Pension & OPEB Policies

San Leandro

GovInvest
Insights to your financial future

Two Major Retirement Benefit Obligations

Pension Benefits

Administered by

CalPERS

- Multi-Employer System
- Multi-Employer Funding Trust

Retiree Health Benefits (OPEB)

Self Administered by

CITY OF SAN LEANDRO
INCORPORATED 1872

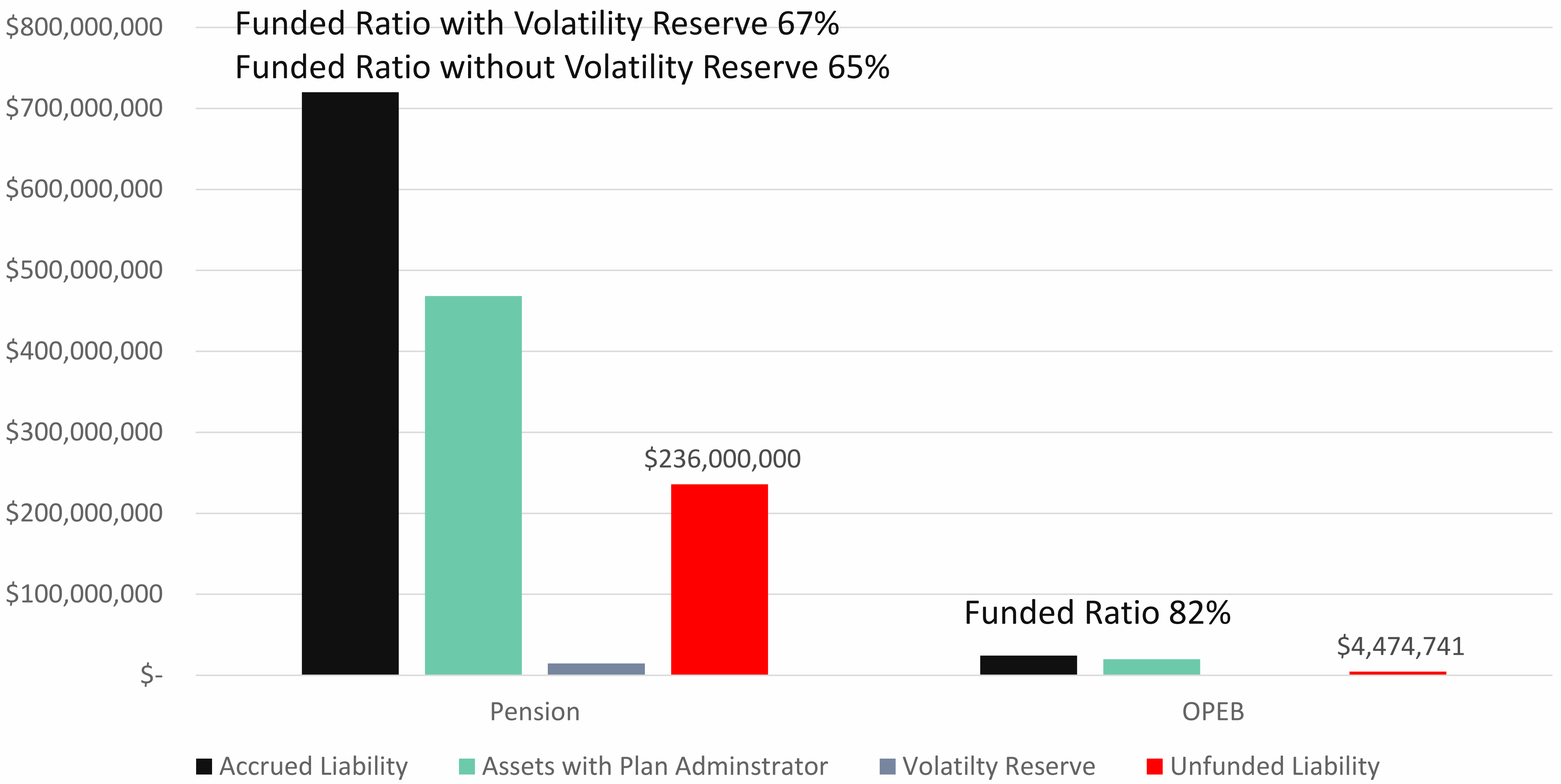
- Single Employer Plan
- Multi-Employer Funding Trust

Objective

- Update funding policy for OPEB and pension liabilities adopted November 2022.

