

CITY COUNCIL REPORT

DATE: October 25, 2018
TO: Mayor and Councilmembers
FROM: Rick Tadder, Management Services Director
CC: Barbara Goodrich, Shane Dille, Kevin Treadway, Leadership Team
SUBJECT: Public Safety Personnel Retirement System Update

The following information is intended to provide a history of the Public Safety Personnel Retirement Plan (PSPRS). This information is based on the June 30, 2017 Actuarial Report for the Fire and Police plans. Actuarial reports are updated annually and are available in December.

DISCUSSION

The City of Flagstaff has two separate pension plans for the City's public safety staff. While all the PSPRS plans are managed by the State, each plan within PSPRS stands alone by City and employee group. The two plans for the City are the PSPRS-Fire and the PSPSR-Police. The contributions and liabilities of these plans are solely the City's.

WHAT IS THE CITY'S CURRENT UNFUNDED LIABILITY

The Unfunded Liability of the City's plans are updated in the annual actuarial reports. The calculation of Unfunded Liability is calculated by taking the total Trust Asset and comparing that to the Accrued Pension Liability. If the Accrued Pension Liability is greater than the Trust Assets, it is called an Unfunded Liability. The most recent year that the plans were fully funded was June 2003. Below is the latest calculation of the City's funding status:

Table with 2 columns: PSPRS - Fire Plan and June 30, 2017. Rows include Trust Assets (\$30,462,678), Accrued Pension Liability (\$85,795,097), and Unfunded Liability/(Excess Assets) (\$55,332,419).

Table with 2 columns: PSPRS - Police Plan and June 30, 2017. Rows include Trust Assets (\$28,674,855), Accrued Pension Liability (\$75,238,736), and Unfunded Liability/(Excess Assets) (\$46,563,881).

	June 30,
PSPRS - City Totals	2017
Trust Assets	\$ 59,137,533
Accrued Pension Liability	\$ 161,033,833
Unfunded Liability/(Excess Assets)	\$ 101,896,300

HOW DID WE GET HERE?

The growth in the unfunded liability cannot be contributed to one single event or policy. There are many issues that impacted the pension funds since 2000. Most notably is related to investment losses and reduced earnings as a result of the 2000 stock market downturn and then again during the Great Recession in 2007-2009. With investments far below the actuarial assumptions and employee contribution rates capped, the City was responsible for making up the difference.

One benefit to PSPRS members that also has a negative impact to the City's liability is the Permanent Base Increase (PBI) allowance for retired personnel. The PBI is based on investment returns but do not have an offset mechanism for years of low investment returns. The PBI is paid out regardless of the financial situation.

Additionally, while the State Legislators attempted to make changes to the PSPRS benefits in 2011, those changes were challenged in the courts. The changes were to increase the employee contribution percentage from a fixed rate of 7.65% to 11.65% and to also reduce the PBI for retired employees. There were two lawsuits that challenged the State's changes. The cases are known as the Fields and Hall cases. The State lost those cases and the plans were reinstated to their prior terms. Pension reform was later approved by the voters in 2016; however, those changes will take years before we see any positive impact to the City's liability.

Changes in actuarial assumptions also have an impact on the City's liabilities. One such change is that prior to the recession there were expectations that the employee base would grow annually to help support the plan. Many cities had to make difficult decisions during the recession and the reduction of staff was one of them. The City has been slow to recover from those reductions to the employee base. This impacts the plan by reducing future contributors to the pension plans. Another actuarial assumption was a built-in wage inflation. Wages became very flat for several years and are not expected to grow as they did in pre-recessionary periods. This also impacts the amount of contributions going into the plans. As mentioned earlier, investment returns have been impacted since 2000. Therefore, when the actuarial report changes (reduces) the assumed rate of return on investments, this lowers the expected amount of money going into the plans. Another benefit that impacted the plan in the past is the benefit for the Deferred Retirement Option Plan (DROP) which during years of low investment returns had negative impacts. However the plan is successful in retaining experienced personnel past their eligible retirement date. Changes have been made to balance the impact of the DROP.

