Approved by City Manager:

CITY of CALABASAS

CITY COUNCIL AGENDA REPORT

DATE: **OCTOBER 15, 2020**

TO: **HONORABLE MAYOR AND COUNCILMEMBERS**

FROM: **RON AHLERS, CHIEF FINANCIAL OFFICER**

SUBJECT: **CONSIDER CITY'S PENSION UNFUNDED ACCRUED LIABILITY (UAL) OF $8 MILLION AND OPTIONS TO PAY DOWN THIS DEBT**

MEETING DATE: **OCTOBER 28, 2020**

SUMMARY RECOMMENDATION:

Staff is seeking direction from the City Council regarding the City of Calabasas' (City) pension plan with California Public Employees Retirement System (CalPERS); specifically the unfunded accrued liability (UAL) of approximately $8 million. The City's pension funding is currently at 79%. The goal is to be 100% funded which requires the City to pay off the $8 million UAL. Based on the City Council direction this evening; staff will present a recommendation to the City Council on how to pay off the $8 million at the mid-year budget report anticipated for February 2021.

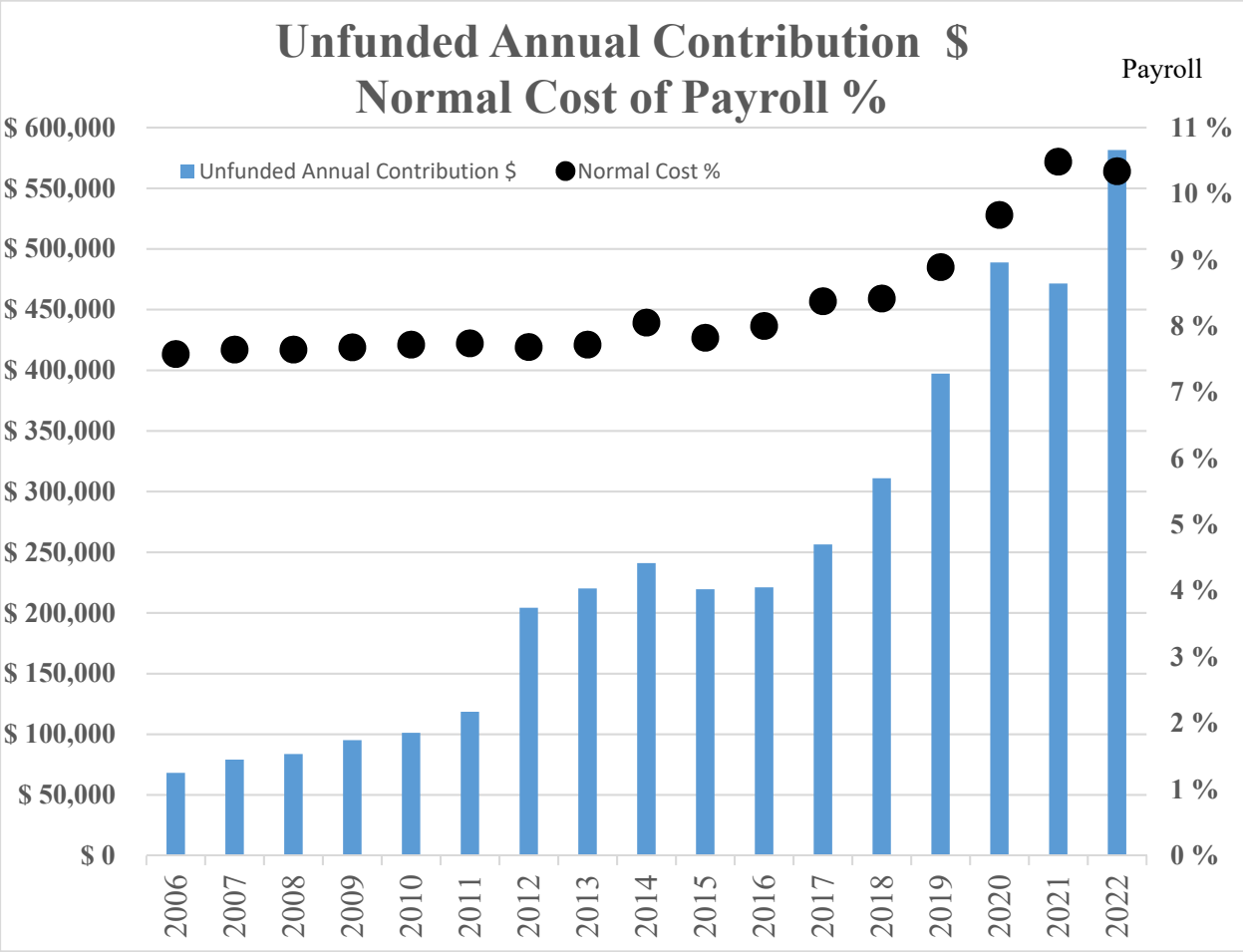
BACKGROUND:

