Financial Challenges Ahead

Rising Pension Costs and options for the City Council

City Finances are Likely to be Stretched in Future Years

- The City's current financial condition is strong – three straight years with surpluses
  - GF unassigned fund balance of nearly $15 million
- The Long Term General Fund Forecast is for narrowing surpluses
- Service challenges ahead will require more resources
  - Staffing the new Fire Station
  - Maintaining police services to a growing population
  - Increased need for street maintenance
  - IT security needs
  - Facility, park and right of way maintenance needs that are expected to grow
- An economic downturn will likely turn surpluses to deficits requiring use of reserves

General Fund Long Term Financial Forecast

- Surpluses (revenues less expenses) have been $4 to $5 million annually. These surpluses are expected to narrow as costs to maintain services are expected to outpace revenue growth.

- A recession coupled with growing needs is expected to create budget deficits by FY 2024.

- Depending upon the length and magnitude of a recession, the City could be forced to use much of its reserves to keep services in place.

- Pension costs are a big piece of these growing costs and warrant review and possible action

Unassigned General Fund Balance and Projected Budget Surpluses provide the Council with Options

- Pension costs are very likely to increase and outpace revenue growth over the next 12 years
- The failure to make required pension contributions would have a significant negative impact on the City and its employees
- The current level of Unassigned General Fund and expected surpluses in the next few years provides the resources to get in front of this challenge
- The Council is in a good position to address the future challenges by putting money aside to deal with these rising costs

CITY OF BEAUMONT
MISCELLANEOUS AND SAFETY PLANS

CalPERS Actuarial Issues – 6/30/18 Valuation
Preliminary Results

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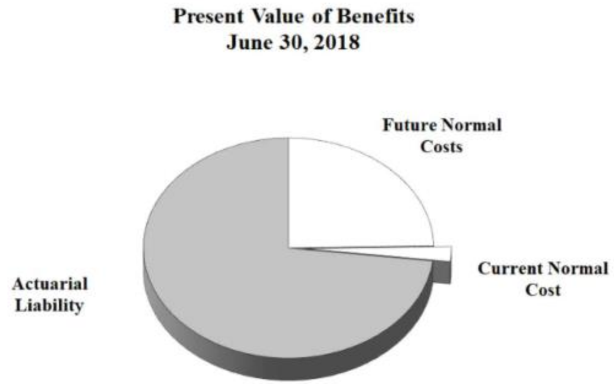
March 3, 2020

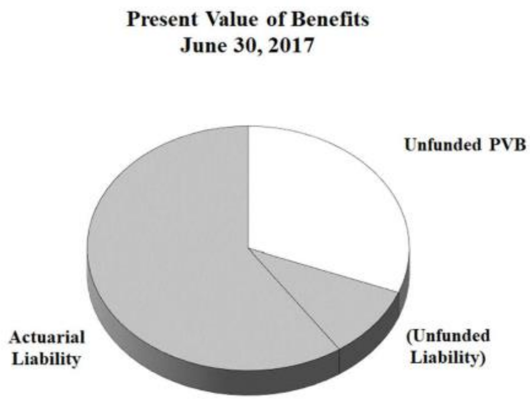
DEFINITIONS

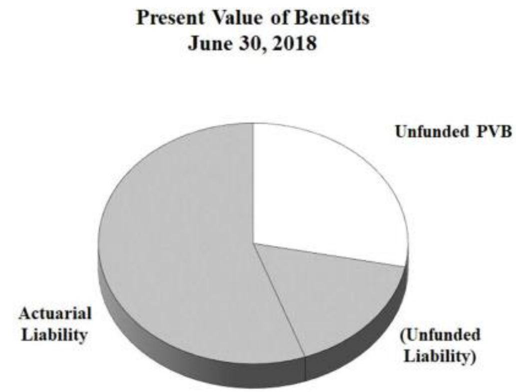


- **PVB - Present Value of all Projected Benefits:**
  - The value now of amounts due to be paid in the future
  - Discounted value (at valuation date - 6/30/18), of all future expected benefit payments based on various (actuarial) assumptions

- **Current Normal Cost (NC):**
  - Portion of PVB allocated to (or "earned" during) current year
  - Value of employee and employer current service benefit
- **Actuarial Liability (AAL):**
  - Discounted value (at valuation date) of benefits earned through valuation date [value of past service benefit]
  - Portion of PVB "earned" at measurement

DEFINITIONS



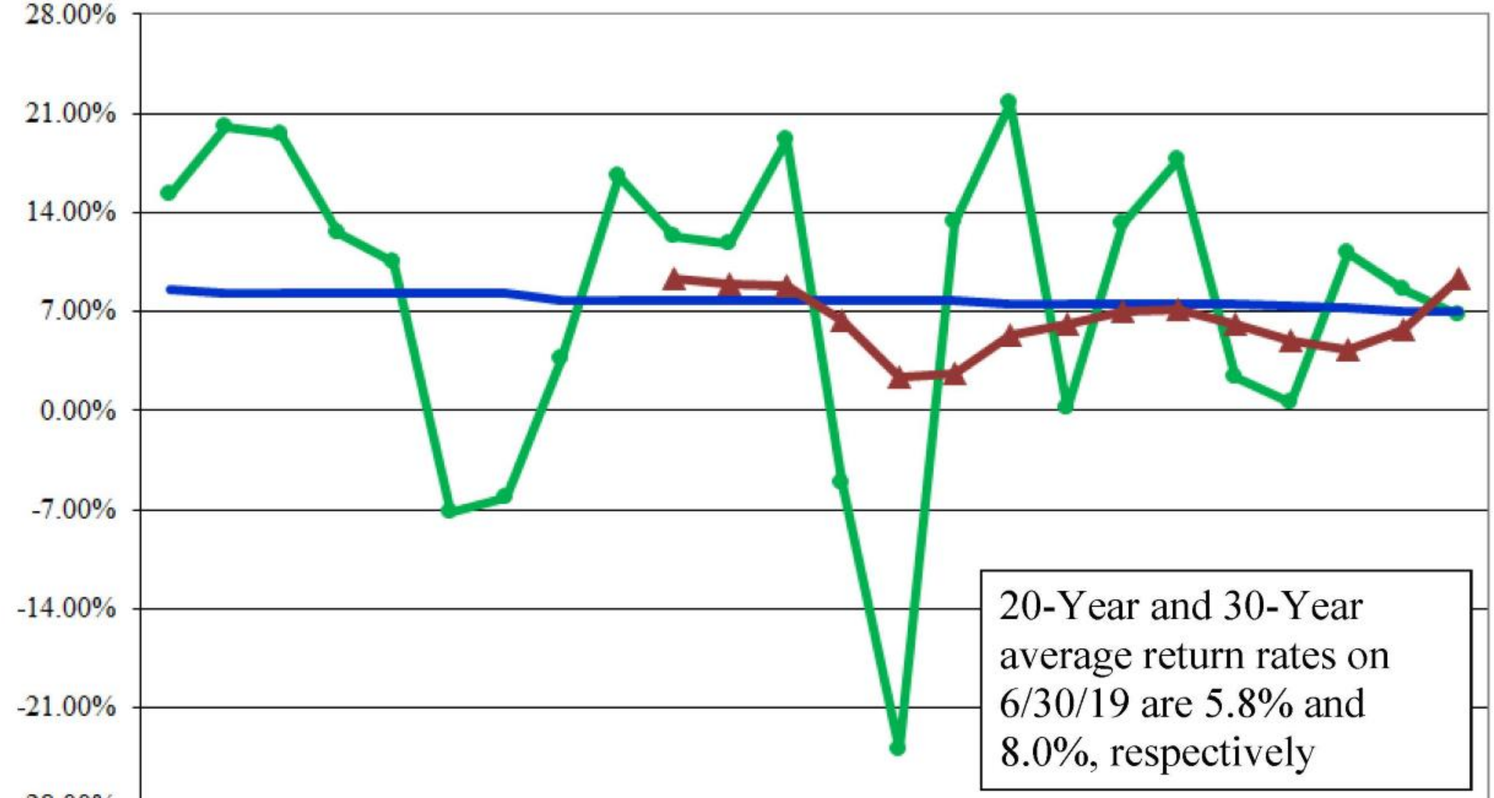


- **Target-** Have money in the bank to cover Actuarial Liability (past service)
- **Unfunded Liability (UAAL or UAL) -** Money short of target <u>at valuation date</u>
  - If all actuarial assumptions were always exactly met, then the plan assets would always equal AAL
  - Any difference is the unfunded (or overfunded) AAL
  - Every year, the actuary calculates the difference between the expected UAAL and Actual UAAL. This is a new layer or amortization base
  - Each new layer gets amortized (paid off) over a period of time as part of the contribution [rate].

