CITY OF SAN FERNANDO
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THE CITY OF SAN FERNANDO

Unfunded Pension and OPEB Liabilities

Strategies to Improve Funding Levels

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Background

- Since 1946, the City has provided a defined benefit pension plan to all full-time employees through CalPERS.
- CalPERS defines “full-time” as working more than 1,000 hours per year for at least five years.

	Miscellaneous			Sworn Police Officers		
	Rate	Income	Retirement Age	Rate	Income	Retirement Age
Tier I*	3.0%	Single Highest Year	60	3.0%	Single Highest Year	50
Tier II**	2.0%	36 month average	55	3.0%	36 month average	50
Tier III***	N/A	N/A	N/A	3.0%	36 month average	55
PEPRA*****	2.0%	36 month average	62	2.7%	36 month average	57

*Misc. hired before 11/12/2005; Sworn hired before 1/6/1994

** Misc. hired before 1/1/2013; Sworn hired before 9/8/2012

*** Sworn hired before 1/1/2013

**** All employees hired after 1/1/2013

Background – Pension Tax

- In 1946, San Fernando voters approved a ballot measure levying an ad valorem property tax necessary to raise the funds necessary to pay the City's annual obligation to CalPERS.
- In 1978, California voters Prop 13 that limited the ad valorem property tax to one-percent (1%) of assessed value, **except those ad valorem property taxes that were approved by voters prior to July 1, 1978.**
- In 1985, the state Legislature capped pre-Prop 13 ad valorem property taxes. San Fernando's rate is **capped at $0.28420 per $100 of assessed value**.
- San Fernando's ad valorem property tax to fund annual CalPERS costs ("Pension Tax") is a special tax that can only be used for the intended purpose and cannot be used for general revenue purposes.

Public Pensions

- Cost of public pensions and sustainability of the current defined benefit system has been part of the national public policy conversation since the "Great Recession"

- Due to risky investment strategies, many public pension systems are vulnerable to economic downturns.

- In 2007, the value of the CalPERS portfolio was **101%** of outstanding liability.

- By 2009, CalPERS only had enough assets to fund **61%** of the long-term liability.

California Pension Reform

- Public Employee Pension Reform Act (PEPRA) significantly reduced benefits for public employees hired after January 1, 2013.
  - Reduced formula and increased age for miscellaneous and safety plans (Misc. = 2.0% @ 62; Safety = 2.7% @ 57)

- In 2017, CalPERS Board voted to decrease discount rate (i.e. expected rate of investment return) from 7.5% to 7.0% by 2021.

- CalPERS Board also voted to decrease amortization period (i.e. the period that annual gains/losses are spread over) from 30 years to 20 years by 2019.

California Pension Reform

- Reforms important to solidify long-term sustainability, but significantly increases costs for members.

Why Do Reforms Increase Costs?

Only two sources of income for CalPERS:

1. Earnings on investments; and
2. Annual charges to members.

If you decrease expected investment earnings, you have to increase member charges to make up the difference.

How Do Cities Fund Pension Costs?

- Every municipal government is funded by a different mix of revenue sources, which typically include Sales Tax, Property Tax, Business Tax, Utility Tax, Hotel Tax, Franchise Fees, User Fees and Permit Fees.

- These taxes and fees are used to fund public safety, infrastructure maintenance, recreation and cultural programming, economic development, and general administration… and employee pensions.

How Does San Fernando Fund Pensions?

- The City of San Fernando is somewhat unique in California as it does not have a Utility Tax or a Hotel Tax; Instead, the City has a special property tax specifically earmarked to pay employee pensions.

- As a result, the City does not currently use General Fund revenue to pay employee pensions.

