City of Fort Bragg

CalPERS Pension Liability Update

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July 8, 2024

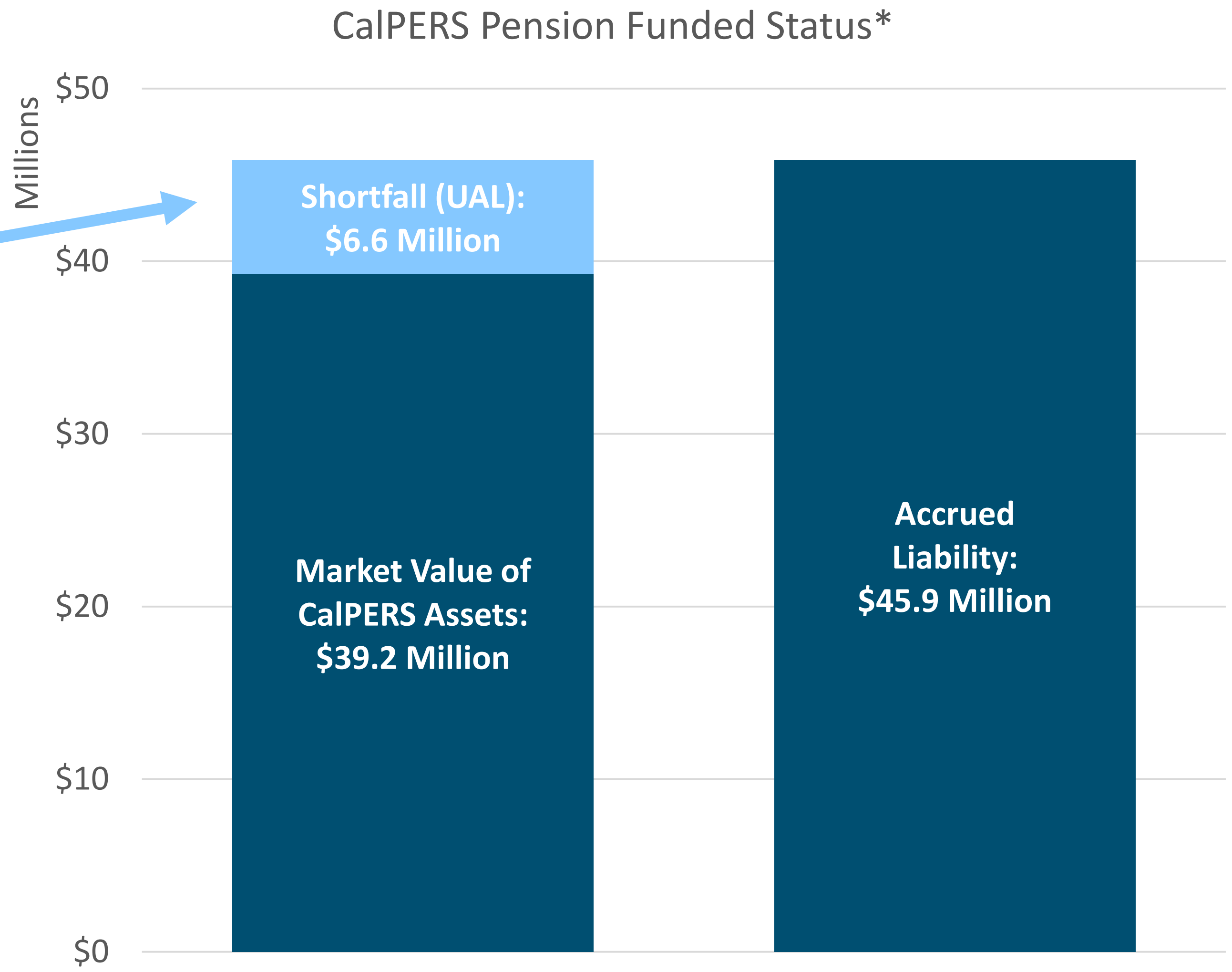
Executive Summary

- City has 5 employee plans with CalPERS: Miscellaneous, PEPRA Miscellaneous, Safety Fire, Safety Police and PEPRA Safety Police
  - Lower cost PEPRA plans helpful to limit future unfunded CalPERS unfunded actuarial liability (“UAL”)
  - 94% of UAL is from older, non-PEPRA (i.e. “Classic”) Plans and not reduced as City transitions to PEPRA
- City issued 2021 Bonds, a portion of which was used to refinance / restructure its UAL
  - Objectives: cash flow savings, smoothing pension payments, fiscal sustainability / resiliency
- $6.6M UAL has reemerged due to CalPERS investment returns below 6.8% target (FY ‘21-22: -7.5% and FY ‘22-23: 6.1%)
  - Increase in payments begin in FY ‘24-25
- Given current City revenues, City must actively manage for these increasing Pension payments to ensure these costs do not “crowd” out other priority services