HOW WE GOT HERE

- Investment Losses
- CalPERS Contribution Policy
- Enhanced Benefits
- Demographics

Annual Return on Market Value of Assets



	'96	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19
MVA	15.3%	20.1%	19.5%	12.5%	10.5%	-7.2%	-6.1%	3.7%	16.6%	12.3%	11.8%	19.1%	-5.1%	-24.0%	13.3%	21.7%	0.2%	13.2%	17.7%	2.4%	0.6%	11.2%	8.6%	6.70%
Discount Rate	8.50%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%	7.75%	7.75%	7.75%	7.75%	7.75%	7.75%	7.75%	7.75%	7.50%	7.50%	7.50%	7.50%	7.50%	7.375%	7.25%	7.00%	7.00%
10-Year Rolling Average										9.3%	9.0%	8.9%	6.4%	2.3%	2.6%	5.4%	6.1%	7.0%	7.1%	6.1%	5.0%	4.3%	5.7%	9.3%

Returns (after 2001) shown are gross returns, unreduced for administrative expenses. The discount rate is based on expected returns net of administrative expenses.

- At CalPERS, Enhanced Benefits implemented using all (future & prior) service
- Typically not negotiated with cost sharing
- City of Beaumont

	Tier 1	PEPRA
• Miscellaneous	3%@60 FAE1	2%@62 FAE3
• Safety Police	3%@50 FAE1	2.7%@57 FAE3

  - Note:
    - ☐ FAE1 is highest one year (typically final) average earnings
    - ☐ FAE3 is highest three years (typically final three) average earnings
- PEPRA tier implemented for new employees hired after 1/1/13
  - Employee pays half of total normal cost
  - 2019 Compensation limit
    - ☐ Social Security participants: $124,180
    - ☐ Non-Social Security participants: $149,016

HOW WE GOT HERE – DEMOGRAPHICS

- Around the State
  - Large retiree liability compared to actives
    - State average: 56% for Miscellaneous, 65% for Safety
  - Declining active population and increasing number of retirees
  - Higher percentage of retiree liability increases contribution volatility

- City of Beaumont percentage of liability belonging to retirees:
  - Miscellaneous 39%
  - Safety 56%

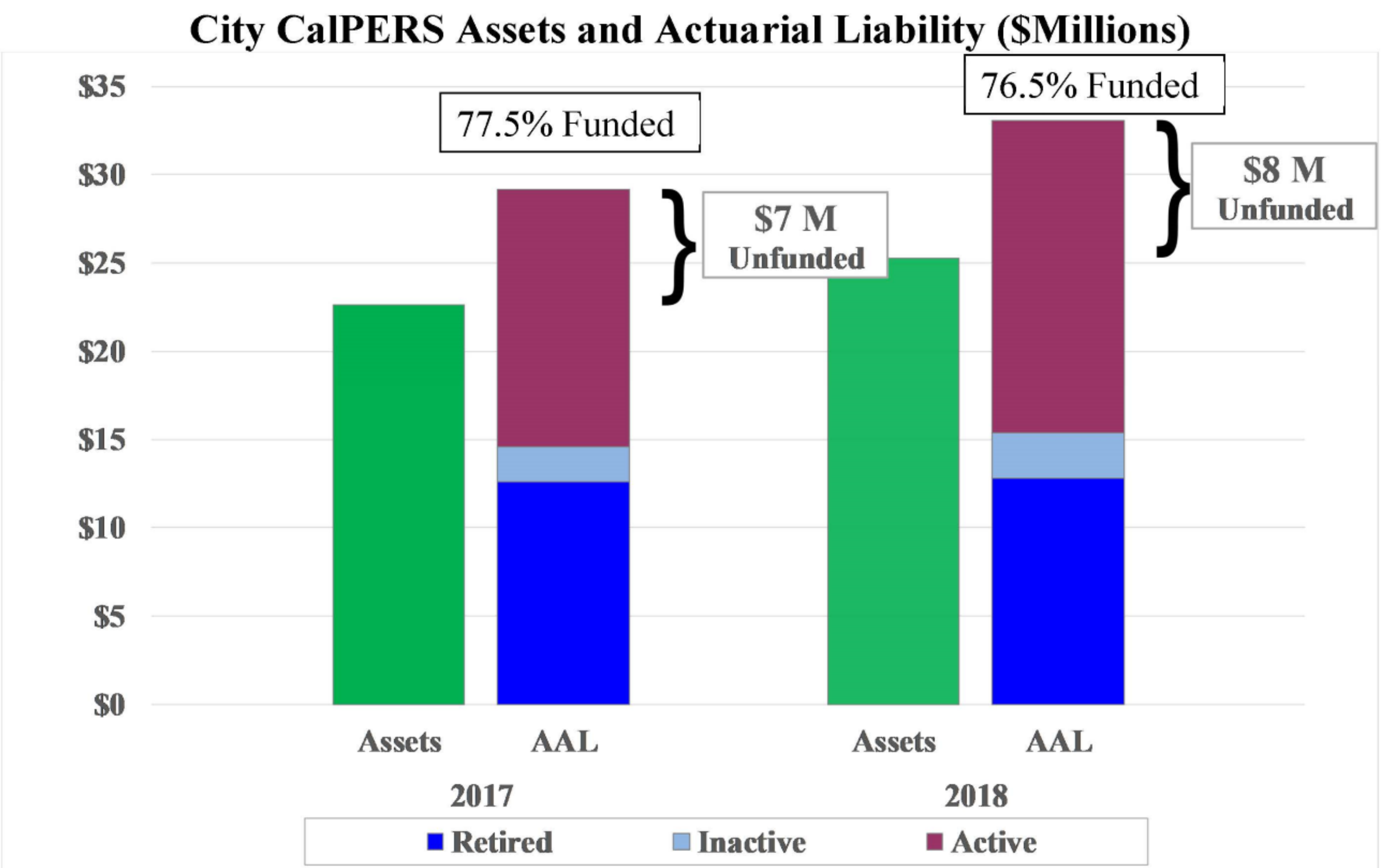
CALPERS CHANGES

- CalPERS has made many recent changes to more accurately project future costs and to pay down unfunded liabilities more quickly and effectively
  - Changes phased in over time, leading to scheduled cost increases

- The "risk mitigation strategy" is designed to reduce future asset volatility, but lower future returns

- All of these changes will increase the City's future costs over the next 20 years.

