

CITY OF FORT BRAGG

CALPERS PENSION PROGRAM REVIEW AND COST MANAGEMENT STRATEGY ASSESSMENT



NHA | ADVISORS
Financial & Policy Strategies.
Delivered.

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Today's Discussion

- I. Background on CalPERS Costs
- II. Historical and Projected CalPERS Costs
- III. Cost Management Strategies
- IV. Conclusion





BACKGROUND ON CALPERS COSTS

City of Fort Bragg CalPERS Summary

- ▶ City of Fort Bragg has a **\$7.3M CalPERS Unfunded Accrued Liability (“UAL”)**, as of the latest CalPERS valuation for 6/30/2024
 - ▶ Miscellaneous Plan: \$4.13M | Safety Plans: \$3.14M
- ▶ CalPERS FY 2024-25 Preliminary Investment Returns: 11.6%
 - ▶ Projected to decrease UAL to \$5.7M (as of 6/30/2025)
- ▶ City also has **\$7.8M of outstanding Lease Revenue Bonds (LRB) – UAL Restructuring**, as of 6/30/2024
 - ▶ Issued in 2021 to restructure \$7.8M of UAL at an all-in interest rate of 3.61%
- ▶ City established a Section 115 Pension Trust in FY 2023-24; **Current Balance: \$3.6M**
- ▶ Continuing to manage ongoing CalPERS UAL costs will be critical for fiscal resiliency; especially amid potential assumption changes this year by CalPERS after their 2025 Asset Liability Management (ALM) Study

