



**CITY OF HEALDSBURG  
CITY COUNCIL AGENDA STAFF REPORT**

**MEETING DATE:** April 15, 2019

**SUBJECT:** Pension Liability Funding Policy

**PREPARED BY:** Heather Ippoliti, Administrative Services Director

**STRATEGIC INITIATIVE(S):**  
Fiscal Responsibility

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**RECOMMENDED ACTION(S):**

Adopt a resolution approving the Pension Liability Funding Policy which establishes a methodology and process for funding current and future costs associated with the city's contractual obligations to provide pension benefits as set forth in the City's labor agreements.

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**BACKGROUND:**

The City is facing significant increases in required pension contributions to address a large unfunded pension liability.

The City contributes to the California Public Employee Retirement System (PERS). A pension is a retirement account that an employer maintains to give employees a fixed payout when they retire. PERS is a defined benefit plan. The payout typically depends on how long the employee works for the employer and the employee's salary.

Investment income, employee contributions and employer contributions fund the total pension cost, including benefits and expenses. Employer contributions are set by actuaries using an investment rate assumption (also known as the "discount rate"), recently lowered from 7.5% to 7% as of June 30, 2018, and other assumptions related to salary, payroll, cost of living, mortality rate, disabilities, terminations and retirements. The maximum employee contribution rates are set by law.

Current California law establishes that public employee retirement benefits are a form of deferred compensation and part of the employment contract. The Courts have established that the vested rights of public employees prevent not only a reduction in the benefits that have already been earned, but also a reduction in the benefits that a member is eligible to earn during future

service. As such, changes to the employees' retirement benefits are considered a negotiable item and must go through the meet and confer process.

Over the years, the City has taken several steps to control pension costs – refunding the side fund, establishing second tiers for new classic members, implementing the Public Employees' Pension Retirement Act ("PEPRA"), and most recently, establishing and funding a Pension Stabilization Fund.

On September 7, 2012, the City issued Pension Obligation Bonds with the proceeds used to pay off the CalPERS side funds which were accruing interest at rate of 7.5%. The bonds carry interest rates of 4.25% and 4.37%, with final maturities in June 2020 and June 2023. The remaining annual debt service ranges from \$1,283,092 in 2020 to \$912,237 in 2023 with Safety retiring in 2020, and Miscellaneous retiring in 2023.

Effective December 16, 2012, the City established second tiers for classic members. The second tiers have a less generous set of benefits and reduce the base contract portion of the employer contribution rate.

Effective January 1, 2013, the State adopted, and the City implemented the California Public Employees' Pension Reform Act ("PEPRA"). PEPRA changed the way CalPERS retirement benefits are applied, and places compensation limits on members.

Effective July 21, 2015 the Council adopted the PARS Public Agencies Post-Employment Benefits trust, better known as the Pension Stabilization Fund. The Pension Stabilization Fund is a mechanism by which to limit the impact of the decisions made by CalPERS on City's finance and therefore the delivery of the public services.

Over the last couple years, the CalPERS Board adopted changes that will increase pension contributions for years to come. For example, in December 2017, based on an experience study, the CalPERS Board approved the adoption of new actuarial assumptions including changes in mortality, retirement rates, salary scale and rate of inflation. And, in February 2018, the CalPERS board approved a revised amortization policy shortening the period over which actuarial gains and losses are amortized to 20 years from 30 years for new pension liabilities.

The projected unfunded liability for the City is significant at \$33.7 million as of June 30, 2018. This increasing liability will result in large increases in employer contribution rates. While the cost of pensions for existing employees is expected to increase moderately over the next 15 years, the payment required to pay for the unfunded liability are expected to grow significantly.

Over the last two years the City has had multiple work sessions where John Bartel provided the City Council and the public with information detailing the pension related financial challenges and the options to address these challenges.