FUNDED STATUS (MILLIONS) - MISCELLANEOUS



Average CalPERS Miscellaneous plan was 72.7% at 6/30/17 and 71.8% at 6/30/18

March 3, 2020

CONTRIBUTION PROJECTION - MISCELLANEOUS

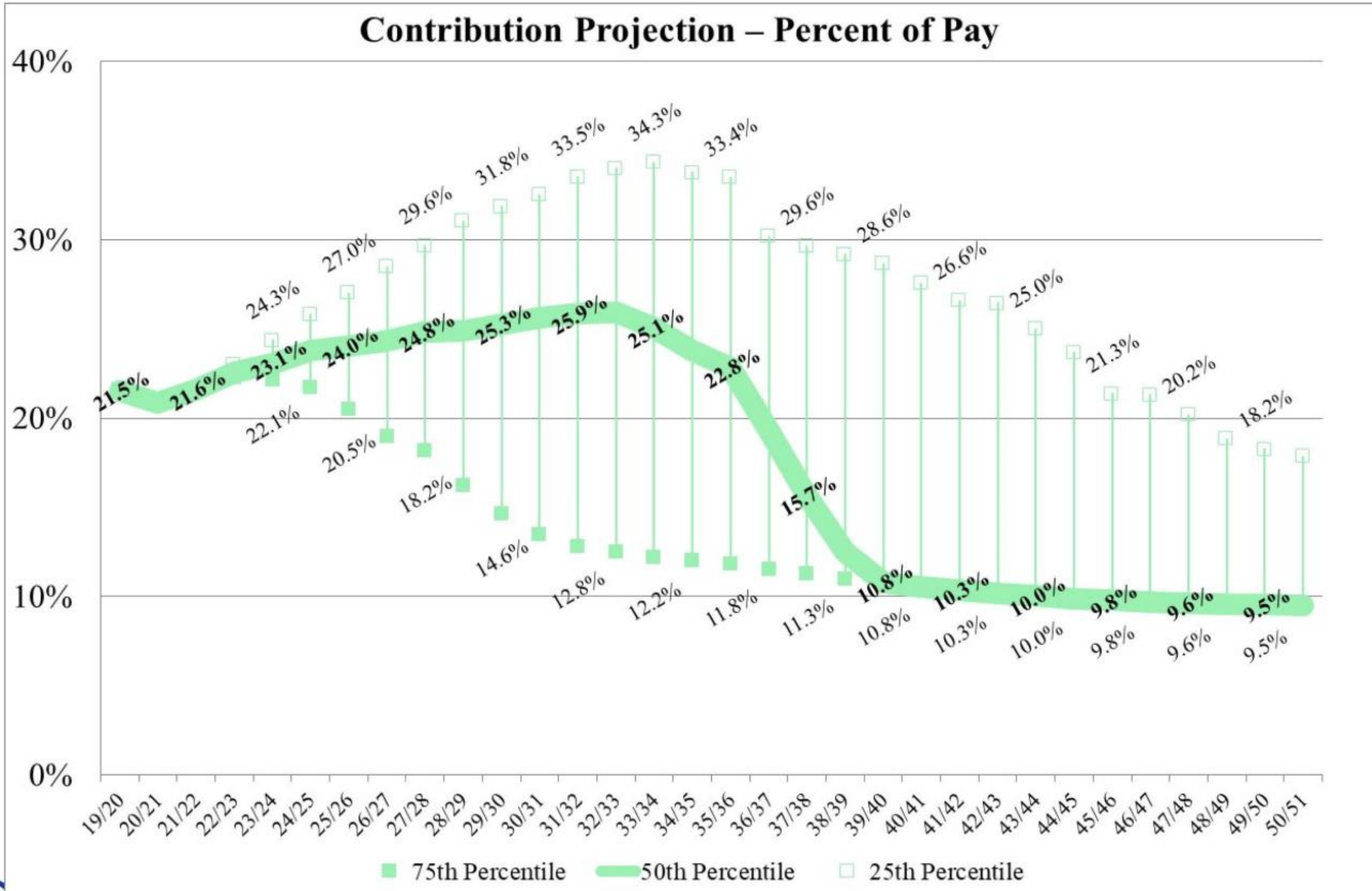
- Market Value Investment Return:
  - June 30, 2019 — 6.7%[1]
  - Future returns based on stochastic analysis using 1,000 trials

Single Year Returns at[2]	25th Percentile	50th Percentile	75th Percentile
Current Investment Mix	**0.1%**	**7.0%**	**14.8%**
Ultimate Investment Mix	**0.8%**	**6.0%**	**11.4%**

  - Assumes investment returns will, generally be 6.5% (as compared to 7.0%) over the next 9 years and higher beyond that.
- Discount Rate decreases due to Risk Mitigation policy
- No Other: Gains/Losses, Method/Assumption Changes, Benefit Improvements
- Different from CalPERS projection
- 92.5% of 2019/20 new hires are PEPRA increases to 100% over 3 years

[1] Gross return based on July 2019 CalPERS press release
[2] N^{th} percentile means N percentage of our trials result in returns lower than the indicated rates.

CONTRIBUTION PROJECTION - MISCELLANEOUS



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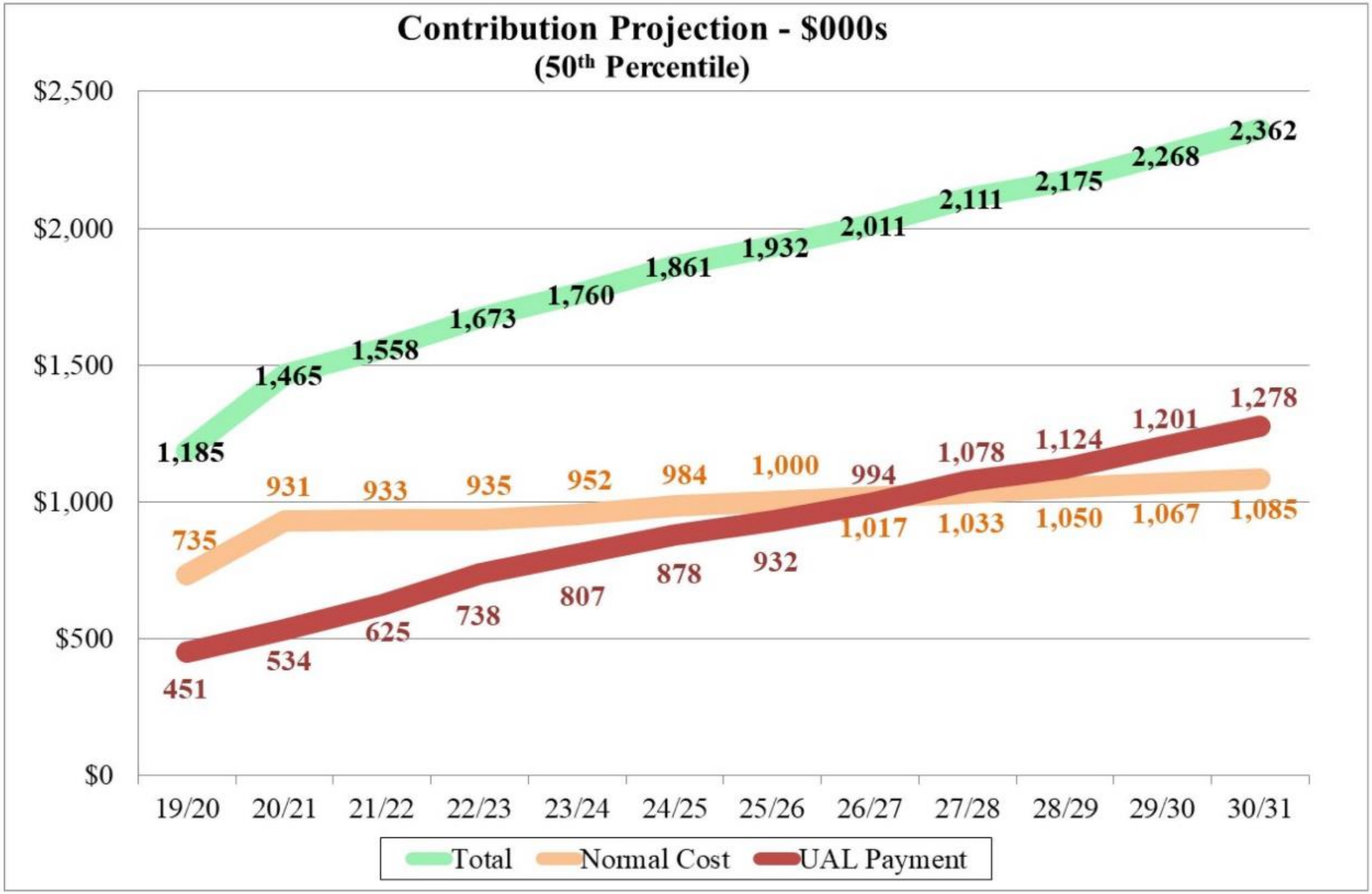
CONTRIBUTION PROJECTION - MISCELLANEOUS