The City's current debt load is too large at $49.8 million. The debit is composed of $38.8 million in Certificates of Participation (COP), $8 million in pension UAL and $3 million in Other Post-Employment Benefits (OPEB) which is retiree medical insurance liability.

This report concerns the pension UAL of $8 million as the City is paying 7% interest on this debt. The on-going savings of paying off this debt are substantial given the high 7% annual interest charge.

Annual Pension Payments

The chart below depicts the City's annual pension payments as two figures: normal cost expressed as a percentage of payroll and the unfunded annual contribution expressed as a dollar amount.



The scale on the left is the annual dollar contribution for the UAL which are the columns. The scale on the right is the normal cost payment which is a percentage of payroll and represented by the black dots. Please note the overall direction is upward for both columns and dots. In fiscal year (FY) 2006, the City paid $68,238 as a contribution to the UAL and the normal cost was 7.578% of payroll. This current year, FY 2021, the UAL contribution is $471,438 and the normal cost is 10.484% of payroll. The UAL contribution is predicted by CalPERS to increase substantially each of the next 10 years to greater than $900,000. CalPERS predicts the normal cost to remain constant at 10.3%. Staff predicts that the normal cost percentage will increase to a minimum of 11% if not 12% by the end of the decade.

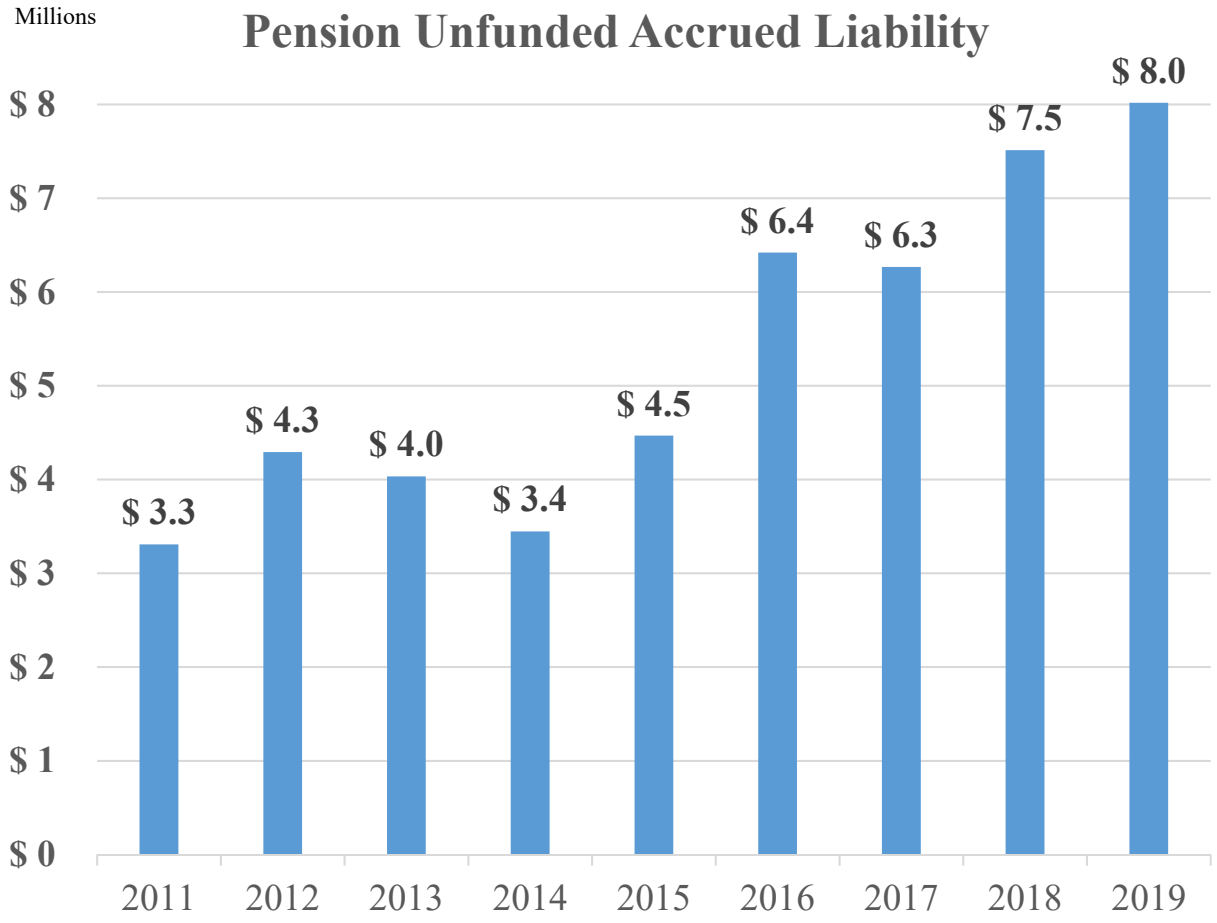
The current annual UAL contributions are not sufficient to pay off the $8 million UAL; that is why the columns keep increasing and growing faster. If the City pays off the

$8 million in pension UAL the annual UAL contributions (columns) will be reduced to near zero.

Pension Unfunded Accrued Liability (UAL)

The chart below depicts the City's pension UAL from June 30, 2011 to June 30, 2019 (latest number). In FY 2011, the pension UAL was $3.3 million and has grown in eight years to $8 million. This is an increase of 142%! This growth rate is incredibly steep and the entire liability needs to be eliminated.

The City is paying a 7% interest charge on this $8 million which calculates to $560,000 annually. However, the City contributed $488,796 in FY 2020 which is less than the $560,000. Therefore, the City is **NOT** covering the interest payment. The City has a history of paying **ONLY** the annual required minimum that CalPERS calculates. This is very poor financial management.

