CITY OF MILPITAS
AGENDA REPORT
(AR)

Item Title:	**Review the Pension Actuarial Report and Direct Staff to Return to the Council with the necessary Documents for the Establishment of a 115 Pension Trust**
Category:	Leadership and Support Services
Meeting Date:	1/21/2020
Staff Contact:	Walter C. Rossmann, 408-586-3111
Recommendation:	Review the Pension Actuarial Report and direct staff to return to City Council with the necessary documents for the establishment of a 115 Pension Trust.

Background:
The City has two pension plans with CalPERS; the Safety Plan for its sworn employees and the Miscellaneous Plan for its non-sworn employees. Since the deep recession about a decade ago, the cost for the City's pension benefit has risen drastically. In FY 2009-10, the pension cost was approximately $7 million for both plans. By 2018-19 the cost increased to approximately $17 million, an increase of 143% over ten years. The primary reasons for the cost increase are investment losses, demographic changes, and CalPERS policy changes (contribution policy changes; amortization policy changes; and discount rate changes).

The major demographic changes are an increase in the retiree population and a longer life expectancy. In FY 2008-09, the City had 276 active or employed Miscellaneous or non-sworn employees versus 228 retired employees. In 2018, the City had 202 active Miscellaneous employees versus 383 retired employees. Within ten years, the retiree population increased by 68%. During the last five years, CalPERS changed various policies to improve funding to the pension system thereby increasing the annual cost to CalPERS agencies such as the City of Milpitas. Changes to the contribution policy included closed versus rolling amortization periods, discontinuing asset smoothing, and introducing five-year ramp-ups to fund changes in the Unfunded Actuarial Liability (UAL). Further, CalPERS reduced its discount rate, the interest rate which its investment portfolio is targeted to earn annually, from 7.75% in FY 2012-13 to 7.00% in FY 2020-21.

Due to the impact of the deep recession, enhanced benefits granted in the 2000s, and CalPERS policy changes, the City's unfunded actuarial liability (UAL) for the Miscellaneous and Sworn Plans combined as of June 30, 2018 stands at $207 million with a combined funded ratio of 65.2%. In FY 2006-07, both plans were more than 100% funded.

Over the last decade this Council as well as previous Councils have taken several actions to mitigate increased pension costs:

1. Planning for funding in the annual budget to ensure that the City pay its annual pension contribution as determined by CalPERS;
2. Working with its bargaining units, the City approved a lower and less expensive pension benefit (Tier 2) for classic employees (effective October 2011 for Miscellaneous employees and April 2012 for Sworn employees); and
3. Setting aside during the last two to three years approximately $34 million of one-time General Fund dollars in the PERS Rate Stabilization Reserve to address the pension plans' UAL.

Analysis:
At the Council meeting, the City's actuary from Bartel and Associates will present the attached pension actuarial report as summarized below and staff will present options to address the City's UAL and investment and utilization of the PERS Rate Stabilization Reserve in the amount of $34 million.

Pension Actuarial Report

Annually, CalPERS issues pension valuations reports for Miscellaneous and Sworn employees' plans providing anticipated pension costs for the current plus five years. To fully understand the long-term impact of pension costs over 30 years staff contracted with Bartel & Associates. Bartel Associates, LLC specializes in providing states, counties, cities, and other public agencies with actuarial consulting services. Its 300+ clients range from special districts, to small and large cities, to state governments.

The attached report provides detailed demographic and historical information as well as pension cost projections for Miscellaneous and Sworn Plans, discusses recent CalPERS policy changes, and provides options for paying down the UAL. Bartel & Associates' representatives will attend the Council meeting to present the report and address Council questions. Additionally, the report will be presented to employees.

City's Pension Unfunded Actuarial Liability

During the last two to three years, the Council set aside $34 million in a PERS Rate Stabilization Reserve to address the City's Pension UAL in the amount of $207 million. Per the City's Reserve Policies, as approved by the City Council, the funds for this reserve shall remain in the General Fund or be transferred into a Section 115 Trust. Based on Council direction, staff reviewed various options to utilize and/or invest the PERS Rate Stabilization Reserve funds as summarized in the table below.

Considerations	City's Cash Pool	Section 115 Trust	CalPERS
Utilization of Reserve Funds	Council may re-designate the use of the reserve funds for any purpose	Funds can only be used for pension related expenditures	Funds can only be used to pay off the Unfunded Actuarial Liability
Flexibility to address potential future budget shortfalls	High	Medium (funds can only be used for pension related expenditures)	Not applicable (funds are transferred to CalPERS)
Reserve Funds estimated investment earnings	approximately 2%	4% to 5% depending on the investment strategy	CalPERS assumed interest rate of 7%
Investment Strategy Choice	Limited	Yes	None (CalPERS administers the funds)
Investment Loss Risk	Very Low	Low to Medium depending on investment strategy	High

To preserve flexibility for utilization of the funds allocated to the PERS Rate Stabilization Reserve while improving the potential to improve interest earnings, staff recommends that the Council direct staff to return to the Council with the necessary documents to establish a Section 115 Trust. Since there are several firms who offer such a trust and related investment services, staff intends to issue a Request for Proposal to recommend the most qualified firm to the Council.

Policy Alternatives:

Alternative 1: Do not direct staff to return to the Council with the necessary documents to establish a Section 115 Trust and keep funds in the PERS Rate Stabilization Reserve.

Pros: Staff time will be dedicated to other high priority projects.
Cons: The City will keep investing PERS Rate Stabilization Reserve funds in the City's investment pool earning a rate around 2%.
Reason not recommended: By transferring PERS Rate Stabilization Reserve funds into a Section 115 Trust, the funds can only be used for pension expenses and be invested in securities generating a long-term higher yield than the City's investment pool. Further, it would preserve spending flexibility for the City during recessionary periods.

Alternative 2: Transfer the PERS Rate Stabilization Reserve funds to CalPERS to pay down the UAL.

Pros: Through an upfront payment of $30 million, the annual payment to CalPERS for pension obligations is estimated to be reduced by several millions.
Cons: The City will not have access to the funds transferred to CalPERS, anymore.
Reason not recommended: By transferring PERS Rate Stabilization Reserve funds to CalPERS, the City will substantially reduce its ability to address budget shortfalls during recessionary times and expose the transferred funds to higher investment loss risk.

Fiscal Impact:

There is no fiscal impact from issuing a Request for Proposal to seek the most qualified firm for the establishment of a Section 115 Trust other than staff time. However, the City will have to pay a fee for the management of the City's assets by an investment firm. Such costs will be determined through the competitive RFP process.

Recommendation:

Review the Pension Actuarial Report; and direct staff to return to City Council with the necessary documents for the establishment of a 115 Pension Trust.

Attachment:

Bartel and Associates Actuarial Report