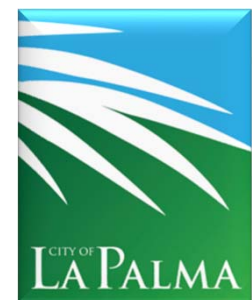

CalPERS Update & Additional Payment Discussion

CITY COUNCIL

FEBRUARY 20, 2018





La Palma Pension Plan

■ 3 Miscellaneous Plans

- Tier I - 2.7% @ 55 – Effective 2003
- Tier II – 2.0% @60 – Effective 2011
- Tier III (PEPRA) – 2.0% @ 62 – Effective 2013

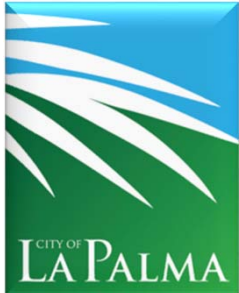
■ 3 Safety Plans

- Tier I – 3.0% @ 50 – Effective 2003
- Tier II – 2.0% @55 – Effective 2011
- Tier III (PEPRA) – 2.0% @ 57 – Effective 2013



CalPERS Basics

- **Normal Cost – Value of benefits earned by active employees during the current fiscal year**
- **Unfunded Accrued Actuarial Liability (UAL) - Amount of accrued pension liabilities that exceed plans assets**
- **Actuarial reports prepared for contracting agencies annually with rate set for the next fiscal year and two years of projected rates**



CalPERS Basics

- **Employee rate is set by statute. Percentage varies depending on formula**
 - **Miscellaneous = 8%, 7% or 6.25%**
 - **Safety = 9%, 7% or 10.25%**
- **EPMC – Amount employer pays on employee contribution (not allowable for Tier III/PEPRA plans)**
- **Investment earnings on assets have historically funded most retirement benefits**

HOW DID WE GET HERE?





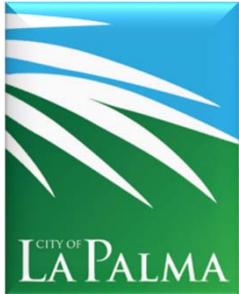
CalPERS History

■ 1999 to 2001– SB 400 / AB 616

- Improved pension benefits – better formulas

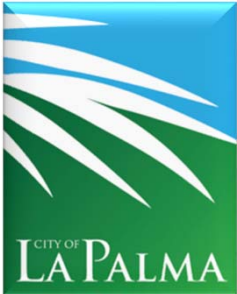
| | BEFORE | AFTER |
|---------------|----------------------------|-----------------------------|
| Miscellaneous | 2% @ 60 & 2% @55 | 2.5% @55, 2.7% @ 55, 3% @55 |
| Safety | 2% @ 55, 2.5% @55, 2% @ 50 | 3% @ 55, 3% @ 50 |

- At time of adoption CalPERS was 137% funded – “Super Funded”
- Contributions by public agencies dropped to near zero
- CalPERS estimated “zero cost” to new benefits
- La Palma Adopts enhanced formulas in 2003



CalPERS History

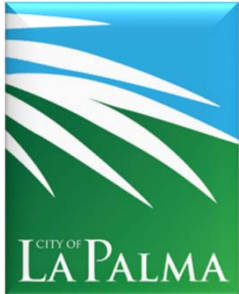
- **2000-2001 – CalPERS takes significant hit due to the dot.com bubble**
 - CalPERS loses \$12 billion in 2001 and \$10 billion in 2002
 - Fund drops below “Super Funded Status”
- **2003 - La Palma Adopts Enhanced Formulas**
- **2008-2009 – The Great Recession**
 - CalPERS loses 34.8% or \$67 billion in value and drops to 61% funded status
- **2012 – Public Employees Pension Reform Act (PEPRA) signed into law establishing a new tier of employees with less generous benefits – Did not modify “Classic” active formulas or retiree benefits**



CalPERS History

- **December 2016 – CalPERS Board moves to lower its discount rate from 7.5% to 7.0% over a phased in process.**
 - CalPERS Circular Letter (CL#200-004-17)

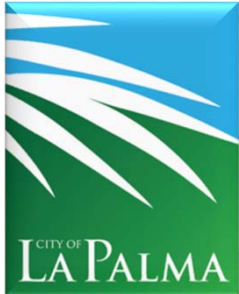
| | | Normal Cost | | UAL Payments | |
|----------------|-----------|---------------|--------------|--------------|--------------|
| Valuation Date | FY Impact | Misc. Plans | Safety Plans | Misc. Plans | Safety Plans |
| 6/30/2016 | 2018-19 | 0.25% - 0.75% | 0.5% - 1.25% | 2% - 3% | 2% - 3% |
| 6/30/2017 | 2019-20 | 0.5% - 1.5% | 1.0% - 2.5% | 4% - 6% | 4% - 6% |
| 6/30/2018 | 2020-21 | 1.0% - 3.0% | 2.0% - 5.0% | 10% - 15% | 10% - 15% |
| 6/30/2019 | 2021-22 | 1.0% - 3.0% | 2.0% - 5.0% | 15% - 20% | 15% - 20% |
| 6/30/2020 | 2022-23 | 1.0% - 3.0% | 2.0% - 5.0% | 20% - 25% | 20% - 25% |
| 6/30/2021 | 2023-24 | 1.0% - 3.0% | 2.0% - 5.0% | 25% - 30% | 25% - 30% |
| 6/30/2022 | 2024-25 | 1.0% - 3.0% | 2.0% - 5.0% | 30% - 40% | 30% - 40% |



