

STAFF REPORT

City Council Business Item

DATE: December 16, 2024

TO: Honorable Mayor and Council Members

FROM: Aaron Felmlee, Finance Director

THRU: Amy Nilsen, City Manager

SUBJECT: **Authorize City Manager to establish the PARS 115 Trust and to execute a \$850,000 Supplemental Budget Request for an Additional Discretionary Payment to the California Public Employee’s Retirement System (CalPERS) Pension Trust and/or the PARS Pension 115 Trust, *Resolution 2024-38***

STAFF RECOMMENDATION:

Authorize City Manager to establish the PARS 115 Trust and to execute a Supplemental Budget Request in the amount of \$850,000 to be paid to the CalPERS Pension Trust and PARS Pension 115 Trust to recognize interest payment savings.

EXECUTIVE SUMMARY:

Unfunded long-term liabilities for City employee pension plans continue to be one of the biggest issues facing local municipalities. In fiscal year 2018-19 staff identified and reviewed a number of potential strategies to address the unfunded pension liabilities including pros and cons of each strategy with the Council. It was determined that making additional discretionary payments when the City was able to was the best strategy and in fiscal years 2018-19, 2020-21, 2021-22, and 2022-23 the Council gave direction to staff to make additional discretionary payments to CalPERS in order to help “smooth” the future mandated unfunded liability payments. This report includes a recap of the pension plan and a discussion of the status and history of the unfunded liabilities.

New accounting standards dramatically impacted local government financial statements by requiring the net pension liability be reported as a liability on the City’s Statement of Net Position; thereby, reducing the City’s financial net position (assets in excess of liabilities). Prior to the change in accounting standards the long term liability amounts referred to as unfunded accrued actuarial liability were not included on the City’s balance sheet. Annual payments for pension costs were paid on a “pay-as-you-go” basis, therefore no additional accrued actuarial expenses were added to City pension costs and there was no additional liability reported on the balance sheet. The addition of these unfunded long-term liabilities to the entity-wide financial statements brought these liabilities to the forefront amongst public officials and can have an effect on the City’s ability to secure future credit (loans, bonds etc.).

CITY PLANS:

City of Fortuna permanent full-time employees participate in the CalPERS retirement system. Sworn employees are covered under the Safety Plan, while all other employees are covered in the Miscellaneous Plan, both of which are a part of the statewide pool. A pooled plan was required by California law for those agencies who had fewer than 100 active members. These assets and

liabilities are pooled with all other safety and miscellaneous plans in the State with fewer than 100 active members to provide a large, risk sharing pool. This risk sharing dramatically reduces large fluctuations in an employer’s pension contribution rate caused by unexpected local demographic events.

Depending on an employee’s position and hire date, a City employee is included in one of the six possible plans in the table below:

Plan	Miscellaneous	Safety
Classic Members (Employees Hired Prior to March 1, 2012)	2.7% @ 55	3.0% @ 50
Tier 2 Plan (Effective March 1, 2012)	2.0% @ 55	3.0% @ 55
PEPRA Plan (Effective Jan 1, 2013)	2.0% @ 62	2.7% @ 57

CALPERS FUNDING REVIEW:

The CalPERS retirement system is funded by three main categories: (1) CalPERS Investment Earnings, (2) employer contributions to CalPERS, (3) employee contributions to CalPERS.

CalPERS reports that over the past twenty years every dollar spent on public employee pensions has been sourced from the following as of June 30, 2024

- 55 cents – CalPERS Investment Earnings
- 34 cents – Employer Contributions to CalPERS
- 11 cents – Employee Contributions to CalPERS

As of Fiscal Year 2023-24, CalPERS announced the following average returns on its investment portfolio:

- 6.6% percent over the past five years
- 6.2% over the past ten years
- 6.7% over the past twenty years

PENSION FUND STABILITY INITIATIVES:

Over the past decade CalPERS has taken steps to stabilize and improve the system’s fiscal strength and lower future risk to the pension trust’s sustainability.

In November 2012, California voters passed the Public Employees’ Pension Reform Act (PEPRA) providing that new employees hired after January 1, 2013 are required to contribute more to their pensions and must also work longer before they can retire and begin to receive the benefits promised by their employers.