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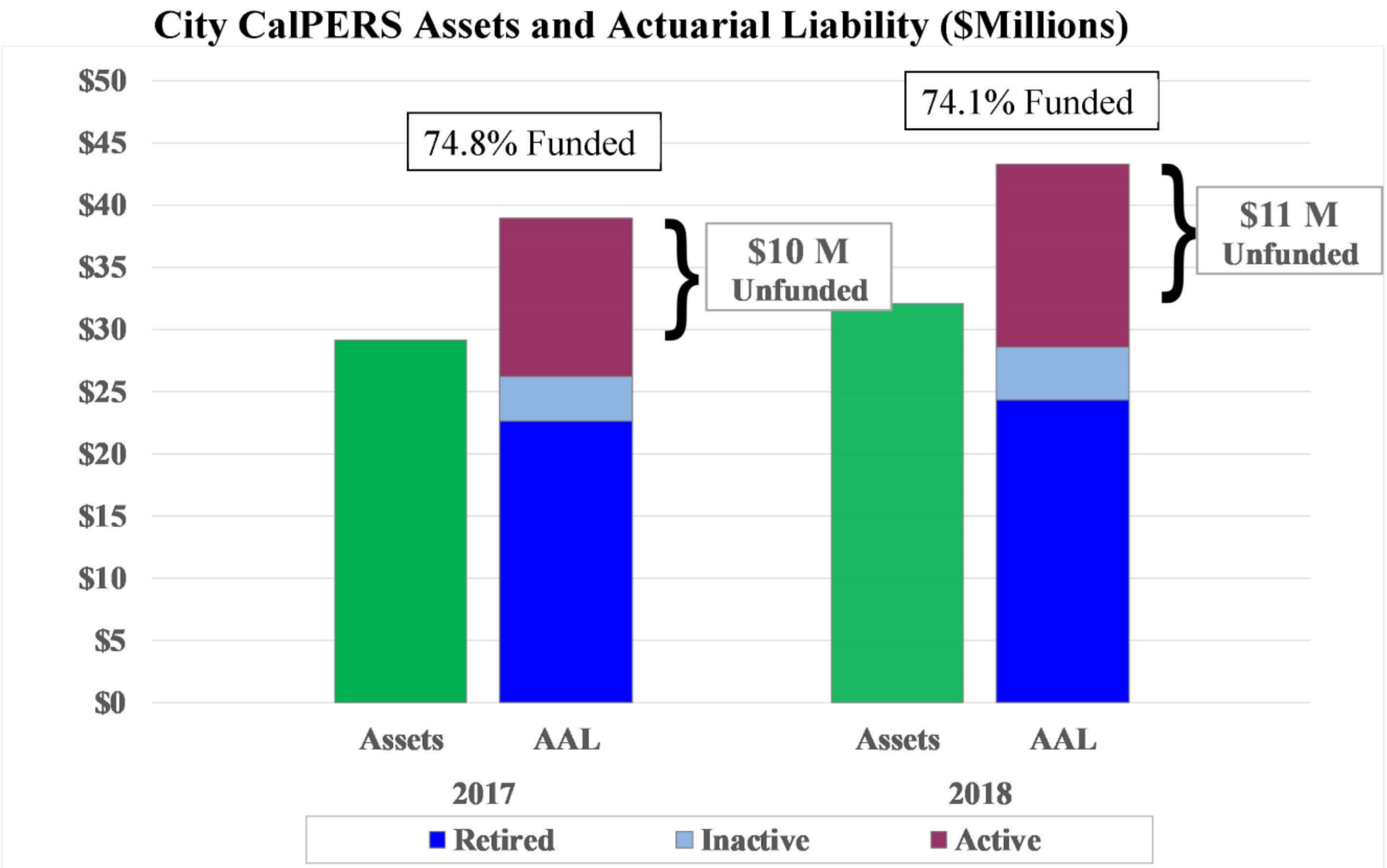
Funded Status - Safety



Average CalPERS Safety plan was 69.4% at 6/30/17 and 68.3% at 6/30/18

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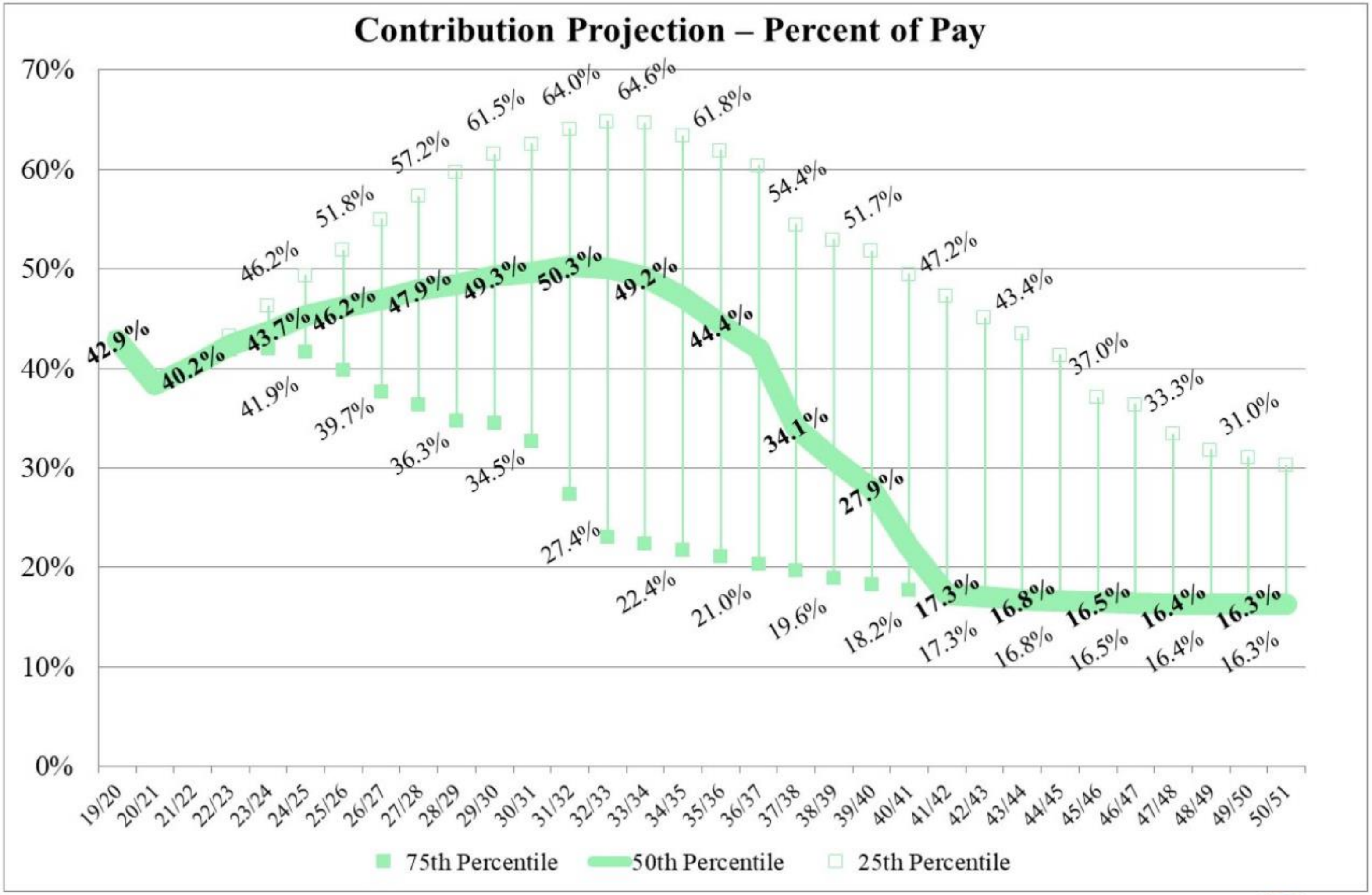
CONTRIBUTION PROJECTION - SAFETY