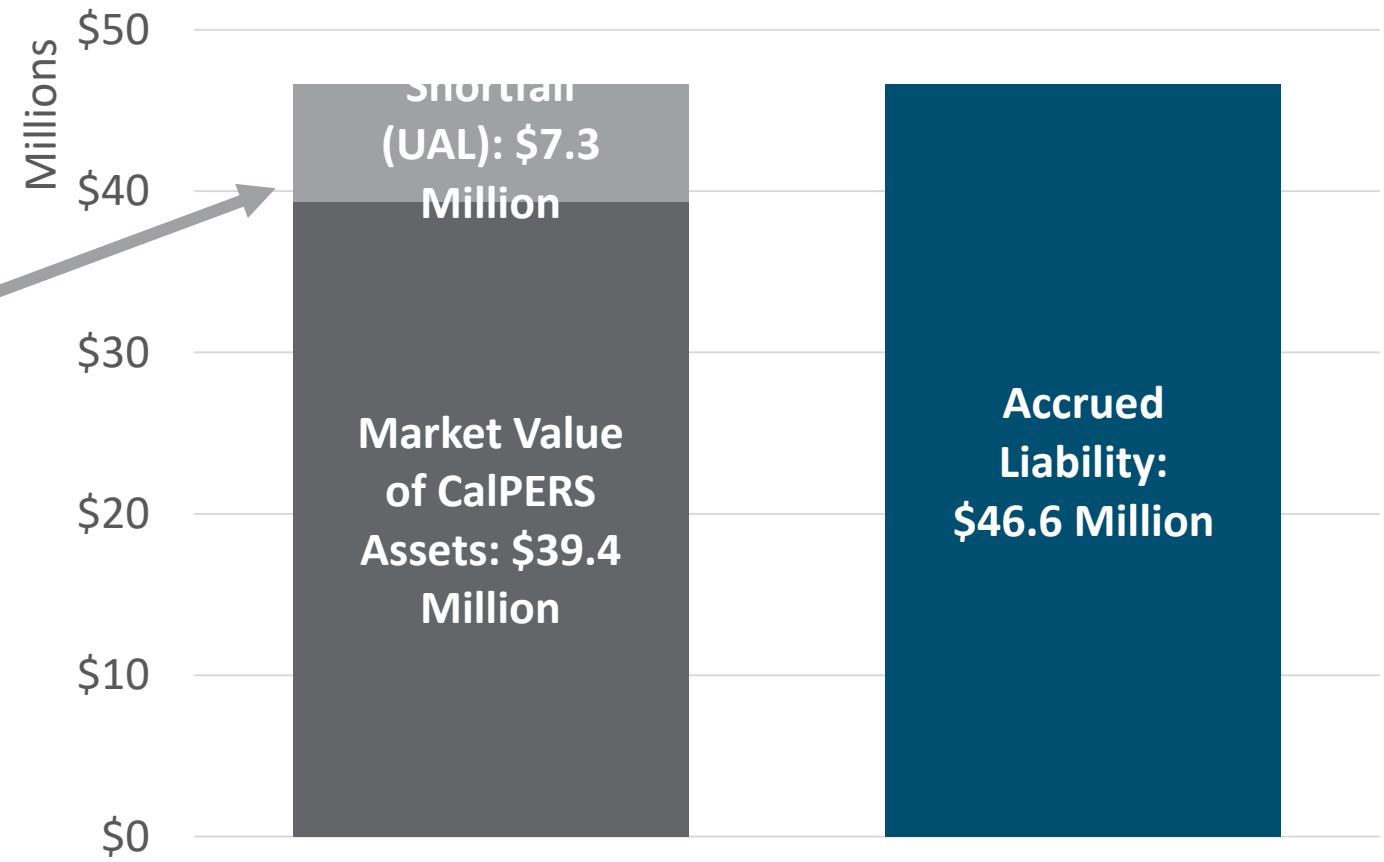


Background on How CalPERS Works

Two Payments Made to CalPERS Annually

- ▶ **(1) Normal Cost (“NC”):**
Annual cost for current employees
- ▶ **(2) Unfunded Accrued Liability (“UAL”):** Annual payment to amortize the “debt” to CalPERS
 - ▶ New UAL is amortized over 20 years
 - ▶ New UAL is created when CalPERS investment returns <6.80%

City of Fort Bragg
CalPERS Pension Funded Status



Source: CalPERS Actuarial Valuation as of June 30, 2024



Historical PERS Returns

5-Year: 8.0%
10-Year: 7.1%
20-Year: 6.7%
30-Year: 7.6%

Why CalPERS Costs Have Trended Higher

Then (late 1990s)...

- ▶ Robust investment returns (10%+)
 - ▶ Retirement plans were “Super-Funded” through the late 1990s
 - ▶ Earnings on funds were more than adequate to cover retirement costs
- ▶ Super-funded status induced widespread retirement benefits enhancements
- ▶ Past funding policies led to contribution holidays and “free” benefit improvements

Now...

- ▶ Sluggish investment returns (not meeting assumptions)
- ▶ Assumptions have changed/grown more conservative
 - ▶ Discount Rate (assumed rate of investment returns): 8.25% → 7.00% → 6.80%
 - ▶ Inflation rate (prices going up)
 - ▶ Mortality rates (people living longer)
 - ▶ Shorter, more conservative amortizations

All assumptions will be revisited by CalPERS during 2025 Asset Liability Management (ALM) Study



How CalPERS Benefits Get Funded

- ▶ Investment earnings used to make up a higher percentage (65%-70%+) of total contributions (pre-2008)

CalPERS
investment earnings

55¢

CalPERS
employers

34¢

CalPERS
members

11¢

CalPERS Pension Buck: a 20-year Average (as of June 30, 2024)



City's CalPERS Retirement Plans

- ▶ 2 Main CalPERS plans: Miscellaneous & Safety
 - ▶ **Miscellaneous:** 193 covered members; \$4.13M UAL
 - ▶ **Safety:** 94 covered members; \$3.14M UAL
- ▶ PEPPRA (effective 2013) helpful to manage long term pension costs for new employees
 - ▶ Enacted revised benefit levels for new plan members
 - ▶ Higher employee contribution rates mean more normal cost is being paid by the employee
- ▶ **However, 93% of current UAL comes from Classic plans and is not impacted by PEPPRA**

