

CITY COUNCIL STAFF REPORT

Current Business Item No. 11

April 25, 2018

File No. 0720-40

SUBJECT: Section 115 Irrevocable Pension Trust Funding Options and Policy Direction on Use of One-Time Resources

DEPARTMENT: Finance Department

RECOMMENDATION:

It is requested that the City Council provide policy direction on funding the Section 115 Irrevocable Pension Trust and use of one-time resources.

FISCAL ANALYSIS:

The General Fund projected CalPERS pension payments, including the portion that is categorized as the unfunded liability portion, will increase over the next five years by approximately \$11 million or 63 percent. City Council policy direction will determine the amounts to be contributed to the Section 115 Irrevocable Pension Trust to help meet these future obligations.

CORRELATION TO THE CITY COUNCIL ACTION PLAN:

This item relates to the Council Action Plan regarding Fiscal Management. The establishment and funding of an Irrevocable Section 115 Pension Trust helps assure sustainability of pension benefits.

PREVIOUS ACTION:

The City Council conducted a Pension Workshop on September 27, 2017, and determined to establish a Section 115 Irrevocable Pension Trust. On February 14, 2018, the City Council authorized the establishment of the Trust with Public Agency Retirement Services (PARS). The City Council also approved a deposit of \$1,984,000 to initially fund the Trust.

BACKGROUND:

The City's adopted budgetary and financial policies require that a long-term financial plan be maintained for the City's General Fund and other City Funds. The policy specifies that this plan should be reviewed and updated as new financial information becomes available. The purpose of the plan is to outline the general approach the City will follow over the long-term to provide and pay for City services, grow the City's economy for the purpose of revenue generation, and control and manage the cost of services and the method of service delivery. The plan also identifies and reviews unfunded liabilities and other deferred costs and include budget strategies to address these obligations.

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With respect to one-time resources, the City’s current policy is to allocate all such funds only to 1.) one-time uses, including capital and other one-time expenditures; 2.) provide transitional funding of operations (for a limited time period with a planned ending date) 3.) increase reserves; or 4.) pay down unfunded liabilities.

Escondido includes the General Fund Multi-Year Financial Plan in the City’s Annual Adopted Operating Budget each year. This Multi-Year Financial Plan projects future revenues and expenditures using various assumptions and budget strategies and highlights the long-term effects of these financial decisions.

The following Multi-Year Financial Plan appeared in the Fiscal Year 2017/18 Annual Operating Budget which was adopted by the City Council and used to fund General Fund operations. The Plan was modified to exclude the use of one-time resources from the Successor Agency Loan Repayment.

Escondido General Fund Multi-Year Financial Plan				
	Adopted FY 2017-18	Projected FY 2018-19	Projected FY 2019-20	Projected FY 2020-21
Operating Revenue	\$ 97.30	\$ 99.20	\$ 101.20	\$ 103.20
Successor Agency Loan Repayment		-	-	-
Transfers In	2.1	2.1	2.1	2.1
Total Sources	\$ 99.40	\$ 101.30	\$ 103.30	\$ 105.30
Required PERS Contribution	\$ 17.40	\$ 19.20	\$ 21.70	\$ 24.30
Operating Budget - All Other	81.3	86.4	90.0	94.3
Transfer Out	0.7	0.7	0.7	0.7
Total Uses	\$ 99.40	\$ 106.30	\$ 112.40	\$ 119.30
Total Sources Over/(Under) Uses	\$ -	\$ (5.00)	\$ (9.10)	\$ (14.00)
\$ in millions				

This Multi-Year Financial Plan shows that projected revenue growth will not keep up with projected expenditure growth, primarily because of pension costs which will rise significantly in upcoming years. Thus, the City is potentially facing a budget deficit of \$14 million by FY 2020-21.