#### **DISCUSSION/ANALYSIS:**

At the January 22, 2019 Council meeting, John Bartel from Bartel Associates, LLC presented three options for funding the unfunded accrued pension liability. The different options set the

target contribution rate, the level and direction of subsequent contributions, post bond retirement, whether that be to the Pension Stabilization Fund, or direct payments to CalPERS post bond retirement.

At that meeting, Staff received consensus from Council to move forward with Option 1 (Direct Payments to CalPERS). Option 1 includes additional contributions of \$7.5 million with payments made directly to CalPERS over a 19 year period, with a target contribution rate of 27% for miscellaneous starting in 2024-25 thru 2035-36, and 53% for safety starting in 2023-24 thru 2036-37. The additional contributions would begin as the bond debt is retired.

Option 1 provides additional interest savings in the long-term, a reduced target rate for a longer time period and a reduced unfunded liability on the City's Balance Sheet. There is a slightly more interest savings with Option 1 over Option 2, plus the City can achieve a slightly lower target rate with Option 1. A lower target rate equates to annual budget savings. For example, the estimated General Fund budget savings in fiscal year 2029-30, is over \$300,000.

	Miscellaneous	Safety
<b>Additional contributions directly to CalPERS (000's)</b>	\$950 from 23/24 to 25/26 \$600 from 26/27 to 28/29 \$400 from 29/30 to 31/32 \$200 from 32/33 to 34/35 (total \$6,450)	\$200 from 20/21 to 22/23 \$150 from 23/24 to 25/26 \$100 from 26/27 to 28/29 \$50 from 29/30 to 38/39 (total \$1,850)
<b>Trust Target</b>		
- Target Rate	27.0%	53.0%
- 1st Year	2024-25	2023-24
- Last Year	2035-36	2036-37

Option 2 included additional contributions of \$7.5 million to the Pension Stabilization Fund over a 19-year period, with a target contribution rate of 27.5% for miscellaneous starting in 2024-25 thru 2035-36, and 53% for safety starting in 2022-23 thru 2036-37. The additional contributions would begin as the bond debt is retired.

Option 3 was to proceed without additional contributions. Target contribution rate of 32.5% for miscellaneous starting in 2024-25 thru 2035-36, and 56.5% for safety starting in 2024-25 thru 2035-36. The additional contributions would begin as the bond debt is retired. This option does not provide stabilization until 2024 vs stabilization provided two years earlier in the other two alternatives.

The proposed resolution documents Option 1 funding plan in a policy. The proposed policy demonstrates prudent financial management practices, promotes long-term and strategic thinking, provides guidance in making annual budget decisions, reassures bond rating agencies, and demonstrates to employees and the public how the unfunded pension liability will be funded to ensure adequate funding for negotiated benefits.

**ALTERNATIVES:**

The proposed action adopts a policy documenting the consensus received from the Council on January 22, 2019. The Council may choose to take no action, in which case staff requests additional direction.

**FISCAL IMPACT:**

While there is no current direct fiscal impact related to the proposed action, over twenty years the City will realize a savings with the implementation of this plan, and more importantly a plan to manage the significant increases without a detriment to offered services. This decision will have material and long lasting financial impacts.

**ENVIRONMENTAL ANALYSIS:**

Pursuant to Title 14, the California Code of Regulations, Section 15302(c) of the California Environmental Quality Act (“CEQA”) guidelines, the proposed action is an administrative activity of the City that will not result in direct or indirect physical changes to the environment.

