The Road Ahead for Managing Rising Pension Costs
Thursday, September 23, 2021 | 2:45 - 4:00pm
Introductions

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Town of Yountville

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Government Finance Consultant

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PARS | Public Agency Retirement Services
What We’re Facing

- Uncertainty
- Rising Pension Costs
- Investment/Market Fluctuation
- Competing Budget Priorities
- “Figuring it out” Too Late
What is an Unfunded Liability?
Rate Volatility

Achieve to Assumptions

- Discount Rate
- Amortization period
- Wage Growth
- Longevity
- Inflation
- Payroll Growth
- Demographic (mortality, etc.)

Actual Experience

- Investment Returns
- Wage Growth
- Payroll Growth
Challenge in Achieving to Assumptions

PERF 10Y Rolling Return

10Y Treasury

Discount Rate

Asset Allocation

Low Risk Assets

Higher Risk Assets

Rate & Return %

0% 2% 4% 6% 8% 10% 12% 14% 16%
21.3% Investment Return

10-year Annualized Rate of Return 8.5%
## Looking Forward

Funding Risk Mitigation Policy = 6.8%

<table>
<thead>
<tr>
<th>Excess Investment Return</th>
<th>Reduction in Discount Rate</th>
<th>Reduction in Expected Investment Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>If the actual investment returns exceed the discount rate by:</td>
<td>Then the discount rate will be reduced by:</td>
<td>And the expected investment return will be reduced by:</td>
</tr>
<tr>
<td>2.00%</td>
<td>0.05%</td>
<td>0.05%</td>
</tr>
<tr>
<td>7.00%</td>
<td>0.10%</td>
<td>0.10%</td>
</tr>
<tr>
<td>10.00%</td>
<td>0.15%</td>
<td>0.15%</td>
</tr>
<tr>
<td>13.00%</td>
<td>0.20%</td>
<td>0.20%</td>
</tr>
<tr>
<td>17.00%</td>
<td>0.25%</td>
<td>0.25%</td>
</tr>
</tbody>
</table>
Looking Forward

Potential Impact to Total Required Employer Contributions
(21.3% Return, Discount Rate Assumptions: 7% through 6%)

20 Year Impact to Required Contributions
Net of 21.3% Investment Return Experience
Looking Forward

Approximate Increase to Normal Cost from Current 7% Discount Rate to New Assumed Discount Rate Alternatives

- **Default (current)**: $610.86K
  - Employee Contributions: $37.48K

- **21.3% IR 6.8% DR**: $648.34K
  - Employee Contributions: $708.34K

- **21.3% IR 6.5% DR**: $708.34K
  - Employee Contributions: $762.07K

- **21.3% IR 6.25% DR**: $762.07K
  - Employee Contributions: $819.47K

Graph showing the increase in total normal cost and employee contributions over fiscal years 20-21 to 45-46.
Looking Forward

If no action is taken...

- **Total Employer Required Contribution**
  - Default (current): $21.01M

- **Annual Amortization Payment**

- **Employer Normal Cost**

- **Employee Contribution**

7% Discount Rate, 6% Investment Return Experience (Ongoing)
- $21.01M from $21.01M No change

Fiscal Year Ending June 30:
- 20-21
- 25-26
- 30-31
- 35-36
- 40-41
- 45-46
Looking Forward

If no action is taken…

(Status Quo: 7% Discount Rate & 7% Investment Experience)
What Can Be Done?

Options for Funding CalPERS

01 Make Additional Discretionary Payment
02 Prefund into a Contingency Reserve Fund
03 Issue Pension Obligation Bonds/Certificates of Participation
04 Prefund into an IRS Section 115 Pension Prefunding Trust
05 Use Above In Combination with Each Other
What are Section 115 Pension Prefunding Trusts?

- Section 115 Trusts can be used by local governments to fund essential government functions (i.e., retiree healthcare, pension)

- In 2015, GASB 68 required disclosing the Net Pension Liability as a line item on the balance sheet

- In 2015, the nation’s first Section 115 Combination Trust (to prefund both pension and OPEB) was established and received the first IRS Private Letter Ruling (PLR) on multiple employer basis

- A PLR ensures tax qualified status whereby any income derived is tax exempt
How Can a 115 Trust Be Structured?

**Subaccounts**

OPEB and pension assets are individually sub-accounted, & can be divided by dept., bargaining group, or cost center.

**Flexible Investing**

Allows separate investment strategies for all OPEB and pension subaccounts.

**Anytime Access**

Trust funds are available anytime; OPEB for OPEB and pension for pension.

**Financial Stability**

Assets can be used to address unfunded liabilities.
Why Prefund Pension Obligations?