CalPERS History

February 2018 – CalPERS reduces agency’s amortization policy from 30 years to 20 years for all investment gains and losses

- **Only for prospective accumulation of amortization. Current accrued unfunded liabilities will not change from where they are currently**
- **Phase-in for recent discount rate reduction not modified**
- **Changes will be reflected in cities June 30, 2019 valuation reports, however city budgets will not be impacted until FY 2021-22**



CalPERS Total Net Investment Return

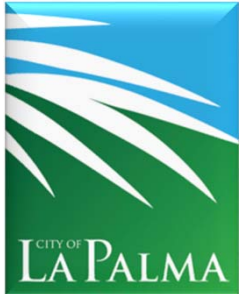
CalPERS Total Net Investment Return (for FY end 6/30)

| | |
|--|--------------|
| FY 2016-17 | 11.2% |
| 3 Years | 4.6% |
| 5 Years | 8.8% |
| 10 Years | 4.4% |
| 20 Years | 6.6% |
| Total since Fund inception (1988) | 8.4% |



Where Are We Now?

- **January 2018 - League of California Cities Retirement System Sustainability Study and Findings**
 1. **Rising pension costs will require cities over the next seven years to nearly double the percentage of their General Fund dollars they pay to CalPERS;**
 2. **For many cities, pension costs will dramatically increase to unsustainable levels, and**
 3. **The impacts of increasing pension costs as a percentage of the General Fund spending will affect cities even more than the state. Employee costs, including police, fire, and other municipal services, are a larger proportion of spending for cities.**



What Has La Palma Done?

- **2011 - Implemented Tier II formulas for employees hired after July 1, 2011**
- **2011 - Required all employees to pay the full employee contribution**
- **Beginning in FY 2012-13 Reduced Full Time staff from 65 to 52 employees**
- **Reduced work week for non-safety employees and changed safety employee work periods and scheduling resulting in a 5% reduction in take home pay**

What Has La Palma Done?

La Palma Annual PERSable Payroll

| | | Miscellaneous | Safety | Total | | |
|----------------------------|-----------|---------------|-----------|-----------|--|-----------|
| | | | | | | + 3% |
| | 6/30/2011 | 2,765,336 | 2,145,368 | 4,910,704 | | |
| Tier II Plans Introduced → | 6/30/2012 | 2,351,449 | 2,218,541 | 4,569,990 | | 4,707,090 |
| | 6/30/2013 | 2,349,734 | 2,303,351 | 4,653,085 | | 4,848,302 |
| PEPRA Plans Introduced → | 6/30/2014 | 2,308,775 | 2,146,462 | 4,455,237 | | 4,993,751 |
| | 6/30/2015 | 2,363,065 | 2,145,674 | 4,508,739 | | 5,143,564 |
| | 6/30/2016 | 2,173,900 | 1,645,995 | 3,819,895 | | 5,297,871 |
| | 6/30/2017 | 2,143,108 | 1,619,369 | 3,762,447 | | 5,456,808 |

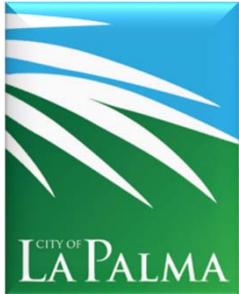
Avg Annual Decline: -4.3%
FY11 vs FY17 -23.4%

+55.8 %



What Has La Palma Done?

- **Currently lobbying State Legislators on the importance of updating laws to allow for further pension reform**
- **December 2017 City Council adopted a Resolution supporting Governor Brown in the elimination of the “California Rule”**
 - **Established that public employee pension benefits, once granted, can never be modified, even for future work, has severely limited government from making meaningful change to the pension system to make it more financially stable and sustainable**

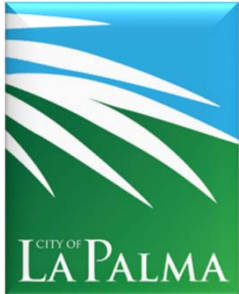


What Has La Palma Done?