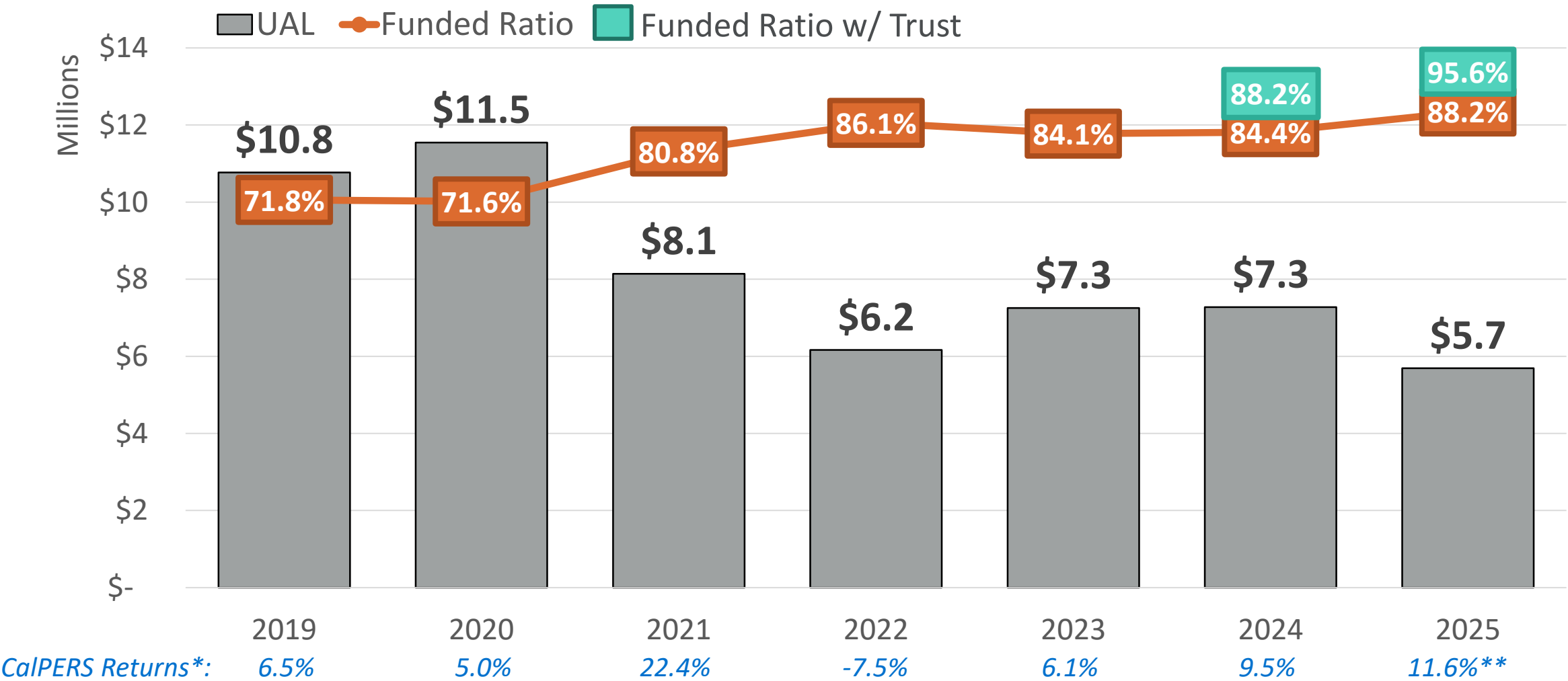




HISTORICAL AND PROJECTED CALPERS COSTS

History of the City's UAL Balance & Funded Ratio

Funded Ratio With and Without Section 115 Trust

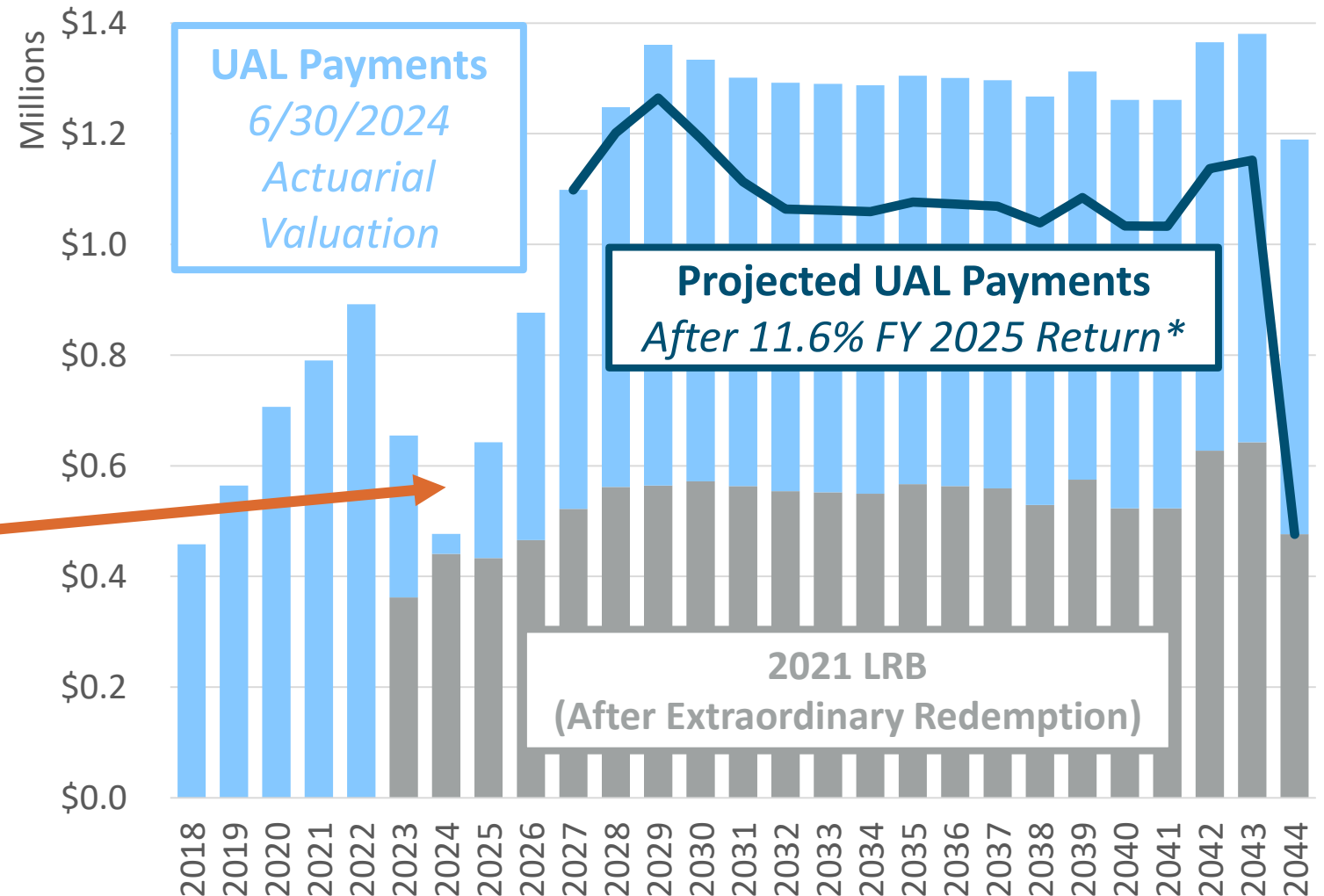


Source: CalPERS Actuarial Valuation Reports & CalPERS Pension Outlook Tool
*CalPERS' Money-Weighted Rate of Return, as reported by CalPERS in its Annual Comprehensive Financial Reports
**CalPERS' Time-Weighted Rate of Return

Historical & Projected CalPERS Payments

Rising Near-Term Payments

- ▶ Combined UAL + LRB payment projected to increase 55% from FY 2026 - FY 2029 (\$877K → \$1.36M)
 - ▶ Combined payment then stays relatively flat until FY 2044
- ▶ CalPERS' 11.6% investment return in FY 2025 could potentially reduce future UAL payments by \$225K per year
- ▶ City took advantage of lower payments in FY 2024 and FY 2025 to fund its Section 115 Pension Trust
 - ▶ Balance as of FYE 2025: \$3.6M



Source: CalPERS Actuarial Valuation Reports & CalPERS Pension Outlook Tool
 *Assumes FY 2024-25 investment returns of 11.6% and 6.8% thereafter.



COST MANAGEMENT STRATEGIES

Pension Cost-Containment Strategies – Not Mutually Exclusive

Prepay UAL early in Fiscal Year ($\approx 3.3\%$ discount)

Negotiate Cost Sharing With Employees

- New employees already governed by lower cost/benefit PEPPRA plans
- Negotiated cost sharing of the City's share

Fresh Start Amortization offered by CalPERS

- Pros: Smooths payment, shortens repayment period; reduces overall interest paid from shorter amortization period
- Cons: New structure "locked-in" + increased annual payments in near term; still amortized at discount rate

Use Cash Reserves to Pay Extra (two options) – *City has a Section 115 Pension Trust with \$3.6M balance*