  - Section 115 Trust Smoothing and Additional Discretionary Payments (“ADPs”) can help stabilize pension cost volatility

Background on How CalPERS Works

Two Annual Payments Made to CalPERS

- **(1) Normal Cost ("NC") =** Cost for current employees
- **(2) UAL:** Payment to amortize this "debt"
  - Amortized over 20 years
  - UAL is increased / decreased when CalPERS investment returns are below 6.80% or above 6.80%, respectively



**Assumes FY 2022-23 investment returns of 6.1%*
Source: CalPERS Pension Outlook Tool

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How Retirement Benefits Get Funded

Money Going In vs. Money Going Out

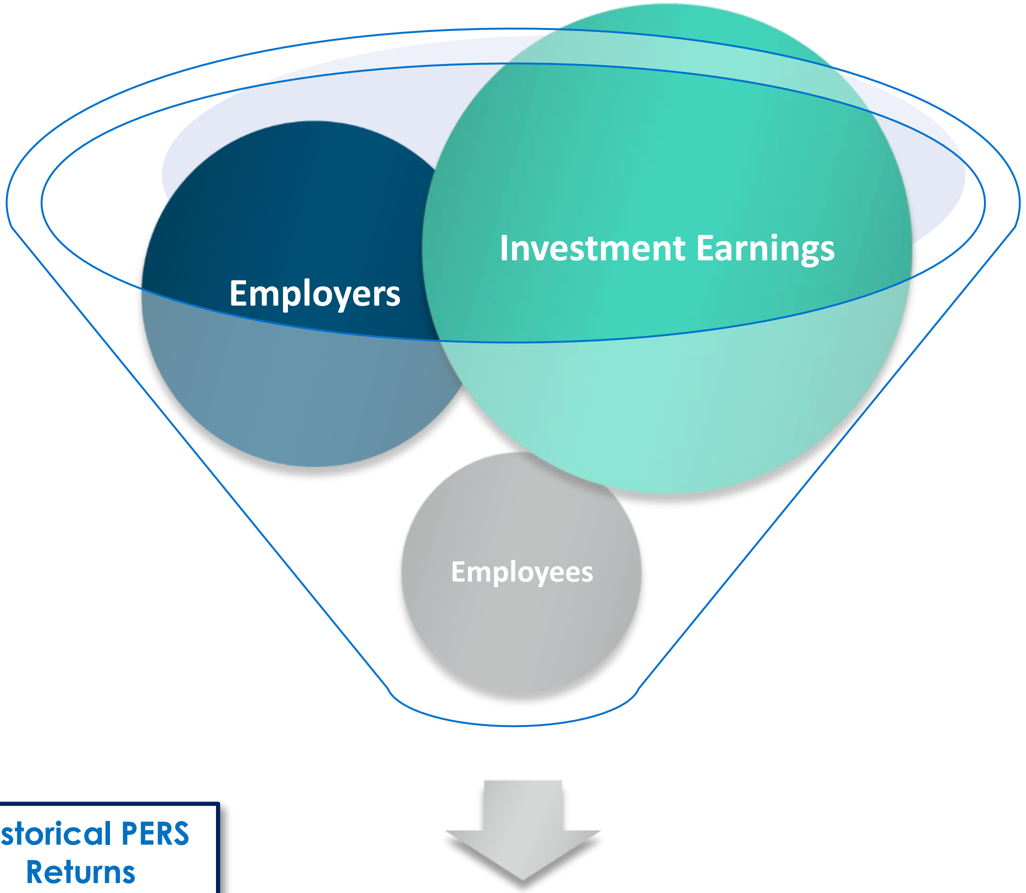
Employee Contributions: ≈11-13%

Employer Contributions: ≈29-32%

- Normal Cost: Payments to keep up with current employees
- UAL: Payments to amortize the Unfunded Accrued Liability