- **In early 2017 began public discussions on methods to address growing unfunded pension obligation**
 - **Additional Lump Sum Payments vs. Section 115 Trust**
- **City Council authorized two \$2.5 million payments to CalPERS**
 - **First payment made in June 2017 (FY 2016-17)**
 - **Second payment included in FY 2017-18 Budget but needs final Council authorization at mid-year**

Unfunded Pension Obligation





La Palma Pension Liability

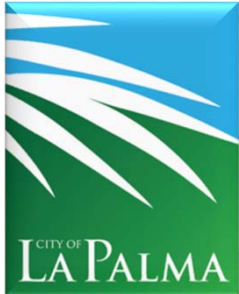
- As of June 30, 2016 Combined UAL - \$20.1 Million
- Increase of \$4.5 Million

MISCELLANEOUS PLANS:

| MARKET VALUE OF ASSETS | ACCRUED LIABILITY | UNFUNDED LIABILITY | FUNDED STATUS |
|------------------------|-------------------|--------------------|---------------|
| 20,210,404 | 28,438,184 | 8,227,780 | 71.1% |

SAFETY PLANS:

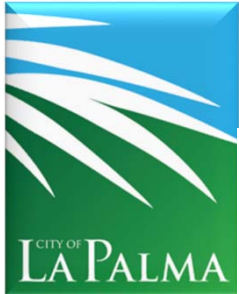
| MARKET VALUE OF ASSETS | ACCRUED LIABILITY | UNFUNDED LIABILITY | FUNDED STATUS |
|------------------------|-------------------|--------------------|---------------|
| 28,088,208 | 39,937,325 | 11,849,117 | 70.3% |



Unfunded Pension Liability

- As of June 30, 2016 Combined UAL - \$20.1 Million
- Increase of \$4.5 Million

| | Miscellaneous Tier I | Safety Tier I | (gain)/loss |
|-----------------------------------|----------------------|------------------|------------------|
| Asset (Gain)/Loss | 1,510,819 | 2,239,258 | 3,750,077 |
| Share of Pre-2013 Pool UAL | (3,265) | (65,604) | (68,869) |
| Non-Asset (Gain)/Loss | (188,347) | (337,894) | (526,241) |
| Assumption Change | 531,794 | 775,212 | 1,307,006 |
| (Decrease)/Increase in UAL | 1,851,001 | 2,610,972 | 4,461,973 |



LUMP SUM PAYMENTS TO CALPERS

PROS:

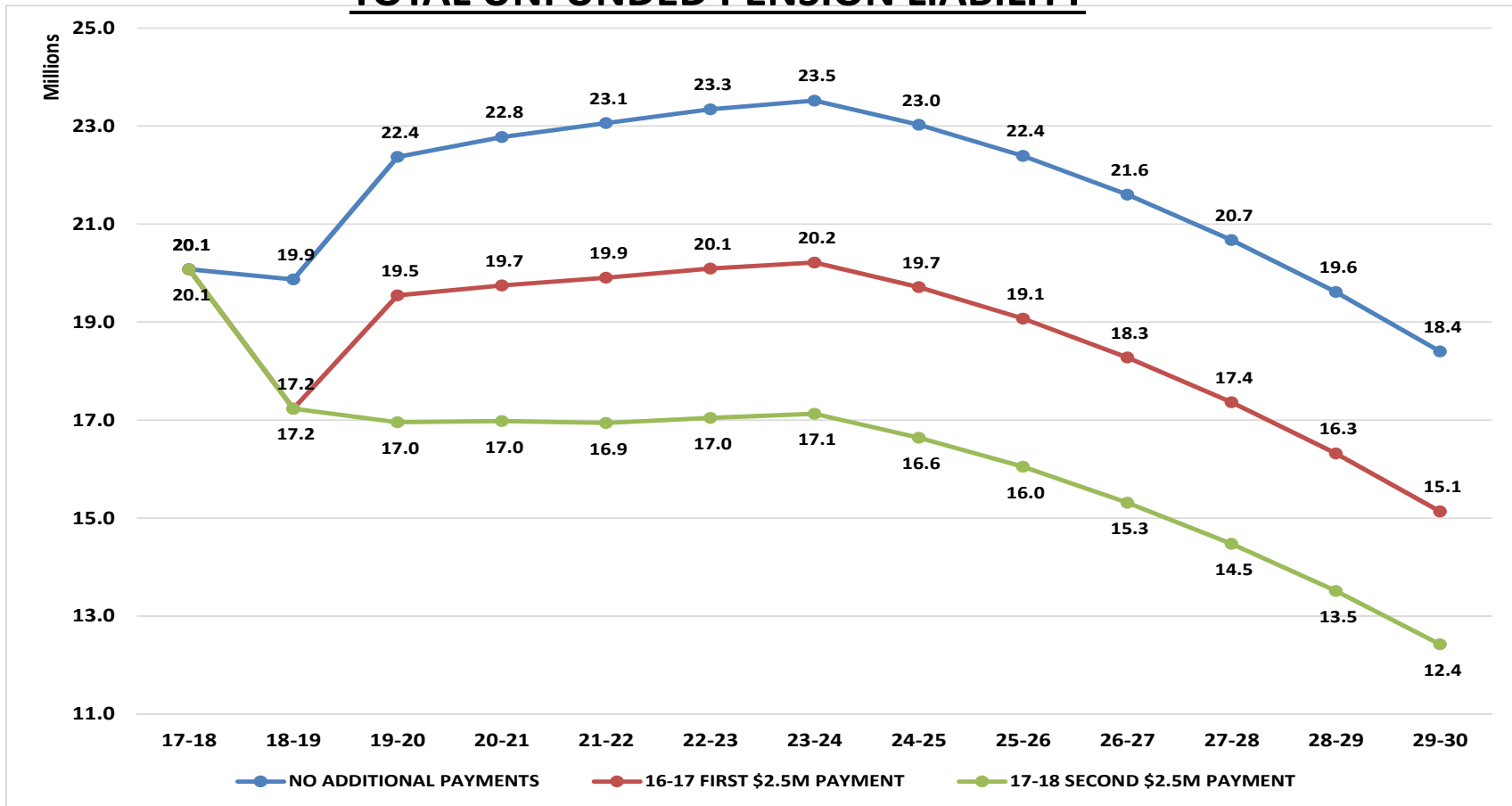
- Reduces on-going annual pension contributions providing relief to the General Fund
- Reduce interest cost of carrying unfunded liabilities
- Greater surpluses to ensure frontline services are maintained and allow for replenishment of reserves

