RESOLUTION NO. 2021-097

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF REEDLEY, ESTABLISHING A PENSION & OTHER POST-EMPLOYMENT BENEFITS FUNDING POLICY

WHEREAS, the City provides defined benefit retirement benefits through the California Public Employees' Retirement System (CalPERS), a multiple-employer public employee defined benefit pension plan, to provide retirement and disability benefits, annual cost of living adjustments and death benefits to plan members and their beneficiaries; and

WHEREAS, with the adoption of Resolution No. 2013-083 and amended from time to time by subsequent resolution, the City chose to conditionally provide *Other-Post Employment Benefits* (OPEB) to eligible employees, retirees and their dependents, also known as the retiree medical plan; and

WHEREAS, the City has historically made 100% of actuarially determined contributions for pension liability and pay-as-you-go premiums for OPEB; and

WHEREAS, in February 2015, the City Council elected to establish a Section 115 trust with the California Employers' Retiree Benefit Trust (CERBT) for the purpose of making employer contributions to be invested and grow tax-free, to prefund health and other post-employment benefit costs for eligible retirees and their beneficiaries; and

WHEREAS, the City began contributing to the CERBT trust 15%, eventually moving to 25%, of estimated annual OPEB pay-as-you-go premiums, resulting in a life to date rate of return on contributions of 12.31% as of June 30, 2021; and

WHEREAS, the City included its first ever pension prefunding payment, known as an Additional Discretionary Payment (ADP) to CalPERS in the FY 2021-22 Adopted Budget, using 25% of the required contribution towards the City's Unfunded Actuarial Liability (UAL) as the allocation methodology; and

WHEREAS, the mutual financial objective of a defined benefit pension plan and a retiree medical plan is to fund the long-term cost of benefits provided to the plan participants. In order to assure that the plans are financially sustainable, the plans should accumulate adequate resources in a systematic and disciplined manner over the active service life of benefitting employees. This funding policy outlines the method the City will utilize to determine and fund its actuarially determined contributions to fund the long-term cost of benefits to the plan participants and annuitants.

NOW THEREFORE, BE IT RESOLVED by the City Council of the City of Reedley to approve the following components of the Pension & Other Post-Employment Benefits Funding Policy, which shall remain in effect until modified, terminated, or rescinded by subsequent resolution of the City Council:

<u>Section 1. CalPERS Pension Plans</u>

a) The City shall make 100% of its required actuarially determined contributions to CalPERS for all pension plans, defined as the Normal Cost and minimum Unfunded Actuarial Liability (UAL) payment. CalPERS actuaries determine the City's required contributions to CalPERS based on annual actuarial valuations. The only exception to making 100% of the required contributions would be a Council authorized declaration of fiscal emergency due to severe economic and/or budgetary conditions.

b) Employer paid pension contributions shall be allocated to available and eligible City funds based on where full-time positions are budgeted.

c) The City shall utilize the Annual Prepayment Option for the UAL portion of the employer contribution for all pension plans to reduce interest expense. The only exception is if the City does not have sufficient cash on hand during the month of July to make the payment and cover other operational expenses, as determined by the Assistant City Manager/Director of Finance.

d) Annually, the City shall budget and set aside sufficient funds to make an Additional Discretionary Payment (ADP) to CalPERS in an amount that is no less than 25% of the current fiscal year required minimum UAL payment for all plans using the Annual Prepayment Option amount for each plan. For example, if the total annual minimum UAL payment for all plans is $1,400,000, the City shall budget an additional $350,000 (25% of $1.4M) for the ADP.

e) Generally, City funds shall contribute to the ADP using the same methodology as regular employer pension contributions, proportional to budgetary position allocations.

f) The City's strategy for the ADPs is to maximize long term savings by applying the payments to the longest remaining amortization periods of each plan, moving to the next longest period if the first is satisfied. This strategy may be modified by staff on a case-by-case basis to make a payment toward the base with the shortest remaining period, which typically leads to the greatest reduction in short-term UAL payments to provide near-term budgetary relief.