- Propose two separate policies with different strategic approaches:
    - ✓ Pension Funding Policy
    - ✓ OPEB Funding Policy

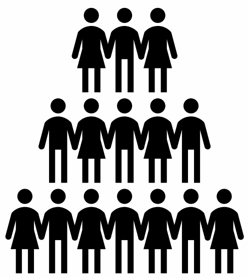
Relative Size of Pension vs. OPEB Obligation as of 6/30/2023



Assumptions Set Future Cost & Funding Expectations

Economic

- Inflation
- Investment Return
- Salary Growth
- Health Care Costs

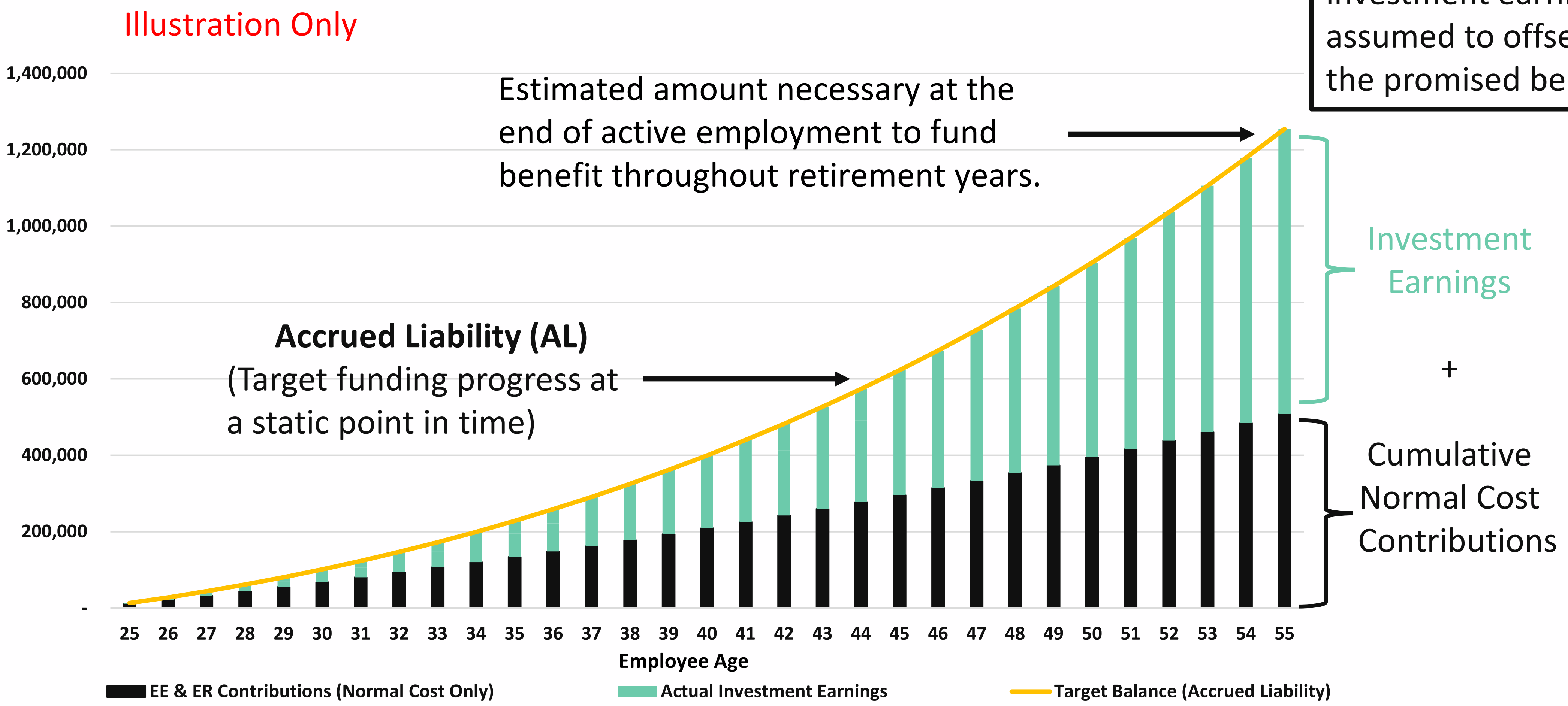


Demographic

- Retirement
- Disability
- Death
- Termination

Hypothetical Prefunding Example for Individual Employee's Retirement Benefit

When benefits are "prefunded," investment earnings are assumed to offset 50% -60% of the promised benefit.



Benefits of Policy Development

Financial Responsibility: It ensures that local governments set aside adequate funds to meet future pension obligations, demonstrating fiscal prudence and responsibility.

Risk Management: A well-structured policy helps manage and mitigate investment risks, ensuring that the pension fund remains solvent even during economic downturns.

Employee Trust and Retention: A well-funded pension plan builds trust among employees, ensuring they feel secure about their future benefits. This can enhance employee morale and aid in retaining experienced and valuable staff.

Budget Stability: Reduces volatility in annual budget allocations by smoothing out contribution requirements over time, which aids in more predictable and stable financial planning.

Credit Rating: A well-funded pension plan can positively impact the local government’s credit rating, potentially leading to lower borrowing costs and better access to financial markets.

Transparency and Accountability: Promotes transparency and accountability in how pension funds are managed, enhancing public trust and confidence in the local government's financial management practices.

What is a Risk Based Capital Reserve (RBC) Policy

A **risk-based capital reserve policy** is a regulatory framework used by financial institutions, such as banks and insurance companies, to ensure they have enough capital to cover potential losses from their risk exposures. The idea is to maintain a buffer of capital that can absorb losses and protect the institution from insolvency.

1. **Purpose**: The primary goal is to ensure financial stability by requiring institutions to hold capital proportional to the risks they take.
2. **Risk Weights**: Different types of assets and activities are assigned risk weights, which determine the amount of capital required. For example, loans with higher risk of default require more capital than safer investments.
3. **Regulatory Standards**: Institutions must meet minimum capital requirements set by regulatory bodies, such as the Basel Committee on Banking Supervision for banks and various state insurance regulators for insurers.
4. **Capital Ratios**: Institutions are evaluated based on capital ratios, such as Tier 1 and Tier 2 capital ratios, which measure the adequacy of their capital relative to their risk-weighted assets.

Pension Risks

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Pension Risks – Which Can a Local Agency Control?

