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The Road Ahead for Managing Rising Pension Costs

Thursday, September 23, 2021 | 2:45 - 4:00pm

Introductions



Kevin O'Rourke, Moderator

*Retired City Manager
Senior Municipal Consultant*



Steve Rogers

*Town Manager
Town of Yountville*



Charles Francis

*Former Finance Director
Government Finance Consultant*



Rachael Sanders

*Senior Manager, Consulting
PARS | Public Agency Retirement Services*

What We're Facing



Uncertainty

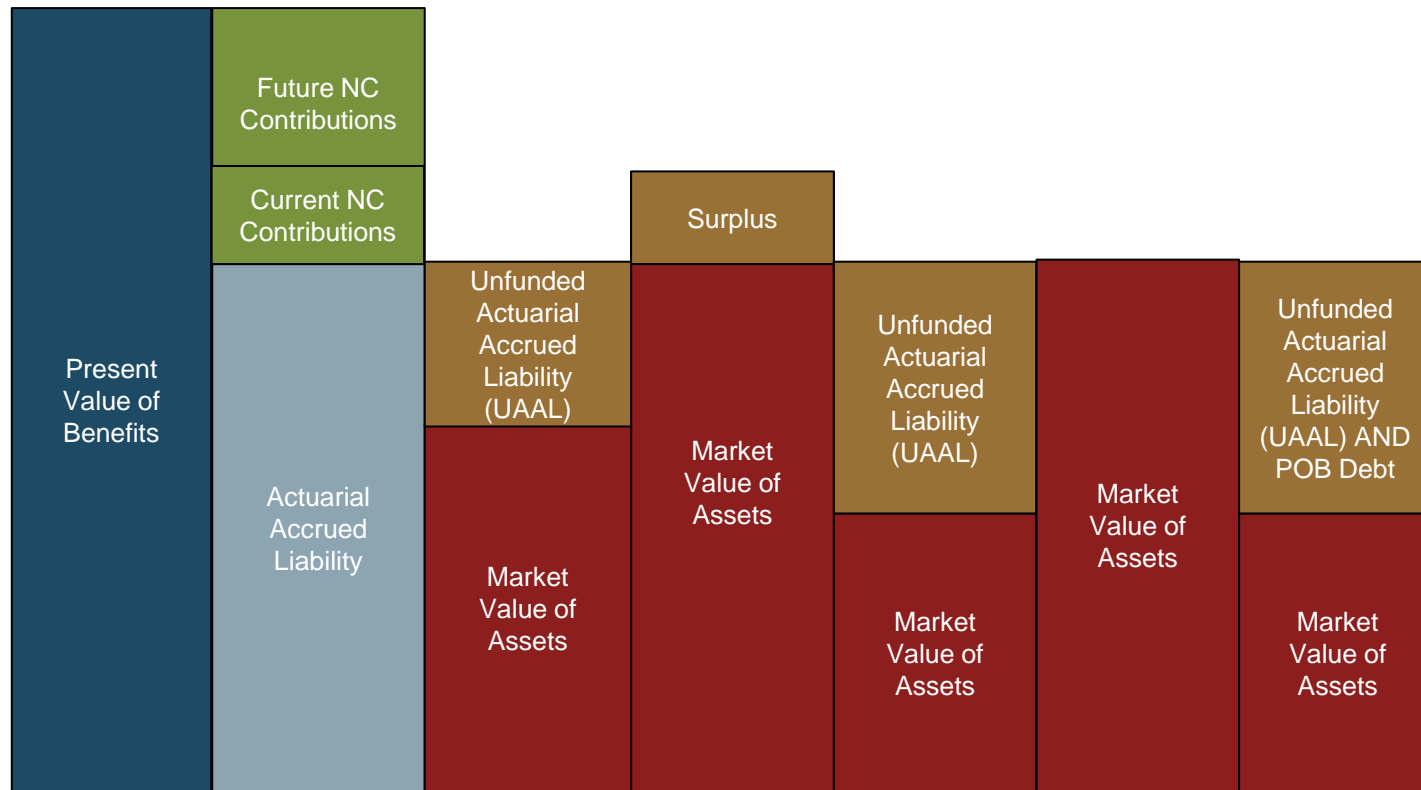
Rising Pension Costs

Investment/Market Fluctuation

Competing Budget Priorities

“Figuring it out” Too Late

What is an Unfunded Liability?