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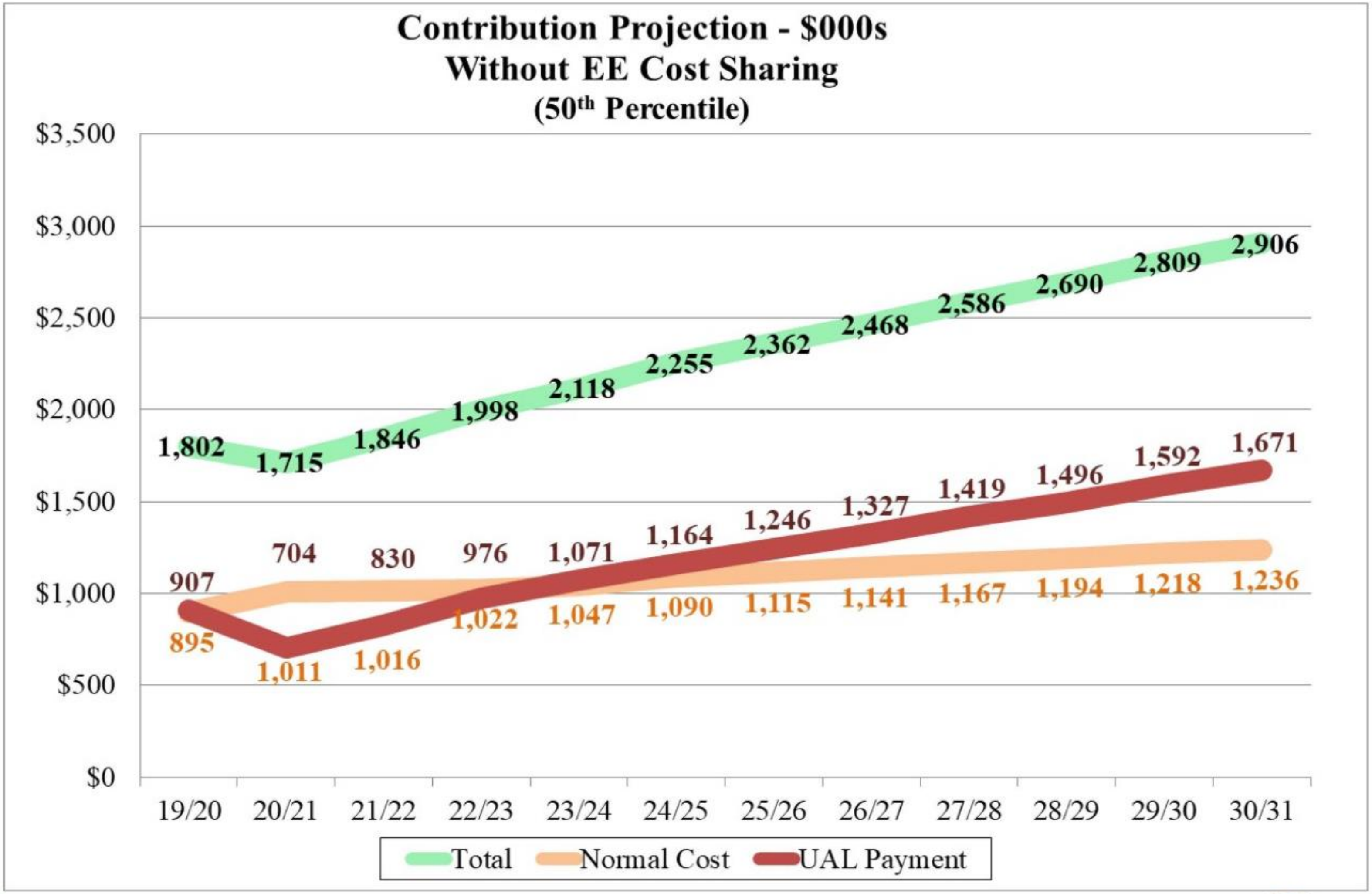
CONTRIBUTION PROJECTION - SAFETY



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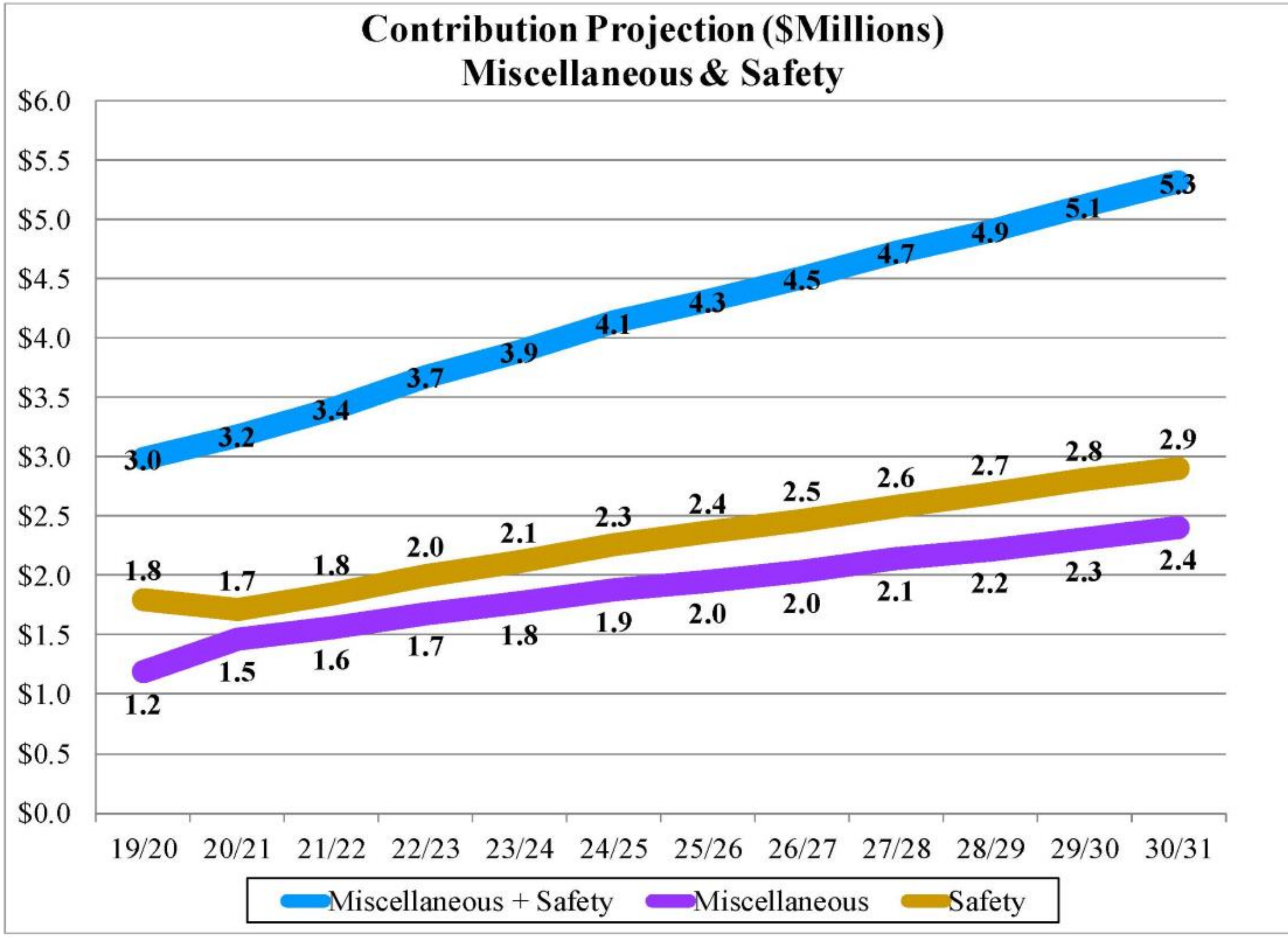
COMBINED MISCELLANEOUS AND SAFETY



LEAVING CALPERS

- Participation in CalPERS is governed by State law and CalPERS rules
- The following are considered "withdrawing" from CalPERS:
  - Exclude new hires from CalPERS & giving them a different pension
  - Stop accruing benefits for current employees
- "Withdrawal" from CalPERS:
  - Treated as plan termination
  - Liability increased for conservative investments
  - Liability increased for future demographic fluctuations
  - Liability must be funded immediately by withdrawing agency
  - Otherwise, retiree benefits are cut

CalPERS Termination Estimates on June 30, 2018 (Amounts in Millions)

Discount Rate	Ongoing Plan 7.00%	Termination Basis 2.5%	3.25%
Miscellaneous			
Actuarial Accrued Liability	$ 33	$ 60	$ 53
Assets	25	25	25
Unfunded AAL (UAAL)	8	35	28
Safety			
Actuarial Accrued Liability	$ 43	$ 81	$ 72
Assets	32	32	32
Unfunded AAL (UAAL)	11	49	40
Total			
Unfunded AAL (UAAL)	19	84	68
Funded Ratio	75.1%	40.4%	45.6%