Investment Earnings: ≈55-60%

- As investments underperform assumptions, employers must make up the difference



Historical PERS Returns
(as of 6/30/2023)
5-Year: 6.1%
10-Year: 7.1%
20-Year: 7.0%
30-Year: 7.5%

Retirement Benefits & Plan Expenses

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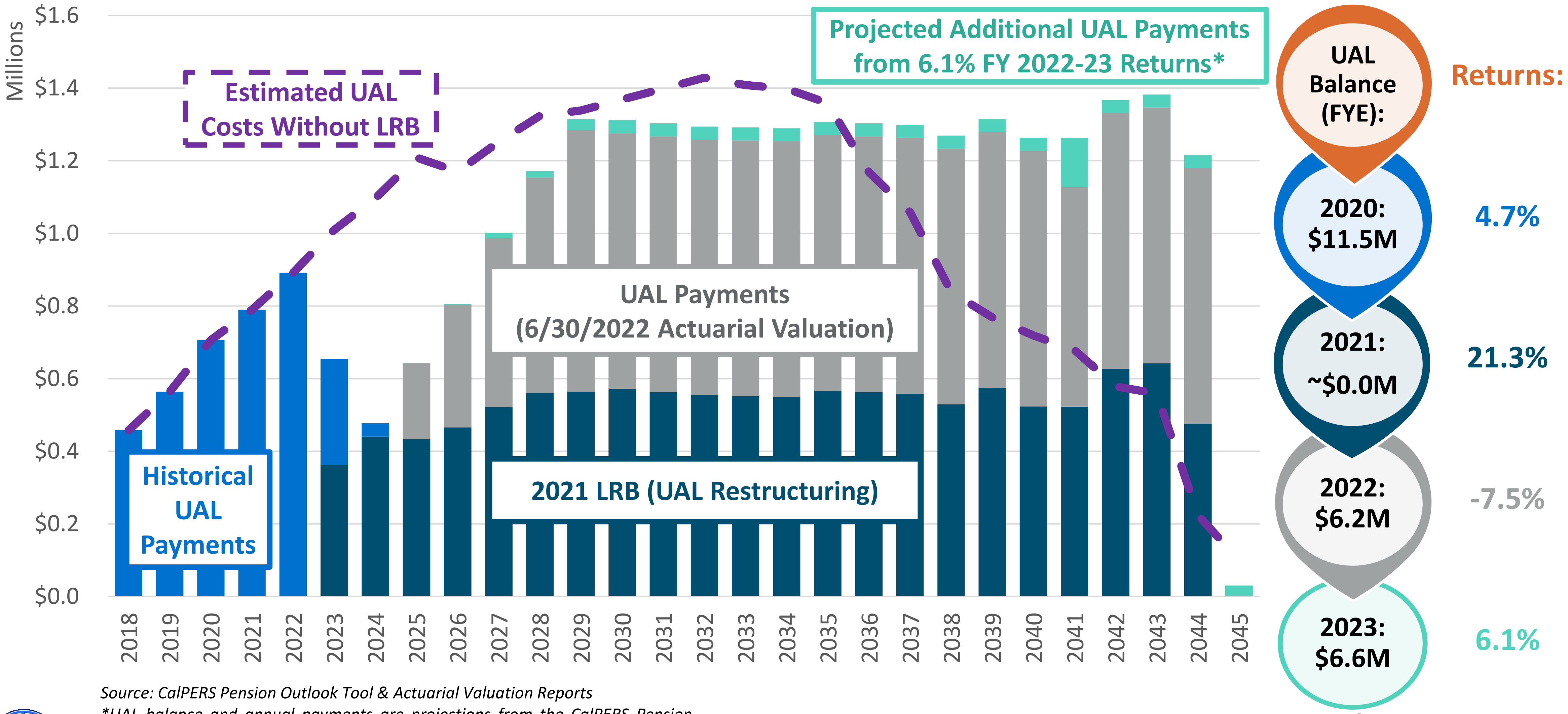
Historical & Projected UAL + 2021 LRB (UAL Restructuring)