Rate Volatility

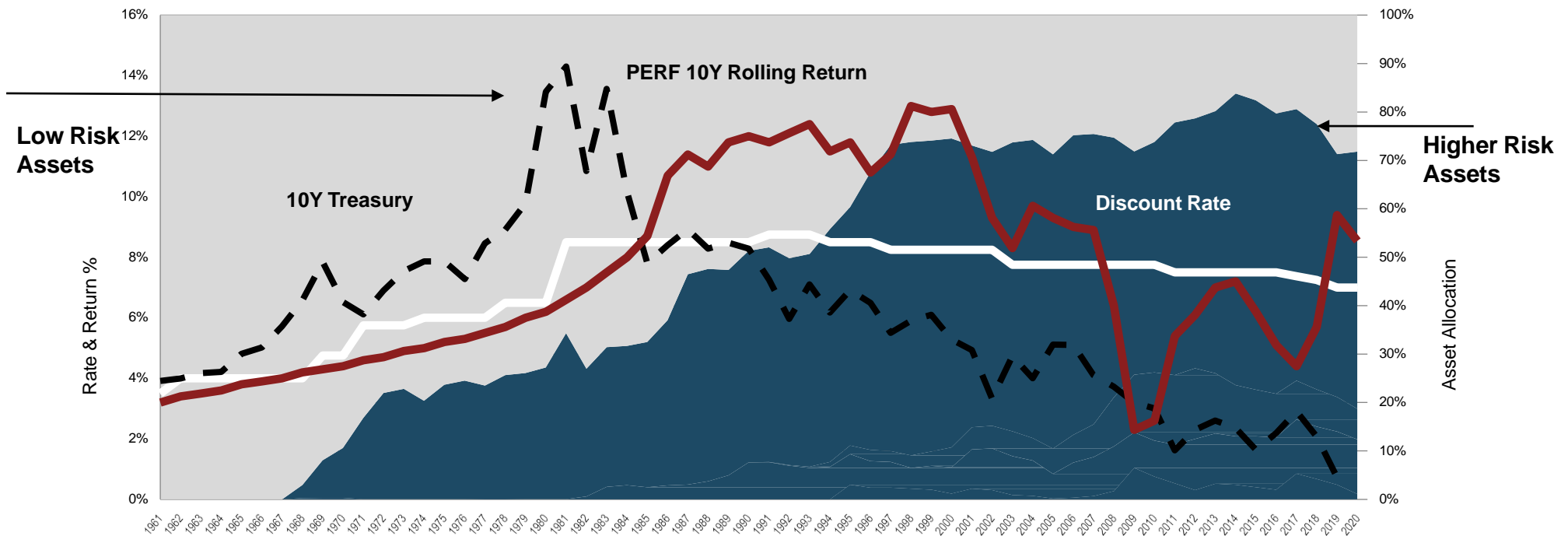
Achieve to Assumptions

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

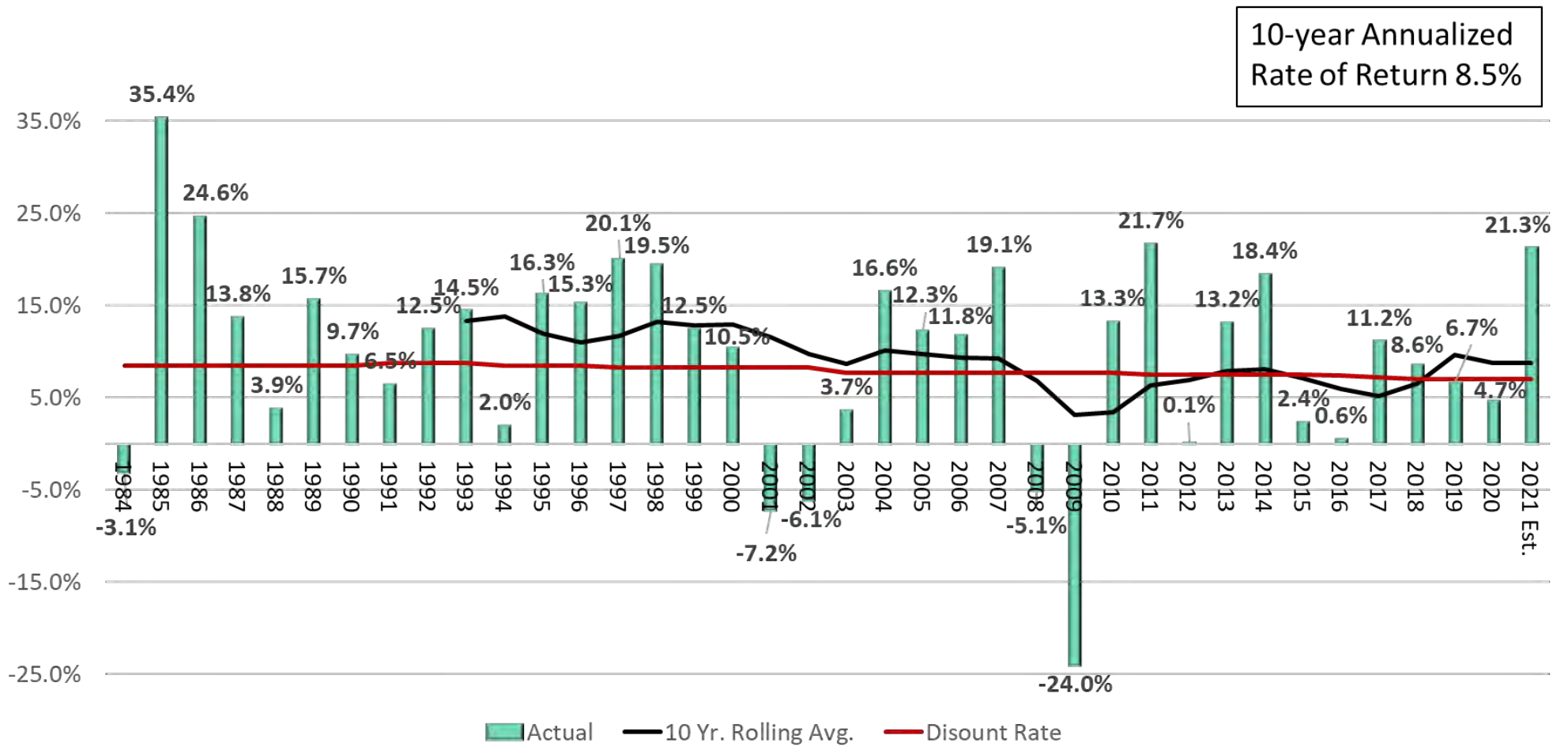
Actual Experience

- Investment Returns