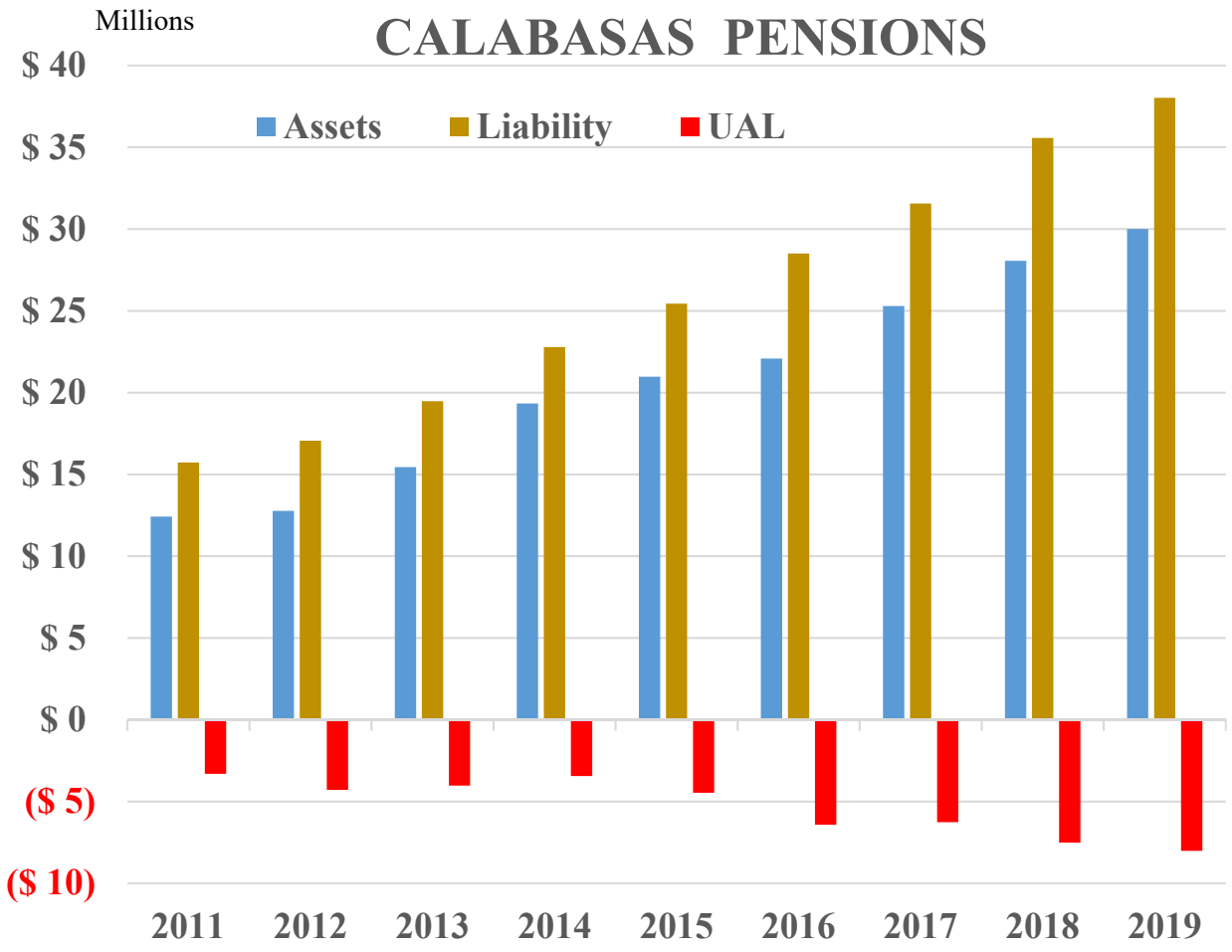


City Pension Assets & Liabilities

The UAL is actually the difference between the assets and liabilities of the City's pension plan with CalPERS. The City's pension plan is funded by three sources: Employee contributions of 7% of payroll, Employer contributions and Investment