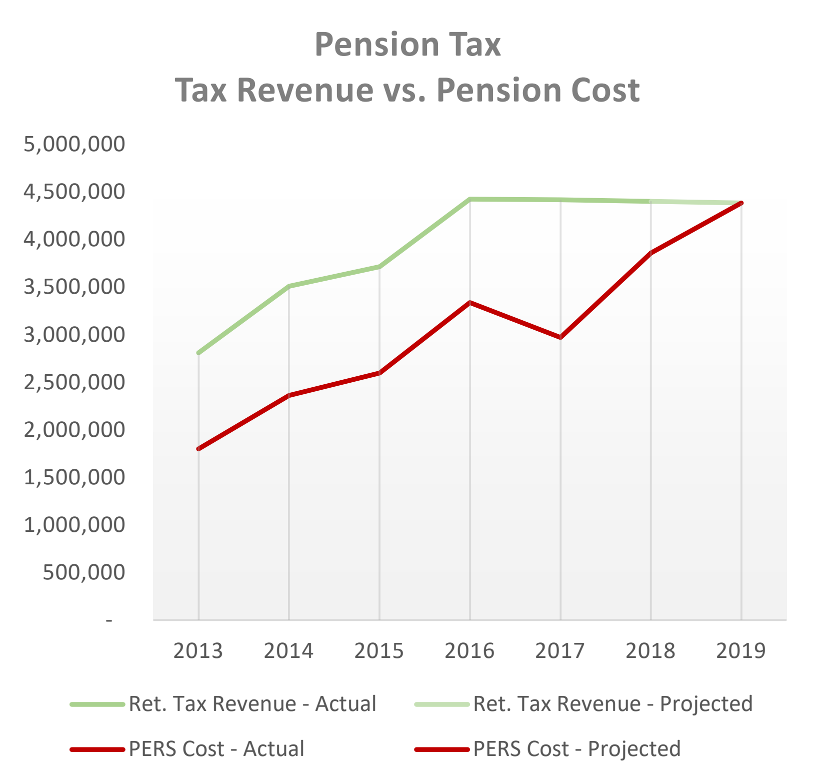
- Therefore, more General Fund revenue can be toward public safety, infrastructure maintenance, recreation and cultural programming, economic development, and general administration.

SAN FERNANDO PENSION TAX

Since 2013, Pension Tax revenue has exceeded annual CalPERS Costs.

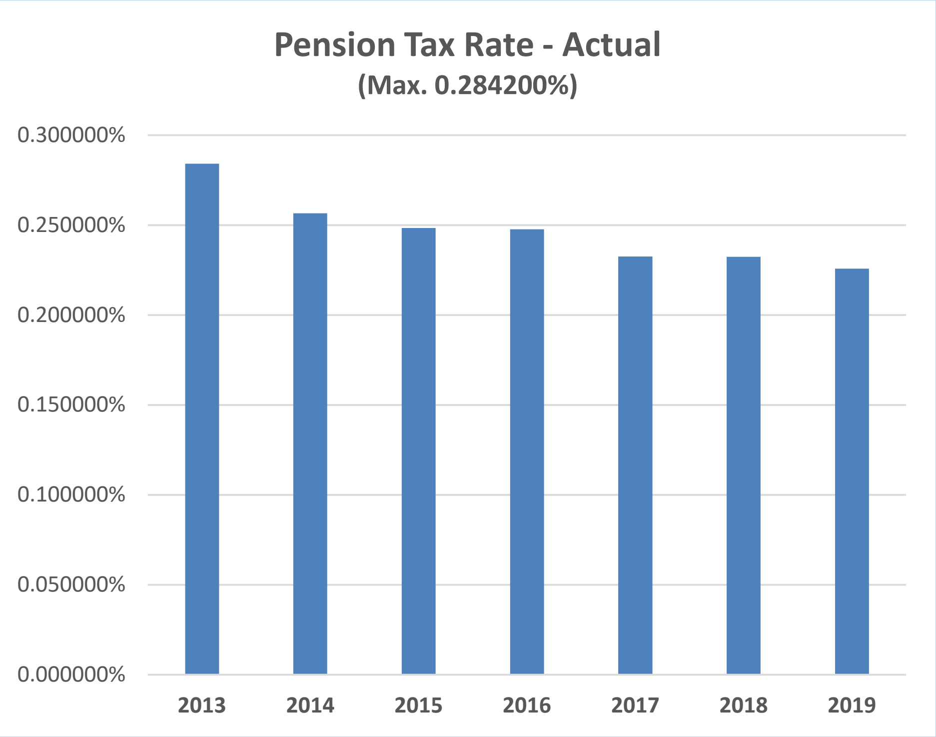
1) Stronger than projected Assessed Value increases.