PAYING DOWN THE UNFUNDED LIABILITY & RATE STABILIZATION

- Make payments directly to CalPERS:
  - Likely best long-term investment return
  - Must be considered an irrevocable decision
    - Extra payments cannot be used as future "credit"
    - PEPRA prevents contributions from dropping below normal cost

  - Option #1: Request shorter amortization period (Fresh Start):
    - Higher short term payments
    - Less interest and lower long term payments
    - Likely cannot revert to old amortization schedule
      - Savings offset when investment return is good (PEPRA)

- Make payments directly to CalPERS (continued):
  - Option #2: Target specific amortization bases:
    - Extra contribution's impact muted by reduced future contributions
      - CalPERS can't track the "would have been" contribution
      - Must continually make payments larger than required in order to pay down UAL faster
    - No guaranteed savings
      - Larger asset pool means larger loss (or gain) opportunity
    - Paying off shorter amortization bases: larger contribution savings over shorter period
    - Paying off longer amortization bases: smaller contribution savings over longer period

IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

- Can only be used to:
  - Reimburse City for CalPERS contributions
  - Make payments directly to CalPERS
- Investments significantly less restricted than City investment funds
  - Fiduciary rules govern Trust investments
  - Usually, designed for long term returns
- Assets don't count for GASB accounting
  - Are considered Employer assets
- Over 100 trusts established, mostly since 2015
  - Trust providers: PARS, PFM, Keenan
  - California Employers' Pension Prefunding Trust (CEPPT) effective July 2019
    - Strategy 1: Expected Return 5% (48 stocks / 52% bonds)
    - Strategy 2: Expected Return 4% (22% stocks / 78% bonds)

IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

- More flexibility than paying CalPERS directly
  - City decides if and when and how much money to put into Trust
  - City decides if and when and how much to withdraw to pay CalPERS or reimburse Agency
- Funding strategies typically focus on
  - Reducing the unfunded liability
    - Fund enough to make total CalPERS UAL = 0
    - Make PEPRA required payments from Trust when overfunded
  - Stabilizing contribution rates
    - Mitigate expected contribution rates to better manage budget
  - Combination
    - Use funds for rate stabilization/budget predictability
    - Target increasing fund balance to pay off UAL sooner

Comparison of Options

- **Supplemental Trust**
  - Flexible
  - Likely lower long-term return
  - Investment strategy choice
  - Does not reduce net pension liability for GASB reporting
  - More visible
- **CalPERS**
  - Locked In
  - Likely higher long-term return
  - No investment choice
  - Reduces net pension liability for GASB reporting
  - More restricted

EXAMPLE OF ADDITIONAL PAYMENTS

Direct Payment to CalPERS

- Following example illustrates additional contribution of:
  - $2 million to CalPERS in September 2020
  - $500,000 for 5 years, beginning in FY 2020/21
  - Contributions allocated to 2 plans based on UAL, 41% and 59% allocated to Miscellaneous and Safety plan respectively

Direct Payment to CalPERS (continued)

- Estimated Savings

	Miscellaneous	Safety
Long Base	**$819,000 @ Sept 2020 + 205,000/5yrs**	**$1,181,000 @ Sept 2020 + 295,000/5yrs**
$ Savings Present Value Savings @ 3%	$2,062,000 858,000	$3,025,000 1,253,000
No Contribution Reduction	**$819,000 @ Sept 2020 + 205,000/5yrs**	**$1,181,000 @ Sept 2020 + 295,000/5yrs**
$ Savings Present Value Savings @ 3%	$3,009,000 1,245,000	$4,531,000 1,853,000
Fresh Start – 15 Years	**N/A**	**N/A**
$ Savings Present Value Savings @ 3%	$1,607,000 628,000	$2,614,000 1,020,000