CONS:

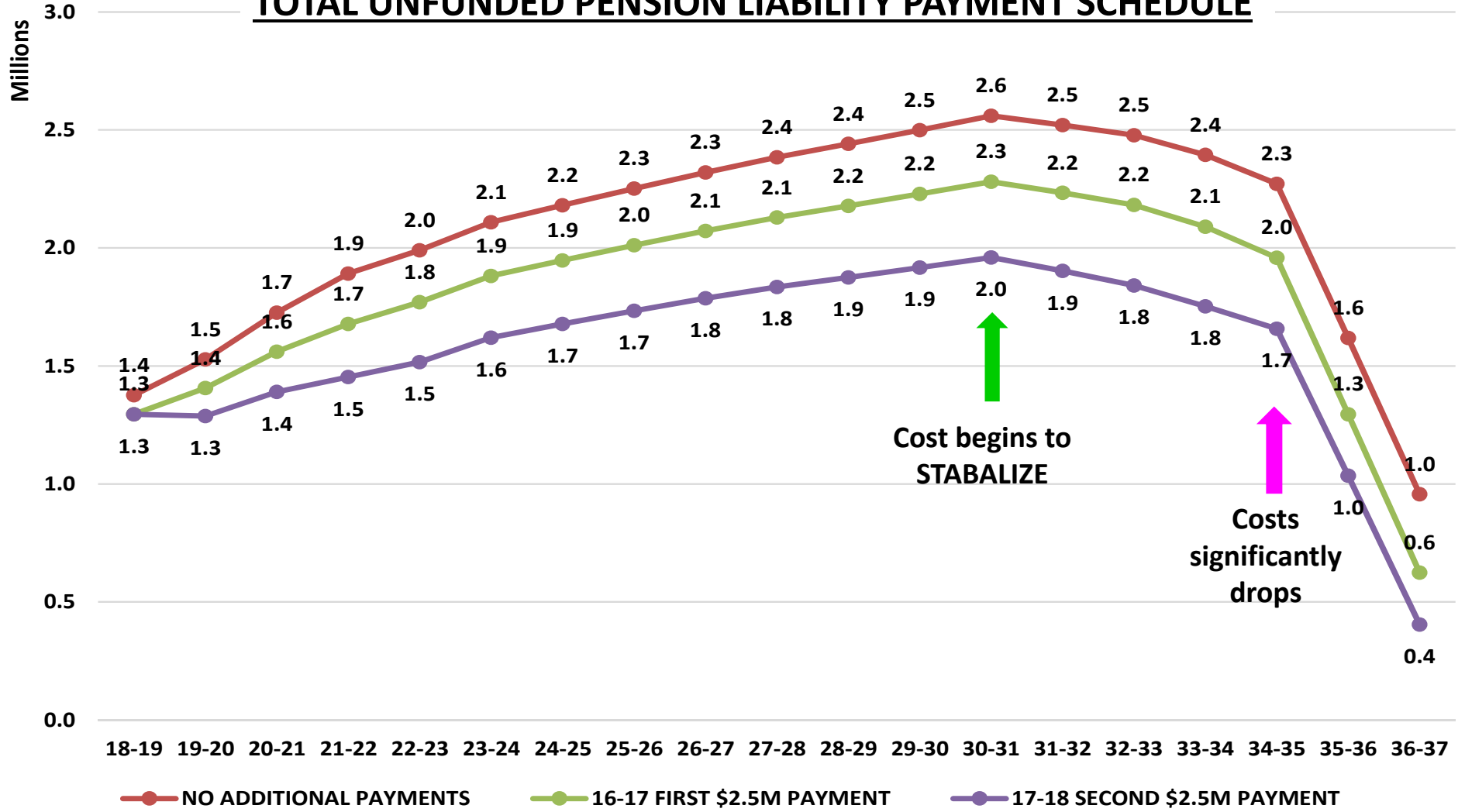
- Economic downturns and possible further CalPERS modifications to their actuarial assumptions could increase pension liability costs in the future
- Reduces budget flexibility by reducing available cash in the short term

