



## STAFF REPORT

**Meeting Date:** January 13, 2015  
**To:** Honorable Mayor & City Council  
**From:** Don Rhoads, Administrative Services Director/Chief Financial Officer  
**Subject:** Update on Pension Rates and Unfunded Liability

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### INTRODUCTION

The City recently received its annual actuarial report from CalPERS providing updated estimates of future pension rates and the level of unfunded liability (UL). Because CalPERS reporting lags by over a year, this report is based on fiscal year 2012-13 activity. Since fiscal year 2012-13 was a positive earnings year for CalPERS (13.2%), the news this year is generally good. Rates are still rising and the UL is still very large, but the level of growth in rates has moderated considerably and projections now show rates finally leveling off by 2019-20, providing something of a light at the end of the tunnel.

### DISCUSSION

The table on the next page shows projected pension rates for the City's "Miscellaneous" (non-safety) employees as well as safety (police and fire) employees. Beside the projected rates the table also shows the projections from last year and the change for comparison. As you can see, in almost all cases the projected rates going out to 2019-20 have declined from last year's projections. Whereas I previously reported that rates five years out were projected to be over 56% for safety and over 27% for miscellaneous employees, now those projections are 4%-5% lower at 51% and 23%, respectively. Note that an additional year has been added to the projection (2020-21) and is projected to level off at about those 51% and 23% levels. This is due in part to the effect of the savings expected from the lower cost Public Employee Pension Reform Act (PEPRA) pension plans enacted in 2012. As more employees join the City under those less expensive plans pension costs should flatten out and in time begin to decline, assuming CalPERS continues to meet or exceed its actuarial assumptions such as its 7.5% earning target.

Also note that for the 2014-15 Miscellaneous plan the rate dropped by 0.4%. This was due to the additional \$2 million allocated to reduce the rates and UL in the 2013-14 budget, which will be further discussed below.

**Projected Pension Rates**

Fiscal Year	Miscellaneous			Safety		
	Projected Rate	Previous Projection	Change	Projected Rate	Previous Projection	Change
2014-15	17.2%	17.6%	-0.4%	37.2%	37.2%	0.0%
2015-16	18.8%	18.8%	0.0%	41.3%	39.5%	1.8%
2016-17	20.2%	22.3%	-2.1%	44.5%	45.1%	-0.6%
2017-18	21.2%	24.1%	-2.9%	46.7%	48.8%	-2.1%
2018-19	22.2%	25.9%	-3.7%	48.9%	52.6%	-3.7%
2019-20	23.2%	27.6%	-4.4%	51.2%	56.4%	-5.2%
2020-21	23.2%			51.1%		

Likewise, the news regarding the City’s unfunded pension liability is generally good because the liability decreased. However, as I described at the mid-year review and again at a budget study session earlier this year, it is somewhat complicated this year because the Governmental Accounting Standards Board (GASB) changed the methodology for calculating the value of assets in the plan from the “Actuarial Value of Assets” (AVA) to the “Market Value of Assets” (MVA) approach and CalPERS has implemented this change. The GASB believes this approach will more accurately represent the level of assets and, therefore, the level of the unfunded liability. The advantage of using the MVA approach is that it is more understandable in that the value of assets is simply the market at a point in time (i.e. June 30), which is fairly straightforward. The disadvantage of the MVA approach is that it is much more volatile. The AVA, however, uses actuarially determined smoothing methods to provide a less volatile picture over time.

The table on the next page shows the change the plan assets and UL showing, for comparison purposes, both the old AVA and new MVA approaches. As you can see, in both cases the UL dropped:

- a modest \$0.5 million in the case of the more stable AVA approach to \$125.5 million; and
- a more substantial \$21.2 million, to \$191.7 million, in the case of the more volatile MVA approach.

Funding levels also increase overall in both cases to 81.3% (AVA) and 71.4% (MVA).