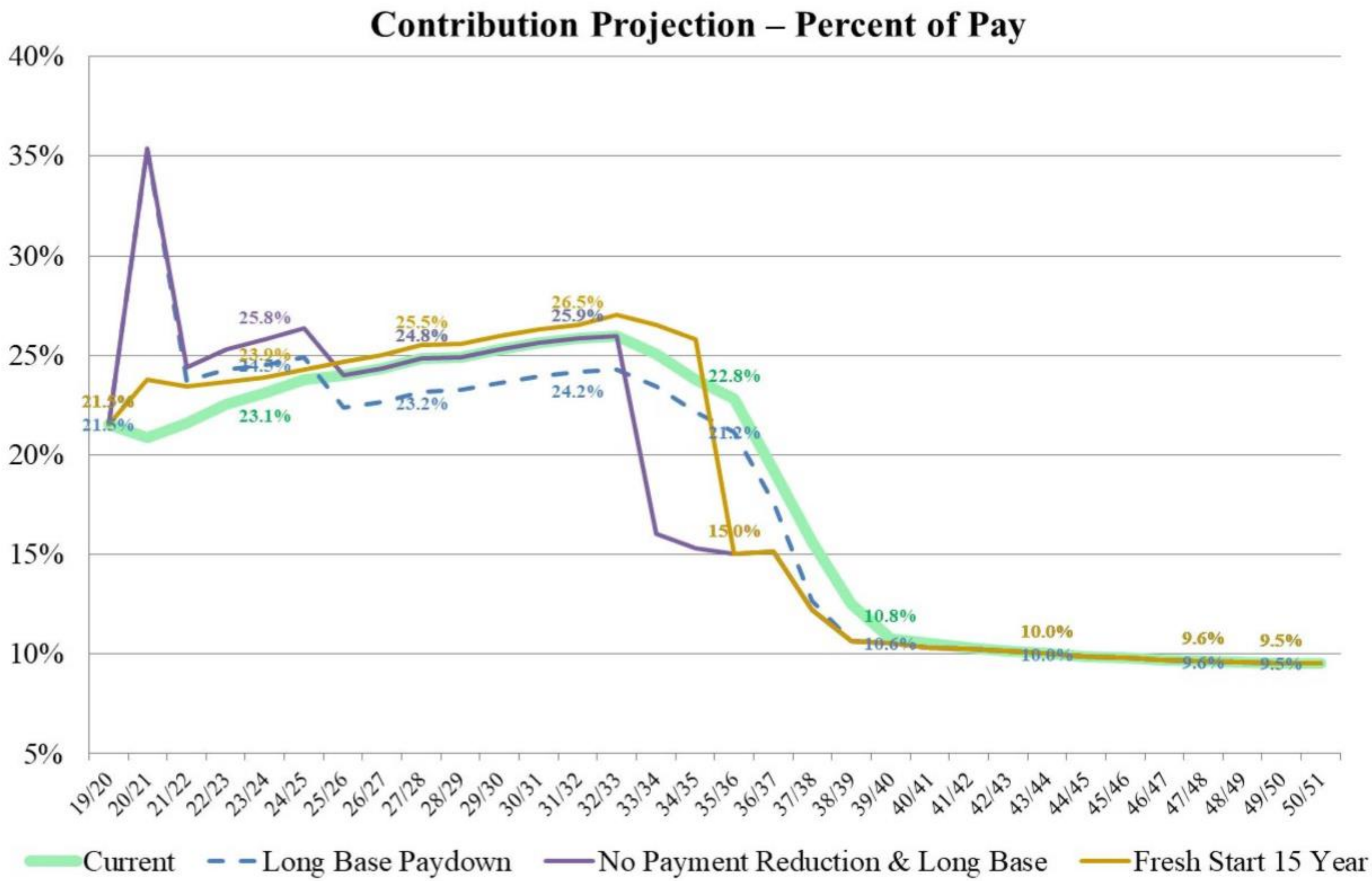
EXAMPLE OF ADDITIONAL PAYMENTS

Payment to 115 Trust

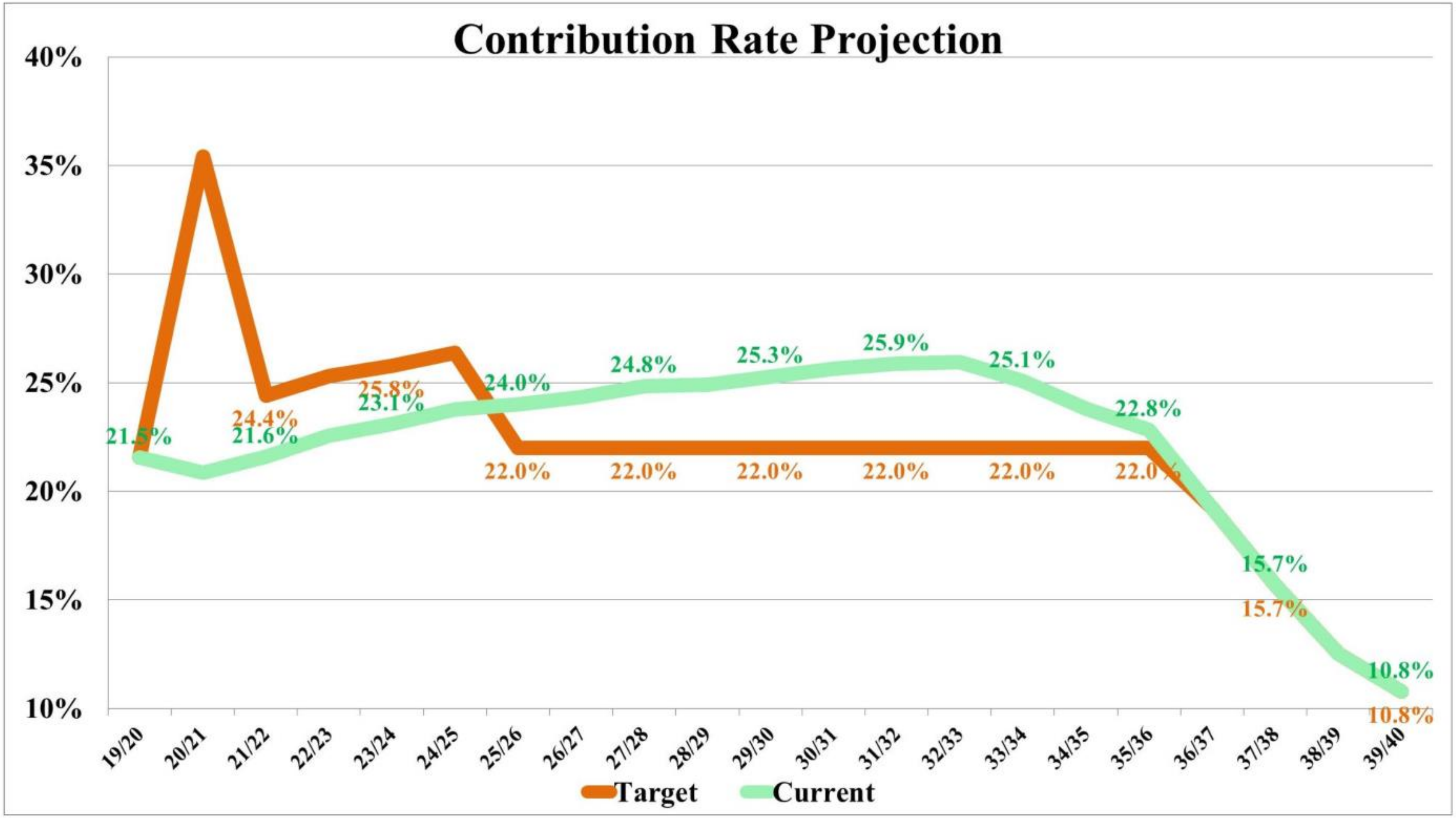
	Miscellaneous	Safety
Trust Contributions	**$819,000 @ Sept 2020 + 205,000/5yrs**	**$1,181,000 @ Sept 2020 + 295,000/5yrs**
Trust Earnings	**5%**	**5%**
Trust Target		
- Target Rate	22.0%	41.4%
- 1st Year withdrawn	2025/26	2026/27
- Last Year withdrawn	2035/36	2036/37
$ Savings (000's)	$985,000	$1,528,000
Present Value Savings @ 3%	324,000	501,000