Section 2. OPEB Retiree Health Plan

a) The City shall make 100% of its required contributions to pay-as-you-go premiums for the OPEB Retiree Health Plan as established by separate enabling resolution.

b) Contributions to pay-as-you-go premiums for current eligible retirees and dependents shall be paid from available and eligible City funds, and shall be allocated 100% to the fund that the eligible retiree's salary was last primarily allocated.

c) The City shall prefund (contribute) to the CERBT trust 25% of estimated annual OPEB pay-as-you-go premiums.

d) Annual prefunding contributions to the CERBT trust shall be based on current year position allocations in the annual budget for those employees eligible for the future benefit.

Section 3. Other Considerations

a) *Policy Modification.* Factors favoring modification of this funding policy may include:

i. Budget deficits that require a temporary suspension of prefunding

ii. Increasing the minimum amount/percentage of pre-funding targets for the pension and/or OPEB Retiree Medical Plans

iii. Change in funding methodology due to economic conditions, regulatory/statutory changes, or financial analysis

b) *Policy Termination.* Factors favoring termination of this funding policy should be limited to the following:

   i. Pension contributions have stabilized and the City has no remaining unfunded liability, defined as all pension plan funded ratios being at least 100% as determined by the most recently available CalPERS Annual Valuation Report.

   ii. The City's OPEB Retiree Medical Plan is 100% funded for projected future benefit costs as determined by the most recently available actuarial valuation; whereupon future plan benefit payments would begin to be paid by CERBT trust funds.

c) *Policy Reinstatement.* Should this funding policy be terminated for the factors above being achieved, and after which, if any of the City pension plans or OPEB Retiree Medical Plan fall below 100% funded status, as determined by an actuarial valuation, City Council and staff should work together to reinstate an appropriate amount of pre-funding payments in the City budget until 100% funded status is reached again.

PASSED AND ADOPTED by the City Council for the City of Reedley, California, at a regular meeting thereof on November 9, 2021, by the following vote:

AYES:	Beck, Soleno, Betancourt, Tuttle, Fast.
NOES:	None.
ABSENT:	None.
ABSTAIN:	None.

APPROVED:

Mary L. Fast

Mary L. Fast, Mayor

ATTEST:

Ruthie G

Ruthie Greenwood, City Clerk

CITY OF REEDLEY
INCORPORATED FEB. 18, 1913

REEDLEY CITY COUNCIL

☐ Consent Calendar
☒ Regular Item
☐ Workshop
☐ Closed Session
☐ Public Hearing

ITEM NO: 8

DATE: November 9, 2021

TITLE: ADOPT RESOLUTION NO. 2021-097 ESTABLISHING A PENSION & OTHER POST EMPLOYMENT BENEFITS FUNDING POLICY

SUBMITTED: Paul A. Melikian, Assistant City Manager

APPROVED: Nicole R. Zieba, City Manager

RECOMMENDATION

Adopt Resolution No. 2021-097 establishing a pension and Other Post-Employment Benefits funding policy, following nationally recognized best practices and memorializing existing City efforts to manage the benefit plans for near term budget stability and sustaining them for future generations. By memorializing the City's existing efforts to manage pension and retiree medical plan obligations into a funding policy, the City Council is formally declaring that current pension and retiree medical plan costs are a budgetary priority, as well as remaining a priority when competing for budget resources necessary in future years to make progress in paying down these obligations for long term sustainability.

EXECUTIVE SUMMARY

On February 23, 2021, the City Council received a presentation on the status of the City's pension plans with the California Public Employees' Retirement System (CalPERS), including a discussion of ways to mitigate rising employer contributions that continue to increase faster than general revenues. The presentation focused on the financial status of the City's pension plans, and the benefits of making *Additional Discretionary Payments* to CalPERS to save money by reducing future interest payments and provide maximum flexibility to the City.

The City has already made progress in making the retiree medical plan financially sustainable. In February 2015, the City Council elected to establish a Section 115 trust with the California Employers' Retiree Benefit Trust (CERBT) for the purpose of making employer contributions to be invested and grow tax-free, to prefund retiree medical benefits for eligible retirees and their beneficiaries. The City began contributing to the CERBT trust 15%, eventually moving to 25%, of estimated annual OPEB pay-as-you-go premiums, resulting in a life to date rate of return on contributions of 12.31% as of June 30, 2021 and a funded status of 4.0% as of the June 30, 2021 actuarial valuation.