01. **Stabilize Costs**
Access funds to reimburse your City for pension-related expenses to help offset rising pension contribution rates

02. **Local Control**
City maintains autonomy over assets, contributions, disbursements, timing and investment risk tolerance

03. **Protection**
Funds in the trust are securely set-aside and protected from diversion for uses other than pension

04. **Diversified Investing**
Assets in an exclusive benefit trust can be diversely invested and may achieve greater returns than your general fund/treasury pool

05. **Rainy Day Fund**
Emergency source of funds when employer revenues are strained in difficult budgetary or economic times

06. **Long-Term Planning**
Prudent solution for managing ongoing pension liabilities on financial statements due to GASB 68
## Why Use a 115 Trust vs. Reserve Account?

<table>
<thead>
<tr>
<th>Reserve Account</th>
<th>115 Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed income investing only</td>
<td>Fixed Income or diversified investing available</td>
</tr>
<tr>
<td>Investments not tailored for long term</td>
<td>Can be tailored for short or long term</td>
</tr>
<tr>
<td>Revocable</td>
<td>Irrevocable (for non-pension expenses)</td>
</tr>
<tr>
<td>Can be accessed for other uses</td>
<td>Dedicated solely for pension costs</td>
</tr>
<tr>
<td>Unprotected from creditors</td>
<td>Exclusive benefit/protected from creditors</td>
</tr>
<tr>
<td>No corporate trustee</td>
<td>Corporate trustee to mitigate fiduciary risk</td>
</tr>
</tbody>
</table>
Investment Flexibility

- Agency maintains oversight of the investment manager and the portfolio’s risk tolerance level

- Investment restrictions that apply to the general fund (CA Government Code 53601) are not applicable to assets held in Section 115 Irrevocable Trust

- Assets held in Section 115 Irrevocable Trust can be invested per Government Code Sections 53216 (Pension) and 53620 (OPEB)

- Investments can be diversified and invested in a prudent fashion

- Investments can be tailored to the Agency’s unique demographics and needs

- Increased risk diversification

Diversified Investing

Assets held in Section 115 Irrevocable Trust can be diversely invested in a prudent fashion per Government Code Sections 53216 (Pension) and 53620 (OPEB).

GOV § 53216 (Pension)

GOV § 53620 (OPEB)
## Sample Portfolio Returns (as of 6/30/21)

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Equity (%)</th>
<th>1 Year</th>
<th>3 Years</th>
<th>5 Years</th>
<th>10 Years</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital Appreciation</strong></td>
<td>65-85%</td>
<td>32.31%</td>
<td>13.14%</td>
<td>12.64%</td>
<td>9.75%</td>
</tr>
<tr>
<td><strong>Balanced</strong></td>
<td>50-70%</td>
<td>27.05%</td>
<td>11.93%</td>
<td>11.26%</td>
<td>8.67%</td>
</tr>
<tr>
<td><strong>Moderate</strong></td>
<td>40-60%</td>
<td>22.58%</td>
<td>10.87%</td>
<td>9.90%</td>
<td>7.81%</td>
</tr>
<tr>
<td><strong>Moderately Conservative</strong></td>
<td>20-40%</td>
<td>14.19%</td>
<td>8.62%</td>
<td>7.25%</td>
<td>6.01%</td>
</tr>
<tr>
<td><strong>Conservative</strong></td>
<td>5-20%</td>
<td>8.00%</td>
<td>6.99%</td>
<td>5.32%</td>
<td>4.63%</td>
</tr>
<tr>
<td><strong>General Fund Returns</strong></td>
<td>0%</td>
<td>0.24%</td>
<td>3.47%</td>
<td>2.06%</td>
<td>1.89%</td>
</tr>
</tbody>
</table>

*(Sample California City)*
## Investment Selection Choice

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Allocation (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Appreciation</td>
<td>5.50%</td>
</tr>
<tr>
<td>(65-85% Equity)</td>
<td></td>
</tr>
<tr>
<td>Balanced</td>
<td>10.00%</td>
</tr>
<tr>
<td>(50-70% Equity)</td>
<td></td>
</tr>
<tr>
<td>Moderate</td>
<td>37.00%</td>
</tr>
<tr>
<td>(40-60% Equity)</td>
<td></td>
</tr>
<tr>
<td>Mod. Conservative</td>
<td>33.00%</td>
</tr>
<tr>
<td>(20-40% Equity)</td>
<td></td>
</tr>
<tr>
<td>Conservative</td>
<td>7.00%</td>
</tr>
<tr>
<td>(5-20% Equity)</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>7.50%</td>
</tr>
<tr>
<td>(Custom)</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

![Pie chart showing investment selection choice](chart)
### Sample Funding Policies