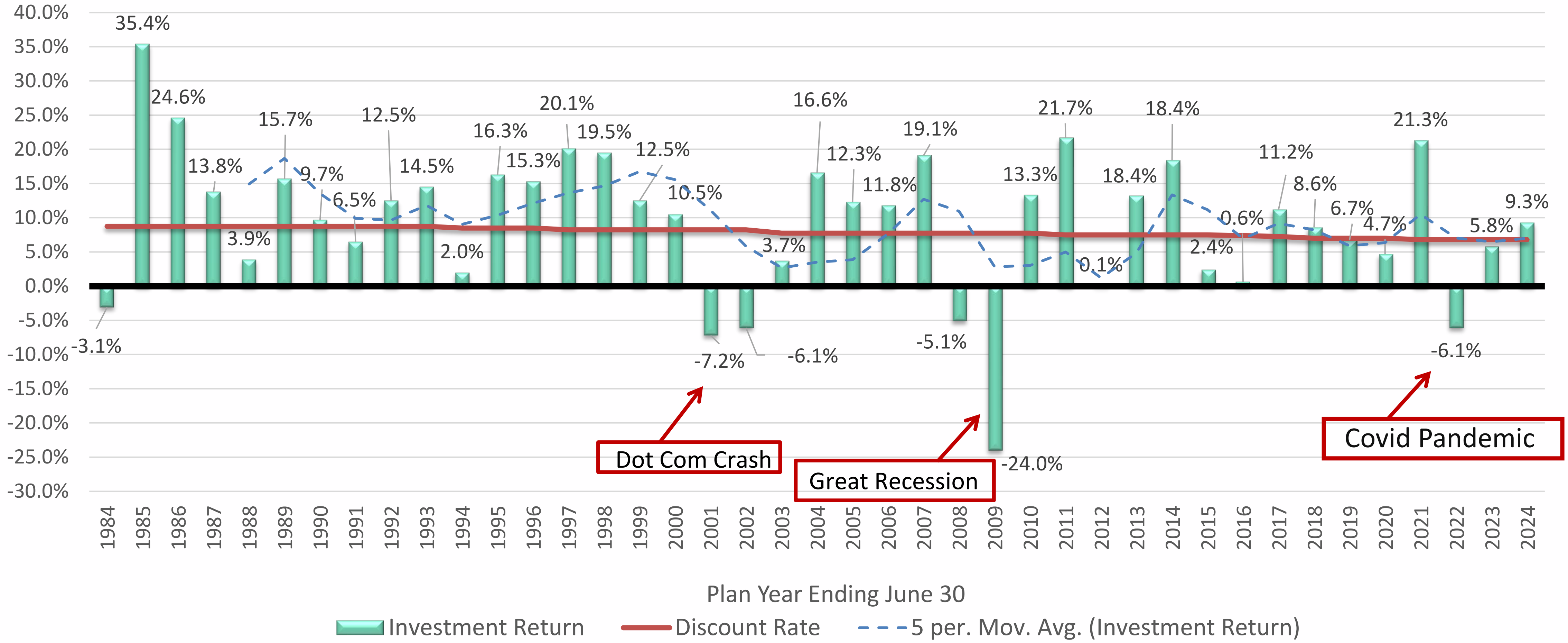
No

- Investment Risk (Most Impactful Risk)
- Contribution Rate Volatility
- Actuarial Risk
- Longevity Risk
- Legislative and Regulatory Risk
- Demographic Losses