- Wage Growth
- Payroll Growth

Challenge in Achieving to Assumptions



21.3% Investment Return



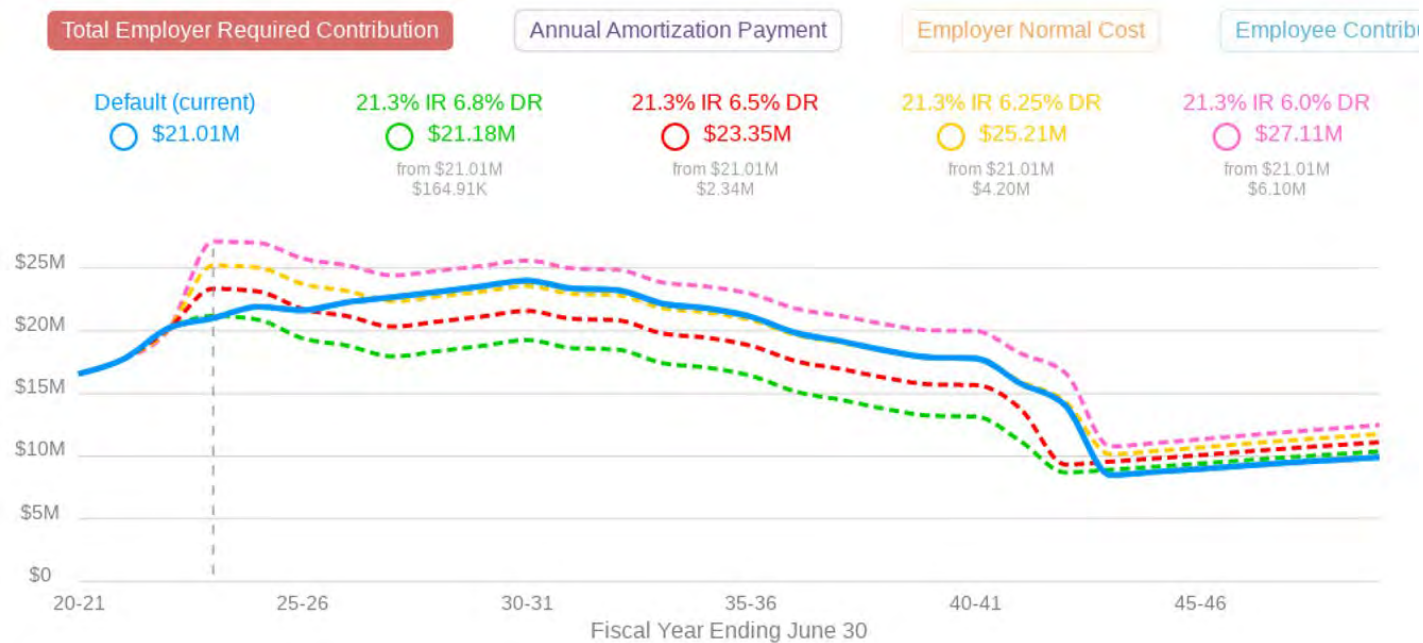
Looking Forward

Funding Risk Mitigation Policy = 6.8%