2) Elimination of RDA resulted in windfall.
   - City began receiving Pension tax from former RDA project areas.



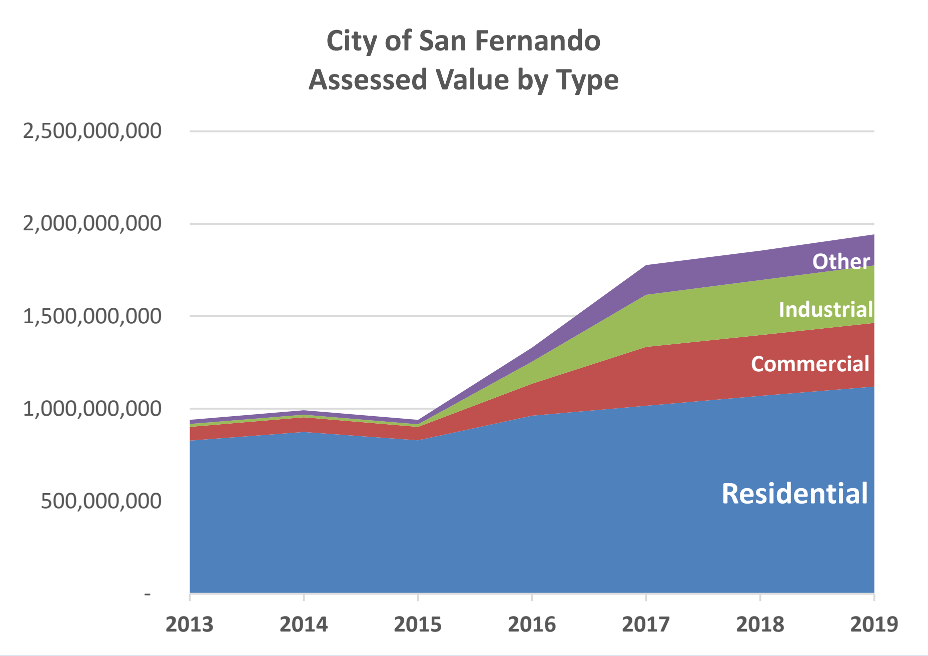
San Fernando Pension Tax

City Council has been able to decrease Pension Tax rate from 0.284% in 2013 to 0.227% in 2019 (projected). Total decrease of 20%.



San Fernando Pension Tax

- Residential accounts for most significant portion of AV (57%).
- Prior to elimination of RDA in 2013, Commercial and Industrial still paid pension tax, but it was given to RDA as tax increment.
- Staff will research whether ad valorem Pension Tax must be levied equally on all property types, or if the levy can differ based on property type.



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San Fernando Pension Projection(1)

A. Projected average annual increases of 7% through 2025.

- Assumes 3% annual growth in payroll (per standard CalPERS actuarial assumptions)

B. Unfunded Liability grows faster than Normal Cost.

- 8.8% per year vs. 4.0% per year

C. Current reserve balance is $5.3 million

- May be invested to generate investment income; or
- May be used to buy down Tax Rate (cost approx. $200,000 per 1 basis point)

	Projected 2019	Projected 2020	Projected 2021	Projected 2022	Projected 2023	Projected 2024	Projected 2025
Assessed Value*	1,942,268,208	1,981,113,572	2,020,735,844	2,061,150,560	2,102,373,572	2,144,421,043	2,187,309,464
Tax Rate (Max. 0.284200%)	0.225788%	0.233699%	0.251850%	0.269765%	0.284200%	0.284200%	0.284200%
Ret. Tax Revenue - Projected	**4,385,408**	**4,629,844**	**5,089,225**	**5,560,272**	**5,974,946**	**6,094,445**	**6,216,333**
Normal Cost	1,724,227	1,804,714	1,938,225	1,996,372	2,056,263	2,117,951	2,181,490
Unfunded Liability	2,661,181	2,825,130	3,151,000	3,563,900	3,925,900	4,180,200	4,402,800
Total PERS Cost - Projected**	**4,385,408**	**4,629,844**	**5,089,225**	**5,560,272**	**5,982,163**	**6,298,151**	**6,584,290**
Projected Surplus(Shortfall)	-	-	-	-	(7,218)	(203,707)	(367,956)
Fund Cash Balance	5,287,196	5,287,196	5,287,196	5,287,196	5,279,978	5,076,272	4,708,316
Cost of 1 basis point reduction	194,227	198,111	202,074	206,115	210,237	214,442	218,731