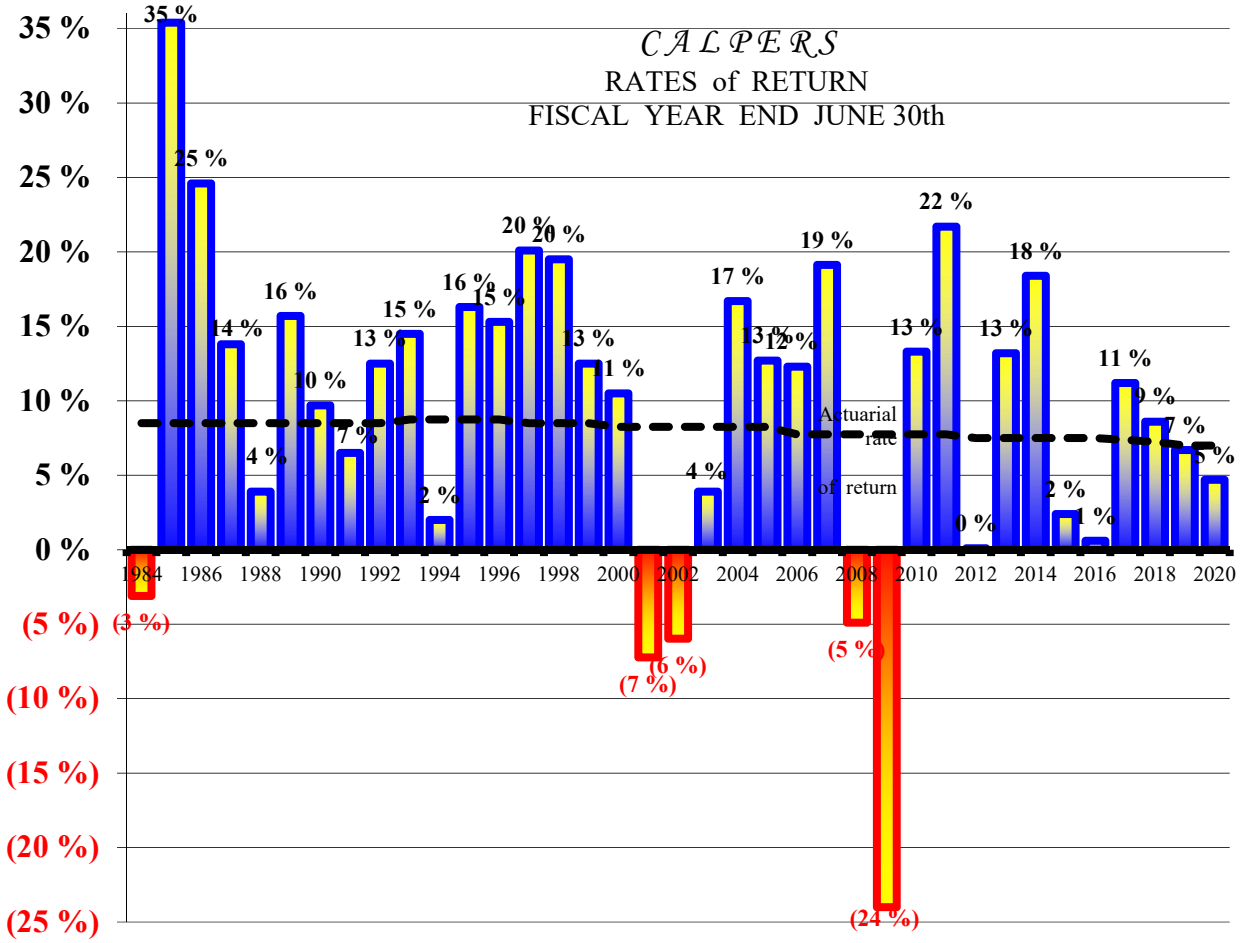
earnings. The State of California does not contribute. The Employee contributions are fixed by state law at 7% of payroll. The investment earnings vary from year to year; either positive or negative. Therefore, the City (Employer) contributions make up the shortfall, if any. On June 30, 2011 the City had $12.4 million in assets with CalPERS and $15.7 million in liabilities which calculates to a UAL of **$3.3 million**. For June 30, 2019, the assets were $30 million and the liabilities were $38 million which equates to an **$8 million** UAL.

Staff predicts the UAL for June 30, 2020 to be a minimum of $9 million and it could be greater than $9.5 million. The time to act was a few years ago; therefore the time to take charge is now.



Investment Earnings

The City currently has $30 million invested with CalPERS. Therefore, the investment earnings on the $30 million have a tremendous impact on the funding of the Calabasas pension plan. Each one percent return equates to $300,000 annually. CalPERS assumes a 7% return which equals $2.1 million annually ($30 million x 7%). The chart below shows the CalPERS investment earnings from FY 1983 to current. The dashed black line depicts the CalPERS assumed investment return for each year. For many years CalPERS assumed investment returns of 8½%, 8¼% and 8%, and only recently has the return assumption been reduced to 7%. Whenever the investment return is below the assumption, the City (Employer) makes up the shortfall. For example, this last year CalPERS earned a positive 4.7%, which is less than the 7% assumption. The year before CalPERS earned 6.7% which is less than 7%.