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

Looking Forward

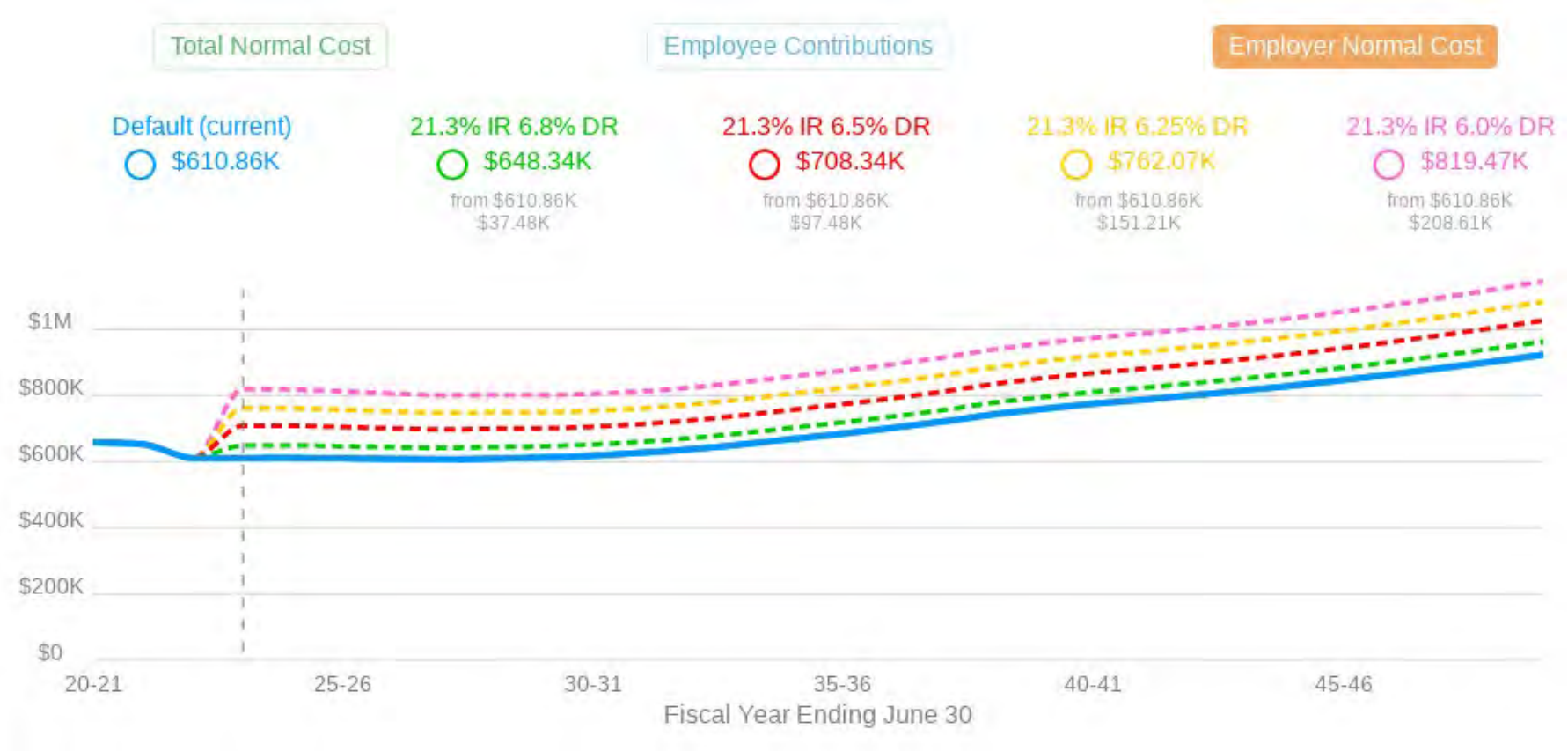
Potential Impact to Total Required Employer Contributions
(21.3% Return, Discount Rate Assumptions: 7% through 6%)