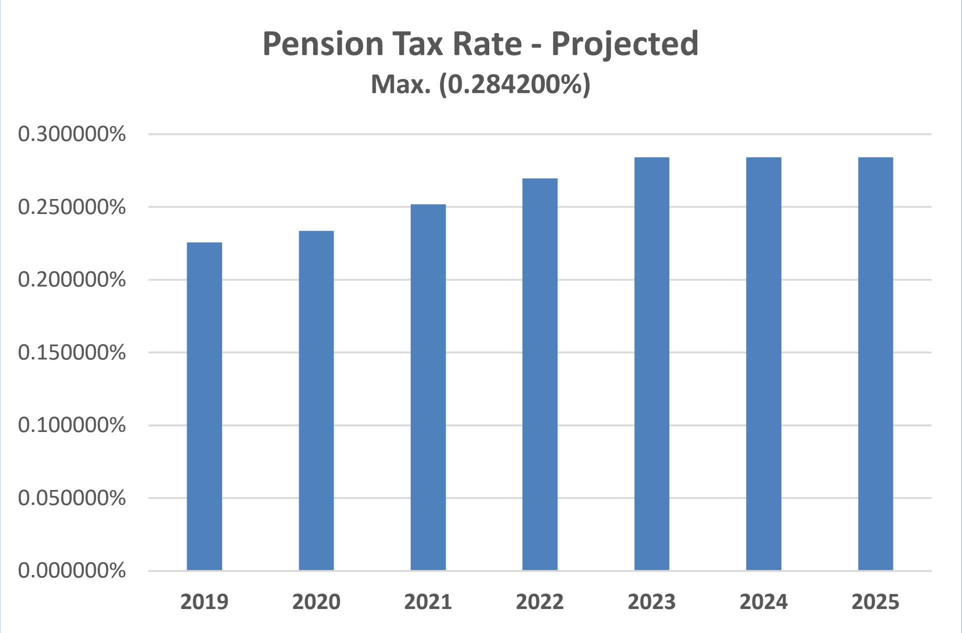
San Fernando Pension Projection

A. Projected CalPERS costs will exceed the statutory maximum rate in FY 2023-2024.

B. Assumes conservative 2% annual AV growth, which is less than 5 year average.

C. Assumes 3% payroll growth, which exceeds current MOU agreements.

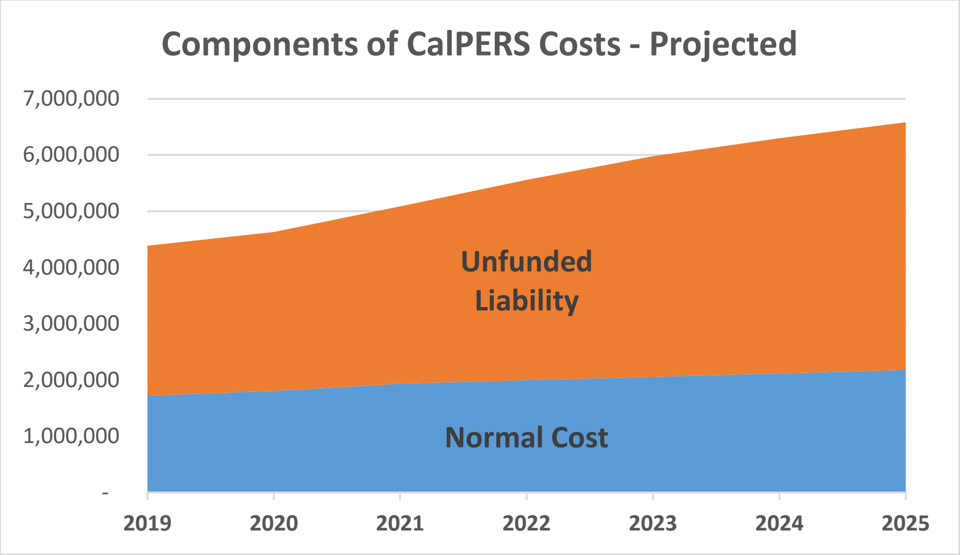
D. Despite the projected increases, the City is in a good position to take steps now to mitigate future increases and stabilize the Pension Tax rate for property owners.