AMORTIZATION BASES

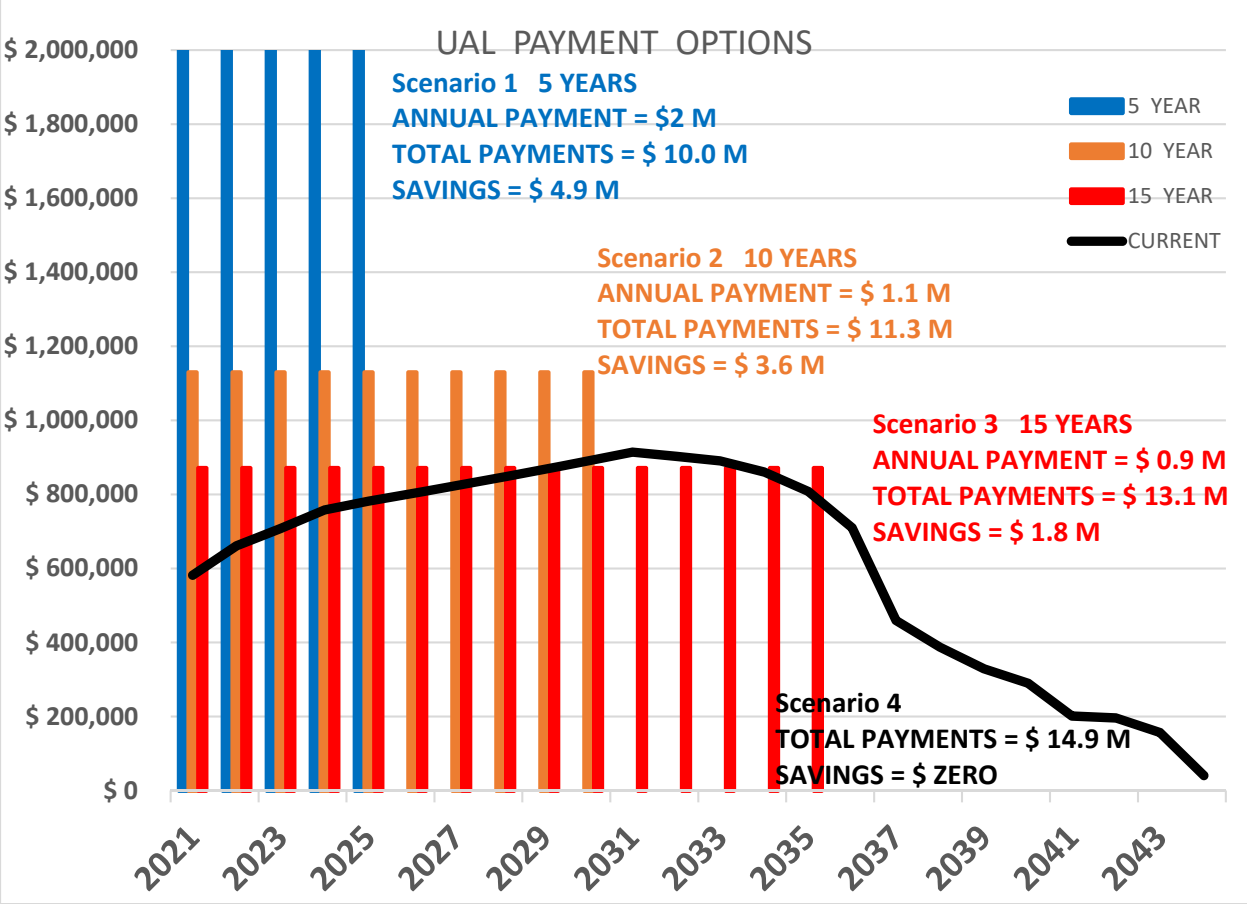
Please refer to pages 11-12 of the attached report "*Miscellaneous Plan of the City of Calabasas, Annual Valuation Report as of June 30, 2019."* The City currently has 21 amortization bases and these are "similar but not equal" to a home mortgage. Each amortization base has a positive (City owes CalPERS) or negative (CalPERS owes City) figure. The column heading "Amort. Period" is the critical number here as any number greater than 21 years results in negative amortization. In other words, the City is not even paying the full interest charges and thereby the balance is actually increasing each year. Overall, the City is not paying enough towards the UAL since the total amount is increasing: **$8,017,806** (6/30/19) to **$8,122,461** (6/30/20) to **$8,203,377** (6/30/21).