Yes

- Liquidity Risk
- Credit and Insolvency Risk
- Funding Risk
- Reputation Risk

CalPERS Historical Investment Returns

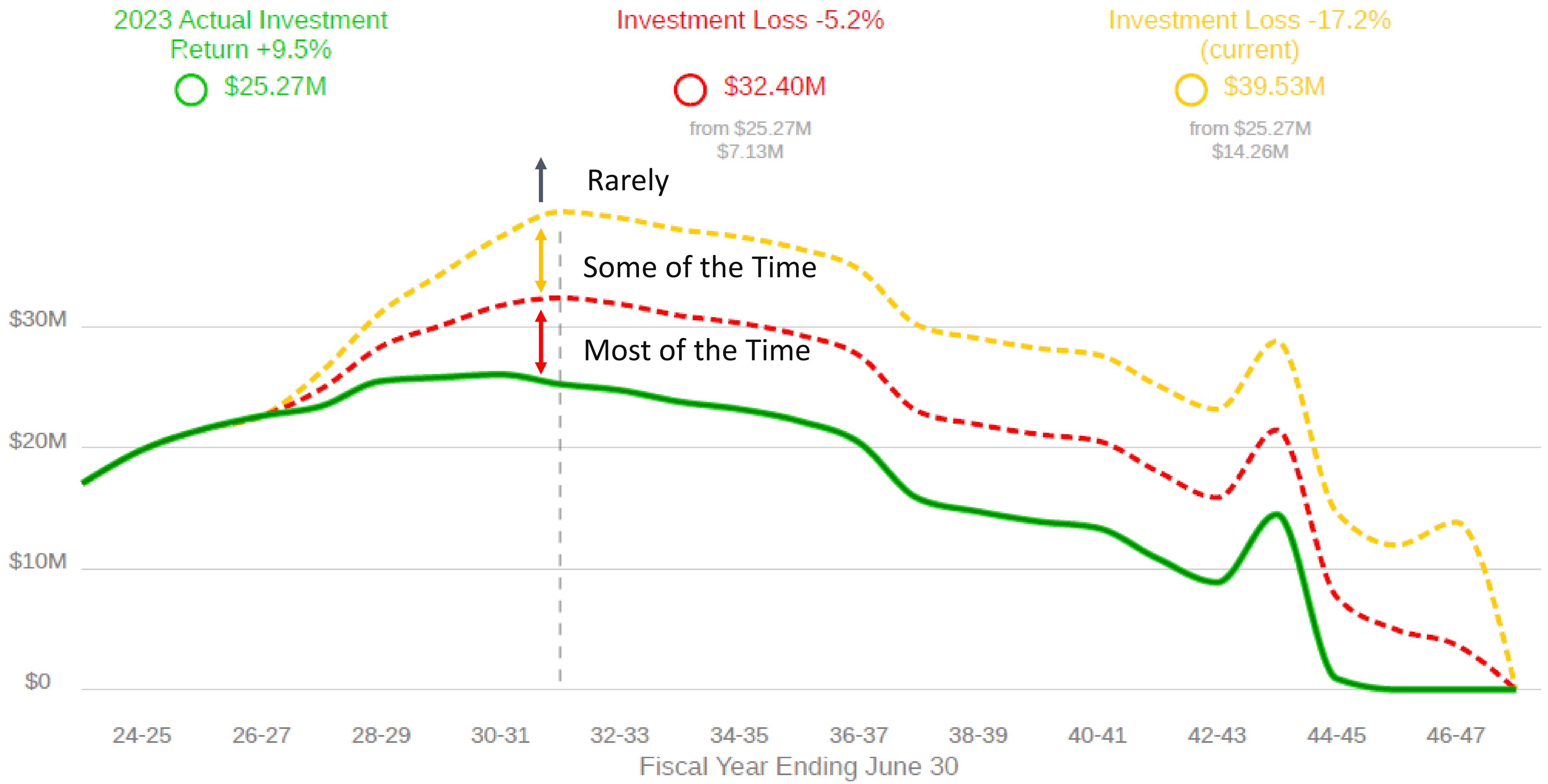


Compound Annual Return					
	1 Year	**5 Year**	**10 Year**	**20 Year**	**30 Year**
June 30, 2024	9.3%	6.6%	6.2%	6.7%	7.7%
June 30, 2023	5.8%	6.1%	7.1%	7.0%	7.5%

Just How Significant is Investment Risk to San Leandro?

	Market Loss	Exerience Loss %	Exerience Loss $	Chance	Years	CL
Most of the time - Less than	-5.20%	-12.00%	$ (88,200,000)	16.0%	6.3	68%
	-5.63%	-12.43%	$ (91,375,200)	15.0%	6.7	70%
	-7.00%	-13.80%	$ (101,430,000)	12.5%	8.0	75%
Some of the Time	-8.58%	-15.38%	$ (113,072,400)	10.0%	10.0	80%
	-10.48%	-17.28%	$ (127,008,000)	7.5%	13.3	85%
	-12.94%	-19.74%	$ (145,089,000)	5.0%	20.0	90%
Rarely - Greater than	-17.20%	-24.00%	$ (176,400,000)	2.5%	40.0	95%