EXAMPLE OF ADDITIONAL PAYMENTS

Direct Payment to CalPERS -Miscellaneous

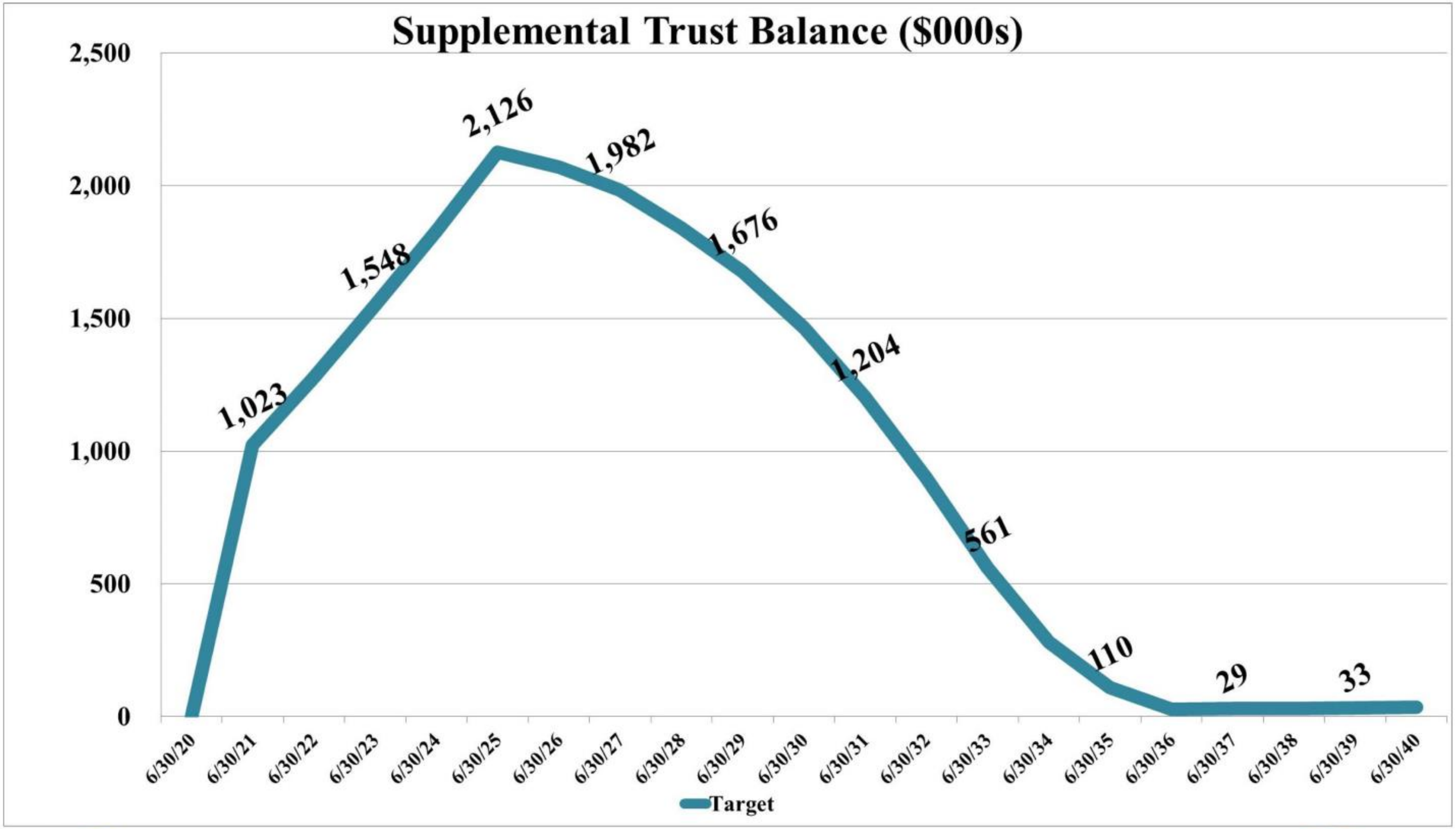


Payment to 115 Trust - Miscellaneous

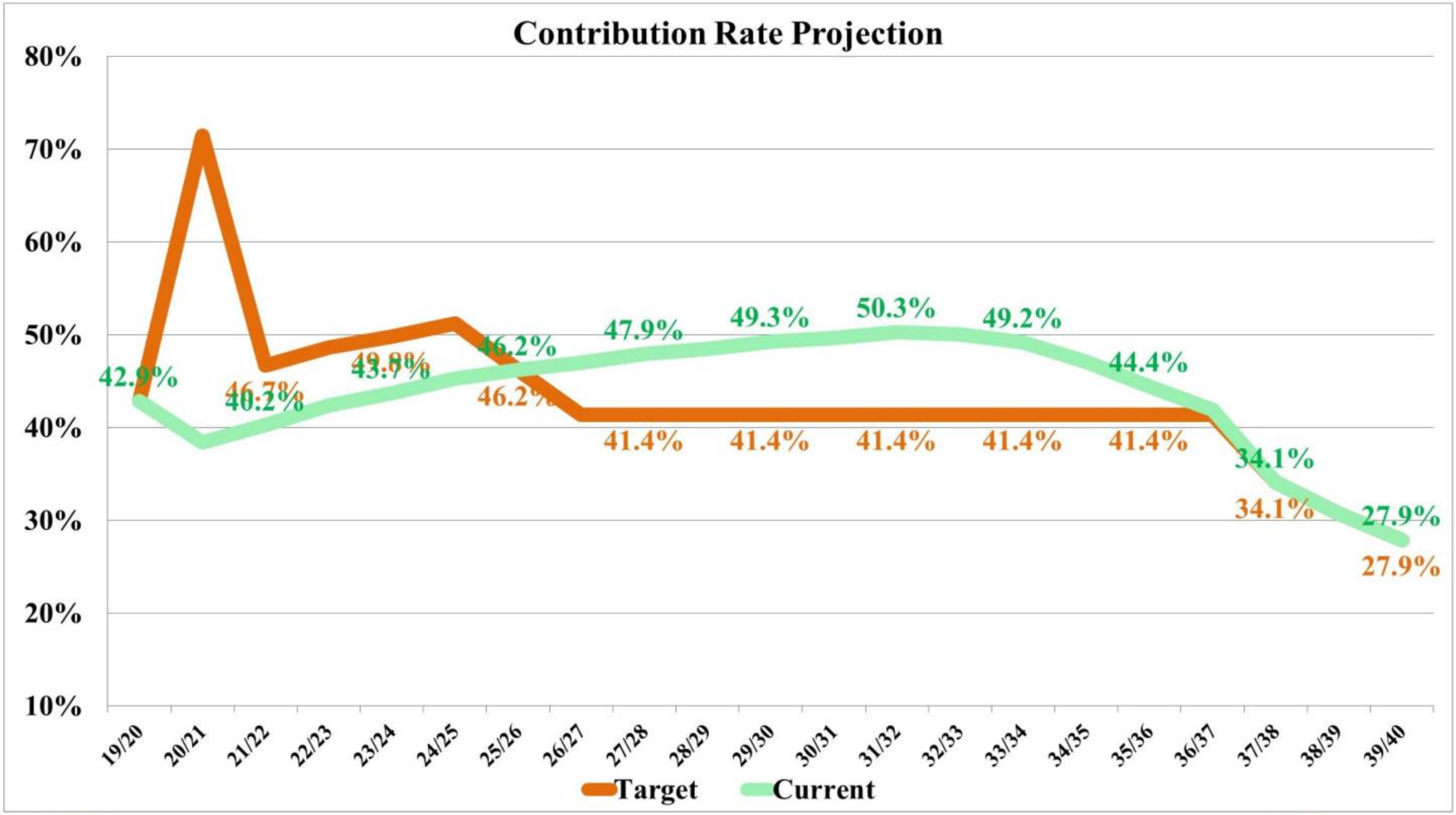


EXAMPLE OF ADDITIONAL PAYMENTS

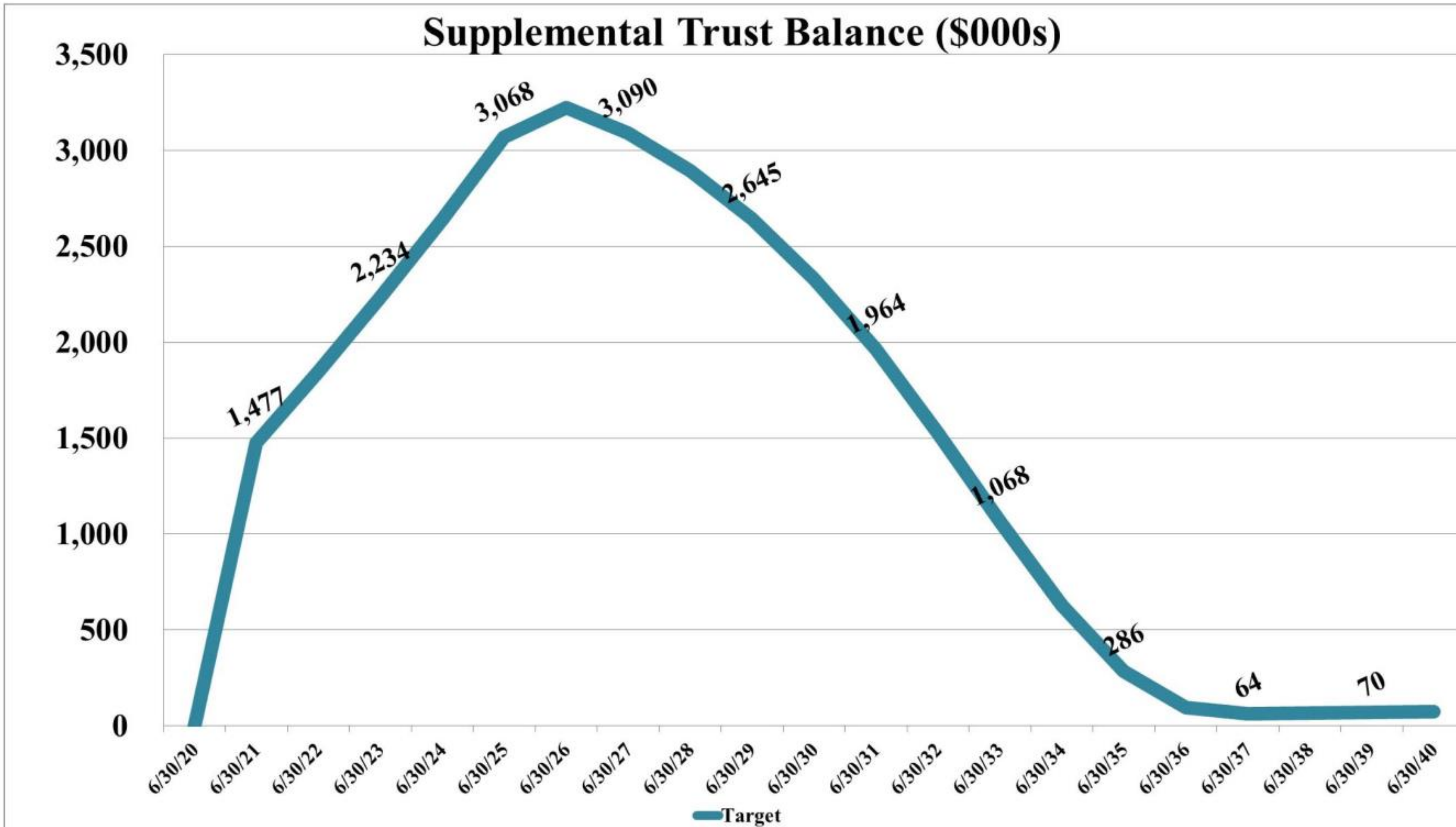
Payment to 115 Trust - Miscellaneous



Payment to 115 Trust - Safety



Payment to 115 Trust - Safety



Questions?

NEXT STEPS

- Discuss the pension liability and its impacts on the budget in future years.
- Discuss options to address the liability and projected escalation in pension costs.
- If there is interest to further consider options to address pension costs, provide guidance to staff.