Source: CalPERS Pension Outlook Tool & Actuarial Valuation Reports

**UAL balance and annual payments are projections from the CalPERS Pension Outlook Tool. Assumes FY 2022-23 investment returns of 6.1%, which is the money-weighted rate of return reported by CalPERS in its FY 2022-23 Annual Comprehensive Financial Report.*

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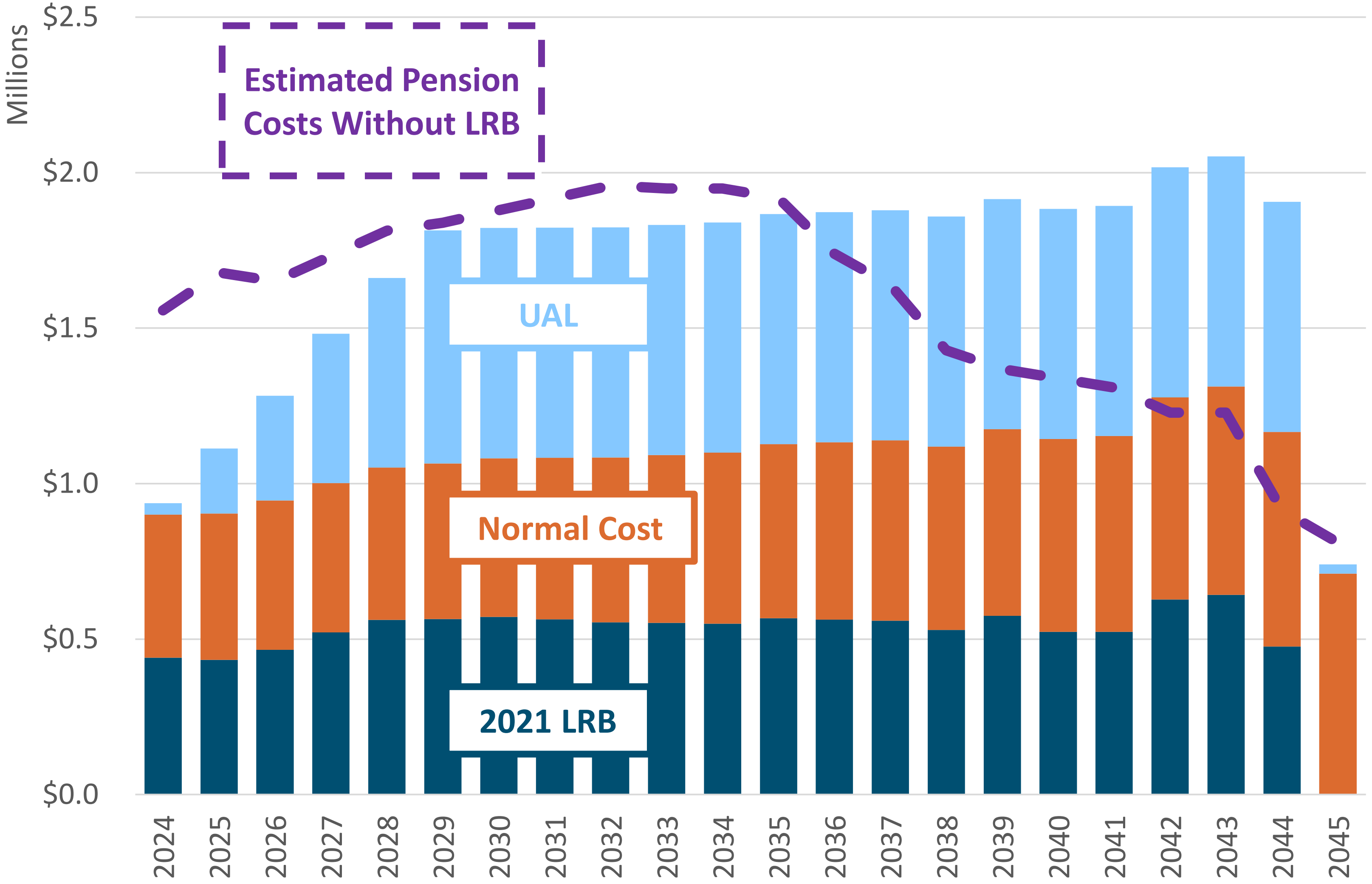
Total Projected Pension Payments (UAL + Normal Cost + LRB)