PRO: Reduces on-going annual pension contributions providing relief to the General Fund

TOTAL UNFUNDED PENSION LIABILITY



TOTAL UNFUNDED PENSION LIABILITY PAYMENT SCHEDULE





PRO: Reduce interest cost of carrying unfunded liabilities

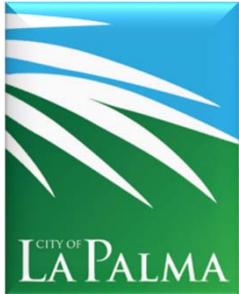
City cannot make in investments what CalPERS charges in interest (7.0% by FY 18-19) on the Unfunded Liability

La Palma PFM Portfolio Performance For Quarter Ended 12/31/17

| | Annualized Return | | |
|--------------|-------------------|---------|---------------------------|
| | 1 year | 3 years | Since Inception (9/30/13) |
| Total Return | .88 | .99 | .91 |

Local Agency Investment Fund

| | 2010-11 | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 |
|------------------|---------|---------|---------|---------|---------|---------|---------|
| Avg Annual Yield | .495 | .382 | .307 | .249 | .269 | .434 | .754 |



CARRYING COST EXAMPLE

| | Unfunded Liability | Additional Payment | Unfunded Liability w/ Add'l Payment |
|---|----------------------|---------------------|-------------------------------------|
| Safety Tier I UAL as of 6/30/16 | \$ 11,832,000 | \$ 2,500,000 | \$ 9,332,000 |
| CalPERS Discount Rate for FY 16-17 | 7.25% | | 7.25% |
| Annual Carrying Cost | 857,800 | | 676,570 |
| | | SAVINGS: | \$181,230 |

ESTIMATED ANNUAL UAL PAYMENT SAVINGS

| FISCAL YEAR | FY19 | FY20 | FY21 | FY22 | FY23 | FY24 | FY25 | FY26 | FY27 | FY28 | FY29 | FY30 | FY31 | FY32 | FY33 | FY34 | FY35 |
|-------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| NO ADD'L PAYMENTS | 1.4M | 1.5M | 1.7M | 1.9M | 2.0M | 2.1M | 2.2M | 2.3M | 2.4M | 2.4M | 2.4M | 2.5M | 2.6M | 2.5M | 2.5M | 2.4M | 2.3M |

TOTAL COST: 36.9M

Annual Payments w/ only one \$2.5 Million Payment (made in FY 2016-17)

| | | | | | | | | | | | | | | | | | |
|----------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| ANNUAL PAYMENT | 1.3M | 1.4M | 1.6M | 1.7M | 1.8M | 1.9M | 1.9M | 2.0M | 2.1M | 2.1M | 2.2M | 2.2M | 2.3M | 2.2M | 2.2M | 2.1M | 2.0M |
|----------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|

TOTAL COST: 32.9M + 2.5M = 35.4M / Savings 1.5 MILLION

Annual Payments w/ two \$2.5 Million Payments (first made in FY 2016-17)

| | | | | | | | | | | | | | | | | | |
|----------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| ANNUAL PAYMENT | 1.3M | 1.3M | 1.4M | 1.5M | 1.5M | 1.6M | 1.7M | 1.7M | 1.8M | 1.8M | 1.9M | 1.9M | 2.0M | 1.9M | 1.8M | 1.8M | 1.7M |
|----------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|

TOTAL COST: 28.5M + 5.0M = 33.5M / Savings 3.4 MILLION

ESTIMATED ANNUAL PAYMENT SAVINGS

Annual Payments w/ two \$2.5 Million Payments (first made in FY 2016-17)

