Civic Center
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San Leandro, California

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Title: Staff Report for Resolution Authorizing Staff to Transfer $6.2M for the Purpose of Funding the City's Post-Retirement Health Care Plan Trust Administered by Public Agency Retirement Services (PARS) from the City's General Fund Unrestricted Reserves

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Staff Report for Resolution Authorizing Staff to Transfer $6.2M for the Purpose of Funding the City's Post-Retirement Health Care Plan Trust Administered by Public Agency Retirement Services (PARS) from the City's General Fund Unrestricted Reserves

SUMMARY AND RECOMMENDATION

One of the City Council's highest priority goals is to place San Leandro on a firm foundation for long-term fiscal sustainability. A key component in achieving this goal is to arrest and diminish unfunded liabilities related to employee benefits. Other factors that meet the goal of sustainability include stable and diversified revenue sources, cost containment, and exposure/risk management.

It is recommended that Council direct staff to contribute $6.2 million to a Public Agency Retirement Services (PARS) trust account to reduce the unfunded liability for retiree healthcare. This account currently holds approximately $7 million, most of which has been funded since 2012.

BACKGROUND

The City Council received reports at its annual planning session in January 2013 regarding the unfunded liabilities of four separate employee funds, including: miscellaneous employee pensions, public safety employee pensions, City retiree health care, and Alameda County Fire Department retiree health care. The total amount of unfunded liabilities in 2013 was $119 million; in 2014, that liability increased to $158 million. The 2017 liability is under review by the City's actuaries and will be reported later this year. The growing annual payment requirement impacts the City's budget and diminishes funds that are available for projects and services.

This growing liability and its potential impact to public services was highlighted in Mayor Cutter's 2015 State of the City Address as a serious issue of concern. A series of meetings subsequently took place, followed by review and discussion by the Finance Committee on June 16 and July 21, 2015.

On September 21, 2015, the City Council adopted a Prioritizing Unfunded Liability Liquidation (PULL) Plan with a 5 - year goal of allocating $5,000,000 toward reducing unfunded liabilities. In addition, Council directed staff to use the following criteria as a financial policy to assist in meeting the PULL plan goal of $5,000,000 and addressing the City's unfunded liabilities to the maximum extent possible:

1. Pay 100% of the Annual Required Contribution (ARC).
2. Direct up to 50% of all annual General Fund carryover toward the PULL Plan.
3. Direct up to 50% of all General Fund land sales toward PULL Plan.
4. Review the 20% emergency contingency fund target with financial advisors and bond counsel toward a goal of 16.6% with any excess funds allocated to meet PULL Plan goal.
5. Create a separate San Leandro trust for the PULL Plan.
6. Provide an annual report to the City Council and Measure HH Oversight Committee on PULL Plan progress.

The City Council has also responded to mitigate the City's growing pension liability by taking the following actions. First, the City has paid the full annual required contribution (ARC), as determined by the actuaries each year. Second, the City Council approved a $24 million refinancing of pension liabilities, which accrue interest cost at the rate of 7.5% per year, with General Fund-backed debt that accrues interest at approximately 4%. Third, the City Council negotiated new labor agreements that require all staff to contribute up to 9% of salary to offset the growing pension cost. These employee contributions were subsequently phased-in, beginning in 2013. Fourth, the labor agreements created an additional pension tier for new employees hired after May 2010, which increased new employees' contribution rates and reduced their defined benefit by 20 percent. Lastly, it is important to note that the City of San Leandro provides its employees with a retiree health care plan that is relatively modest in scope. This prudently structured plan has served to reduce the long-term financial liabilities associated with providing the benefit.

The State of California also has offered some relief by passing the Public Employees' Pension Reform Act (PEPRA). As a result of this legislation, employees hired after January 1, 2013 pay at least 6.75% of salary toward their pension, must retire at an older age, and will receive a reduced defined benefit. Existing "classic" CalPERS members (enrolled prior to January 1, 2013), are not subject to most of these changes imposed by PEPRA.

In May 2014, CalPERS notified the City of a "pension surcharge" to its Safety Plan due to a formula change implemented by CalPERS. The Pension surcharge was estimated to be approximately $1.15 million annually. In May 2015, City staff appealed to CalPERS and received an alternative payment option, which would reduce City Public Safety Plan pension contributions during the next three years and produce present value savings over the next 30 years. This option was discussed at the Finance Committee meeting held in June 2015. The Committee determined that the extra payments in the years after the first three years to be too high, and instead recommends extra payments in the next five years if possible as described below.

In August 2016, CalPERS acknowledged that its investment rate of return was below its target, which resulted in an increase of $20 million of the City's unfunded liability and an increase in the ARC.

In December 2016, the CalPERS Board voted to reduce its expected rate of return from 7.5% to 7.0%. This reduction will increase the City's unfunded liability and ARC.

DISCUSSION

Unfunded liabilities represent a cumulative challenge that has grown over many years. The City has made this issue a priority and is working toward awareness, approaches and strategies to diminish its scale and impact. The City Council also has taken the following steps to lower the City's unfunded liability:

- Employee labor contracts that require all employees to pay the full employee share.
- 100% payment of ARC starting in 2014.
- 100% ARC payment plus $750,000 in FY 2015, $2,500,000 in FY 2016 and $750,000 in FY 2017
- In addition, the Council directed staff to take the following steps:
- Financial language to require payment of 100% of ARC.
- Adoption of a financial policy to utilize up to 50% of fiscal year carryover for PULL Plan.
- Adoption of a financial policy to utilize up to 50% of General Fund land sales for PULL Plan.
- Lower City Council goal from 20% reserves in emergency contingency fund to 16.7%, and utilize current excess to buy down city unfunded liability debt.
- Explore creation of a separate trust for the PULL Plan.

Failure to act would have the impact of a growing unfunded liability. This growing unfunded liability will result in less funding available for projects, programs and services. A PULL Plan is both a City Council and staff concern. Just as a household can elect to pay more than its required monthly mortgage payment to reduce its long-term debt, so too is a PULL Plan designed to minimize the financial burden borne by taxpayers. A PULL Plan should also identify a stated financial target or goal.

The PARS trust account currently has a balance of approximately $7 million. The recommended action would increase that balance to approximately $13,200,000.

<u>Fiscal Impact</u>

As noted above, the PULL Program calls for 50% of all General Fund carryover funds to be committed to pay down unfunded pension and retirement liabilities. In Fiscal Year 2015-16, a combination of strong economic conditions and certain one-time factors resulted in a carry-over of approximately $12,400,000 at the close of the fiscal year. Accordingly, $6,200,000 is available from the General Fund unrestricted reserve. Currently, this reserve, if invested in the Local Agency Investment Fund (LAIF), yields 0.78%. The PARS trust account invests in a portfolio of equity and fixed income securities, which has yielded 5.5% per year during the past five years.

ATTACHMENTS

None

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