- Section 115 Trust – Separate trust solely dedicated to pension/OPEB
 - City's annual UAL cost and Normal Cost can be supplemented with the Trust
- ADP – direct payments to CalPERS to reduce UAL
 - Choose optimal amortization bases to pay off

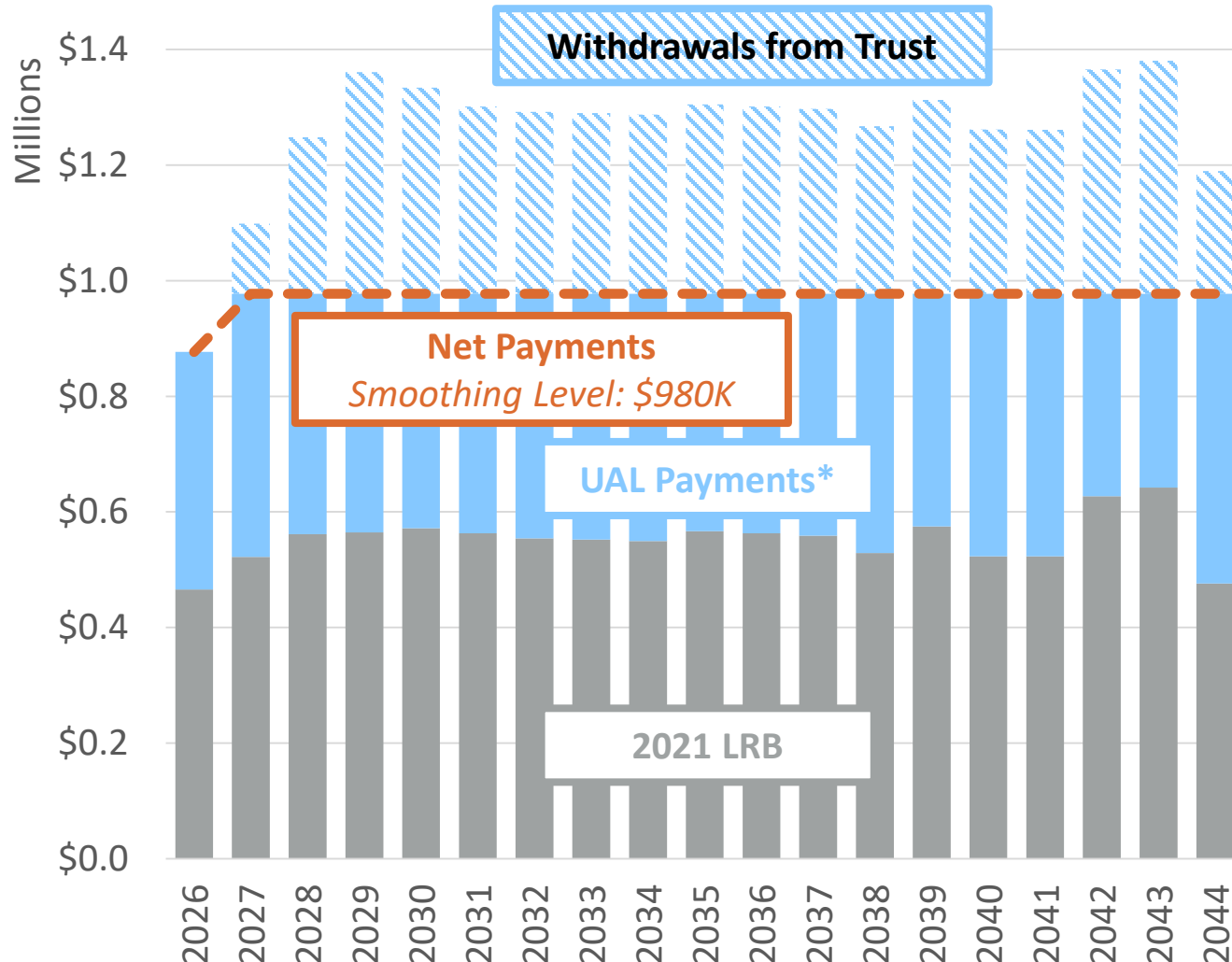
Restructure All or Portion of Remaining UAL – *City did this with its 2021 LRB Restructuring*

- Restructure portion of UAL at lower bond interest rate and "smooth out" payments for enhanced budget predictability, near and mid-term potential savings, and preservation of cash for other critical projects **NOT RECOMMENDED GIVEN CURRENT INTEREST RATES**