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

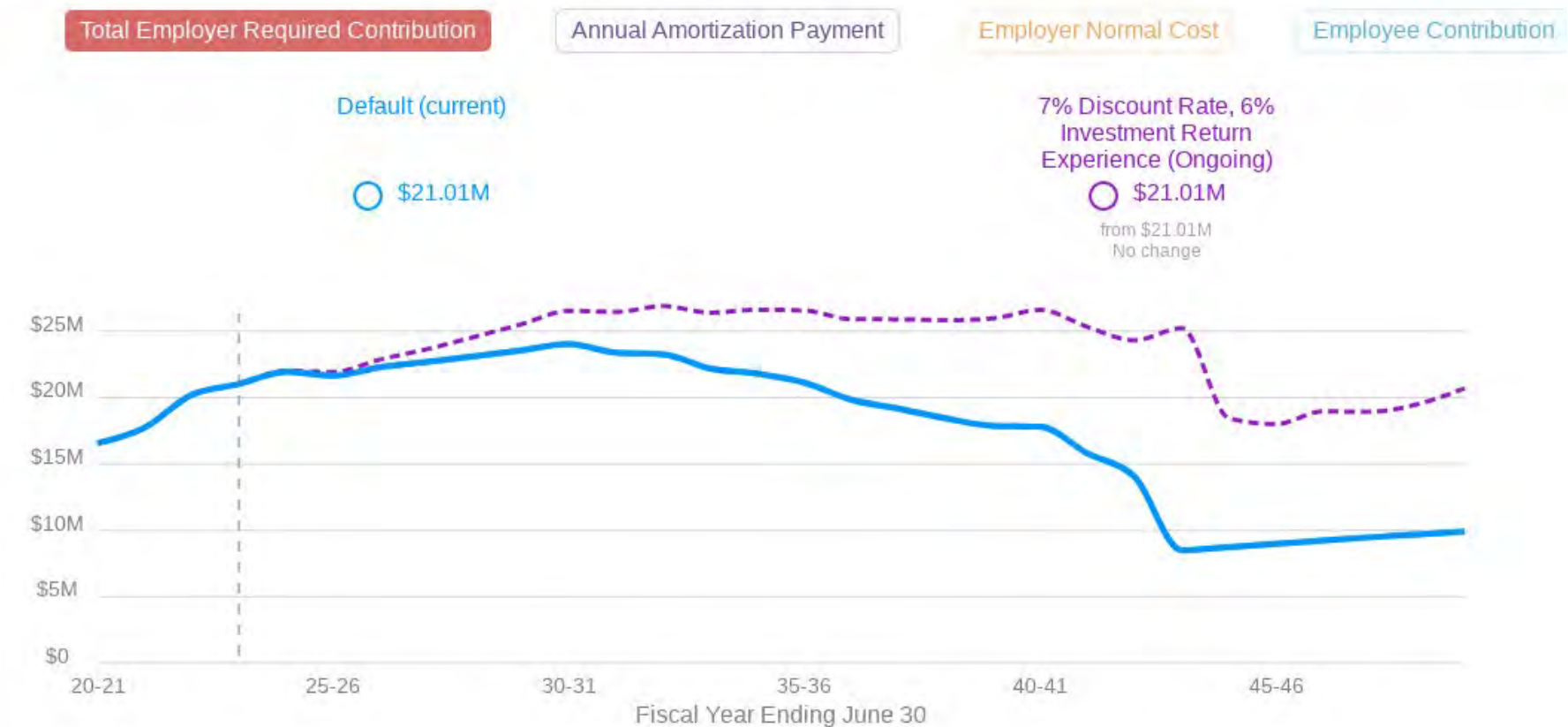
Looking Forward

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



Looking Forward

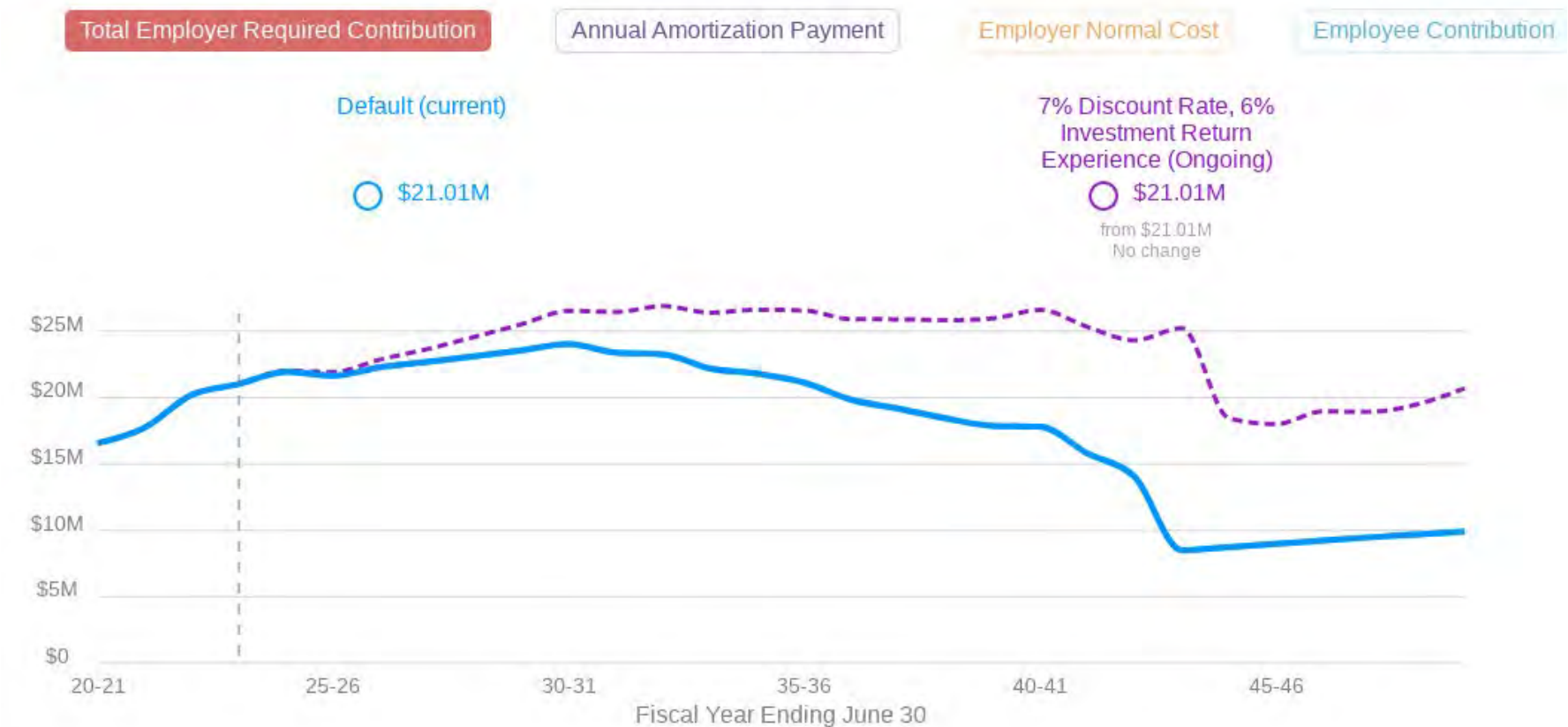
If no action is taken...