This report does not address all events or policy issues/changes that may have impacted the unfunded liability. It is intended to provide some examples of what contributed to the increase in the City's unfunded liability.

WHAT HAS THE CITY IMPLEMENTED?

In 2014, a Pension Task Force was created to address concerns of the PSPRS plans and develop recommendations. On August 19, 2015, the task force released their report "The Yardstick: A Tool to Evaluate Proposed Reforms of Arizona's Public Safety Personnel Retirement System (PSPRS)". Appendix B: Employer Recommended Practices provides examples of how an employer can manage parts of their plans. Below are all the recommendations and what the City is implementing:

1. Budget contributions for DROP members
 - a. The City began budgeting/paying the contributions for DROP members starting in fiscal year 2017 with adding contributions for 1/3 of the DROP members each year for 3 years.
2. Prepay your budgeted contributions
 - a. Beginning July 1, 2016, the City has prepaid its contribution to the pension plans based on budgeted expense.
3. Do not defer the impact of the Fields case
 - a. The City chose not to defer the Fields case impacts over 3 years.
4. Review Local Board practices – Board members have the responsibility of managing member eligibility, pre-existing conditions, and disability claims.
5. Prepare a comprehensive study
 - a. The City has budgeted for an actuarial review and policy development.
6. Pay off the unfunded liability (debt) earlier
7. Create a pension funding policy
 - a. The City will be creating a pension funding policy for Council adoption this fiscal year as part of the fiscal year 2020 budget process.

WHEN WILL THE PSPRS PENSION LIABILITY BE FULLY FUNDED?

For the June 30, 2006 Actuarial Report, a closed period for amortization of thirty years was established to pay down the unfunded liability. This meant that rate/contributions calculated in the actuarial report would demonstrate that the unfunded liability would be \$0 at the end of that period. This was effective for the fiscal year 2008 City budget and would countdown annually until fully funded in fiscal year 2037.

In the 2017 state legislative session, legislation passed that would allow plan holders to increase their closed amortization period up to a maximum of 30 years. This is a one-time option and cannot be reverted back to the shorter period. Council must approve a resolution and submit to the PSPRS Board for approval.

Effective this year, the PSPRS-Fire plan has 19 years remaining and is to be paid off in fiscal year 2037.

For the PSPRS-Police plan, Council passed a resolution to increase the amortization period to the maximum 30 years allowed. Council approved the change to allow budget authority to provide a 3% merit to sworn police personnel. This plan now has 30 years remaining and is planned to be paid off in fiscal year 2048. The change to a 30-year amortization period reduced the City's minimum contribution by \$975,580 per year; however, the City only reduced the contribution by the \$345,000 to provide merits and, therefore, the additional contribution of \$630,580 will be paid annually. See next section.

Excess contributions would not change the amortization period but would reduce the minimum annual contributions into the plan.

FISCAL YEAR 2019 CONTRIBUTION AMOUNTS

The City's fiscal year 2019 contributions are based on the Actuarial Report for the period ending June 30, 2017.

Fire:

Fiscal Year 2019	Contribution Rate	Minimum Contribution
Employer Normal Retirement Cost	14.03%	\$ 951,322
Employer Amortization of Unfunded Liability	70.14%	\$ 4,755,934
	84.17%	\$ 5,707,256

Police:

Fiscal Year 2019	Contribution Rate	Minimum Contribution	Additional Contribution
Employer Normal Retirement Cost	11.85%	\$ 1,031,726	n/a
Employer Amortization of Unfunded Liability	35.49%	\$ 3,089,955	\$ 630,580
	47.34%	\$ 4,121,681	\$ 630,580

Total: Fiscal year 2019 budgeted public safety pension expense is \$10,459,517.

RECOMMENDATION / CONCLUSION

This report is for information only.