Section 115 Trust Smoothing Example #1

No Additional Deposits; 6/30/2024 CalPERS Valuation



Assumptions:

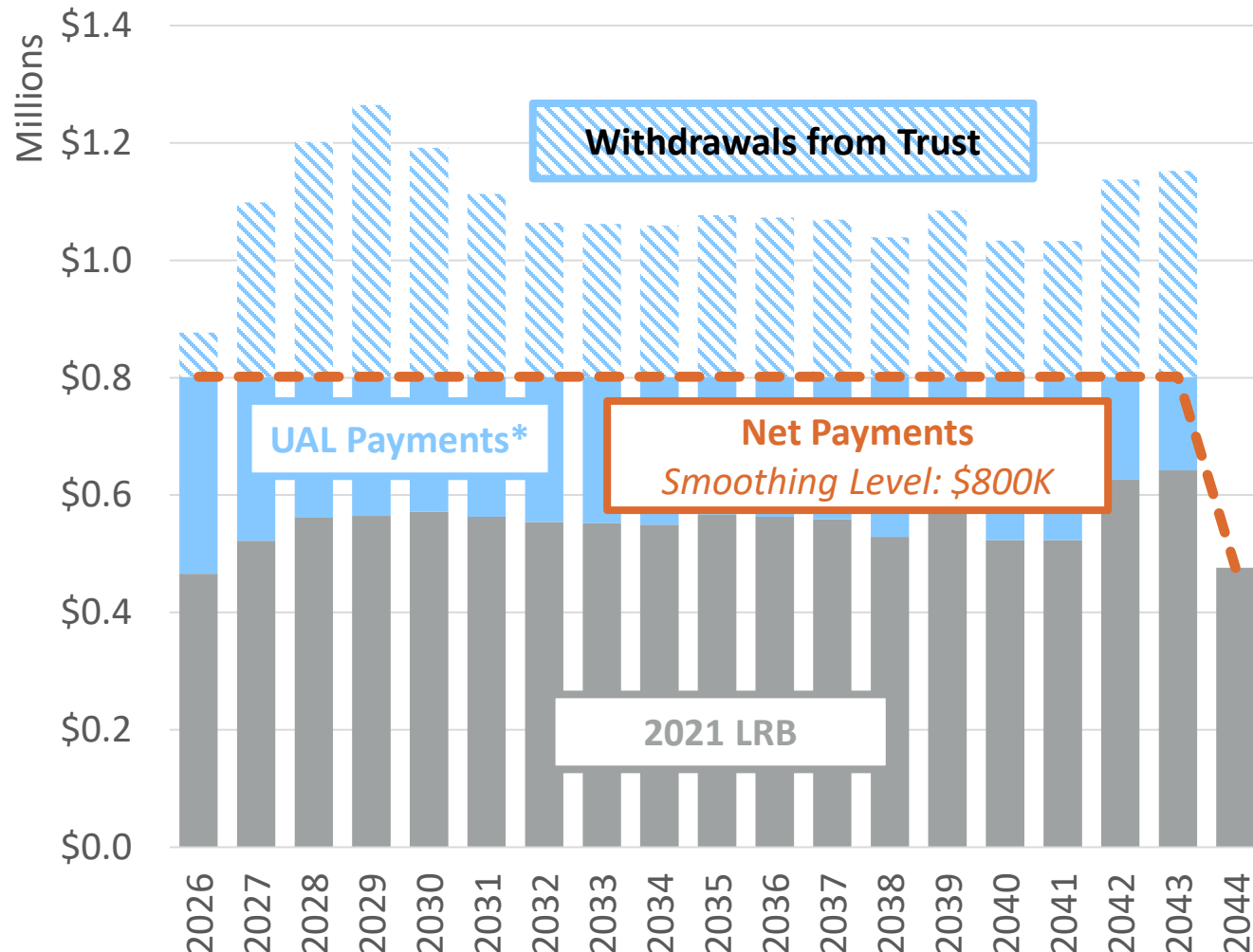
- ▶ **CalPERS Discount Rate:** 6.8% (no change)
- ▶ **CalPERS Investment Returns:** FYE 2024 Actuarial Report (9.5% in FY 2023-24; 6.8% thereafter)
- ▶ **UAL Balance:** \$7.3M
- ▶ **Beginning Trust Balance:** \$3.6M
- ▶ **Total Additional Deposits:** \$0M
- ▶ **Trust Annual Investment Earnings:** 5.00%
- ▶ **Ending Trust Balance:** \$0 (FYE 2044)



