



CITY COUNCIL AGENDA REPORT

MEETING DATE: February 4, 2014

ITEM NUMBER:

SUBJECT: PENSION COST REDUCTION RECOMMENDATIONS—FIRST STEPS

DATE: JANUARY 24, 2014

FROM: FINANCE DEPARTMENT

PRESENTATION BY: STEPHEN DUNIVENT, INTERIM FINANCE DIRECTOR

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RECOMMENDED ACTION:

1. With respect to the Pension Oversight Committee
 - a. Receive and file the Pension Oversight Committee Report
 - b. Approve the distribution of the Committee Facts Volumes 1, 2 and 3.
 - c. Provide direction regarding the Committee's future activities
2. Authorize the lump-sum prepayment of the City's annual required contribution for the Miscellaneous and Police Retirement Plans beginning in July 2014.
3. Authorize the use of the City's annual savings from the lump-sum prepayment of the Miscellaneous and Police Retirement Plans to make additional payments to the Fire Side Fund beginning in July 2014 with the goal of paying off this fund early.
4. Authorize the Finance Director, with the concurrence of the City CEO, to annually review recommended actions two and three and implement or suspend them each fiscal year as appropriate to the City's financial condition at the time.
5. Authorize a one-time additional \$1,000,000 payment to the Fire Side Fund this fiscal year using funds that were budgeted in FY 2012-13 and FY 2013-14.
6. Provide direction on continuing the practice of budgeting an additional \$500,000 per year for the purpose of paying down unfunded pension liabilities.

BACKGROUND:

Retirement plans for City employees are administered by the California Public Employees' Retirement System (CalPERS or PERS). The City's current annual cost for retirement benefits is \$18,006,842 or nearly 17.5% of the City's General Fund budget. (Attachment A) As of June 30, 2012, the Unfunded Actuarial Accrued Liability (unfunded liability) for the City's three retirement plans combined is \$228 million. (Attachment B) The City wants to find ways to reduce both the annual retirement cost and the unfunded liability of these retirement plans.

As part of the last two budget cycles, the City set aside a total of \$1,000,000 for the purpose of reducing the unfunded pension liabilities.

The City Council established a Pension Oversight Committee in February 2013. Its mission is to review pension and pension financial matters and to evaluate and advise

the Council on pension issues. Attachment C is the committee's first report on its work and accomplishments. The committee drafted initial recommendations that range from actions that can be taken now, issues that need further analysis and items that are part of the labor negotiation process or would require legislative changes.

This staff report outlines actions that can be taken now as first steps with existing resources to reduce the City's annual pension cost and unfunded liability. The recommendations in this report were reviewed by the Pension Oversight Committee on January 8, 2014. A majority of the members support the recommendations in this agenda report.

ANALYSIS:

Annual Pension Contribution Lump-sum Prepayment: The City traditionally pays its annual required contribution to PERS on a bi-weekly basis as part of the payroll process. PERS offers a lump-sum prepayment option that allows employers to prepay the entire annual contribution at a discounted amount. The discount is approximately 3.5% of the total annual contribution in consideration that the funds will be invested with PERS for a longer period of time. This discount compares favorably to the composite interest rate of less than 0.5% currently earned on cash and investments held by the City. The lump-sum prepayment is required after June 30 and before the first payroll of the new fiscal year. The lump-sum prepayment amounts and savings for each retirement plan are shown on Attachment B. The lump-sum prepayments would save \$226,551 on the Miscellaneous Employee Plan, \$263,225 on Police employee Plan, and \$177,176 on Fire employee Plan. Staff recommends prepaying only the Miscellaneous and Police Plans at this time due to the cash flow impact and because the Fire employees are in a pooled plan with safety employees of other employers. The total lump-sum prepayment for the two groups is \$13,301,139. The combined gross savings from the lump-sum prepayment for the Miscellaneous and Police Plans is \$489,776 less the lost interest income of \$33,253 for a net annual savings of \$456,523.

Cash Flow Analysis: The lump-sum prepayment of the Miscellaneous and Police Plans will require \$13,301,139 in cash (plus the regular Fire Plan bi-weekly payment) in early July. Cash investments will be managed to provide for this payment. Cash flow projections (Attachment D) are based on the current fiscal year actual/projected revenues (with modest increases of \$1 million each in property taxes and sales tax for next fiscal year) and expenses overlaid with next fiscal year retirement costs and the lump sum prepayment. The cash flow model also assumes the rescheduling of the General Fund lump sum contribution to the Capital Improvement Program Fund to December. With the lump-sum prepayment, the General Fund cash balance would temporarily dip to a low point of \$15,041,249, staying above the reserve threshold of \$14,125,000. The cash balance would be restored over the fiscal year as the City's bi-weekly payments to PERS for the two groups would not be required.