More specifically, the General Fund projected pension payment, including the portion that is categorized as the unfunded liability portion will increase over the next five years by approximately \$11 million or 63 percent. On an even longer term basis, based on pension contribution projections beginning in FY 2023-24, the General Fund will need to make an average annual pension contribution of \$35 million per year over the next 20 years. By comparison, the current payment is

only \$17.4. In other words, the required pension payments will roughly double over the next 20 years. This is not sustainable.

CalPERS GENERAL FUND CONTRIBUTIONS (In Millions)			
Fiscal Year	Unfunded Liability Portion	Total PERS Projected Cost	Annual Percentage Increase
2017-18	\$10.1	\$17.4	
2018-19	\$12.0	\$19.2	11%
2019-20	\$14.3	\$21.7	13%
2020-21	\$16.1	\$24.3	12%
2021-22	\$18.3	\$26.5	10%
2022-23	\$20.2	\$28.4	7%

To address this looming issue, the City Council has started by authorizing and creating Section 115 Irrevocable Pension Trust with Public Agency Retirement Services (PARS). This Trust will be used to set aside and hold money to meet future pension liabilities. Funds placed in the Trust are irrevocably committed only to pension obligations, whether regular portions or unfunded liability portions. Funds held in the Trust can be invested in the same manner as funds in a typical pension fund rather than as part of the City's General Fund, which means a potentially higher rate of return.

Additionally, the Section 115 Trust can also be used to stabilize rates at the local level. Recent changes in rate smoothing strategies by CalPERS have increased volatility in employer contribution rates. Monies set aside in a Section 115 Trust can be used to ease budgetary pressures resulting from unanticipated spikes in employer contributions rates.

At this point in time, the source of funding for the City of Escondido's Section 115 Trust is one-time resources. The City Council recently approved an initial deposit of \$1,984,000, which had been previously set aside in the PERS Rate Smoothing Reserve.

Staff is also recommending that the Trust only be funded and used by the City's General Fund. This is because the General Fund has more limited options, than other City funds, to deal with volatile PERS rate changes with 78 percent of revenue coming from taxes and 85 percent of uses spent on employee services.

It is imperative for the public, City employees, and policymakers to remain acutely aware of the CalPERS unfunded liability issue at all times in making financial decisions. The failure to constantly monitor the City's ability to address this liability would have drastic and adverse consequences not just for employees, but also for providing public services.

To keep the issue front and center, City staff has developed a dynamic fiscal sustainability planning tool that will provide ongoing evaluation of revenues, expenditures, up to date liability projections, as well as contributions towards and uses of the Section 115 Trust. This planning tool will be reviewed and updated regularly as part of any major financial decisions which the City must make, whether involving one-time receipts or expenditures, ongoing budget decisions, or even operational changes which have budgetary impact. Section 115 Trust monies are an important part of the ongoing financial structural stability of the City and will be a major component of the tool.

In addition to moving funds from the interim PERS Rate Smoothing Reserve to the Section 115 Trust, Staff also recommends City Council direction to make the following additional contributions to the Trust:

- The Successor Agency Loan Repayment that will total a little over \$14 million over the next 4 years shall all be contributed to the Section 115 Trust.
- Future proceeds from the sale of City property belonging to the General Fund shall all be contributed to the Section 115 Trust.
- At the end of each fiscal year, Finance Staff shall determine if any General Fund surplus exists. If so, the year-end surplus will be used first to address deficiencies or matters of fiscal concern identified by the City Manager. The remaining surplus will then be split with 50 percent used to fund the Section 115 Trust and 50 percent used to address City Council special projects.

It should be noted that even with the additional contributions referenced above, as incorporated in the planning tool, there will remain significant future liabilities that must be addressed. Thus, staff also recommends that the City Council provide policy direction regarding the amount of future one-time funds which should be contributed to the Trust.

APPROVED AND ACKNOWLEDGED ELECTRONICALLY BY:

Sheryl Bennett, Deputy City Manager/Admin. Svs.
4/19/2018 2:50 p.m.

Joan Ryan, Assistant Director of Finance
4/19/2018 2:50 p.m.