



City Council Agenda Item

City Council Meeting Date: July 16, 2019

TO: Jim Throop, City Manager

FROM: Dean Albro, Management Services Director
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SUBJECT: Approve Prepayment of the Fiscal Year 2019-20 Annual Unfunded Actuarial Liability for the Miscellaneous and Safety California Public Employees' Retirement System Plans

Recommendation:

Staff recommends the City Council approve the prepayment to California Public Employees' Retirement System (CalPERS) of the Fiscal Year (FY) 2019-20 annual portion of the City's Unfunded Actuarial Liability (UAL) for each plan in the total amount of \$5,616,641 (a 3.5% discount realizing a benefit to the City of \$200,042 compared with the total payments of \$5,816,683, if the prepayment being recommended were not made) and authorize the payment of the FY 2019-20 portion of the UAL by July 31, 2019.

Background:

In 2003, CalPERS "pooled" the City of Lompoc's (City) Safety retirement plans as there were less than 100 participants in each Safety plan. The City's Miscellaneous retirement plan remained as a standalone plan as it had more than 100 participants in 2003 when pooling was introduced.

In 2011, the City contracted with CalPERS for two new Safety retirement tiers under the Safety plan. One of the new tiers was for Police staff hired after August 27, 2011, the effective date. The other new tier was for Fire staff hired after September 24, 2011. Both tiers provide for the retirement benefit commonly known as "3% at 55" compared to the "3% at 50" retirement benefit provided to staff hired before the effective dates. The new tiers are commonly referred as "Tier 2".

In 2012, the State of California (State) passed legislation authorizing two additional Safety retirement tiers effective January 1, 2013. Again, one was for Fire staff and the other was for Police staff. These are commonly known as "Tier 3" or PEPRAs. Each one provides the "2.7% at 57" retirement benefit.

The City contracted with CalPERS for a Tier 2 Miscellaneous plan (2% at 60) effective for employees hired after November 19, 2011. Effective January 1, 2013, the State passed

legislation authorizing a third tier for Miscellaneous plans (2% at 62). As the City's Miscellaneous plan was not pooled in 2003, the three tiers are accounted for in the single City Miscellaneous plan.

The discount available for prepaying the UAL is approximately equal to one-half the expected return of the CalPERS investment portfolio, or approximately 3.5% of the CalPERS expected return of 7.0%. While the recommendation applies to the City's fiscal year UAL contributions, the City remains obligated to pay the Normal Cost as a percentage of employee pay through the CalPERS payroll reporting process on an ongoing basis through FY 2019-20 and beyond.

Discussion:

The City has a Miscellaneous and Safety retirement plans each with three tiers. The chart below is a summary of the full payment requirements and the discounts payment option for each of the City's plans for FY 2019-20:

	<u>Miscellaneous</u>	<u>Safety</u>					<u>Total</u>	
	<u>Tier 1,2 & 3</u>	<u>Tier 1</u>		<u>Tier 2</u>		<u>Tier 3</u>		
		<u>Fire & Police</u>	<u>Fire</u>	<u>Police</u>	<u>Fire</u>	<u>Police</u>		
Annual UAL Payment	\$ 3,793,144	\$ 2,012,767	\$ 3,050	\$ 1,262	\$ 3,212	\$ 3,248	\$ 5,816,683	
Annual UAL Pre-Payment	3,662,694	1,943,546	2,945	1,219	3,101	3,136	5,616,641	
Prepayment Discount	\$ 130,450	\$ 69,221	\$ 105	\$ 43	\$ 111	\$ 112	\$ 200,042	

The savings realized for FY 2019-20 of \$200,042 by prepaying the UAL is comparable to the \$170,918 saved in FY 2018-19. As CalPERS continues to ramp up contributions started in FY 2015-16 and continuing through FY 2031-32 due to the phase out of smoothing methods adopted in the Great Recession, and implementation of the reduction of the assumed rate of return from 7.5% to 7.0%, the prepayment discount savings will likely continue to grow as the absolute amount of annual contributions grow.

Fiscal Impact:

Prepayment of the City's UAL for the Safety and Miscellaneous plans using the CalPERS "Annual UAL Prepayment Option" will save the City \$200,042 in payments during the upcoming FY 2019-20. The Insurance and Benefit Fund, an internal service fund, will advance the resources to pay the lump sum payments and will recoup the advance through payroll allocations throughout the year. The payroll allocations are from departmental charges as part of budgeted compensation costs. As a result, the Insurance and Benefit Fund will have fewer resources to invest as part of the City's investment program during the year but will recover the full amount of the advance by the time the final payroll is processed prior to June 30, 2020. The anticipated reduction in investment income opportunities are less than the gain to departments from the prepayment. The current yield on the City's investments is estimated at 2% compared to the 3.5% discount, which would be realized from the UAL prepayment. In the future, if interest rates continue

to increase and exceed the annual discount, the City can then reanalyze the effectiveness of the annual prepayment option.

This Annual UAL Prepayment Option being recommended is one of the opportunities available to reduce the City’s long-range UAL balances. The City is not prohibited from paying more than the contribution amount provided by CalPERS. CalPERS provides a number of alternate amortization schedules the City can use to reduce our long-range UAL obligations.

Since the inception of the UAL payment feature, the City has prepaid the annual required contributions for both the Miscellaneous and the pooled Safety plans. The chart below, shows the payments made since FY 2015-16 including the proposed payment for FY 2019-20.

Fiscal Year	<u>Miscellaneous</u>	<u>Safety</u>					<u>Total</u>
	<u>Tier 1,2 & 3</u>	<u>Tier 1</u>	<u>Tier 2</u>		<u>Tier 3</u>		
		<u>Fire & Police</u>	<u>Fire</u>	<u>Police</u>	<u>Fire</u>	<u>Police</u>	
2016-17	n/a	\$ 1,207,023	\$ -	\$ -	\$ -	\$ 93	\$ 1,207,116
2017-18	2,548,469	1,364,529	-	-	1,456	1,780	3,916,234
2018-19	3,074,810	1,636,677	2,718	453	2,085	2,284	4,719,027
2019-20	3,662,694	1,943,546	2,945	1,219	3,101	3,136	5,616,641

Conclusion:

The one-year discount opportunity is available only through July 31, 2019, for prepaying the City’s obligations of its UAL contributions. The prepayment option was included in the adopted Biennial Budget FYs 2019-21 and will result in savings of \$200,042 in FY 2019-20 if implemented, bringing total savings in the budget to \$515,163.

Respectfully submitted,

Dean Albro, Management Services Director

APPROVED FOR SUBMITTAL TO THE CITY COUNCIL:

Jim Throop, City Manager