Investment Losses



Pension Policy

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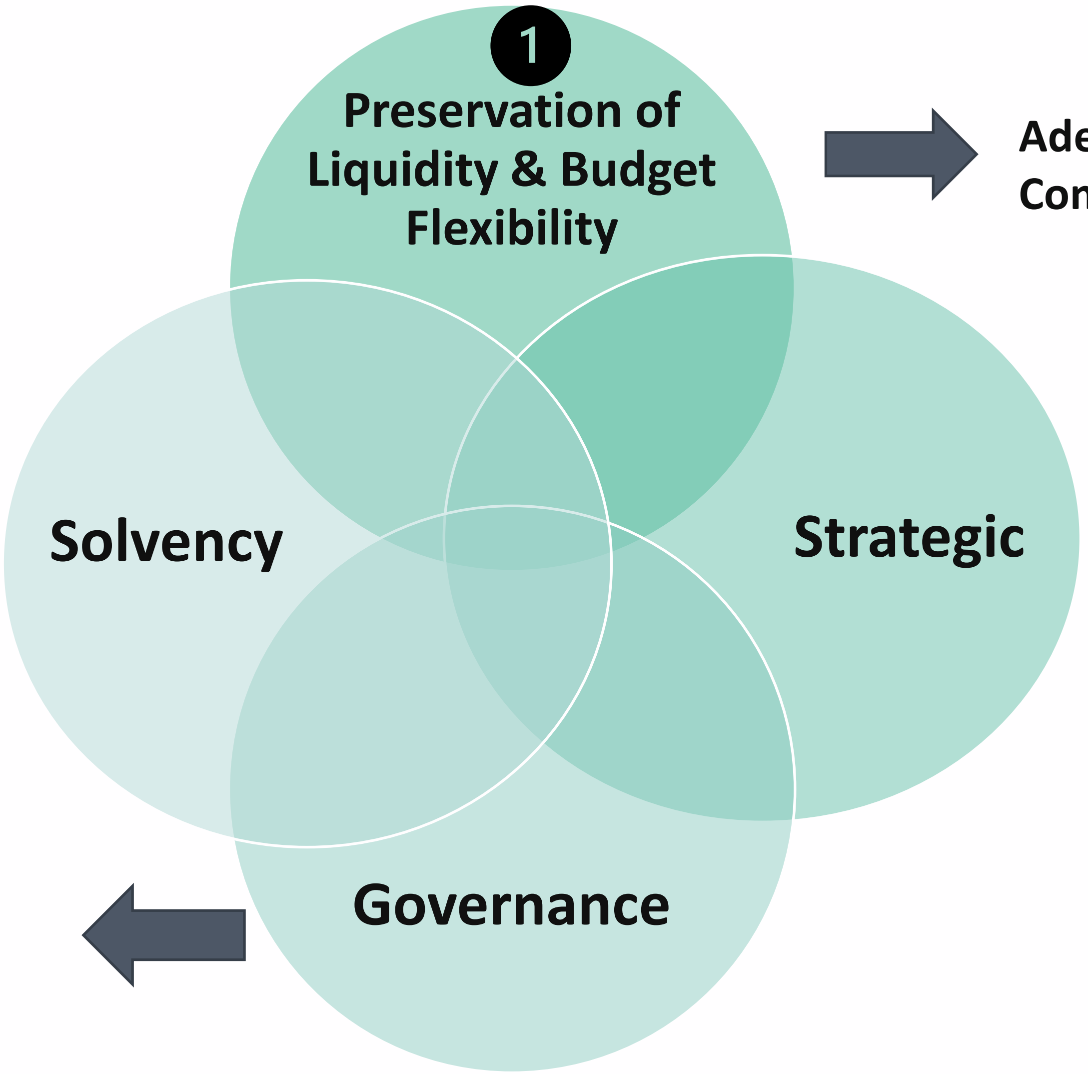
Pension Risk Management Goals



Adequate Reserves and Continuity of Service to Citizenry

Maximize Principal and Payment Reduction

Maximize Interest Savings

Regular Review, Transparent Disclosures

Pension Policy Strategy

STRATEGY

The pension funding strategy centers on maintaining external reserves that provide a balance between protecting against investment losses and preserving financial flexibility. The strategy includes gradual reserve growth and cautious management of liquidity.