Effective during the 2014-15 fiscal year the expected rate of return on CalPERS pension fund’s investments referred to as the “discount rate” was reduced from 7.75% to 7.5%. In December 2016, CalPERS voted to lower its discount rate in steps beginning in FY 2018-19 from 7.5% to 7.0%. CalPERS again voted to lower the discount rate to 6.8% in July 2021. Lowering the discount rate impacts local governments because with lower expected returns over time this will require contribution rates to increase to provide sufficient assets to pay pension benefits.

FORTUNA UNFUNDED LIABILITY STATUS:

As of June 30, 2023 the City of Fortuna’s proportionate share of the net pension liability for each plan is shown in the below table:

	Scenario 1 - 1% Decrease (5.90%)	Current Discount Rate (6.90%)	Scenario 2 - 1% Increase (7.90%)
Miscellaneous Plan	\$ 9,018,517	\$ 5,378,476	\$ 2,382,411
Safety Plan	\$ 7,752,881	\$ 5,058,204	\$ 2,855,114
Total	\$ 16,771,398	\$ 10,436,680	\$ 5,237,525

In FY 2017-18, the City of Fortuna was mandated by CalPERS to pay \$427,958 towards the City’s proportionate share of the unfunded liability. For FY 2022-23 the mandated payment was \$798,707. An overall increase of 87% in seven years.

FUTURE PROJECTED UNFUNDED LIABILITY PAYMENTS:

Fiscal Year	Payment	Fiscal Year	Payment
24-25	\$ 810,054	35-36	\$ 1,178,800
25-26	\$ 951,551	36-37	\$ 933,592
26-27	\$ 1,025,404	37-38	\$ 754,583
27-28	\$ 1,083,608	38-39	\$ 679,086
28-29	\$ 1,222,326	39-40	\$ 618,320
29-30	\$ 1,249,317	40-41	\$ 577,176
30-31	\$ 1,271,906	41-42	\$ 497,352
31-32	\$ 1,295,130	42-43	\$ 418,560
32-33	\$ 1,281,887	43-44	\$ 770,189
33-34	\$ 1,267,234	44-45	\$ 61,364
34-35	\$ 1,234,369		

The chart above shows that the mandated liability payment is projected to increase by over \$500,000 by fiscal year 2031-32. The City would be hard pressed to make such a payment without making cuts to the budget elsewhere. In order to address the unfunded liability issue now rather than let it get to those exorbitant numbers staff is recommending making Additional Discretionary Payments or distributions into a 115 Trust in order to “smooth” the payments and reduce the peak years.

ANALYSIS OF UNFUNDED LIABILITY STRATEGY:

The strategy to make Additional Discretionary Payments (ADP) offers the following benefits:

- The City’s additional payments are discretionary as to time and amount of payment, providing flexibility if future circumstances allow for higher, lower or perhaps no payments for that particular fiscal year.
- The City would be initially credited with the CalPERS’ assumed ROR. For FY 2024-25 the rate is set at 6.8%. Under CalPERS practices, additional contributions would be applied evenly over a period of time (can be chosen by the City).

- Functions like a homeowner making additional mortgage principal payments, this strategy provides flexibility and if the City commits to a funding strategy with regular pay-downs, the unfunded liability could be retired ahead of the scheduled amortization period by a number of years.
- Greater average return (6.2% average return last 10 years) than can be achieved through City's investment policy and practices (1.58% average return for LAIF).

This approach offers the following risks:

- The primary drawbacks to making additional contributions directly to CalPERS are that the City would have less flexibility, as the City would not control the timing of when funds would be applied.
- CalPERS has stated that once monies are paid into the pension trust, they are never returned back to the City. Future assets in excess of liabilities, should they occur, will not be refunded back to the City.
- City receives interest on additional discretionary payments in tandem with what CalPERS earns, which can be volatile. Below is a list of the last ten years earnings rate:

Year	Rate	Year	Rate
2023	5.8%	2018	8.60%
2022	- 6.1%	2017	11.20%
2021	21.3%	2016	0.60%
2020	4.70%	2015	2.40%
2019	6.70%	2014	18.40%

The strategy to make distributions into a PARS 115 Trust offer the following benefits:

- The City's distributions into the trust are discretionary as to time and amount of payment, providing flexibility if future circumstances allow for higher, lower or perhaps no payments for that particular fiscal year.
- The City could take an investment approach that ranges from conservative to more aggressive. Five total investment strategies available.
- The City will maintain local control over assets; distributions from the trust can be made for any pension-related expense.
- Greater average return (6.39% average return last 10 years for Moderate Strategy) than can be achieved through City's investment policy and practices (1.58% average return for LAIF).