**ATTACHMENT(S):**

Resolution

Pension Liability Funding Policy

CITY OF HEALDSBURG

RESOLUTION NO. 51-2019

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF  
HEALDSBURG APPROVING THE PENSION LIABILITY  
FUNDING POLICY

WHEREAS, over the years, the City has taken several steps to control pension costs – refunding the side fund, establishing second tiers for new classic members, implementing the Public Employees’ Pension Retirement Act (“PEPRA”), and establishing and funding a Pension Stabilization Fund; and

WHEREAS, per the City’s audited financial statements, as of June 30, 2018, the City reported a liability of \$33,703,985 for its proportionate share of the net pension liability; and

WHEREAS, taking into consideration the CalPERS board changes, the City is anticipating the pension rates to increase significantly over the next 20 years; and

WHEREAS, at the January 21, 2019 Council meeting, John Bartel from Bartel Associates, LLC presented three options for funding the unfunded accrued pension liability; and

WHEREAS, the different options set the target contribution rate, the level and direction of subsequent contributions, post bond retirement, whether that be to the Pension Stabilization Fund, or direct payments to CalPERS post bond retirement; and

WHEREAS, Option 1 (Direct Payment to CalPERS) provides additional interest savings in the long-term, a reduced target rate for a longer time period and a reduced unfunded liability on the City’s Balance Sheet; and

WHEREAS, Staff received consensus from Council to move forward with Option 1 (Direct Payments to CalPERS) and direction to return to Council with a policy for their consideration.

NOW, THEREFORE, BE IT RESOLVED that the City Council of the City of Healdsburg does hereby approve the attached Pension Liability Funding Policy.

PASSED, APPROVED AND ADOPTED this 15th day of April 2019, by the following vote:

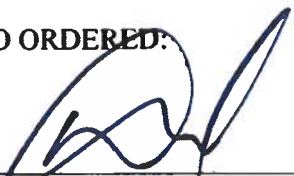
AYES: Councilmembers: (5) Gold, McCaffery, Mitchell, Naujokas and Mayor Hagele

NOES: Councilmembers: (0) None

ABSENT: Councilmembers: (0) None

ABSTAINING: Councilmembers: (0) None

SO ORDERED:

  
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David Hagele, Mayor

ATTEST:

  
Stephanie Williams, City Clerk

Resolution No. 51-2019  
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I, STEPHANIE A. WILLIAMS, City Clerk of the City of Healdsburg, do hereby certify that the foregoing is a full, true, and correct copy of Resolution No. 51-2019 adopted by the City Council of the City of Healdsburg on the 15th day of April, 2019.

  
Stephanie A. Williams  
Stephanie A. Williams, City Clerk

# **City of Healdsburg**

## **Pension Liability Funding Policy**

### **1. PURPOSE**

The purpose of this policy is to establish methodology and a process for funding current and future costs associated with the City's contractual obligations to provide pension benefits as set forth in the City's labor agreements. The policy also:

- Demonstrates prudent financial management practices;
- Promotes long-term and strategic thinking;
- Provides guidance in making annual budget decisions;
- Reassures bond rating agencies; and
- Demonstrates to employees and the public how the unfunded pension liability will be funded to ensure adequate funding for negotiated benefits.

### **2. BACKGROUND**

A pension is a retirement account that an employer maintains to give employees a fixed payout when they retire. The City's plan is a defined benefit plan. The payout typically depends on how long the employee works for the employer and the employee's salary.

Investment income, employee contributions and employer contributions fund the total pension cost, including benefits and expenses. Employer contributions are set by actuaries using an investment rate assumption (also known as the "discount rate"), lowered from 7.5% to 7% as of June 30, 2018, and other assumptions related to salary, payroll, cost of living, mortality rate, disabilities, terminations and retirements. The maximum employee contribution rates are set by law.

Current California law establishes that public employee retirement benefits are a form of deferred compensation and part of the employment contract. The Courts have established that the vested rights of public employees prevent not only a reduction in the benefits that have already been earned, but also a reduction in the benefits that a member is eligible to earn during future service. As such, changes to the employees' retirement benefits are considered a negotiable item and must go through the meet and confer process.

Over the years, the City has taken steps to control pension costs – refunding the side fund, establishing second tiers for new classic members, implementing the Public Employees' Pension Retirement Act ("PEPRA"), and establishing and funding a Pension Stabilization Fund.