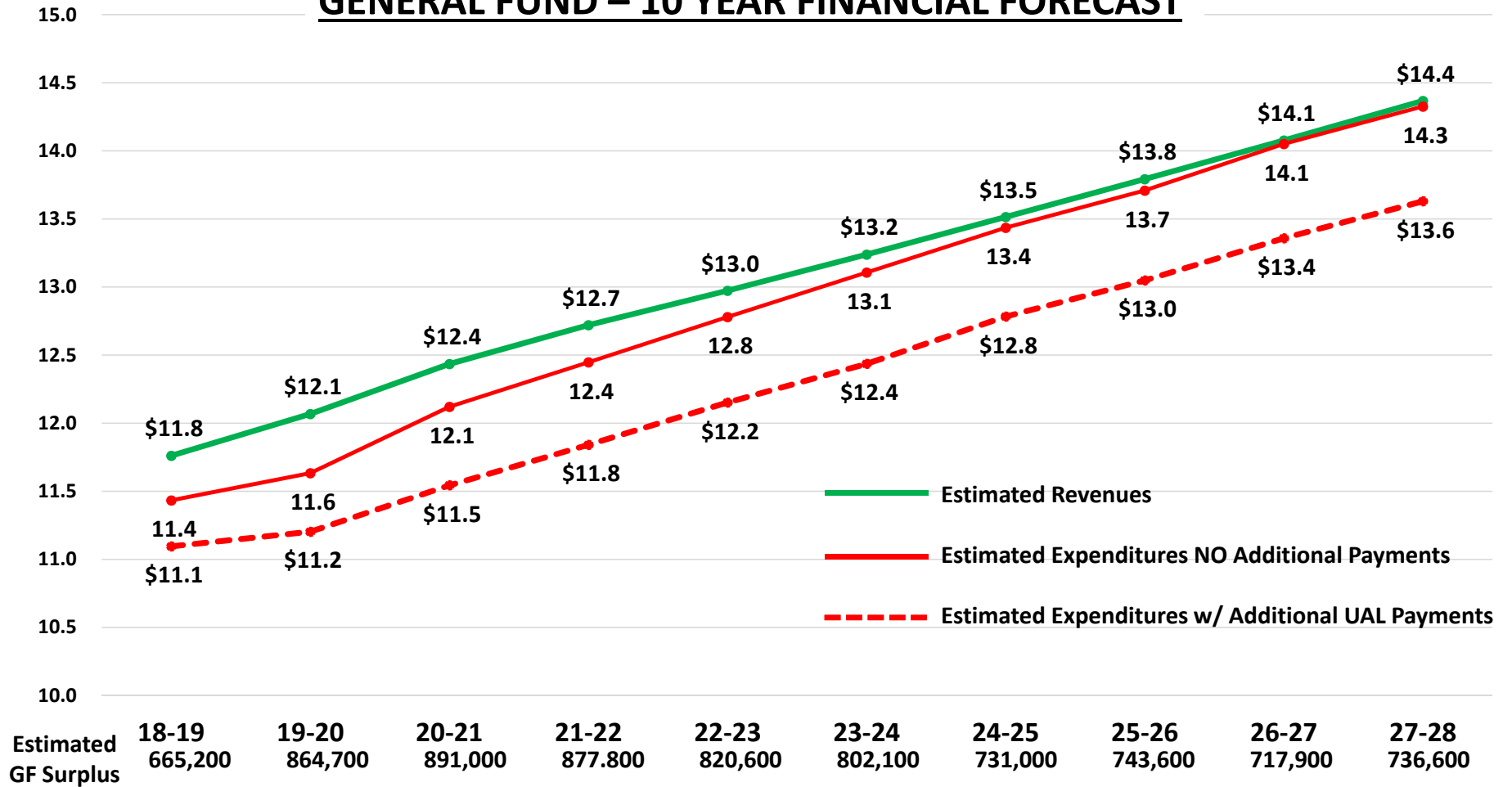
| | | | | | | | | | | | | | | | | | |
|----------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| ANNUAL PAYMENT | 1.3M | 1.3M | 1.4M | 1.5M | 1.5M | 1.6M | 1.7M | 1.7M | 1.8M | 1.8M | 1.9M | 1.9M | 2.0M | 1.9M | 1.8M | 1.8M | 1.7M |
|----------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|

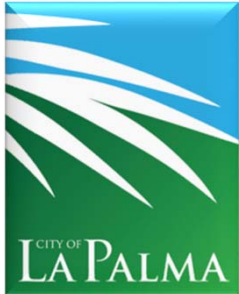
TOTAL COST: 28.5M + 5.0M = 33.5 / Savings 3.4 MILLION

| Investment Amount | Interest Rate (LAIF Avg Monthly Yield Jan' 18) | # of Years | Total Interest Earnings |
|-------------------|---|------------|-------------------------|
| 5,000,000 | 1.35% | 17 | \$1,289,043 |

PRO - Greater surpluses to ensure frontline services are maintained and allow for replenishment of reserves.

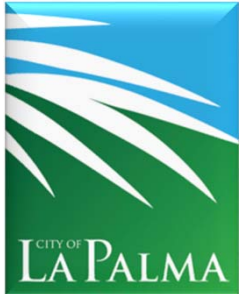
GENERAL FUND – 10 YEAR FINANCIAL FORECAST





CON: ECONOMIC DOWNTURNS AND FURTHER ASSUMPTION CHANGES COULD INCREASE FUTURE LIABILITY

- **Establishment of Pension Stabilization Trust to manage future volatility**
 - **Potential greater interest earnings than achievable through City's general investments**
 - **Provides budget flexibility and ability to adapt to changes in the economic conditions**