This approach offer the following risks:

- For reporting purposes this is an indirect offset on the City's balance sheet and does not increase the funded status of the City's pension plans with CalPERS.
- Plan requires a 0.25% PARS trust administration fee and 0.35% Investment Management fee.
- 115 Trust distributions can be made for any pension related reason which means that future distributions from the trust could be made towards the Normal Cost and not towards the City's unfunded liability.

Given the magnitude of the projected increases, the long-term fiscal sustainability of the City depends upon taking prudent, meaningful, and swift actions to address the City's pension obligations.

FINANCIAL IMPACT:

Staff is recommending utilizing a large portion of FY 23-24 investment revenue that exceeded the budget be re-invested into the PARS 115 Trust and/or by making an additional payment directly to CalPERS. The FY 23-24 investment revenue budget vs actual is shown in the below chart.

Fund #	Fund Name	FY 23-24 Activity	FY 23-24 Budget	Difference
100	General Fund	(604,187.07)	(40,000.00)	(564,187.07)
200/210	Storm Drain / Solid Waste	(4,760.35)	-	(4,760.35)
500/550	Water / Wastewater	(418,147.29)	(20,000.00)	(398,147.29)
590	Transit Fund	2,954.69	-	2,954.69
	Total	(1,024,140.02)	(60,000.00)	(964,140.02)

Staff is recommending Council authorize a total SBR of \$850,000. Those monies would be required to be taken from General Fund, Storm Drain, Solid Waste, Water, Wastewater, and Transit reserves as the investment revenue over budget went to reserves on June 30, 2024. The allocation between funds would be as shown in the table below.

Allocation Table				
Plan Type	Fund Number	Fund Name	Allocation %	Amount
Safety Tier I	100	General Fund (and GF Dependent Funds)	100.00%	250,000
Misc Tier I	100	General Fund (and GF Dependent Funds)	52.00%	312,000
Misc Tier I	200/210	Storm Drain/Solid Waste	0.87%	5,220
Misc Tier I	500/550	Water/Wastewater	44.65%	267,900
Misc Tier I	590	Transit	2.48%	14,880
Total				850,000

As mentioned above CalPERS has a target investment rate of 6.8% and over the last 10 years has averaged a rate of return of 6.2%.

The PARS Pension 115 Trust has 5 investment strategies that the City can choose from and are shown in the table below. Staff recommends starting with the Moderate Strategy to begin with and can always revisit the Strategy at a later date.

Strategy	Equity	10-Yr Returns*
Capital Appreciation	65-85%	8.09%
Balanced	50-70%	7.23%
Moderate	40-60%	6.39%
Moderately Conservative	20-40%	4.67%
Conservative	5-20%	3.37%

Staff is recommending that Council make a \$250,000 ADP to CalPERS and deposit \$600,000 into the PARS Pension 115 Trust.

RECOMMENDED COUNCIL ACTION:

1. Receive staff presentation and review Council questions with staff;
2. Open public comment;
3. Close public comment;
4. Motion to Authorize City Manager to establish the PARS 115 Trust and to execute a Supplemental Budget Request in the amount of \$850,000 to be paid to the CalPERS Pension Trust and PARS Pension 115 Trust to recognize interest payment savings by adopting *Resolution 2024-38*, ready by title only. Roll call vote.

ATTACHMENTS:

- *Resolution 2024-38 “A Resolution of the City Council of the City of Fortuna Approving the Adoption of the Public Agencies Post-Employment Benefits Trust Administered by Public Agency Retirement Services (PARS)”*
- Agreement for Administrative Services