- Annual pension payment are increasing:
  - Total pension costs increase from ~$940k (FY'24) to ~$1.89M (FY'29)



Source: *CalPERS Actuarial Valuation Reports and CalPERS Pension Outlook Tool. Pension Outlook Tool assumes FY 2022-23 returns of 6.1% and 6.80% returns from FY 2023-24 onward.*

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Cost-Containment Strategies – Not Mutually Exclusive

(1) Prepay UAL early in Fiscal Year (≈ 3.3% discount) → *City does this annually*

(2) Negotiate Cost Sharing With Employees

- Negotiated cost sharing of the City's share → *City did this in 2018*
- New employees already governed by lower cost/benefit PEPRA plans

(3) Voluntary Fresh Start Amortization offered by CalPERS

- Pros: Smooths payment, shortens repayment period; reduces overall interest paid (from shorter term)
- Cons: Retain 6.8% rate; Higher payments from same rate + Shorter Term; New structure "locked-in"

(4) Use Cash Reserves to Pay Extra (two options)

- Section 115 Trust – Separate trust solely dedicated to pension/OPEB → *City has a $1.95M Section 115 Pension Trust*
- ADP – Reduce UAL through direct lump sum payment to CalPERS

(5) Restructure All or Portion of Remaining UAL

- 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 → *2021 Bonds did this*

Additional Discretionary Payment ("ADP")