*Source: CalPERS Actuarial Valuation as of June 30, 2024

Section 115 Trust Smoothing Example #2

No Additional Deposits; 11.6% CalPERS Returns in FY 2024-25



Assumptions:

- ▶ **CalPERS Discount Rate:** 6.8% (no change)
- ▶ **CalPERS Investment Returns:** 11.6% in FY 2024-25; 6.8% thereafter
- ▶ **UAL Balance:** \$5.7M
- ▶ **Beginning Trust Balance:** \$3.6M
- ▶ **Total Additional Deposits:** \$0M
- ▶ **Trust Annual Investment Earnings:** 5.00%
- ▶ **Ending Trust Balance:** \$0 (FYE 2043)



**Source: CalPERS Pension Outlook Tool. Assumes FY 2024-25 investment returns of 11.6% and 6.8% thereafter.*



CONCLUSION

Conclusion

- ▶ City of Fort Bragg has been proactive in managing rising pension costs
 - ▶ 2021 UAL Restructuring: City restructured \$7.8M of UAL at an interest rate of 3.61%
 - ▶ Section 115 Pension Trust: \$3.6M balance as of FYE 2025
 - ▶ **These actions have led to an overall funding ratio that is above the City's peers**
- ▶ City's \$3.6M Section 115 Pension Trust is very strong at 2.5x of its FY 2026 UAL + Normal Cost + LRB payment
 - ▶ The Trust can help mitigate the pressure on the City's General Fund from rising pension costs over the next 10-20 years, while also providing budgetary flexibility
- ▶ City should stay vigilant to combat the impact of rising pension costs, including an annual review of pension cost projections + ongoing pension cost management strategies
 - ▶ City should reassess pension cost projections once CalPERS finishes its 2025 Asset-Liability Management Study in November 2025
 - ▶ Another update in early 2026 may be beneficial to better re-calibrate the 115 smoothing strategy and potential future deposits/withdrawals



