

City of Arcata

Administrative Policies and Procedures

Subject: Pension Funding Policy

Effective Date: Upon Approval by City Council

Originating Department: Finance Department

INTRODUCTION

As part of its overall compensation plan, the City of Arcata (City) provides a defined benefit pension to its employees. This benefit is administered by the California Public Employees Retirement System (CalPERS) and is funded through contributions from the City and its employees, and from investment earnings on those contributions. Volatility in the investment earnings, policy and administrative changes at CalPERS and revisions to actuarial assumptions have decreased the plan's funded status. The City anticipates additional changes in administration of the plan which will increase the financial stability of the pension but will also increase City contributions in future years.

I. PURPOSE

The purpose of this policy is to define how the City's pension funding obligations will be met. Implemented strategies will strive to:

- 1.1** Stabilize and reduce projected pension contributions; and
- 1.2** Increase the funding ratio for the City's Safety and Miscellaneous plans.

II. POLICY

It is the policy of the City to fulfill its obligation to its residents and employees to maintain fiscally responsible management practices and to ensure that promised retirement benefits are funded. To achieve these obligations the City will meet its pension funding obligations as follows:

2.1 Actuarially Determined Contributions

Each fiscal year, the City will contribute to CalPERS the amount determined by CalPERS actuaries to be the minimum required employer contribution for that year. The minimum contribution consists of two components, normal cost and unfunded accrued liability (UAL). The normal cost is expressed as a rate that is applied to pensionable payroll costs and reflects the cost of pension benefits earned by employees in the current fiscal year. The UAL payment is a flat dollar amount that represents a portion of the cost of past benefits earned by employees, but for which, because of deviations in actual experience and changes in assumptions about investment performance, the normal cost rates established for those prior years has been determined to be insufficient to provide the promised retirement benefit. The CalPERS actuaries recalculate the total UAL each year and an updated multi-year amortization schedule is provided to show the projected annual minimum payments.

2.2 Annual UAL Prepayment

CalPERS offers the option to make monthly payments on the UAL or prepay the entire annual amount at a discounted level by the end of July. As such, the City will make every effort to prepay its annual obligation each year to achieve budgetary savings. By prepaying the FY 2023-24 UAL by July 31, the City saved \$66,865.

2.3 Section 115 Pension Trust

The City will establish and maintain a pension stabilization fund in the form of a Section 115 Pension Trust. The initial funding level is \$2,500,000 as included in the City's Adopted FY 2023-24 budget. Assets in the Section 115 Pension Trust may be used only for pension related costs and at the direction of the City Council. The City will consider contributions to or use of the Section 115 Pension Trust funds as part of developing the annual operating budget and in consideration of other reserve levels and budgetary requirements.

2.4 Targeted Funding Level

The City's goal is to achieve and maintain a funded status for each of its plans of between 90% and 100%. A funded status of 100% signifies that the City's pension assets with CalPERS match its accrued liabilities.

2.5 Additional Discretionary Payments

CalPERS allows member agencies to make additional discretionary payments (ADPs) at any time and in any amount, which would serve to reduce the UAL and future required contributions. The City Council has provided for ADPs in the FY 2023-24 Adopted budget in the amount of \$5,000,000. The City will consider this option as part of developing the annual operating budget and in consideration of evaluating reserve levels and its other budgetary requirements.

2.6 Funding Commitment

Going forward, the City Council policy will be that twenty-five percent (25%) of any surplus in the General Fund at year-end will be used to reduce the current UAL, either by funding the City's Section 115 Pension Trust Fund or making ADPs.

2.7 Transparency and Reporting

Funding of the City's pension plans should be transparent to vested parties including plan participants, annuitants, the City Council and Arcata residents. To achieve this transparency, the following information shall be available:

- a. Copies of the annual actuarial valuations for the City's CalPERS plans.
- b. The City's Annual Comprehensive Financial Report shall be published on the City's website. This report includes information on the City's annual contributions to the pension system and their funded status.
- c. The City's annual operating budget shall include the City's contributions to CalPERS.

2.8 Pension Obligation Bonds (POBs)

POBs or a similar debt issuance such as Lease Revenue Bonds (LRBs) used to make payments towards the City's UAL are tools that can be used to provide an additional discretionary payment to CalPERS upon the determination that the cost to borrow the funds for the payment is less than continuing to make the projected prescribed UAL payments at the current discount rate. If the City issues POBs or LRBs, the following guidelines will apply:

- a. Expert advice and analysis by actuaries and municipal advisors will be utilized to stress test the risk of a market crash and threshold at which the City would be worse off issuing POBs or LRBs versus not.
- b. The interest rate on the POBs or LRBs shall be at least 2.5% less than the current CalPERS discount rate.
- c. The final maturity date on the POBs or LRBs will be no more than the current term of the UAL.
- d. The POBs or LRBs structure will contain an early call provision.

2.9 Maturity of POBs or LRBs

As the annual required lease payments on the Series 2015 Refunding Lease Obligation (CalPERS Refinancing Project) decrease as the debt comes closer to final maturity in 2029, staff will present a plan to reallocate all or a portion of annual debt service payments to reduce the current UAL, either by funding the City's Section 115 Pension Trust Fund or making ADPs.

2.10 Review of Funding Policy

Funding a defined pension plan requires a long-term horizon and regular review to ensure that it continues to further the City's commitments as it applies to pension obligations. The City will review this policy at least once a year during development of its annual budget to ensure it is complying with this policy and to determine if changes to the policy are needed to ensure adequate resources are funding the UAL.