Looking Forward

If no action is taken...

(Status Quo: 7% Discount Rate & 7% Investment Experience)



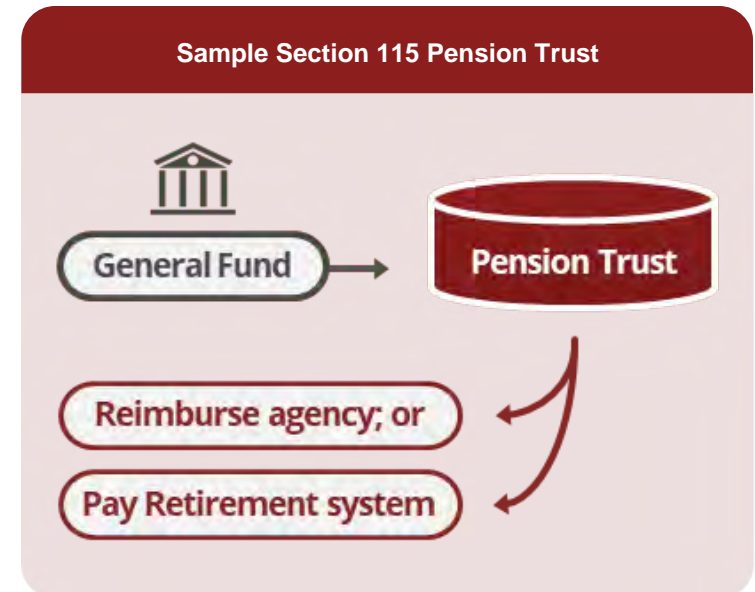
What Can Be Done?

Options for Funding CalPERS

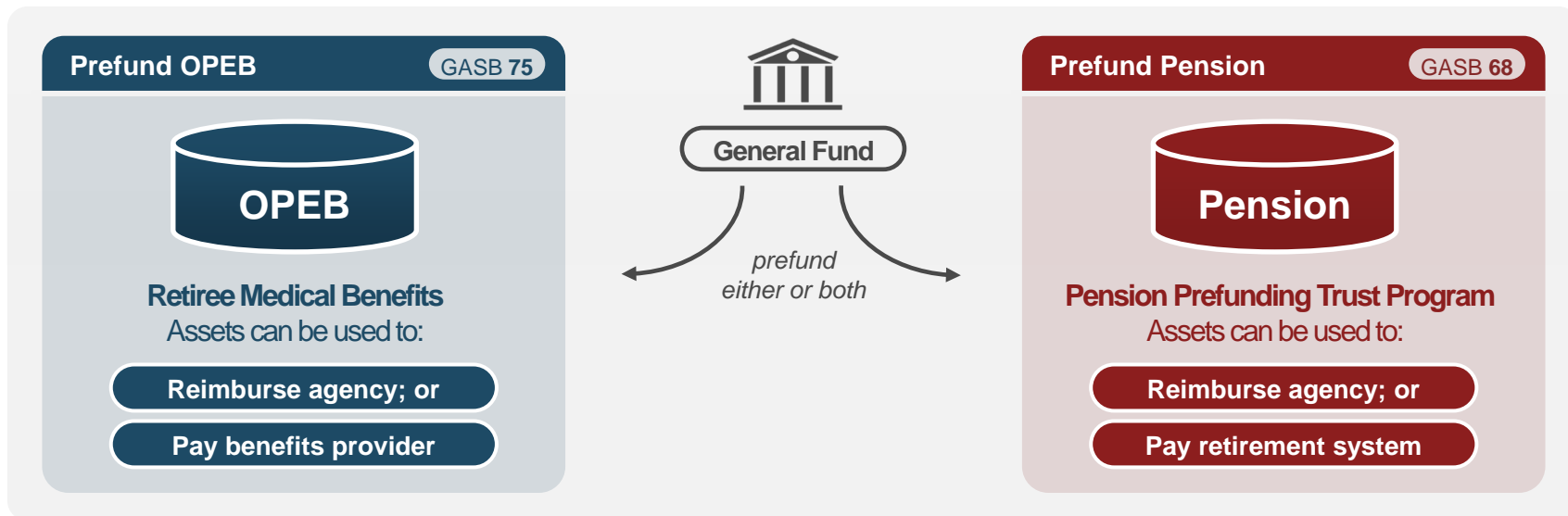
- 01 Make Additional Discretionary Payment
- 02 Prefund into a Contingency Reserve Fund
- 03 Issue Pension Obligation Bonds/Certificates of Participation
- 04 Prefund into an IRS Section 115 Pension Prefunding Trust
- 05 Use Above In Combination with Each Other

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

Anytime Access

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

Flexible Investing

Allows separate investment strategies for all OPEB and pension subaccounts.