**Change in Unfunded Pension Liability**  
(millions)

	Misc Plan		Safety Plan		Total	
	2012	2013	2012	2013	2012	2013
Accrued Liability	\$278.1	\$288.4	\$370.3	\$382.9	\$648.4	\$671.3
Actuarial Value of Assets	229.8	242.4	292.6	303.5	522.3	545.9
Unfunded Liability (AVA basis)	<u>(\$48.3)</u>	<u>(\$46.0)</u>	<u>(\$77.7)</u>	<u>(\$79.5)</u>	<u>(\$126.0)</u>	<u>(\$125.5)</u>
Percent Funded (AVA basis)					80.6%	81.3%
Market Value of Assets	191.6	213.4	243.8	266.3	435.5	479.6
Unfunded Liability (MVA basis)	<u>(\$86.5)</u>	<u>(\$75.1)</u>	<u>(\$126.4)</u>	<u>(\$116.7)</u>	<u>(\$212.9)</u>	<u>(\$191.7)</u>
Percent Funded (MVA basis)					67.2%	71.4%

Additional Funds to Reduce Pension Rates and Unfunded Liability

Last fiscal year (2013-14) the City Council allocated \$2 million toward paying down the pension UL, which was sent to CalPERS. This reduced the Miscellaneous plan pension rate by 0.383%. This may not sound like much but is creating a real dollar savings and is projected to save approximately \$141,000 this fiscal year, a return of 7.3%. The City Council allocated an additional \$2 million in the current year's budget (2014-15) as well. The options given to the City Council at budget time were very limited as follows:

1. Make only the required pension payments each year
2. Advocate at the State level for additional pension reform legislation
3. Make additional payments to reduce future pension rates

When the budget was presented last spring, however, the City Council requested additional options because they were not comfortable at that time with allowing the new \$2 million allocation to be sent to CalPERS again as it had been the year before. Since that time staff has been researching this matter and discussing options with the City's actuary and legal counsel and has discovered another option only recently approved by the Internal Revenue Service, and that is a Section 115 Trust.

### Option for Paying Down the Pension Unfunded Liability

A Section 115 Trust (referring to Section 115 of the Internal Revenue Code) is an irrevocable trust, which means dollars put into that trust cannot be taken back out except to satisfy the purposes of the trust. Section 115 Trusts have been used for some time as a vehicle for setting aside funding to reduce an agency's unfunded retiree medical (i.e. Other Post-employment Benefit – OPEB) liabilities, but this vehicle had never been approved by the IRS for funding pension unfunded liabilities until a few months ago. While the irrevocability of the Trust limits how the funds can be used, it also allows the Trust to invest proceeds in higher earning assets that the City does not have access to by law. This would give the City more control over how assets were invested, but would also carry with it the risk of potential loss of assets should the economy take another steep dive.

Here are some of the key features and pros/cons of a Section 115 Trust:

- Administered by Public Agency Retirement Services (PARS) – a privately held corporation, not a state agency and not related to CalPERS. PARS currently manages the City's retirement plan for the City's part-time/seasonal employees;
- 375,000+ participants;
- \$1.6 billion in assets under administration;
- PARS has requested a private letter ruling from IRS to establish their Section 115 Trust – ruling timeframe is 4-6 months;
- Pros:
  - Alternative to sending funds to CalPERS;
  - Maintain greater local control of assets. Investments can be tailored to the City's desires and risk tolerance;
  - Would reduce City's unfunded pension liability;
  - Would reduce net pension liability on City's balance sheet;
  - Higher potential earnings than City can achieve;
- Cons:
  - City retains fiduciary responsibility for the program while there is potential for negative investment performance;
  - Funding a Section 115 Trust would lower UL but not pension rates that are calculated by CalPERS;
  - Assets placed into the Trust can only be earmarked for pension funding purposes and cannot be used for other purposes should an unexpected need arise;
  - Adds administrative complexity (new program to administer, oversight of plan assets, etc.);
  - Very limited precedent for utilizing a Section 115 Trust for pension funding purposes – only one other agency is known to have used this tool.