Recommended Pension Stabilization Strategies

1) Establish a Section 115 Irrevocable Trust.
   - Increase investment returns 2% - 4% per year

2) Refinance the unfunded liability tail.
   - Potential reduction of interest cost from 7% to 5%.



3) Pre-pay annual CalPERS at the beginning of the year.
   - Saves $100,000+ per year

4) Research Pension & OPEB forecasting software

Additional Pension Stabilization Strategies

1) Draw down on rate stabilization reserves.
   - Reserve balance can be used to buy down the Pension Tax rate to avoid increases or implement increases over a number of years. Cost to buy down the rate is approximately $200,000 per one basis point.
   - For example, if a tax rate of 0.23% is required to cover the annual CalPERS costs, the City Council may wish to draw down $200,000 from the Pension Tax fund balance and only levy a tax rate of 0.22%, or draw down $400,000 and levy a rate of 0.21%, and so-on.
   - This strategy is not recommended at this time as it is a short term strategy.

2) Negotiate employee cost sharing if Pension Tax revenues do not cover CalPERS costs in future MOUs.

Other Post-Employment Benefits (OPEB): Retiree Healthcare

Background

- Employees that service retire or disability retire directly from the City receive some level of lifetime paid healthcare benefit.
- Employees hired prior to July 1, 2015 receive fully paid lifetime medical benefits (excluding PERSCare for Tier II employees).
- All employees hired after July 1, 2015 receive the state statutory minimum toward retiree medical insurance; currently $133 per month.
- 20 of 99 current active employees that may qualify for retiree health benefits will receive the reduced benefit.

	Miscellaneous			Sworn		
	Benefit	**Max. Payment**	**Covered Parties**	**Benefit**	**Max. Payment**	**Covered Parties**
Tier I*	100% Paid	None	Employee and eligible dependents	100% Paid	None	Employee and eligible dependents
Tier II**	100% Paid	Excludes PERSCare	Employee and eligible dependents	100% Paid	Excludes PERSCare	Employee and eligible dependents
Tier III***	State min.	$133/month	Not applicable.	State min.	$133/month	Not applicable.

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Retiree Healthcare Benefits

- Currently paid on a "pay-as-you-go" basis, which means the City only pays the monthly premium for the 94 retired employees and surviving spouses.
- City not currently pre-funding the cost of retiree health benefits for the 99 current active employees that may qualify for retiree health benefits.
- According to the most recent actuarial valuation, the City should be setting aside approximately $2 million per year to fully fund future retiree health benefits.(2)

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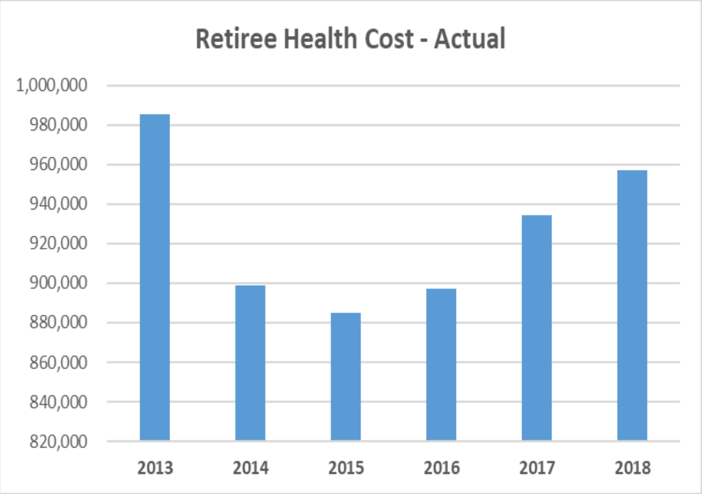
Retiree Healthcare Benefits