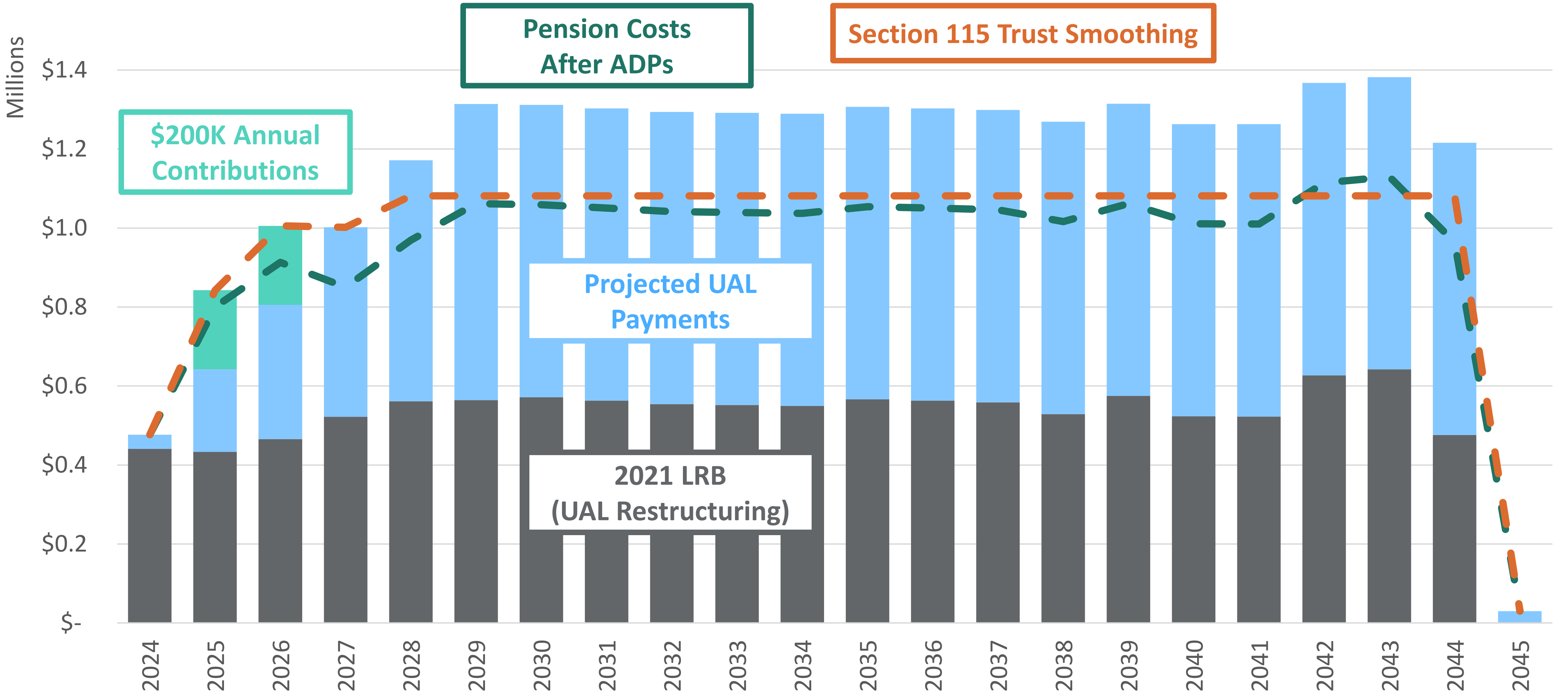
- **What is it?** Direct payment to CalPERS which then eliminates payments associated with the portion of the UAL paid off (6.8% interest rate assumed)
- **Advantages:**
  - Reduced UAL / higher CalPERS funding ratio
  - Reduced future payments
  - CalPERS investment portfolio has potential for higher 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

- **What is it?** Depositing money into an account which then earns interest and can be directed to pay only pension (Normal or UAL) or OPEB costs
- **Advantages:**
  - Flexibility: Can earn potentially higher returns (vs. non-115 Trust City cash reserves) & also City can decide how and when to direct spending of 115 Trust funds:
    - <u>Shorter-Term Benefit</u>: Apply funds to ***"smooth"*** payment spikes in UAL and/or Normal Cost
    - <u>Longer-Term Benefit</u>: Trust funds can grow over time and pay off a large % of UAL in the future
  - Diversification: "Shock Absorber" for CalPERS investment performance
- **Disadvantages:**
  - Requires reserves/surplus contributions to build account balance
  - Investment risk (dependent on type of investment portfolio)
  - Doesn't reduce UAL (and increase funding ratio) until funds are transferred to CalPERS

Section 115 vs. ADP Comparison

Using $1.95M City has Accumulated



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Comparison of Section 115 Trust & ADP Preliminary Analysis

Strategy:	ADP	Section 115 Trust Smoothing
Assumed Interest Rate Benefit	6.80%*	4.00%*
Estimated Gross Savings	$4.53 Million	$3.58 Million
Contributions	$2.35 Million	$2.35 Million
Estimated Net Savings	**$2.18 Million**	**$1.23 Million**
Budgetary Flexibility	$0 (ADPs deposited cannot be retrieved from CalPERS)	Assets in Trust are available to City for pension costs
Target Smoothing Level	Net payments fluctuate	$1.08 Million

**Assumed long-term investment returns; Not fixed or guaranteed.*

Takeaways

- Rising pension costs are a challenge facing most public agencies, and the City has *aggressively* addressed this challenge through strategies such as:
  - Refinanced/restructured UAL debt in 2021 to save interest and to "smooth" payment
  - Building up Section 115 Trust reserves ($1.95M Balance)
- Yet, significant CalPERS UAL balance / required payment has re-emerged
  - Requires continued vigilance to pro-actively manage the payment on this liability to ensure other priority services are not impacted
    - Consider making direct ADPs to CalPERS to pay down UAL
    - Consider growing City's Section 115 Trust