So the Council can consider all options, here are some key features and pros/cons regarding using CalPERS to reduce the UL:

- The Public Employee Retirement System (CalPERS) is an agency of the state of California;
- 1.7 million participants;
- \$301.1 billion in assets under administration (as of 12/22/14);
- Pros:
  - Would reduce City's unfunded pension liability;
  - Would also lower pension rates resulting in ongoing bottom-line savings (estimated savings of \$141,000 in current fiscal year from last year's \$2 million contribution);
  - Administratively easier to implement since there is nothing new to set up and administer;
  - Would reduce net pension liability on City's balance sheet;
  - Higher potential earnings than City can achieve;
- Cons:
  - Assets placed into CalPERS can only be earmarked for pension funding purposes and cannot be used for other purposes should an unexpected need arise;
  - Do not have control over how assets are invested;

### **FISCAL IMPACT**

Immediate fiscal impact would be allocation of \$2.5 million of the 2013-14 budget surplus to reduce the City's unfunded pension liability. Longer term fiscal impacts could also include a reduction in pension costs depending on option chosen by Council. For example, allocating the additional funds to CalPERS would reduce the pension rate by approximately 0.5% and save an estimated \$176,000 annually. Allocating the funds to a new Section 115 Trust would not have an immediate impact on pension rates but would reduce the pension UL.

### **RECOMMENDATION**

As part of the Council discussion regarding the allocation of the 2013-14 budget surplus staff has suggested adding another \$2.5 million for reducing the pension UL to the \$2 million already earmarked by Council during the last budget process, for a total of \$4.5 million. If Council is interested in learning more about the Section 115 Trust option, staff recommends bringing this concept to the Citizen's Budget Review Committee for their input and review, and then returning to Council at a later date for further discussion and direction. In the meantime, the \$2 million or, if approved, \$4.5 million in funding for pension UL reduction would not be disbursed to either CalPERS or to PARS until directed by Council to do so.

  
Don Rhoads  
Approved By



## STAFF REPORT

**Meeting Date:** January 13, 2015

**To:** Honorable Mayor & City Council

**From:** Don Rhoads, Administrative Services Director and Chief Financial Officer  
Don Harrison, Budget & Revenue Officer

**Subject:** Discussion of FY 2013/14 Year-End General Fund Surplus and Possible Use

**Attachments:** 1. Attachment A – FY 2013/14 Surplus

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### **INTRODUCTION**

At the end of FY 2013/14, the unaudited General Fund surplus was \$13.8 million. City Council financial policies require that a General Fund reserve be maintained equal to 40% of the operating revenues of the fund. Year-end revenues exceeded FY 2014/15 budgeted revenues by \$4.4 million. Therefore, \$1.8 million of the surplus has been set aside for this reserve. This results in available surplus of about \$12 million. These funds are available for allocation/appropriation by the City Council. The City Council's Financial Policies also call for one-time funds such as year-end surplus funds to be used for one-time expenses and not ongoing expenses.

### **DISCUSSION**

#### **Use of Available General Fund Balance**

It is a good financial practice to use one-time funds for investments in one-time capital, unfunded liabilities, or working capital for investment such that the use of funds results in future efficiencies or other future expenditure savings or increased revenue. It is also a good practice, and one which is noted by bond rating agencies, to use General Fund excess funds only for general purposes and not for the support of enterprises, which should be fully supported from enterprise revenues.

Based on previously stated City Council priorities, its prior allocations of surplus revenue, and input from City departments, staff has identified the following areas as recommended uses for these available funds:

**PERS Unfunded Liability Reduction**

The presentation on the City's pension rates and unfunded liability precedes this presentation and recommends that the City Council consider allocating an additional \$2.5 million for the reduction of the City's unfunded liability.

**OPEB (Retiree Medical Coverage) Unfunded Liability**

Though the City has made great strides in addressing OPEB (Retiree Medical Coverage) actuarial unfunded liability in recent years, there remains a much reduced actuarial unfunded liability of about \$12.5 million. It is recommended that \$500,000 of the surplus be allocated for further reducing this unfunded liability.