<table>
<thead>
<tr>
<th>No.</th>
<th>Policy Description</th>
<th>City</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Contribute 50% of a given year’s realized year end surplus to address pension liability</td>
<td>Alameda/Solana Beach</td>
</tr>
<tr>
<td>02</td>
<td>Contribute full amount of annual PERS employer cont., allowing anytime access to trust assets</td>
<td>City of Brea</td>
</tr>
<tr>
<td>03</td>
<td>Contribute funds to stabilize PERS employer Misc. and Safety rates through FY 23-24</td>
<td>City of Healdsburg</td>
</tr>
<tr>
<td>04</td>
<td>“One equals five plan” - $1M contribution for 5 years will save taxpayers $5M over 25 years</td>
<td>City of Huntington Beach</td>
</tr>
<tr>
<td>05</td>
<td>Contribute Employer contribution equal to the 2.8% discount rate, with difference going into the Section 115 Trust</td>
<td>City of Sausalito</td>
</tr>
<tr>
<td>06</td>
<td>Contribute the annual savings realized from Reduction in UAL payment resulting from Pension Obligation Bonds issuance</td>
<td>City of Placentia</td>
</tr>
<tr>
<td>07</td>
<td>Earmark a portion of a local sales tax to be set aside for unfunded pension liabilities</td>
<td>City of Fountain Valley</td>
</tr>
<tr>
<td>08</td>
<td>Use ongoing savings from prepaying CalPERS unfunded liability vs. higher monthly payments</td>
<td>City of Pasadena</td>
</tr>
<tr>
<td>09</td>
<td>Use one-time revenue source and lower the minimum General Fund Reserve level (30% → 20%)</td>
<td>City of Glendale</td>
</tr>
</tbody>
</table>
A Case Study: Town of Yountville
Managing Rising Pension Costs
## Located in Napa Valley

- Less than one square mile
- World class restaurants, premium hotels
- Home to the historic Veterans Home of California
- Population of 2,966 (includes Veterans Home)
- Median age: 64 years

## $17M Total Expenditure Budget

- Top three General Fund revenues:
  - Transient Occupancy Tax (52%)
  - Property Tax (21%)
  - Sales Tax (12%)
- Staff of 31 full-time employees
- Contract with Napa County for law enforcement and fire protection services.
Proactive Approach to Managing Future Retiree Healthcare (OPEB) & Pension (PRSP) Costs

- **OPEB** IRS Section 115 Irrevocable Trust established by Town Council Resolution in June 2011.
- Initial contributions were discretionary based on available Unassigned Fund Balance in the GF at fiscal year end.
- In December 2011 Town Council adopted percentage of full-time salary funding policy:
  - Fiscal Year 2012/13: 8%
  - Fiscal Year 2013/14: 9%
  - Fiscal Year 2014/15: 10%
- In June 2014 Town Council approved a policy to fully fund the Annual Required Contribution (ARC) each year. Actuaries estimated % of full-time salaries:
  - Fiscal Year 2015/16: 14%
  - Fiscal Year 2016/17: 14%
  - Fiscal Year 2017/18 to Fiscal Year 2019/20: 14.5%
- **Pension Rate Stabilization Plan (PRSP)** Section 115 Trust established by Town Council Resolution in December 2017.
- All contributions have been discretionary based on available Unassigned Fund Balance in the GF at fiscal year end.

- Discretionary contributions to both trusts were suspended in the third quarter of Fiscal Year 2019/2020 to help mitigate COVID-19 related revenue losses.
Trust Utilization

**OPEB Trust**
- First use in FY 2020/2021 to reimburse Town for Monthly Retiree Health Premiums
  - $138,000
- Continued use beginning in FY 2021/2022
  - $115,000

**Pension Trust**
- First use in Fiscal Year 2020/2021 to reimburse Town for annual Unfunded Actuarial Accrued Liability (UAAL) payment to CalPERS
  - $276,080
- Continued use beginning in FY 2021/2022
  - $324,536
Going Forward

• Discretionary contributions into the trust could be presented to the Town Council as a suggested use for any Unassigned Fund Balance in the General Fund after the close of Fiscal Year 2020/2021.

• Contributions to the OPEB trust could potentially resume in Fiscal Year 2022/2023 at a reduced rate of approximately 7% of full-time salaries rather than the previous 14.5%.

• Similarly, contributions to the Pension trust could also potentially resume in Fiscal Year 2022/2023 as available fund balance allows.
Preparing for the Future: How Does the Town Respond to a Potential Emergency?

Assigned for Budget Contingencies
(Reserve set at $438,386)

Assigned for Legal Contingencies
(Reserve set at $200,000)

Revenue Stabilization
Policy: Minimum funding target is 25% of TOT revenue.
(Reserve Fund Balance $2,045,748)

Emergency Reserve
Policy is 20% of General Fund Operating Expenditures; proposed budget meets minimum
(Reserve Fund Balance $2,045,748)
Preparing for the Future

**Retiree Health**
- Retiree Health Insurance ($115,000)
- OPEB Trust (Balance as of July 31, 2021: $5,710,535)
- Discretionary contribution to the OPEB Trust Fund (Suspended for one more fiscal year)

**Pension**
- UAAL Payment to CALPERS $324,526
- Pension Trust Fund (PRSP) (Balance as of July 31, 2021: $2,580,118)
- Discretionary Contribution to Pension Trust Fund (Suspended for one more fiscal year)
Questions?

I THINK WE'RE THE ONES WHO ARE GOING TO NEED A STRESS TEST!!!
Contacts

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