BEAUMONT
CALIFORNIA

Staff Report

TO: Mayor, and City Council Members

FROM: Jeff Mohlenkamp, Finance Director

DATE March 3, 2020

SUBJECT: Pension Liability Presentation and Discussion

Background and Analysis:

As of June 30, 2019, the City had an unrestricted General Fund balance of approximately $15 million or approximately 42% of expenditures. The City has one-time funds available to apply toward the unfunded pension liability.

On December 17, 2019, the City Council reviewed the Long-Term Financial Forecast (“LTFF”) prepared by staff. The LTFF, which is included as Attachment A, projects that expenditures and needs of the City will likely exceed available resources in the event of a moderate level recession. Even without a recession, the forecast demonstrates a narrowing surplus and likely deficits in future years due to the needs of the City outpacing revenue growth.

Due to these anticipated challenges, staff contracted with Bartel Associates, LLC to complete a full review of our pension plan and the associated costs, included as Attachment B.

<u>Pension Costs Overview</u>

One of the costs that is projected to outpace revenue growth is pension costs. Pension costs for the City are divided into two categories (1) normal costs and (2) unfunded liability as follows:

Normal Costs - This is the cost associated with existing employees and is computed as a percentage of wages.

Liability Costs - This is the cost associated with past and current employees where the estimated cost of future retirement benefits exceeds the amount of funds available in the system to pay those benefits.

Each year the City makes payments to CalPERS for each of the normal costs and the liability costs.

There are two major inputs into the pension system that is managed by CalPERS. This includes (1) the pension contributions made by the City/Employees into the system (for both normal costs and the unfunded liability), and (2) the investment returns those funds generate.

Pension costs are projected to grow at approximately 7% annually over the next 12 years. The reason pension costs are expected to escalate at this pace is that the City currently has an unfunded liability of approximately $16 million in its pensions.

An unfunded liability is created when the contributions and/or investment returns are insufficient to pay for the projected cost to employees when they retire. The primary driver of the current liability is the lack of sufficient investment returns. Currently, CalPERS has estimated that the investment returns for the system will be 7%. Should these returns be realized, pension costs are projected to increase each year through FY 2032-33.

<u>Long Term Pension Costs Outlook is Better</u>

In 2013, several adjustments were made to the CalPERS pension system through the California Employees Pension Reform Act ("PEPRA"). PEPRA was a significant modification to pensions for public employees and it served to significantly reduce future liabilities of the system. All employees that are new to the CalPERS system after the implementation of PEPRA receive reduced pension benefits. Some notable changes in PEPRA include:

- The age to collect full retirement is increased:
  - Miscellaneous – increased from 60 to 62 years of age, and
  - Safety – increased from 50 to 57 years of age.

- The retirement credit for employees is reduced:
  - Miscellaneous – credit per year of service reduced from 3.0% to 2.0%, and
  - Safety – credit per year of service reduced from 3.0% to 2.7%.

- A cap on the amount of pensions is included – there was previously a very high cap on pensionable wages at $285,000; the current cap of wages that contribute to pensions is slightly under $150,000 annually.

Each of these elements serves to reduce the cost to the City for pensions. Since PEPRA went into effect, there has been a minimal liability accrued from the employees under this plan. Essentially, the PEPRA plan appears to be sustainable over the long-term horizon. After FY 2033, the pension liability is expected to be paid off and almost all employees will be in the PEPRA plan. This will leave only normal costs for existing employees as the costs of previous employees and retirees should be fully funded.

This will result in a significant drop in pension costs on a going forward basis.

Options to Address the Pension Liability and Increasing Pension Costs

The City has little choice other than to make its pension obligation payments to CalPERS. The failure to make these payments would have significant consequences for both employees and the City. As a result, it is prudent to consider these costs as a requirement. Since these costs are expected to increase significantly over the next 12 years, the Council should consider options to provide for continuity of these payments even in times when budget challenges are significant.

There are a few options for Council consideration. Management has conferred with our consultant, Bartel Associates, LLC and has determined that two of these options have the most merit as follows:

Place Funds into a Pension Trust (115 trust)

The pension trust option allows for the City to create an irrevocable trust and to place funds into the trust. The funds could then be used at a future date to reduce the burden of pension costs as they escalate or in the event of an economic downturn. This option provides for the most future flexibility and allows the Council to set up the trust as a reserve to either systematically or situationally address future financial challenges associated with these projected increases in pension costs.

Pay Down the Unfunded Liability by paying Cal PERS Directly

The City could elect to pay a portion of its liability to directly reduce the costs associated with this portion of the annual costs. Once a payment is made to CalPERS, our accounts will be credited. The City could not get these funds back in the event of a financial downturn, so it reduces our future flexibility.

A comparison of these two options is below.

Pension Trust	CalPERS Unfunded Liability Payment
- Flexible - Likely lower long-term return - Investment strategy choice - Does not reduce pension liability for financial reporting - More visible	- Locked In (no return of funds) - Likely higher investment return - No investment choices - Reduces pension liability for financial reporting - More restricted

Fiscal Impact:

The cost of the pension analysis completed by Bartel Associates, LLC is approximately $15,000. This includes meetings with management and this presentation to the City Council.

Recommended Action:

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.

Attachments:

A. Long Term Financial Forecast for the General Fund – FY 2020 through FY 2029
B. Pension Cost Analysis dated January 16, 2020 – Bartel Associates, LLC