Fire Side Fund: At the time the City retirement plan for Fire employees was placed into PERS, there were fewer than 100 City Fire employees. Therefore the employees were placed in the general PERS Fire safety pool. The funded status of the City's Fire Plan was less than that of the general PERS Fire safety pool therefore PERS required that a

City Fire Side Fund be created to account for the difference in funding. The difference in the funding status was valued at \$22,690,635 on June 30, 2010. (Attachment E) The current balance of the Side Fund as of June 30, 2013 has grown to \$24,941,538 due to payroll variances and the offering of retirement incentives in 2010 and 2011. The annual payment of the side fund is 17.741% of payroll or \$1,826,662 estimated for this fiscal year. PERS charges the City an annual interest rate of 7.5% on this fund. Under the current payment plan, the fund will be paid off in 20 years.

This fund is a good candidate for early payment for several reasons. First, the balance is small enough in comparison to the other unfunded liability amounts to be paid off early in a reasonable amount of time and in amounts that the City can currently afford. Second, early payoff will save the City 7.5% in interest cost on the unpaid balance. Finally, when the fund is paid off, the employer contribution rates for Fire employees will be reduced by the 17.741% yielding a 38% reduction in the City's retirement cost for these employees.

An additional payment of \$1,000,000 can be made to the Fire Side Fund this fiscal year using funds already set aside for the purpose of pension liability reduction. If this were the only additional payment, all other assumptions being equal, the Fire side fund would be paid off two years early saving over \$4 million. (Attachment E, Projection 1)

Staff recommends investing the \$489,776 gross savings from the annual lump-sum prepayment of the Miscellaneous and Police Plans in July 2014 as an additional annual payment to the Fire Side Fund. If this is done on an annual basis, combined with the one-time \$1,000,000 payment, the Fire side fund would be paid off seven years early saving nearly \$12 million. (Attachment E, Projection 3) Attachment F illustrates the impact of additional payments to the Fire Side Fund.

Self-Sustaining Plan: The recommendations above are designed to create a self-sustaining retirement cost reduction plan. Savings from annual lump-sum prepayment of the Miscellaneous and Police Plans can be dedicated toward paying down the unfunded liability of the Fire side fund. In the future, when the Fire side fund is paid off, savings could be directed to paying down the remaining unfunded liabilities in the Miscellaneous and Police Plans. The City could also free up the budgeted amount of \$500,000 per year that has been set aside for this purpose and redirect it for other needs of the City such as the rebuilding of reserves.

ALTERNATIVES:

The Council has several alternatives to the staff recommendations. Regarding the annual contribution lump-sum prepayment, none, one or all three of the plans could be prepaid. Two plans are recommended for lump-sum prepayment at this time due to the cash flow impacts and the fact that Fire employees are in a pooled fund. The annual savings from lump-sum prepayment could be directed elsewhere but this would hinder progress toward the goal of further reducing pension unfunded liabilities and cost.

The \$1,000,000 already set aside could be reserved for future use or directed toward liabilities other than the Fire side fund. The recommended use of the \$1,000,000 for

the Fire side fund represents a significant step toward reducing the unfunded liability and the associated 7.5% interest cost in that fund.

The annual appropriation of \$500,000 per year for reduction of pension liabilities could be continued. This would make the funds unavailable for other City purposes such as rebuilding reserves.

CONCLUSION:

Gross annual savings of \$489,776 (\$456,523 net) can be achieved by prepaying the annual contribution for the Miscellaneous and Police Plans. Using the gross savings plus the \$1,000,000 budgeted in the last two years to make additional payments to the Fire Side Fund can completely pay down the liability of this fund seven years early saving over \$12 million. The recommended plan is self-sustaining by using savings from the lump-sum prepayment to pay down the Fire Side Fund. This plan could also free up \$500,000 in the City budget for other purposes.

Stephen Dunivent
Interim Finance Director

Thomas R. Hatch
City CEO

- Attachments:
- A. [FY 2013-14 City Budget Chart—General Fund Appropriations](#)
 - B. [CalPERS Actuarial Valuation Summary Information](#)
 - C. [Pension Oversight Committee Initial Report](#)
 - D. [General Fund Cash Flow Projection](#)
 - E. [Fire Side Fund Projections](#)
 - F. [Fire Side Fund Graph](#)