Key elements of the strategy include:

1. **Liquidity Focus**: Reserves are designed to stabilize the annual budget in times of volatility rather than fully cover the entire experience losses.
2. **Incremental Growth**: The reserve levels reflect a moderate approach to reserve building, with the possibility of increasing targets as the agency's financial condition improves.

Key Pension Policy Reserve Targets

RESERVE TARGETS

The reserve targets are defined as follows:

1. **Minimum Reserve: 3% of accrued pension liability.** This minimum level allows for modest cushion for short-term needs. While intended as a minimum amount on reserve. However, this reserve level may be deployed to make minimum required employer contributions to CalPERS when a confluence of factors such experience losses and revenue shortfalls would otherwise strain operations.
2. **Target Reserve: 8% of accrued liability.** This target offers a balanced level of protection while maintaining flexibility in budget management. Funds accumulated between the 3% and 12% target range may be deployed more strategically to reshape the UAL payment curve or otherwise pay down the UAL balance more efficiently to stop negative amortize amortization are derive additional interest savings.
3. **Maximum Reserve: 12% of accrued liability.** The upper limit provides sufficient coverage to manage a significant experience loss. Once this level of external reserves is reached, funds could be used to pay the minimum required, employer contributions. Policy goals, adequacy of reserves and strategy should be periodically revisited for effectiveness. Any adjustments to the reserve levels should be made in accordance with the policy's RBC framework and risk tolerance.

Buffer / Reserve Target Calculations

20-Yr. UAL Repayment Schedule, 5-Yr. Smoothing Ramp

(Accommodative Pmt. But Inefficient Amortization)

Default UAL Repayment Schedule

Hypothetical Funding Loss

Count	Val Yr.	5Yr Ramp Up Hypothetical Loss Balance	20 Payment	Funding Loss	Confidence Level
	2023	$ 113,072,400		-15.38%	80%
	Pmt Yr	$ 120,761,323			Cum. Total
1	2026	$ 128,973,093	$ 2,772,237		$ 2,772,237
2	2027	$ 134,878,320	$ 5,544,474		$ 8,316,712
3	2029	$ 138,320,160	$ 8,316,712		$ 16,633,423
4	2030	$ 139,131,101	$ 11,088,949		$ 27,722,372
5	2032	$ 137,132,243	$ 13,861,186		$ 41,583,558
6	2033	$ 132,132,520	$ 13,861,186		$ 55,444,744
7	2035	$ 126,792,815	$ 13,861,186		$ 69,305,930

AL	Target Reserve Bal.		% of AL	
$ 735,000,000	$ 16,633,423	3 Yrs.	2.3%	Min
	$ 41,583,558	5 Yrs.	5.7%	
	$ 69,305,930	7 Yrs.	9.4%	Max

20 Yr. UAL Repayment Schedule, No Smoothing Ramp

(No Negative Amortization but Higher Payments)

Alternative UAL Repayment Schedule

To Avoid Negative Amortization

Count	Val Yr.	Level Dollar No Ramp Hypothetical Loss Balance	20 Payment	Funding Loss	
	2023	$ 113,072,400	*Initial loss*	-15.38%	80%
	Pmt Yr	$ 120,761,323		Est. UAL Pmt	Total
1	2026	$ 128,973,093	$ 11,597,719		$ 11,597,719
2	2027	$ 117,375,374	$ 11,597,719		$ 23,195,438
3	2029	$ 105,777,655	$ 11,597,719		$ 34,793,157
4	2030	$ 94,179,936	$ 11,597,719		$ 46,390,876
5	2032	$ 82,582,217	$ 11,597,719		$ 57,988,595
6	2033	$ 70,984,498	$ 11,597,719		$ 69,586,314
7	2035	$ 59,386,779	$ 11,597,719		$ 81,184,033