**Property Acquisition**

In recent years, the City Council has allocated \$5.75 million for Property Acquisition with the most likely use for these funds being the purchase of property for use as a parking facility in the Southeast section of the City, and \$2.15 Million for Southeast Enhancements, all of which remains available for appropriate projects. Given the great cost of property in the City and the great need for additional parking and other improvements in the Southeast portion of the City, it is recommended that the City Council allocate an additional \$2.75 million from available General Fund balance for Property Acquisition.

**Subway Litigation**

The City Council has allocated funds over the past few years to challenge the Subway Route under Beverly Hills High School. Additional funds are needed to continue this effort. It is recommended that \$525,000 from the surplus be allocated to this effort.

**Santa Monica Boulevard Traffic Mitigation Contingency**

The reconstruction of Santa Monica Boulevard east of Wilshire is fully funded. However, it is recommended that \$150,000 of the surplus funds be set aside as a contingency for traffic mitigation measures should such be needed to minimize traffic impacts of the project which would cause disruption for residents, businesses and shoppers in the community thus impacting sales tax revenue.

**Santa Monica Boulevard Reconstruction West of Wilshire**

As mentioned above the reconstruction of Santa Monica Boulevard east of Wilshire is fully funded, but additional funds may be needed when it is practical to move forward with reconstruction west of Wilshire Boulevard. It is recommended that \$750,000 of the surplus be set aside as a portion of the funding which might be needed for this project. It is anticipated that a portion of the reconstruction of this section may be funded through private sources as part of the development of the Waldorf Astoria Hotel and 9900 Wilshire.

**Trousdale Traffic Management**

Traffic Management measures for the Trousdale Estates Area including Automated License Plate Reader (ALPR) Cameras and equipment, traffic management devices (e.g., traffic circles and chicanes) and additional signage. It is recommended that \$300,000 of the surplus be allocated to this effort.

### **Right of Way Alley Pavement Project**

There is a need to grade, pave, stripe and create storage areas in the sixty foot right of way located between Alden and Third Street. A portion of the public right of way has been earmarked for a future decant facility and groundwater well site. Existing CIP funds have been earmarked for the decant facility. However, funds were not earmarked to develop the remaining area. This will maximize the use of the area for additional Public Works Services vehicle and heavy equipment parking as well as equipment storage in the public right of away. It is recommended that \$300,000 surplus be set aside for this project.

### **Storm Water Detention, Retention, and Treatment Facility**

The City is scoping out a detention, retention, and/or treatment facility in response to negotiated terms related to National Pollutant Discharge Elimination System (NPDES) requirements. It is recommended that \$500,000 of the surplus be used as placeholder funding.

### **Restoration of Greystone Mansion Theatre**

With adoption of the FY 2014/15 budget, the City Council approved \$500,000 through the CIP as seed money for restoration of the Greystone Mansion Theatre. Staff is working on an effort to raise funds to cover the unfunded portion of the Theatre restoration. To “jump-start” this effort, it is proposed that the City set aside \$250,000 of the surplus to match private contributions made for the restoration of the theatre.

### **Coldwater Park Playground Equipment**

The playground equipment and surface below at Coldwater Park is quite aged and somewhat obsolete. Replacement of the equipment and installation of a surface providing greater fall protection is recommended and would cost approximately \$500,000.

### **La Cienega Park**

The CIP includes about \$7 million for a new community center at La Cienega Park. The total cost of a community center is expected to be more than this, though it is also expected that development of large projects in the City in the near future will also generate additional parks and recreation funding. It is recommended that the City Council set aside an additional \$1.5 million for this project which could be freed up if Parks and Recreation funds are available.

### **Civic Center Cooling Tower Replacement**

The cooling tower serving the Central Plant of the civic center complex climate control system is in need of replacement. Public Works Services Department had intended to include this replacement in the CIP considerations for the FY 2015/16 budget, but given the availability of surplus funds and recent discovery of more immediate need for replacement, the use of surplus funds for this purpose is recommended at a cost of \$300,000.