CON: Reduces budget flexibility by reducing available cash in the short term

- **City's additional payments made from Unassigned Spendable General Fund Balance**
- **Additional payments expected to actually provide relief to the General Fund by lowering annually required UAL payments**
- **City has very conservative Fund Balance Reserve Policy to ensure economic stability**



General Fund Balance

- **As of June 30, 2017, City's General Fund Unassigned Fund Balance was \$4.9 million**
- **\$1.6 million used for purchase of property in August 2017**
- **\$3.3 million available to be applied toward second \$2.5 million**
- **No FY 2017-18 Revenue to be used for second payment**

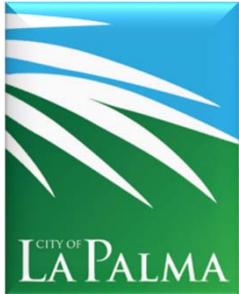


FUND BALANCE RESERVE POLICY

| General Fund | Target Balance | FY 2017-18 Balance |
|------------------------|--|--------------------|
| Emergency Reserve Fund | 50% of Fiscal Year Expenditures & minimum of 25% of the year-end operating surplus will be allocated | <i>\$5,080,000</i> |

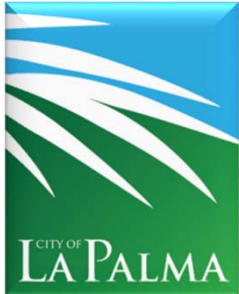
**Government
Finance Officers
Association
(GFOA)**

| RISK LEVEL | RECOMMENDED RESERVE LEVEL |
|------------------|---------------------------|
| Minimal | 16.6% |
| Low to Moderate | 17 – 25% |
| Moderate to High | 26 – 35% |
| High | > 35% |



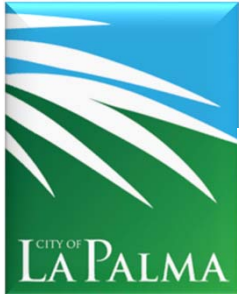
FUND BALANCE RESERVE POLICY

| Capital Funds | Target Balance | Estimated Ending FY 17-18 Balance |
|------------------------------|---|-----------------------------------|
| Capital Outlay Reserve (COR) | \$2,000,000 at end of 10 year planning period | <i>\$4.2 Million</i> |
| Utility Funds | Target Balance | Estimated Ending FY 17-18 Balance |
| Water Funds | Combined total of Water and Water Capital Reserve Funds equal to 5% of replacement value of fixed assets of the water utility – FY 17-18 - \$1.9 million | <i>\$3.1 Million</i> |
| Sewer Funds | Combined total of Sewer and Sewer Capital Reserve Funds equal to 10% of replacement value of fixed assets of the water utility – FY 17-18 – \$2.6 million | <i>\$3.1 Million</i> |



FUND BALANCE RESERVE POLICY

| INTERNAL SERVICE FUNDS | Target Balance | Estimated Ending FY 17-18 Balance | Funded Level |
|------------------------|---|-----------------------------------|--------------|
| Risk Management | \$1,000,000 | \$1,002,352 | 100% |
| Employee Benefits | 50% of Compensated Absences | 297,360 | 124% |
| Facility Maintenance | \$50,000 | 52,583 | 105% |
| Vehicle Replacement | 33% of replacement value of all rolling stock | 1,349,498 | 184% |
| Technology | Full Replacement Value | 629,834 | 101% |



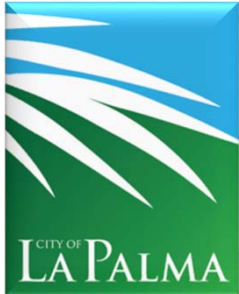
LUMP SUM PAYMENTS TO CALPERS

PROS:

- Reduce interest cost of carrying unfunded liabilities
- Reduces on-going annual pension contributions providing relief to the General Fund
- Greater surpluses to ensure frontline services are maintained and allow for replenishment of reserves

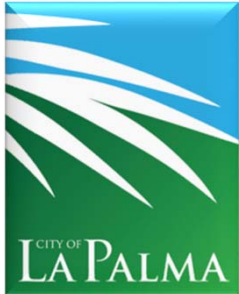
CONS:

- Economic downturns and possible further CalPERS modifications to their actuarial assumptions could increase pension liability costs in the future – **Pension Stabilization Fund would address**
- Reduces budget flexibility by reducing available cash in the short term – **City utilizing unassigned fund balance and no future revenue to make one-time payment, solid fund balance reserve policies, and upfront payments will actually provide relief to the general fund increasing available cash**



What happens if the City stops paying CalPERS?

