CITY OF BELVEDERE

FINANCE SUB-COMMITTEE:
Taskforce on Pensions & OPEBs

AGENDA

March 16, 2021
Via Zoom
9:00 a.m.

Join Zoom Meeting
https://us02web.zoom.us/j/4136417003?pwd=TXB1T1pERy8rcG5Hbkdjd1Y2NFVBUT09

Meeting ID: 413 641 7003
Passcode: Belvedere

Dial by your location
833 548 0282 US Toll-free
877 853 5247 US Toll-free
888 788 0099 US Toll-free
833 548 0276 US Toll-free

Meeting ID: 413 641 7003
Passcode: 310801

1. Approve minutes from March 9, 2021 meeting.
2. Briefings/Discussion of the City’s pension position and potential strategies for managing pension liabilities.
3. Briefings/Discussion of the City’s OPEB position and potential strategies for managing OPEB liabilities.
4. Adjourn.

Attachments:

1. Memo to the Taskforce and associated attachments.

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Date posted: March 15, 2021.

SPECIAL MEETING
FINANCE SUB-COMMITTEE
Taskforce on Pensions and OPEBs
Tuesday, March 9, 2021
1:00 PM
on Zoom remote platform

MINUTES

COMMITTEE PRESENT:	Steve Block, Bob McCaskill, David Walker, Sally Wilkinson
COMMITTEE ABSENT:	N/A
OTHERS PRESENT:	City Manager – Craig Middleton, Admin. Services Manager – Amber Johnson

CALL TO ORDER OF SPECIAL MEETING

The meeting was called to order at 1:00 p.m.

SCHEDULED ITEMS

1. The Committee discussed the background and relevant issues around the City's pension and OPEB liabilities. After discussion, follow-up tasks were assigned to various members of the Committee to be presented at a future meeting for analysis.

ADJOURN

The meeting was adjourned at 3:00 p.m.

THE FOREGOING MINUTES were approved at a regular meeting of the Finance Committee on March 16, 2021 by the following vote:

AYES: _
NOES: _
ABSENT: _
ABSTAIN: _

APPROVED ____________________
Sally Wilkinson, Chair

ATTEST ________________________________
Amber Johnson, Admin. Services Manager

CITY OF BELVEDERE
Memorandum

March 14, 2021

TO: Taskforce on Pensions and OPEBs

FROM: Amber Johnson, Administrative Services Manager

SUBJECT: Status of Tasks Assigned to Committee Members

At the end of the prior meeting of the Taskforce on March 9th, various Committee members were assigned follow-up tasks to be shared with the entire Committee at its March 16th meeting. These tasks are listed below with responses from the responsible parties as of the writing of this memo.

1. **Develop investment strategy paper (incl meeting with CEPPT) – Steve & Bob**
   Response: See Attachment A for worksheets that compare CalPERS and PARS 115 Trusts, including: a summary comparison, investment performance, and investment targets.

2. **Develop timeline to implementation, including drop dates – Amber & Craig**
   Response: See Attachment B.

3. **Obtain health insurance quotes from Keenan (all) and Covered California (retirees) – David & Amber**
   Response: Keenan is developing a comprehensive health insurance quote for the City's active and retired employees. Covered California does not provide options for Medicare retirees, so this option is somewhat limiting. We have also reached out to our risk insurance partners for a self-insured insurance option, but do not have enough details at present to formulate a thorough analysis of all the options. We will continue to gather quotes and potential plan details and return with a report at a later date.

4. **Draft pension funding policy document – Sally & Amber**
   Response: See Attachment C.

5. **Proposed Taskforce Update to Finance Committee – Sally**
   Response: See Attachment D.

Attachment A

Comparison of CalPERS vs PARS Section 115 Pension Plans

Rev. 3/12/21

(Items in yellow have revisions)

	CalPERS CEPPT Plans	PARS
Size of Fund: # Calif. Agencies	28 pension plans plus 578 OPEB plans	225 plans in California (pension/OPEB)
Assets under Administration	$14.5 B (Sec. 115 plans only)	$5.1 B
Asset Allocation Options	2 funds (CEPPT #1 and #2)	5 active and 5 passive funds
Active vs Passive Options	Passive only	Active or passive
Transferability to a different Sec 115 Plan?	Yes	Yes
Termination restrictions	None	30 days notice
Can reimburse city for pension expenses?	Reimbursement of current year payments	Reimburse prior and current year payments
Limit on number and amounts of pay-ins?	No	No
Who is underlyting investment manager?	State Street	HighMark
Diversified from CalPERS?	Yes	Yes
Fund custodian	State Street	US Bank
Admin + Investment Mgmt Expense	0.25% (includes 0.025% to State Street)	0.6% (includes 0.35% to HighMark)
Investment implementation strategy	Managed to reduce tracking error	Intended to produce alpha thru tactical allocation
Expected Return	CEPPT #1: 5% CEPPT #2: 4% (10 year)	PARS Conservative: 4.668% (30 year) PARS Moderately Conservative: 5.47% (30 year) PARS Moderate: 6.33% (30 year)
Expected Risk (sigma)	CEPPT #1: 8.2% CEPPT #2: 5.2% (10 year)	PARS Conservative: 3.5% (30 year) PARS Moderately Conservative: 4.8% (30 year) PARS Moderate : 7.92% (30 year)
Fund creation date	CEPPT #1: Oct. 2019 CEPPT #2: Jan. 2020	OPEB: 2005 Pension: 2015
Target Allocations	(see attached)	(see attached)
Historical Performance	(see attached)	(see attached)