Utilizing feedback from the City Council from the February 2021 workshop, the City included its first ever pension prefunding payment (Additional Discretionary Payment) to CalPERS in the FY 2021-22 Adopted Budget, using 25% of the required contribution towards the City's Unfunded Actuarial Liability (UAL) as the allocation methodology.

The attached policy has been developed to formally recognize the City's existing efforts to responsibly manage its ongoing pension and retiree health care plan obligations. Most significantly, the policy is in response to large annual pension cost increases as a result of lower than anticipated investment returns by CalPERS over many years, retired employees living longer and CalPERS policies adopted that require all cities to payback pension investment losses and actuarial liability over the next 20 years for any new unfunded liability.

BACKGROUND

The City provides defined benefit retirement benefits through CalPERS to provide retirement and disability benefits, annual cost of living adjustments and death benefits to plan members and their beneficiaries. Additionally, with the adoption of Resolution No. 2013-083 and amended from time to time by subsequent resolution, the City chose to conditionally provide medical coverage to eligible employees, retirees and their dependents, also known as Other Post-Employment Benefits (OPEB). As part of the annual budget, the City has historically made 100% of actuarially determined contributions for CalPERS pension liability, and 100% of coverage premiums for OPEB retiree medical benefits.

The mutual financial objective of a defined benefit pension plan and a retiree medical plan is to fund the long-term cost of benefits provided to the plan participants. In order to assure that the plans are financially sustainable, the plans should accumulate adequate resources in a systematic and disciplined manner over the active service life of benefitting employees. The proposed policy prioritizes funding for these benefit plans, and outlines the method the City will utilize to determine and fund its actuarially determined contributions to fund the long-term cost of benefits to the plan participants and annuitants.

The Government Finance Officers Association (GFOA) has published a Best Practice, attached, called *Core Elements of a Funding Policy* in which is states "GFOA recommends that every state and local government that offers defined benefit pensions and/or OPEB formally adopt a funding policy that provides reasonable assurance that the cost of those benefits will be funded in an equitable and sustainable manner."

POLICY DETAIL

The policy memorializes the City's long-standing practices of making 100% of its required contributions to CalPERS for all pension plans. CalPERS actuaries determine the City's required contributions CalPERS based on annual actuarial valuations. The only exception to making 100% of the required contributions would be a Council authorized declaration of fiscal emergency due to severe economic and/or budgetary conditions. The policy also calls for the City to continue taking advantage of the Annual Prepayment Option for the UAL portion of the employer contribution for all pension plans to reduce interest expense.

Additional Discretionary Payments

The policy also formalizes the recent practice, introduced in the FY 2021-22 Adopted Budget, of budgeting for an Additional Discretionary Payment (ADP) to the CalPERS pension plans to pay more than the minimum required contribution towards the City's UAL. Specifically, the policy calls for the City to set aside and budget sufficient funds to make an ADP to CalPERS in an amount that is no less than 25% of the current fiscal year required minimum UAL payment for all plans using the Annual Prepayment Option amount for each plan. For example, if the total annual minimum UAL payment for all plans is $1,400,000, the City would budget an additional $350,000 (25% of $1.4M) for the ADP.

The policy calls for the ADPs to maximize long term savings by applying the payments to the longest remaining amortization periods of each plan, moving to the next longest period if the first is satisfied. This strategy may be modified by staff on a case-by-case basis to make a payment toward the base with the shortest remaining period, which typically leads to the greatest reduction in short-term UAL payments to provide near-term budgetary relief.

OPEB Retiree Health Plan

Similar to the pension plans, the policy memorializes the City's long-standing practice of paying 100% of coverage premiums for the OPEB Retiree Health Plan as established by separate enabling resolution, from available and eligible City funds, allocated 100% to the fund that the eligible retiree's salary was last primarily allocated. Under the policy, the City will also continue to prefund dollars to the CERBT trust equivalent to 25% of estimated annual OPEB pay-as-you-go premiums, with payments based on current year position allocations in the annual budget for those employees eligible for the future benefit.

Seven years later, this prefunding activity is now an established part of the City's budget and appears to have struck an appropriate balance that is both making headway in setting aside funds for future retirees without having a disproportionate impact on current year budgets.

