

City of Healdsburg

Pension Liability Funding Policy

1. PURPOSE

The purpose of this policy is to memorialize the methodology and process for funding current and future costs associated with the City's contractual obligations to provide pension benefits as set forth in the City's labor agreements. The policy also:

- Demonstrates prudent financial management practices;
- Promotes long-term and strategic thinking;
- Provides guidance in making annual budget decisions;
- Reassures bond rating agencies; and
- Demonstrates to employees and the public how the unfunded pension liability will be funded to ensure adequate funding for negotiated benefits.

2. BACKGROUND

A pension is a retirement account that an employer maintains to give employees a fixed payout when they retire. The City's plan is a defined benefit plan. The payout typically depends on how long the employee works for the employer and the employee's salary.

Investment income, employee contributions and employer contributions fund the total pension cost, including benefits and expenses. Employer contributions are set by actuaries using an investment rate assumption (also known as the "discount rate"), lowered from 7.0% to 6.8% as of July 1, 2021, and other assumptions related to salary, payroll, cost of living, mortality rate, disabilities, terminations, and retirements. The maximum employee contribution rates are set by law.

Current California law establishes that public employee retirement benefits are a form of deferred compensation and part of the employment contract. The Courts have established that the vested rights of public employees prevent not only a reduction in the benefits that have already been earned, but also a reduction in the benefits that a member is eligible to earn during future service. As such, changes to the employees' retirement benefits are considered a negotiable item and must go through the meet and confer process.

Over the years, the City has taken steps to control pension costs. In 2012 the City issued Pension Obligation Bonds to pay off CalPERS side funds at a lower interest rate and established second tiers for classic members. In 2013, the City adopted the Public Employee's Pension Retirement Act ("PEPRA"). In 2015, the City established the Pension Stabilization Fund and began making contributions to the fund. In 2019, the City adopted the initial version of this policy.

3. POLICY

3.1 Establishment of Pension Stabilization Fund

Effective July 21, 2015 the Council adopted the PARS Public Agencies Post-Employment Benefits IRS Section 115 approved trust, also known as the Pension Stabilization Fund. The premise behind the Trust is to set-aside monies in the fund with a City determined investment policy and pull out the funds as needed to achieve a level contribution by the City's budget. The Pension Stabilization

Fund is an important tool the City can use to limit the impact of future decisions made by CalPERS on the City's finances and ensure the delivery of public services.

3.2 Governance and administration of the established Trust:

The City Council established the Trust and defined the initial goals and policies for the administration of the Trust funds. The City Manager and staff have overall responsibility for the Trust and will manage the Trust in accordance with the City Council's adopted policies.

Trust Administrator, PARS, keeps plan documents current to ensure that they reflect the substantive plan and provides ongoing consulting, reporting and plan accounting records.

Trustee, currently US Bank, will be the plan's trust and custodian and will safeguard the assets in the Trust, hold the investment securities for safekeeping and make disbursement on request.

Investment Manager, currently Highmark Capital Management, will recommend investment portfolio allocations based upon the Pension Trust Funds. High Mark has adopted Investment Guidelines based on initial City Council input, revised to comply with existing law in November 2021 (Attachment 1), and manages City assets in accordance with the guidelines.

The Asset Allocation Investment Strategy chosen by a Council committee is rated as Moderately Conservative in regard to risk tolerance. Attachment 1 provides more detail on the asset allocation and breakdown.:

This policy recognizes that there will be future market volatility and that actual economic and demographic experience will differ from assumed experience. Accordingly, this policy is intended to provide flexibility to smooth such volatility and experience in a reasonable, systematic and financially sound manner.

3.3 Liability Funding Plan: Use of Pension Stabilization Fund

The City is required to make annual UAL payments to CalPERS to cover outstanding liabilities based on the amortization schedules for those liabilities. The amount of payment is forecasted annually by CalPERS and is impacted by annual return rates, changes to the discount rate, and changes in actuarial analysis inputs and outputs.

City staff will include in the two-year budget details on projected UAL costs and anticipated use of the Trust. Given the Trust's ability to generate interest, the City will endeavor to limit trust fund withdrawals, maximizing potential for Trust Fund growth over time.

3.4 Additional Contribution paid directly to CalPERS

The City will annually review its ability to make additional contributions to CalPERS to further reduce unfunded liabilities and propose budget action to Council as appropriate. When making additional contributions, the City will seek maximum interest savings. Additional contributions paid to CalPERS will be applied to pay down the following amortization bases (in order):

- Miscellaneous: Pre-2013 Share of UAL Pool (maturity 2036), 2014 Assumption Change (maturity 2036), and 2016 Assumption Change (maturity 2038)

- Safety: 2014 Assumption Change (maturity 2036, Pre-2013 Share of UAL Pool (maturity 2037), 2016 Assumption Change (maturity 2038), and 2017 Assumption Change (maturity 2039)

3.5 Transparency and Reporting

Funding of the City's pension benefit should be transparent to all parties including City employees, retirees, recognized employee organizations, the City Council and City residents. To achieve this level of transparency, the following information shall be available:

- a. Copies of the actuarial valuations for the City's pension plans shall be published on the City's website.
- b. The City's Annual Financial Statements shall be published on the City's website. The financial statements include information on the City's pension plans, contributions to the Trust, and the funded status of the plans.
- c. The City's annual operating budget shall include appropriations for contributions to the Trust, to CalPERS and the annual pension costs.

3.6 Review of Funding Policy

Funding pension liability requires a long-term plan. The City will review this policy at a minimum biennially, coincident with preparation of the actuarial valuations, to determine if changes to this policy are necessary to ensure adequate resources are being accumulated to fund pension benefits.