefits and advantages of the trust are also present for these other jurisdictions.

The concept of this program is relatively new, having only been established for less than two years. These liabilities that are being addressed are long-term liabilities that will take many years to correct, so the ultimate success of the program will depend on a variety of factors including the ability to fund the trust, the overall investment returns of the City-controlled trust, and the actual plan experience of the underlying retirement system (i.e., CalPERS).

To provide an example of how other jurisdictions are investing plan assets, here is a breakdown of those 75 agencies that have already adopted the program:

Investment Strategy Type / % of Agencies in Strategy	
Money Market (0% Equities)	2%
Conservative (15% Equities)	10%
Moderately Conservative (30% Equities)	34%
Moderate (50% Equities)	27%

Balanced (60% Equities)	17%
Capital Appreciation (75% Equities)	5%
Custom	5%

6. What is our current annual payment and what percentage will our contribution to the fund be of that number?

The City's Fiscal Year 2016-2017 contribution is estimated to be $6.2 million. The City Council initially directed that $500,000 per year be deposited in the fund. That equates to 8% of FY 16-17 contributions. However, in an effort to balance the proposed FY 2017-2018 General Fund budget, staff is recommending reducing the on-going allocation to $250,000.

7. Are there additional policies needed for the City in association with this fund? What existing state laws are there and do we need to be augmenting them?

Please see #3 above. Existing state laws do provide additional flexibility with respect to plan investments compared to the City's current investment guidelines. The City (Finance Subcommittee) would work with the investment advisors to develop an Investment Guideline Document (IGD) with respect to assets held in the trust.

8. Timeline for developing those financial policies, if necessary.

If City Council accepts the staff recommendation to utilize the Finance Subcommittee to develop policies (including the Investment Guidelines Document), staff anticipates that policies would be prepared within 60-90 days.

9. Are there any reference guides from John Bartel on these issues?

According to Mr. Bartel, there are no reference guides on this topic at this time. However, Bartel and Associates commonly recommend the establishment of a pension stabilization fund as a more meaningful actions a jurisdiction can take to smooth future rate increases.

10. Will this limit our risk more or less than PERS? Compare the two risks.

This will reduce our exposure to the risks associated with CalPERS' aggressive style of investments, which are currently geared to attain 7.5% returns. CalPERS uses a diversified portfolio that has many different asset classes. For example, pension funds are invested in real estate, equities (stocks), bonds, and corporate debt. Investments in a City controlled trust can potentially be invested more conservatively than CalPERS, which can reduce the overall investment risk to the City. Please see Attachment #9 which includes investment options.

11. Compare and contrast this fund with what was done before

Generally speaking, the City has made only the required contributions as calculated by CalPERS each year. With the exception of a one-time payment to CalPERS in the 1990s used to pay down unfunded liabilities, and the issuance of pension obligation bonds in 2008 to payoff liability side funds in the safety pools, no additional payments have been made. However, please note that all regular, required payments to CalPERS include a component to pay down unfunded pension liabilities.

In FY 2003-2004, in the face of rising pension costs, the City established a Pension Stabilization reserve within the General Fund. This reserve was funded with one time moneys totaling $2,024,505 realized from a utility cost allocation study. Pension contribution increases totaling $2.2 million were expected in FY 2003-2004 and FY 2004-2005. The reserve was ultimately used in FY 2005-2006 ($680K), with the balance ($1.3 million) utilized in FY 2006-2007.

This new pension stabilization fund will act in much the same way the 2003-2004 reserve was intended, except that the City will have the ability to reduce pension costs through higher investment earnings potential than can currently be achieved with general City investments. Funds may be drawn to stabilize annual pension payments so that substantial increases can be eased into operational expenditure budgets and reduce immediate impacts on service levels.

12. How does this limit our risk with the volatility of PERS?

See #10 above.

13. Compare the annual payments and financial commitments of this fund vs. CalPERS

There are no financial commitments or annual minimum payments required for the trust fund. It can be determined on an ad-hoc basis by the City Council, or through a policy approved by the City Council. Conversely, CalPERS requires certain minimum payments each year to fund the normal cost of pensions as well as unfunded liabilities. The Pension Stabilization program's major requirement is that the funds may be used only for pension costs, and that reimbursements cannot exceed more than one year's worth of actual pension costs, which currently exceed $6 million. For example, if the City did contribute $500,000 to the fund, the City would have immediate access to request a distribution of that original contribution since it is well below the City's current annual pension costs.