Policy Modification/Termination

Factors favoring modification of the funding policy would include budget deficits that require a temporary suspension of prefunding, increasing the minimum amount/percentage of pre-funding targets for the pension and/or OPEB Retiree Medical Plans, or a change in funding methodology due to economic conditions, regulatory/statutory changes, or financial analysis.

Justification for termination of the policy is limited to circumstances that will likely not be met in the near-term, such as pension contributions have stabilized and the City has no remaining unfunded liability and/or the City's OPEB Retiree Medical Plan is 100% funded for projected future benefit costs.

The policy concludes with a provision that should all pension and retiree medical plans become fully funded and the funding policy is ended, if any of the City pension plans or OPEB Retiree Medical Plan fall below 100% funded status, as determined by an actuarial valuation, City Council and staff should work together to reinstate an appropriate amount of pre-funding payments in the City budget until 100% funded status is reached again. Based on projections, the plans will not be fully funded for many years, so this is a forward-looking statement to provide guidance to councilmembers and staff in the future.

FISCAL IMPACT

As of June 30, 2020 the total UAL for all six City pension plans and the retiree healthcare plan totals $23,293,332, made up of $16,486,480 in CalPERS pension liability (all plans) and $6,806,852 in net OPEB liability.

The pension liability of $16,486,480 as of June 30, 2020 reflects an increase of $1,361,070 (or 9%) since June 30, 2019. The required minimum UAL payment next fiscal year (FY 2022-23) will be $1,393,716.

Under the proposed funding policy, the City will set aside and budget an additional 25% of the annual required UAL payment for an ADP, which, for next year, would equate to $348,429, spread amongst all City funds that have full-time positions paid from them. The City budgeted $304,653 in the current year budget for this payment, which was made in August 2021.

It is anticipated that pension fund contributions will eventually stabilize around the year 2030 and will slowly be reduced until the outstanding unfunded pension liability is paid in full by the year 2045. This policy would remain in place until such time pension contributions have stabilized and the City has no remaining unfunded liability or projected liability in the future.

ATTACHMENTS

Resolution No. 2021-097
GFOA Best Practice "Core Elements of a Funding Policy"

BEST PRACTICES

Core Elements of a Funding Policy

GFOA recommends that governments adopt a funding policy that provides reasonable assurance that the cost of those benefits will be funded in an equitable and sustainable manner.

Compensation packages for active workers may include pensions as well as health-care and other similar benefits for those employees after they have completed their active service. Generically, health-care and other benefits are described as other postemployment benefits (OPEB) to distinguish them from pensions.[1] Employers are required to recognize the cost of pension benefits as employees earn them, and the Governmental Accounting Standards Board (GASB) extends this same requirement to OPEB.[2] While pensions have long been funded on an actuarial basis, OPEB plans have not. The change in accounting standards has focused attention on the costs of OPEB, including concerns about rising health-care costs and an aging public-sector workforce. The real issue is not the change in accounting standards for such a funding policy and OPEB, as such, but rather the underlying budgetary and funding challenge that those accounting standards highlight. Meeting this challenge requires governments to ensure that both pension and OPEB are sustainable over the long term - that they are affordable to stakeholders, competitive, and sufficient to meet employee needs, and that they may be reasonably expected to remain so.

GFOA recommends that every state and local government that offers defined benefit pensions and/or OPEB formally adopt a funding policy that provides reasonable assurance that the cost of those benefits will be funded in an equitable and sustainable

manner. Such a retirement benefits funding policy would need to incorporate the following principles and objectives:

1. Every government employer that offers defined benefit pensions or OPEB should obtain no less than biennially an actuarially determined contribution (ADC) to serve as the basis for its contributions to those respective plans;

2. The ADC should be calculated in a manner that fully funds the long-term costs of promised benefits, while balancing the goals of 1) keeping contributions relatively stable and 2) equitably allocating the costs over the employees' period of active service;

3. Every government employer that offers defined benefit pensions or OPEB should make a commitment to fund the full amount of the ADC each period. (For some government employers, a reasonable transition period will be necessary before this objective can be accomplished);

4. Every government employer that offers defined benefit pensions or OPEB should demonstrate accountability and transparency by communicating all of the information necessary for assessing the government's progress toward meeting its pension funding objectives.