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?

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

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)

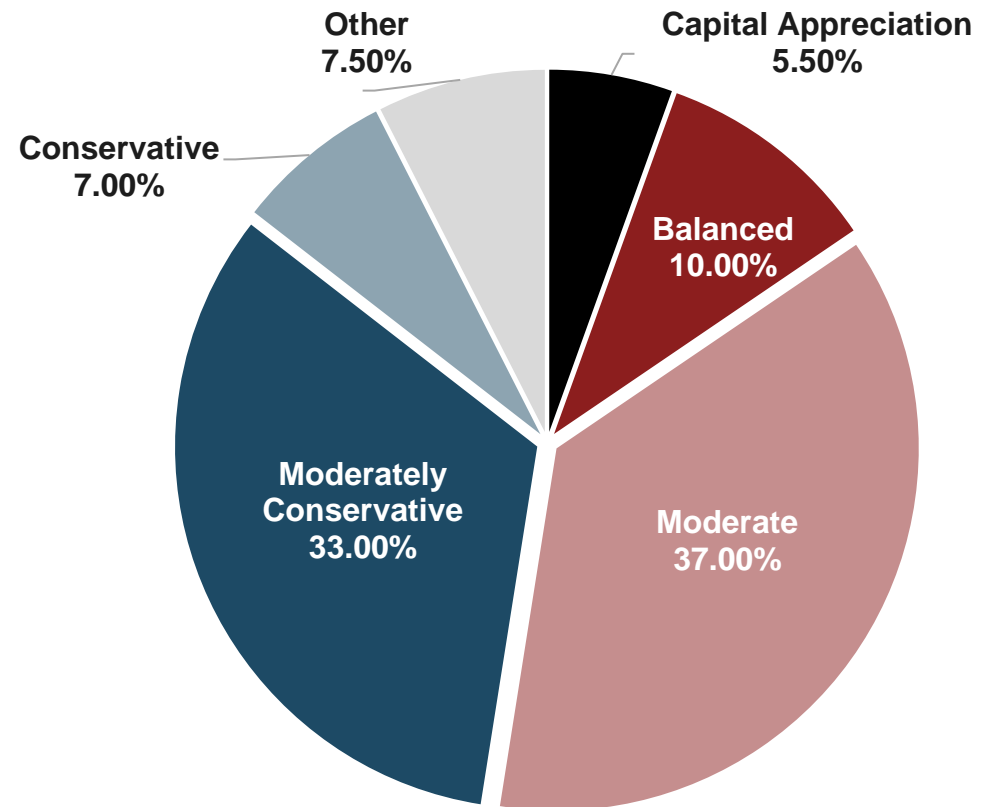
GOV § 53620 (OPEB)

Sample Portfolio Returns (as of 6/30/21)

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

Investment Selection Choice

Strategy	Allocation (%)
Capital Appreciation (65-85% Equity)	5.50%
Balanced (50-70% Equity)	10.00%
Moderate (40-60% Equity)	37.00%
Mod. Conservative (20-40% Equity)	33.00%
Conservative (5-20% Equity)	7.00%
Other (Custom)	7.50%
TOTAL	100.00%



Sample Funding Policies

- | | | |
|----|---|--------------------------|
| 01 | Contribute 50% of a given year's realized year end surplus to address pension liability | Alameda/Solana Beach |
| 02 | Contribute full amount of annual PERS employer cont., allowing anytime access to trust assets | City of Brea |
| 03 | Contribute funds to stabilize PERS employer Misc. and Safety rates through FY 23-24 | City of Healdsburg |
| 04 | "One equals five plan" - \$1M contribution for 5 years will save taxpayers \$5M over 25 years | City of Huntington Beach |
| 05 | Contribute Employer contribution equal to the 2.8% discount rate, with difference going into the Section 115 Trust | City of Sausalito |
| 06 | Contribute the annual savings realized from Reduction in UAL payment resulting from Pension Obligation Bonds issuance | City of Placentia |
| 07 | Earmark a portion of a local sales tax to be set aside for unfunded pension liabilities | City of Fountain Valley |
| 08 | Use ongoing savings from prepaying CalPERS unfunded liability vs. higher monthly payments | City of Pasadena |
| 09 | Use one-time revenue source and lower the minimum General Fund Reserve level (30% → 20%) | City of Glendale |



A Case Study: Town of Yountville

Managing Rising Pension Costs

A Unique Small Town

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.
- \$4.1M Net Pension Liability as of June 30, 2020.
- \$640K Net OPEB Liability as of June 30, 2020.