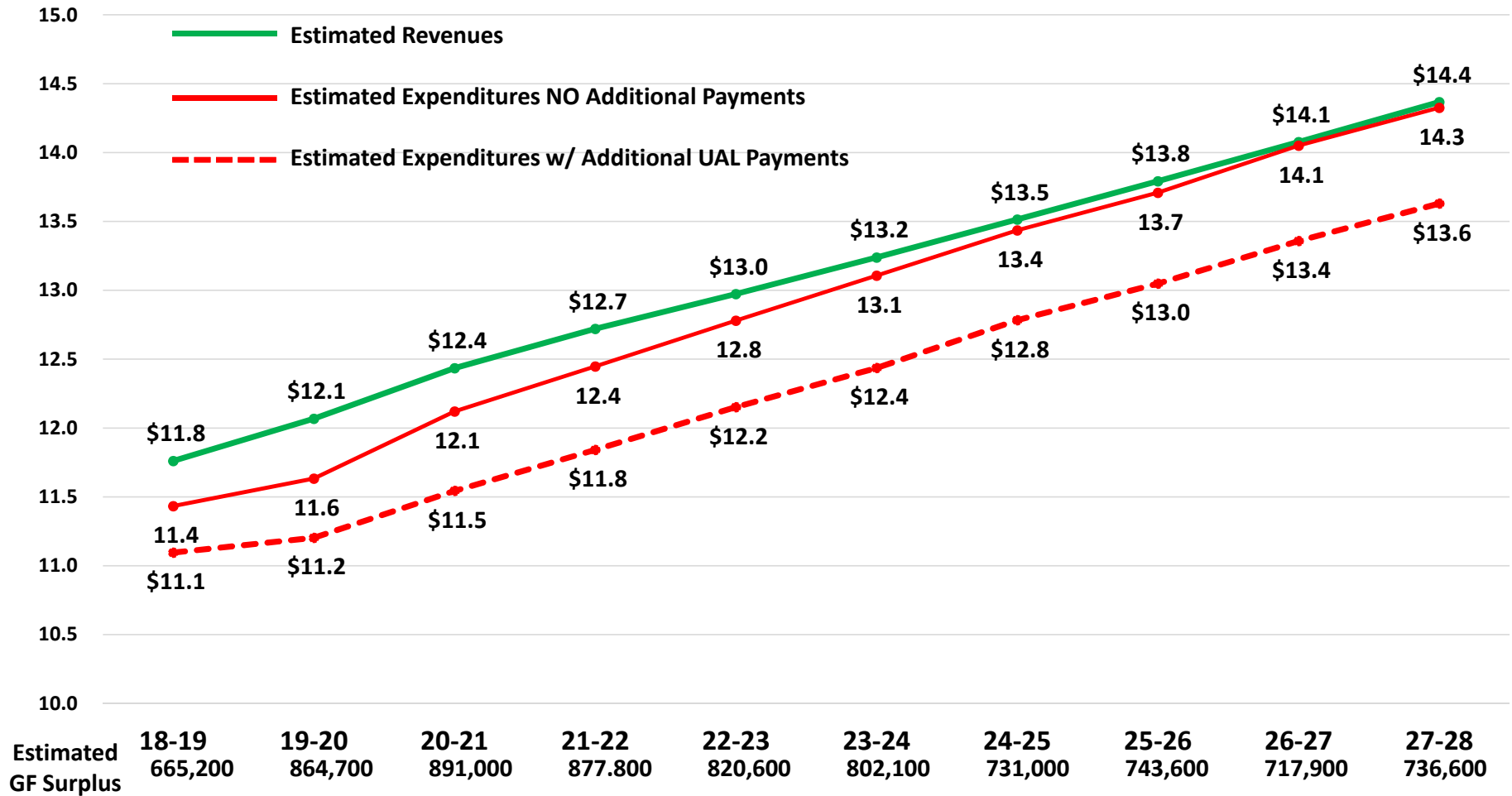
- City's obligation does not end even if it withdraws
- City's pension fund is transferred to a pool of terminated pension accounts with a much lower return on investment which substantially increases the unfunded liability



HYPOTHETICAL TERMINATION LIABILITY

| MARKET VALUE OF ASSETS (6/30/17) | ACCRUED LIABILITY | UNFUNDED LIABILITY | FUNDED STATUS |
|---|--|---------------------------------------|----------------------|
| \$48,298,612 | 68,375,509 | 20,076,897 | 70.6% |
| MARKET VALUE OF ASSETS (6/30/17) | TERMINATION LIABILITY 3.0% ROI | UNFUNDED TERMINATION LIABILITY | FUNDED STATUS |
| \$48,298,612 | 117,401,262 | 69,102,680 | 41.1% |
| MARKET VALUE OF ASSETS (6/30/17) | TERMINATION LIABILITY 1.75% ROI | UNFUNDED TERMINATION LIABILITY | FUNDED STATUS |
| \$48,298,612 | 137,347,205 | 89,048,594 | 35.2% |

PRO - Greater surpluses to ensure frontline services are maintained and allow for replenishment of reserves.





Recommended Council Actions

- **Adopt Resolution approving second \$2.5 million lump sum payment to CalPERS**
 - **Payment applied evenly between the Tier I Miscellaneous and Safety plans**
 - \$1,250,000 to Miscellaneous Tier I**
 - \$1,250,000 to Safety Tier I**