These principles and objectives necessarily will affect decisions related to the treatment of three core elements of a comprehensive pension funding policy:

- *Actuarial cost method* - The technique used to allocate the total present value of future benefits over an employee's working career (normal cost/service cost).

- *Asset smoothing method* - The technique used to recognize gains or losses in pension assets over some period of time so as to reduce the effects of market volatility and stabilize contributions.

- *Amortization policy* - The length of time and the structure selected for increasing or decreasing contributions to systematically eliminate any unfunded actuarial accrued liability or surplus.

To ensure consistency with the principles and objectives described above, the GFOA recommends that a pension funding policy treat each of its core elements as follows:

- **Actuarial cost method**. The actuarial cost method selected for funding purposes should conform to actuarial standards of practice and allocate normal costs over a period beginning no earlier than the date of employment and should not exceed the last assumed retirement age. Moreover, the selected actuarial cost method should be designed to fully fund the long-term costs of promised benefits, consistent with the objective of keeping contributions relatively stable and equitably allocating the costs over the employees' period of active service.[3] While not the only method that would satisfy this criterion, the entry age method—level percentage of pay normal cost—is especially well suited to achieving this purpose.

- **Asset smoothing.** The method used for asset smoothing should:
  - Be unbiased relative to market. For example:
    - The same smoothing period should be used for both gains and losses, and
    - Market corridors (a range beyond which deviations are not smoothed), if used, should be symmetrical [4], and
  - Provide for smoothing to occur over fixed periods (the use of rolling periods normally should be avoided), ideally of five years or less, but never longer than ten years.
  - Provide for a market corridor if smoothing is to occur over a period longer than five years.
- **Amortization.** Amortization of the unfunded actuarial accrued liability [5] should:
  - Use fixed (closed) periods that
    - Are selected so as to balance the twin goals of demographic matching (equitable allocation of cost among generations) and volatility management (funding at a level percentage of payroll) and
    - Never exceed 25 years, but ideally fall in the 15-20 year range;
  - Use a layered approach for the various components to be amortized (that is, an approach that separately tracks the different components to be amortized); and emerge as a level percentage of member compensation or as a level dollar amount.

- **Additional considerations for plans closed to new entrants.** When a plan is closed to new participants, the aggregate actuarial cost method – level percentage of pay normal cost – is especially well suited for funding.

  For closed plans with no remaining active members:

  - Special attention needs to be given to the mix of investments (given the shorter time horizon); and

  - In comparison to open plans:
    - Asset smoothing periods should be shorter (typically no longer than three years);

    - Corridors, if used, should be narrower; and

    - Amortization periods should be shorter (typically no longer than 10 years for gains and losses).

- For closed plans that still have active members:
  - The continued use of level percent of member compensation amortization remains appropriate, but not for a long period (i.e., as the number of active members decreases); and

  - In comparison to open plans:
    - Asset smoothing periods should be shorter;

    - For asset smoothing periods that exceed five years, a corridor (not to exceed 20 percent) should be used; and amortization periods should be shorter.
- **Other policy statements**. A funding policy can also give a government an opportunity to make statements identifying the conditions under which future benefit enhancements or reductions would be evaluated. For example, a funding policy could state that future benefit enhancements would only be considered if the cost of those enhancements do not cause the plan's funded ratio to go below 100%, or in the alternative, cause the ADC to rise above a certain level.

Notes:

1 Some government employers choose to augment other elements of employee compensation rather than providing OPEB.

2 See GASB Statement No. 75, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* The Financial Accounting Standards Board (FASB) has required the same of private-sector employers since the implementation of FASB Statement No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions, which was released in 1990.

3 Employers using some other actuarial cost method should carefully monitor demographic changes and trends in the covered workforce inasmuch as such changes could result in increased employer contributions as a percentage of payroll.

4 Generally, the appropriate corridor will depend upon the length of the smoothing period, with longer smoothing periods requiring narrower corridors.

5 Special considerations may apply to the amortization of a surplus (e.g., use of a longer amortization period).

References:

Conference of Consulting Actuaries Public Plans Community, *Actuarial Funding Policies and Practices for Public Pension Plans*, October 2014

Wells Fargo Municipal Securities Research, *Analyzing Public Pensions, Item 5. Are There Constraints on Benefit Enrichment?*, April 23, 2014

Board approval date: Friday, September 30, 2016