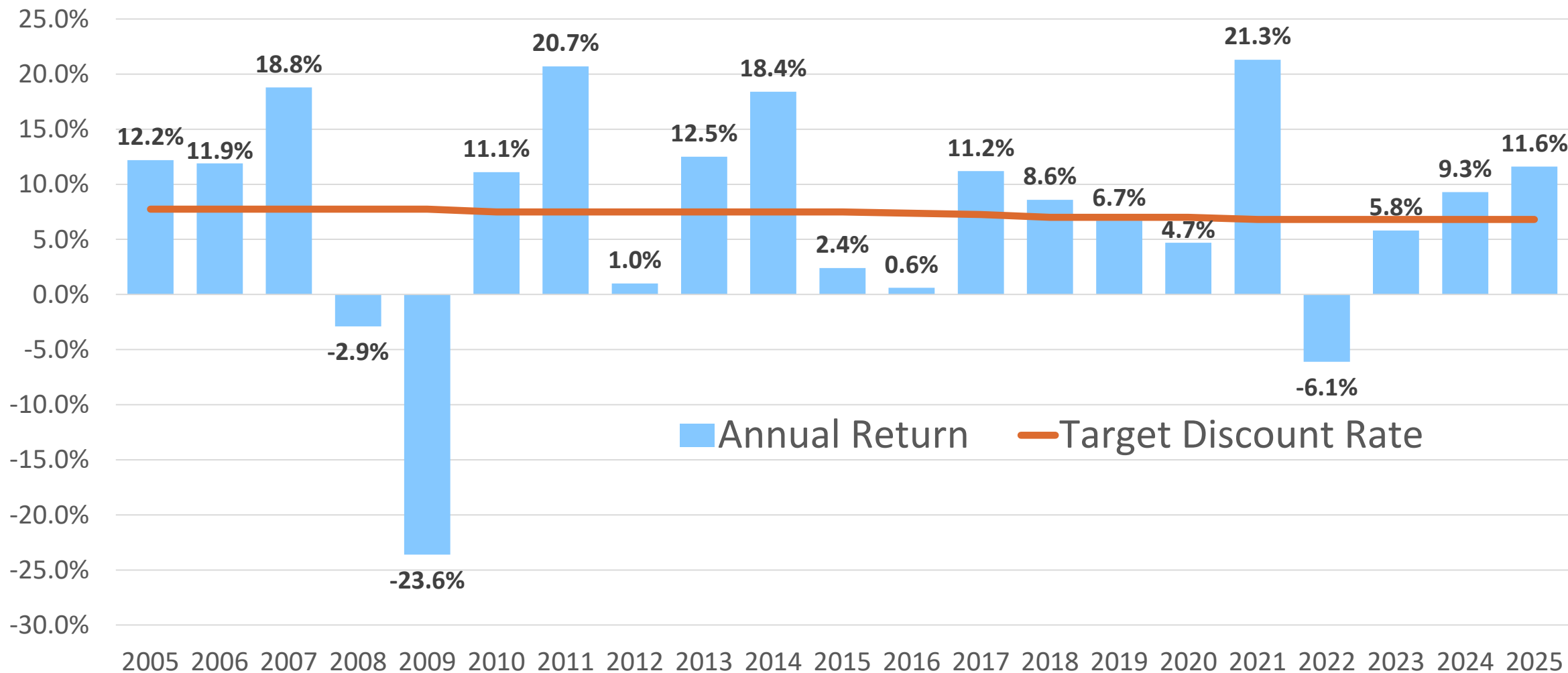


QUESTIONS?



APPENDIX – ADDITIONAL RESOURCES

CalPERS Historical Preliminary Investment Returns (Time-Weighted)*



**Preliminary Investment Returns represent the time-weighted rate of return and reflect private market asset valuations as of March 31. The money-weighted rate of return, used in the CalPERS ACFR and Valuation Reports may differ from the Preliminary Investment Returns. Source: CalPERS.*

Section 115 Trust – Overview

Consideration for Funds Earmarked for Pension and OPEB

- ▶ **What is it?** Restricted Account for pension and/or OPEB
- ▶ **Advantages:**
 - ▶ Potential Higher Investment Returns in Managed Account
 - ▶ *In FY 2025, Moderate Risk Section 115 Trust portfolios (40-50% Equity / 50-60% Fixed Income) had investment returns of 8.5-11.0%*
 - ▶ Longer-Term Benefit: Trust funds can grow over time and pay off a large % of UAL or OPEB liability in the future
 - ▶ Shorter-Term Benefit: Apply funds to “**smooth**” payment spikes in UAL, Normal Cost, or OPEB; can reimburse City for pensions costs made if severe budgetary challenges
 - ▶ Flexibility – more investment options than CalPERS and the City can decide when and how to use
- ▶ **Disadvantages:**
 - ▶ Doesn't directly reduce UAL until funds are transferred to CalPERS
 - ▶ Requires reserves/surplus contributions to build account balance
 - ▶ Investment risk (dependent on type of investment portfolio)



Additional Discretionary Payment (“ADP”)

- ▶ **What is it?** City makes ADP directly to CalPERS and CalPERS eliminates payments associated with the portion of the UAL paid off, essentially giving the City credit at the discount/interest rate (currently 6.8%)
- ▶ **Advantages:**
 - ▶ Reduced UAL / higher CalPERS funding ratio
 - ▶ Reduced future payments
 - ▶ Broader, less restrictive CalPERS investment portfolio has potential for higher returns
- ▶ **Disadvantages:**
 - ▶ Requires reserves / surplus to fund
 - ▶ Re-investment and market timing risk with ADP funds
 - ▶ Less budgetary flexibility and investment control (vs. Section 115 Trust option)



Section 115 Trust vs. CalPERS ADP Comparison

OPTION	Section 115 Trust	CalPERS ADP
Reduced UAL & UAL Payments with CalPERS	No	Yes
Reduced Pension Liability in Financial Report (ACFR)	No (Shows up as an asset on the City's financial statements)	Yes
Control of Investment Strategy	Yes	No
Funds Managed By	Trust Administrator	CalPERS
Flexibility in Uses	Yes	No
Enhanced Budgetary Flexibility	Yes	No
Savings	Varies; Depends on when City utilizes funds to pay liabilities	Immediate; Length of time varies based on which amortization component is paid off