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)

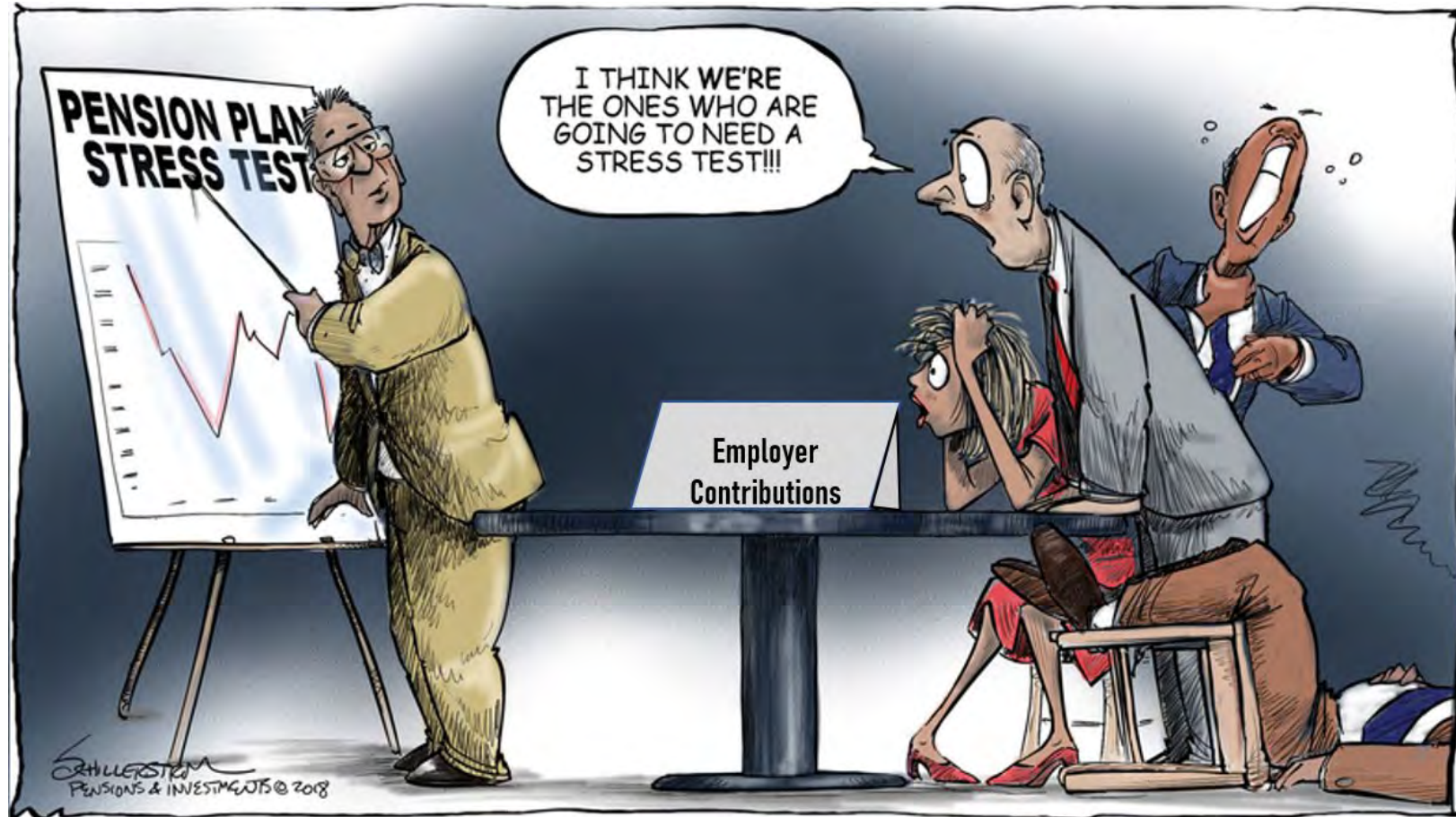
Pension

UAAL Payment to CALPERS
\$324,526

Discretionary Contribution to Pension Trust Fund
(Suspended for one more fiscal year)

Pension Trust Fund (PRSP)
(Balance as of July 31, 2021:
\$2,580,118)

Questions?



Contacts

Steve Rogers
Town Manager, Yountville
707-944-8851
srogers@yville.com

Charles Francis
Former Finance Director
818-572-3965
charlesdfreancis3@gmail.com

Rachael Sanders, CEBS
Senior Manager, Consulting
800-540-6369 x 121
rsanders@pars.org

Kevin O'Rourke
Retired City Manager
707-249-5356
kevin@kolgs.com

Thank you for attending!



www.pars.org



800-540-6369