### **Fire Department Urgent Equipment Needs**

The Fire Department has identified equipment which is urgently needed and which is not included in the FY 2-14/15 budget. Specifically, personal protective equipment and supplies are needed for fire fighters during a situation involving an “active shooter.” This equipment is intended to minimize loss of life through expediting the delivery of critically needed medical care to patients that could otherwise be beyond the reach of traditional EMS providers or otherwise not receive care within the timeframe necessary to save lives and has an approximate cost of \$100,000. Also needed are 14 automated external defibrillators (AEDs) for Police motorcycles. The Defibrillators are needed because the manufacturer of the devices currently on the Police motorcycles will no longer support these devices. The estimated cost to replace the AEDs is \$16,000.

### **Increase in Budget Stabilization Reserve**

In recent years, the City Council has set aside \$2 million in a Budget Stabilization Reserve to serve as a "Rainy Day" fund for meeting future unexpected revenue shortfalls and allowing for an orderly reduction of spending rather than abrupt cuts to responsibly manage the City's fiscal considerations. It is recommended that the City Council allocate another \$1 million of the surplus to this reserve.

### **General Fund Reserve Contribution**

As addressed above, it is a good financial practice to utilize available one-time funds for the reduction of current or future expenses or the generation of additional future revenues. Use of surplus or one-time funds for ongoing expenses is not considered good policy as such practice will likely lead to ongoing deficits as the ongoing revenues may not provide for the ongoing expenditures. The recommendations above, substantially reduce future expenses through reduction of liability claims, prevention of theft, reduction of future payments and interest on unfunded liabilities, or provide for potential increases in revenue through increased economic development, or provide for needed investment in City facilities on a one-time or limited basis. The Attachment A provides an itemization of the recommendations and amounts recommended herein.

There are many advantages to addressing the needs which staff proposes with the one-time funds available. In most instances, the proposed uses of the surplus are for projects which are high City Council priorities or for activities/projects which will be required at some point in the near future so that allocating funds while they are currently available will prevent future disruption through displacing the funding of other activities. Investing in the reduction of unfunded liabilities saves the City future costs of financing these liabilities such as interest costs. The disadvantages of following the recommendations contained in this report are substantially opportunity costs. If the funds are spent for these proposed uses, they will not be available for other unidentified projects which might be of greater value or in much greater need of funding. Use of City funds usually involves a balancing act in that the choices for use of the City's scarce resources inevitably preclude the use of those funds for other worthy uses. As reasonable people can disagree on what may be the best use for a scarce resource, there are nearly always opportunity costs when City resources are allocated.

### **FISCAL IMPACT**

The appropriation of FY 2013/14 General Fund surplus will result in the reservation and/or expenditure of up to \$12 million from available fund balance.

### **RECOMMENDATION**

Staff recommends that the City Council consider allocating FY 2013/14 General Fund surplus of revenues over expenditures and make appropriations for same for one-time activities, reduction of unfunded liabilities and/or retention of available fund balance of up to \$12 million.



Don Harrison  
Budget & Revenue Approval



Don Rhoads  
Approved By

# **Attachment 1**

**FY 2013/14 Surplus**

Est. Amount Available:	\$12,063,400
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**Possible Investments**

## Unfunded liabilities

PERS (employee pensions)	2,500,000
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OPEB (Retiree Health Coverage)	500,000
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Land Acquisition	2,750,000
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Subway Litigation	525,000
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Santa Monica Boulevard Traffic Mitigation Contingency	150,000
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Santa Monica Boulevard (Seed for West of Wilshire)	750,000
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Trousdale Traffic Monitoring and Mitigation	300,000
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Public Works Yard Alley Pavement	300,000
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Storm Water Retention Basin	500,000
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Greystone Theatre Restoration Donation Match	250,000
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Coldwater Park Playground	500,000
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La Cienega Park Community Center	1,500,000
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Civic Center Cooling Tower Replacement	300,000
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Active Shooter Protective Equipment for Firefighters	100,000
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Defibrillators for Police Motorcycles	16,000
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Budget Stabilization Fund	<u>1,000,000</u>
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Total	\$11,941,000
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Unallocated (increase in fund balance)	\$122,400
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