Staff recommends the City Council direct CalPERS to refinance (CalPERS term ~ "fresh start") these 21 amortization bases into one consolidated base with an amortization period of 12 years or less. The rationale for the 12 years is the average age of the Classic employee is 50.9 years. If we assume the average employee age at retirement is 63.0 years, then the average remaining tenure of the classic employee is 12.1 years (63.0 - 50.9 = 12.1). Therefore, the City pays off the current Classic plan UAL when the last Classic employee retires (on average).

DISCUSSION:

With the prior graphs as background data, the decision before the City Council is how to pay off the $8 million in UAL. If the City does nothing, the City will continue to underpay and not cover the annual interest charges on the $8 million UAL. The unfunded annual contributions will continue to grow and will be greater than $900,000 annually by the end of the decade.

Staff recommends the City take an active role in the financial management of the City's pension plan and make additional payments towards the $8 million UAL. The chart below displays four scenarios for the City Council to consider.



The City can continue to make the minimum required payments to CalPERS (Scenario 4, black line). The City will pay $14.9 million from 2021 to 2044 with zero savings. The annual contributions will increase to $914,091 in FY 2031 and then decrease. These are CalPERS projections and staff has zero confidence that these figures will actually happen (in other words, the figures will be larger). CalPERS has a long history of underestimating as can be discerned from the City's history of payments.

Three Options to Consider

The City can decide to make additional contributions to shorten the payment plan and save on interest charges. The 15-year plan (Scenario 3, red) has annual payments of $0.9 million; therefore total payments of $13.1 million and savings of $1.8 million. The 10-year plan (Scenario 2, orange) has annual payments of $1.1 million; therefore total payments of $11.3 million and savings of $3.6 million. The 5-year plan (Scenario 1, blue) has annual payments of $2 million; therefore total payment of $10 million with savings of $4.9 million.

Recommended Action to Consider

Staff recommends the City Council consider paying $4 million this current fiscal year (FY 2021) and $4 million next year (FY 2022) along with refinancing the amortization bases into one base with a term of 12 years. In 12 months CalPERS will issue their annual report for June 30, 2020 and the City Council can consider the next steps in paying off the remaining balance in the UAL.

FISCAL IMPACT/SOURCE OF FUNDING:

The source of funding will be distributed to various funds where employee salaries are posted. The majority of the money would be funded by: General Fund, Library Fund, Tennis & Swim Center, landscape district funds and other grant funds.

General Fund Reserves

As of June 30, 2020 the General Fund Reserve (Fund 10) is $13.7 million and the Management Reserve (Fund 60) is $5.3 million for a total of $19 million. The City has historically stated that the minimum reserve required is $10 million. Therefore, there is $9 million available to pay down the pension UAL as of June 30, 2020. The General Fund would pay the majority of the UAL but not the entire amount.

REQUESTED ACTION:

City Council direct staff on which option they prefer. Staff will return at the mid-year budget study session in February 2021 with a recommendation and appropriation in order to make the first payment to CalPERS for the additional unfunded contributions.

ATTACHMENTS:

A - *CalPERS ~ Miscellaneous Plan of the City of Calabasas, Annual Valuation Report as of June 30, 2019.*

B - *CalPERS ~ PEPRA Miscellaneous Plan of the City of Calabasas, Annual Valuation Report as of June 30, 2019.*