AL	Target 115 Bal.		% of AL
$ 735,000,000	$ 34,793,157	3 Yrs.	4.7%
	$ 57,988,595	5 Yrs.	7.9%
	$ 81,184,033	7 Yrs.	11.0%

Proposed Reserve Framework

More Conservative

% of Accrued Liability (AL) Minimum	Target	Maximum	Dollars Minimum	Target	Max
2.00%	5.0%	8.00%	$ 14,700,000	$ 36,750,000	$ 58,800,000
3.00%	8.0%	12.00%	$ 22,050,000	$ 58,800,000	$ 88,200,000
5.00%	10.0%	15.00%	$ 36,750,000	$ 73,500,000	$ 110,250,000
5.00%	10.0%	20.00%	$ 36,750,000	$ 73,500,000	$ 147,000,000

Recommend Actions Based on CalPERS Funded Status

4. Actions Based on CalPERS Funded Status

Funding at CalPERS should be between 70-90% of the accrued pension liability with a goal of 85%. Specific actions will be triggered based on the funded status at CalPERS:

1. **CalPERS Funded Status Falls Below 70%**: Consider supplementing the minimum required contributions to CalPERS by 1-2% of the accrued liability from annual budgetary surplus or from §115 trust reserves, provided the external reserve exceeds its minimum target balance of 3% of accrued liability.
2. **CalPERS Funded Status Falls Between 70-90%**: Consider use of reserves cautiously and strategically to supplement minimum contributions PERS where only where opportunities exist to achieve significant interest savings or to stop negative amortization.
3. **CalPERS Funded Status Reaches 90% or more:** Only make minimum contributions to CalPERS unless there is a compelling reason to do so. An example might be to offset a significant known loss not reflected in the latest valuation yet.

Suggested but Flexible Reserve Schedule

5. Reserve Replenishment Strategy

Replenishment of reserves may be structured based on payroll allocations and/or augmented by annual budget surplus. Guidelines may resemble the following or other plan replenishment plan approved by the City Manager.

1. **Mild Reserve Depletion: 1-2% of payroll.** (Minimum reserve balance reached but less than target reserve balance of 8% of accrued liability).
2. **Moderate Depletion: 2-4% of payroll.** (Minimum balance is greater than 50% but less than 100% of Minimum).
3. **Significant Depletion: 4-6% of payroll** (Target minimum depleted below 50% of Target).

OPEB Policy

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OPEB Plan

1. Well-funded OPEB Plan
2. Legacy Benefits Closed to New Participants
3. Current Promise to New Employees Limited to PHEMCA Minimum Only
4. Liability Growth Should Taper Off
5. Relatively Insignificant Unfunded Liability
6. Kudos to the City Staff & Governing boards and committees! Very few OPEB Plans are as well funded!
7. Resulting OPEB Policy is relatively basic in comparison to the Pension Policy

Key Elements of OPEB Funding Policy

OPEB Prefunding Trust (Trust)

As is best-practice, the City endeavors to appropriate the ADC* each year during the annual budget process and contribute an equal amount to the OPEB Trust. Optionally, to avoid potential investment risk, the City may contribute to the Trust an amount equal to the ADC but net of the current year estimated retiree benefit payments and implied subsidy to the Trust. At its discretion, the City may reimburse itself from the Trust for all benefits paid to retirees and beneficiaries as well as any implied subsidy contributed to the Trust.

2. Pay-Go Funding

From time to time, budgetary hurdles may impede the City's ability to contribute the full ADC the Trust. However, at a minimum, the City is fully committed to fully funding its ongoing promised benefit to eligible retirees and their beneficiaries on a Pay-Go basis.

3. Surplus Proceeds

Nothing in this policy shall preclude the City from making additional discretionary contributions to the trust to increase the funded status of the long-term OPEB obligation.

*Actuarial Determined Contribution(ADC)

Recommendations

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Recommendation

- **With the Finance Committee's concurrence or as otherwise modified, recommend the Pension and OPEB Funding policies for Council Consideration**

Questions