Compare CalPERS and PARS Sec. 115 Investment Performance

Rev. 3/11/21

NOTE: •CalPERS CEPPT pension plans have only existed for 1 yr. But, CalPERS CERBT (OPEB) plans have a longer history.
•Thus, data below compares PARS Funds to CalPERS CEPPT and CERBT funds with comparable fixed income target allocations.

Annualized Net Returns (as of 12/31/20)

	Fixed Income Target	1 Yr	3 Yr	5 Yr	10 Yr	
PARS Conservative - Active	80%	8.43%	5.50%	5.24%	4.15%	
PARS Conservative - Passive	80%	7.96%	5.23%	4.75%	3.83%	
PARS Mod Conservative-Active	65%	10.16%	6.46%	6.52%	5.39%	
PARS Mod Conservative-Passive	65%	9.14%	6.16%	6.16%	5.10%	
CalPERS CEPPT #2	73%	8.54%	n/a	n/a	n/a	(only 1 year of data)
PARS Moderate - Active	45%	12.32%	7.85%	8.38%	6.89%	
PARS Moderate - Passive	45%	10.63%	7.25%	7.86%	6.68%	
						No significant difference in historical performance
CalPERS CERBT #2	43%	12.21%	8.12%	8.91%	n/a	
CalPERS CERBT #3	49%	10.70%	7.27%	7.60%	n/a	
CalPERS CEPPT #1	47%	11.24%	n/a	n/a	n/a	(only 1 year of data)
PARS Balanced-Active	35%	13.46%	8.55%	9.30%	7.64%	
PARS Balanced-Passive	35%	11.47%	7.77%	8.73%	7.41%	
PARS Capital Appreciation-Active	20%	13.90%	9.16%	10.32%	8.55%	
CalPERS CERBT #1	25%	13.31%	8.62%	9.85%	7.96%	

CalPERS and PARS Sec. 115 Plan Investment Targets

	Equity	Fixed	TIPS	REITS	Liquidity	Policy Ranges (plus or minus)
CalPERS CEPPT #1	40%	47%	5%	8%	0%	5% for Equity & Fixed ; 3% for TIPS
CalPERS CEPPT #2	14%	73%	5%	8%	0%	5% for Equity & Fixed ; 3% for TIPS
PARS Conservative	15%	80%	N/A	*	5%	Equity -10%/+5%; Fixed -20%/+15%
PARS Moderately Conservative	30%	65%	N/A	*	5%	Equity -10%/+15%; Fixed -15%/+15%
PARS Moderate	50%	45%	N/A	*	5%	Equity -10%/+10%; Fixed -5%/+15%
PARS Balanced	60%	35%	N/A	*	5%	Equity -10%/+10%; Fixed -5%/+15%
PARS Capital Appreciation	75%	20%	N/A	*	5%	Equity -10%/+10%; Fixed -10%/+10%

* included under Equity

Timeline of Finance Committee and City Council Meetings
April - June 2021

Meeting	Actions	Meeting Date	Materials Due
Finance Committee	1. Review and discuss the Taskforce pension strategy recommendation (first review).	3/26/2021	3/24/2021
Finance Committee	1. Review Library request in context of prelim budget numbers. 2. Form recommendation to Council regarding Library request.	4/6/2021	4/1/2021
City Council	1. Consider Finance Committee recommendation regarding Library request. If current fiscal year funding is recommended: a. Resolution to amend current year budget to make a payment to the Library.	4/12/2021	4/7/2021
Finance Committee	1. Review draft Budget; make recommendation to Council. 2. Finalize recommendation to Council regarding pension strategy, including various recommended Administrative Policy Manual (APM) revisions.	4/19 - 4/23/21	4/15 - 4/19/21
City Council	1. Consider Finance Committee recommendation regarding pension strategy. If approved, several resolutions require adoption: a. Resolution to establish 115 Trust. b. Resolution to amend APM to include new policy on 115 funding. c. Resolution to amend APM to include revised investment policy language. d. Resolution to amend APM to clarify General Fund reserve policy. e. Resolution to amend current year budget to fund the trust. 2. Consider Draft Budget.	5/10/2021	5/3/2021
None	1. Establish 115 account and transfer funds	5/17/2021	N/A
City Council	1. Adopt Final Budget.	6/14/2021	6/7/2021