- Annual “pay-as-you-go” retiree health cost is approximately $1 million per year.
  - Unlike Pensions, Retiree Health does not have a dedicated funding source.
  - Paid from the General Fund and Enterprise Funds.

- Although the annual cost of retiree health is much less than pensions, the unfunded liability is almost $10 million greater.



<u>Why?</u>

Unlike pensions, the City is not pre-funding Retiree Health and no dedicated funding source.

GASB 74 & 75(2)

- For FYE June 30, 2018, new government financial reporting requirements (GASB 74/75) will require the entire unfunded liability for OPEB, currently valued at $42.8 million, be included on the City's Statement of Net Position (i.e., net worth).

- This will have a significant impact as it will decrease the City's Net Position to less than zero.
    - This is **not a new liability**. In fact, City Council actions over the last few years have served to reduce the liability.
    - It is a new financial reporting requirement to calculate and include an **existing** unfunded liability on the City's balance sheet.

Recommended OPEB Stabilization Strategies

1) Establish a Section 115 Irrevocable Trust and appropriate additional funds each year.
   - Increase investment returns 2% - 4% per year

2) Continue to work toward cost sharing for healthcare benefits for active employees. Use savings to pre-fund retiree health through Section 115 Irrevocable Trust.

3) Research Pension & OPEB forecasting software.

CONCLUSION

Despite the rising costs of pensions and retiree healthcare, San Fernando is well positioned to take steps to stabilize long-term costs.

Pension fund reserve gives City Council flexibility to implement multiple taxpayer rate stabilization strategies.

Strong negotiations have limited the City's long-term exposure to active and retiree health care costs.

Although a number of strategies have been included in this report, the two strategies that can be implemented fairly quickly and have the greatest impact are:

1) Establishing an IRC Section 115 Irrevocable Trust for pension and OPEB costs, and
2) Explore the savings to refinance the City's unfunded pension liability tail.

CITATIONS

(1) Per California Public Employees' Retirement System Annual Valuation Report as of June 30, 2016, dated August 2017 for:

a) MISCELLANEOUS FIRST TIER PLAN OF THE CITY OF SAN FERNANDO (CalPERS ID: 2236157495)
b) PEPRA MISCELLANEOUS PLANOF THE CITY OF SAN FERNANDO (CalPERS ID: 2236157495)
c) MISCELLANEOUS SECOND TIER PLAN OF THE CITY OF SAN FERNANDO (CalPERS ID: 2236157495)
d) SAFETY FIRST TIER PLAN OF THE CITY OF SAN FERNANDO (CalPERS ID: 2236157495)
e) SAFETY SECOND SECOND PLAN OF THE CITY OF SAN FERNANDO (CalPERS ID: 2236157495)
f) SAFETY THIRD TIER PLAN OF THE CITY OF SAN FERNANDO (CalPERS ID: 2236157495)
g) PEPRA SAFETY POLICE PLAN OF THE CITY OF SAN FERNANDO (CalPERS ID: 2236157495)

All reports above are available on the CalPERS website:

https://www.calpers.ca.gov/page/employers/actuarial-services/employer-contributions/public-agency-actuarial-valuation-reports

Reports are searchable by the City's CalPERS ID: 2236157495 or entering "San Fernando" in the "Name" field. The data included in this report are from the "2016" report for each Tier.

(2) Per Actuarial Valuation Report prepared by Bartel Associates, LLC; *June 30, 2018 GASBS 75 Accounting Information As of Measurement Date June 30, 2017*; dated June 20, 2018. Available on the City's website: http://ci.san-fernando.ca.us/finance/financial-documents/ in "Special Presentations"

Questions?

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