### **3. POLICY**

#### **3.1 Establishment of Pension Stabilization Fund**

Effective July 21, 2015 the Council adopted the PARS Public Agencies Post-Employment Benefits IRS Section 115 approved trust, better known as the Pension Stabilization Fund. The premise behind the trust is to set-aside monies in the fund with a City determined investment policy and pull out the funds as needed to achieve a level contribution by the City's budget. In other words, the Pension Stabilization Fund is a mechanism by which to limit the impact of the decisions made by CalPERS on the City's finance and therefore the delivery of the public services.

The following outlines the governance and administration of the established Trust:

City Council establishes the Trust and defines policies for the administration of the Trust funds.

City Manager and staff have overall responsibility for the Trust funds and will develop and manage procedures in accordance with the City Council's adopted policies.

Trust Administrator, PARS, keeps plan documents current to ensure that they reflect the substantive plan and provides ongoing consulting, report and plan account records.

Trustee, currently US Bank, will be the plan's trust and custodian and will safeguard the assets in the Trust, hold the investment securities for safekeeping and make disbursement on request.

Investment Manager, currently Highmark Capital Management, will recommend investment portfolio allocations based upon the Pension Trust Funds; adopted investment policies and manage those assets accordingly.

The Asset Allocation Investment Strategy chosen by a Council committee is the Highmark Moderately Conservative with the following Asset Allocation:

- Allocation: 30.5% stocks (20-40% range), 69% bonds (50-80% range), 0.5% cash (0-20% range)
- Breakdown: Large cap 15.25%, mid-cap 2.25%, small cap 4.5%, international 7.25%, REITs 1.25%

This Policy recognizes that there will be investment market place volatility and that actual economic and demographic experience will differ from assumed experience. Accordingly, this Policy is intended to provide flexibility to smooth such volatility and experience in a reasonable, systematic and financially sound manner.

### 3.2 Liability Funding Plan

	Miscellaneous	Safety
<b>Additional contributions directly to CalPERS (000's)</b>	\$950 from 23/24 to 25/26 \$600 from 26/27 to 28/29 \$400 from 29/30 to 31/32 \$200 from 32/33 to 34/35 (total \$6,450)	\$200 from 20/21 to 22/23 \$150 from 23/24 to 25/26 \$100 from 26/27 to 28/29 \$50 from 29/30 to 38/39 (total \$1,850)
<b>Trust Target</b>		
- Target Rate	27.0%	53.0%
- 1st Year	2024-25	2023-24
- Last Year	2035-36	2036-37

### 3.3 Additional Contribution paid directly to CalPERS



Seeking maximum interest savings, the additional contributions paid to CalPERS will be applied to pay down the following amortization bases (in order):

- Miscellaneous: Pre-2013 Share of UAL Pool (17 years amortization), 2014 Assumption Change (17 years amortization), and 2016 Assumption Change (19 years amortization)
  
- Safety: 2014 Assumption Change (17 years amortization), Pre-2013 Share of UAL Pool (18 years amortization), 2016 Assumption Change (19 years amortization), and 2017 Assumption Change (20 years amortization)

### **3.4 Transparency and Reporting**

Funding of the City's pension benefit should be transparent to all parties including City employees, retirees, recognized employee organizations, the City Council and City residents. In order to achieve this transparency, the following information shall be available:

- a. Copies of the actuarial valuations for the City's pension plans shall be published on the City's website.
- b. The City's Annual Financial Statements shall be published on the City's website. The financial statements include information on the City's pension plans, contributions to the Trust, and the funded status of the plans.
- c. The City's annual operating budget shall include appropriations for contributions to the Trust, to CalPERS and the annual pension costs.

### **3.5 Review of Funding Policy**

Funding pension liability requires a long-term plan. The City will review this policy at a minimum biennially, coincident with preparation of the actuarial valuations, to determine if changes to this policy are necessary to ensure adequate resources are being accumulated to fund pension benefits.