City of Belvedere – Pension Funding Policy

The City of Belvedere is committed to fiscal sustainability. In keeping with this principle, it maintains minimal debt, and generous reserves to cope with exogenous shocks. One of the biggest threats to the City's ongoing fiscal sustainability is its rising pension costs. The overarching goal of the City's new Pension Funding Policy is to avoid the risk of crowding out vital public services in future years, and to provide balance sheet space to finance essential infrastructure projects in the years ahead, by funding its accrued pension obligations at a more prudential rate. Thanks to sensible budget planning, it has the financial resources to do this without negative impacts on service delivery.

The City contracts with the California Public Employees' Retirement System (CalPERS) for its employee defined-benefit pension plans. The City is statutorily required to pay the Annual Required Contribution (ARC) to CalPERS. The ARC comprises two elements; the Normal Cost Rate (NCR), which is the annual cost of service accrual, and the Unfunded Accrued Liability (UAL) Payment, which represents the catch-up portion of costs. CalPERS calculates the NCR and the UAL based on a 7.0% discount rate, which mirrors its 7.0% expected return on plan assets. The City recognizes that this 7.0% investment target is ambitious and does not align with actual experience, nor necessarily expected experience. As losses mount, annual catch-up costs accelerate. To address this shortcoming, the City's Pension Funding Policy comprises the following elements:

Discount Rate: Commencing FY21-22, the City will use a discount rate of <u>CalPERS' expected return on plan assets *minus* 100 basis points</u> to value its pension obligations. This will peg the City's discount rate at 6.0% for FY21-22. Recognizing that CalPERS may reduce its own discount rate in coming years, this 6.0% rate will be fixed for three to five years until the next standing pension funding review (see later) when the "CalPERS minus 100" rule will be reapplied and reset. This stepped approach will facilitate sensible budget planning.

Funding Goal and Timeframe: The City's goal is full funding. It will seek to have assets to cover 100% of accrued pension liabilities valued presumptively at "CalPERS minus 100" within 20 years. This calibrates with CalPERS own amortization rules, which allow losses (or gains) to be amortized over 20 years.

Funding Calculation: The City will use CalPERS Pension Outlook Tool to calculate what the NCR and the annual UAL Payment would be if a 6.0% discount rate were applied to the City's four CalPERS' pension plans instead of CalPERS' discount rate. This additional cost will be smoothed over a five-year period and the annual cost included in the City's budget.

Funding Vehicle: The additional funds set aside by the City will be transmitted to a Section 115 pension trust no less than annually. The assets will be managed conservatively, reflecting the City's general risk aversion and pension plan maturity. The City's Finance Committee will establish trust and investment parameters for approval by the City Council.

Trust Seeding: By no later than June 30, 2021, the City will seed the Section 115 trust with $1.5 million of funds; $1.2 from excess reserves and $300,000 from the City's non-binding pension reserve account, which will be dissolved.

Oversight & Review: The City's Finance Committee will conduct a standing pension funding review every three to five years to reset the discount rate (using the "CalPERS minus 100" rule unless there is clear evidence favoring a different margin), adjust annual funding costs and fix payments until the next review. It may also recommend transferring money from the 115 trust to CalPERS or making a discretionary payment to the 115 trust or CalPERS from excess reserves if any exist at that time. The Finance Committee will send its recommendations to the City Council for approval.

Financial Reporting: The City recognizes the importance of ensuring that pension obligations included in the City's financial statements, particularly its Comprehensive Annual Financial Report, are consistent with CalPERS and will continue to use CalPERS' discount rate for these purposes. This facilitates easy comparison with other agencies and avoids possible negative impacts on *perceived* credit quality. The City equally recognizes the importance of communicating its pension stewardship. It will therefore include an annual pension update, describing its pension funding policy, trust assets and adjusted funded status in its annual budget report.

Reserve Requirements: The City maintains a robust minimum reserve policy, with reserves required to equal to no less than six months of general fund operating expenses, debt financing costs and fire contract costs net of fire tax revenues. Transfers to the 115 trust and Additional Discretionary Payments made to CalPERS will be excluded from the reserve requirement calculation (denominator) because they are discretionary in nature. This is consistent with the City's existing treatment of discretionary payments to CalPERS and internal money transfers.