14. How does it compare to the cushion that is already included by Finance in the annual budgets?

Aside from any *budgeted* General Fund surplus amount there is no budgeted cushion per se. Salaries and benefits are generally budgeted with a vacancy factor (4% in FY 2016-2017) in recognition of the fact that all positions are not filled 100% of the year. This factor applies to CalPERS contributions, which are budgeted at 96% of estimated cost.

Budget aside, the City typically generates year-end General Fund surpluses (e.g., revenues in excess of expenditures) which may be directed to the fund either through policies or on an ad-hoc basis by the City Council.

15. What other jurisdictions have similar pension liabilities? How are they addressing them? Which ones are using PARS?

Attachment #10 includes unfunded liabilities as a percentage of payroll for comparator agencies (these were provided by Bartel Associates last year). Attachment #11 lists PARS' clients utilizing the Pension Stabilization Reserve Fund program. PARS has 30 cities and 45 public agencies in the state of California using the pension fund method. Other agencies may be addressing unfunded liabilities by issuing pension obligation bonds (interest arbitrage between CalPERS and borrowing rate), borrowing from other agency funds that may have sufficient working capital, reducing the amortization period with CalPERS (reduces interest expense but increases payment amounts), or using one-time money to reduce unfunded liabilities with CalPERS.

16. Can the funds be used for OPEB liabilities as well?

No. While one trust fund may be established for both OPEB and pension stabilization purposes, funding must be used for the purpose intended at the time of deposit.

17. What will the process be for accessing the pension stabilization funds?

A written request to the trust administrator will be submitted with direction on whether the requested funds are to be refunded to the City after incurring the expense, or paid directly to CalPERS to satisfy the required contribution or payment.

18. What impact on the existing funds and process will the new Pension Stabilization program fund have?

The pension stabilization funds will reduce reliance on on-going resources through increased earnings potential above that level achievable with the City's general investments.

POLICY ALTERNATIVES:

***ALTERNATIVE #1*:**
Establish a Pension Rate Stabilization Fund (Recommended)

PROS:

- The City maintains oversight of investment management and control over the risk tolerance level of the portfolio
- Assets can be accessed to offset unexpected rate increases thereby stabilizing on-going pension expenditures
- Assets held in the fund allow for greater investment flexibility and risk diversification compared to the City's general investments
- Pending Governmental Accounting Standards Board (GASB) approval, funds deposited into the trust may address the City's Net Pension Liability which is now reported on the City's balance sheet in accordance with Government Accounting Standards Board (GASB) Statement No. 68
- Depositing assets in a trust will be a positive development to Moody's and Standard and Poor's in the City maintaining Triple-A credit ratings from both of these entities
- Maintains budget flexibility and adapts to changes in the City's economics from one year to the next
- Can utilize the trust to accelerate payoff of selected liabilities (Option #2) by accumulating moneys and paying off those liabilities once sufficient funding has been achieved

CONS:

- Does not necessarily achieve the savings obtained through other options such as reducing amortization or paying off existing liabilities

***ALTERNATIVE #2*:**
Accelerate amortization of existing unfunded liabilities

PROS:

- Reduces interest cost of carrying unfunded liabilities at CalPERS

CONS:

- Reduces budget flexibility by locking in higher required long term payments to CalPERS which could be in addition to higher payments resulting from poor investment performance

***ALTERNATIVE #3*:**
Payoff selected unfunded liabilities

PROS:

- Reduces interest cost of carrying unfunded liabilities at CalPERS
- Reduces on-going annual pension contributions

CONS:

- Reduces budget flexibility by reducing available cash

***ALTERNATIVE #4*:**
Establish an Internal Discount Rate Upon Which to Base Contributions

PROS:

- Increases the amount of money allocated to pay down liabilities or reserve for further rate stabilization purposes

CONS:

- Reduces budget flexibility by allocating financial resources to pensions

PUBLIC OUTREACH/INTEREST:
After analysis, staff determined that public outreach was not required for this issue.

ENVIRONMENTAL REVIEW
Not required.

LEGAL REVIEW
The City Attorney has reviewed this report and determined that no additional legal analysis is necessary.

Attachments:

1. Resolution No. 17-0062
2. Bartel & Associates Pension Projections - May 2017

3. Amortization Schedule - Miscellaneous Plan
4. Amortization Schedule - Police Plan
5. Amortization Schedule - Fire Plan
6. Amortization Bases - Miscellaneous Plan
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9. Highmark Investment Options
10. Unfunded Liabilities for Comparator Agencies
11. PARS Client List for Pension Rate Stabilization Program
12. PowerPoint Presentation - Options for Addressing Pension Costs
13. City Council Staff Report (Due to the large number of pages for this particular staff report, this is an alternative option to review the complete staff report. This attachment is only available online.)