Fiscal Impact: Application of a 6.0% discount rate reduces the City's funded status with CalPERS from 93.4% to 83.5% and increases its UAL from $1.6 million to $4.5 million as of June 30, 2019 (latest available data). Factoring in a $1.5 million upfront payment to the 115 trust, annual UAL payments will increase by approximately $200,000 p.a. and the NCR will increase by approximately $100,000 p.a. for the next three to five years on a smoothed basis, generating a total fiscal cost of $300,000 p.a. The City will terminate its $100,000 annual transfer to its non-binding pension reserve and the additional $200,000 p.a. will come from a headcount deferral, with no anticipated impacts on service delivery. The City is confident it can continue to meet its reserve requirements.

Employee Contributions: In accordance with PEPRA guidelines and compatible with other local agencies, the City will increase Classic employee contribution rates to 8.0% of salary for Miscellaneous employees and to 12.0% of salary for Safety workers by no later than FY23-24. The offsetting reduction in employee costs is excluded from the fiscal impact calculation above.

In sum, the City is fortunate to have the fiscal flexibility to implement a best-in-class pension funding plan, thanks to years of sensible budget planning. The policy formalizes an existing soft arrangement of using excess reserves to make discretionary payments to CalPERS whenever affordable. The City is committed to honoring its pension obligations and living within its means.

Development of the City's Pension Funding Policy was guided by the following five tenets:

- The cost of employee benefits should be paid by the generation of taxpayers who receives services.
- Actuarial assumptions should be prudential to ensure that promised benefits can be paid.
- Funding shortfalls should be closed expeditiously. The goal is full funding.
- Large swings in employer contribution rates are undesirable. Smoothing is desirable.
- Funding policies and underlying assumptions should be clearly delineated and regularly reviewed.

Taskforce on Pensions & OPEB Interim Report to Belvedere Finance Committee

Date: March 23, 2021

Background

On January 12, 2021, the City of Belvedere's Finance Committee established a Taskforce on Pensions & OPEBs ("taskforce"), comprising four of its seven members. The taskforce was assigned the job of recommending a package of reforms to reduce the City's unfunded pension and other post-employment benefit (OPEB) obligations, to ensure the City's ongoing fiscal sustainability. The taskforce was asked to report back to the full Finance Committee when it had made substantive progress. The taskforce has met six times in the past 10 weeks and is ready to recommend a package of measures to reduce the City's pension risk. Policy ideas on OPEBs are still being developed.

Pension Funding Tenets

The taskforce suggests the City adopt the following five tenets as the basis of its pension funding policy:

1. The cost of employee benefits should be paid by the generation of taxpayers who receives services.
2. Actuarial assumptions should be prudential to ensure that promised benefits can be paid.
3. Funding shortfalls should be closed expeditiously. The goal is full funding.
4. Large swings in employer contribution rates are undesirable. Smoothing is desirable.
5. Funding policies and underlying assumptions should be clearly delineated and regularly reviewed.

Actuarial Assumptions

The first question the taskforce sought to answer in analyzing the City's pension risk is whether the City's pension obligations are appropriately valued by CalPERS. There was broad agreement that the 7.0% discount rate used by CalPERS to discount future pension benefit payments, which is based on its expected return on plan assets, is too optimistic, thereby understating the City's pension liabilities. The taskforce set about determining a more appropriate discount rate selection methodology. It considered the merits of using a "risk-free" discount rate (based on an index of high-quality corporate bonds) or relying on analyst forecasts of future investment returns, for example those laid out in Horizon's Annual Survey of Capital Market Assumptions. It concluded that a risk-free discount rate is likely too conservative, given CalPERS actual investment mix, and that analyst forecasts are no more likely to be correct than those of CalPERS' investment office, which also consults with outside advisors. The taskforce observed that CalPERS itself is projecting a 5.67% annual return on plan assets over the next 10 years (it assumes a 7.85% return in the outer years to reach its overall 7.0% average return).

Factoring in the City's risk aversion and plan maturity, and acknowledging the unpredictability of financial markets, the taskforce agreed the City should adopt a discount rate equal to CalPERS' expected return on plan assets minus a margin of 100 basis points. This would peg the City's discount rate at 6.0% for FY21-22. Recognizing that CalPERS may reduce its own discount rate in coming years, the taskforce agreed the 6.0% rate should be maintained for a period of 3-5 years and then be reviewed by the Finance Committee as part of a standing review of the City's pension funding strategy (see later).

The taskforce reviewed the other economic and demographic assumptions underpinning CalPERS' model and concluded the risks are evenly balanced. The City's demographic risks are pooled, and the pooled experience has largely tracked expectations.

Annual Funding Costs

Having agreed a 6.0% discount rate assumption, the taskforce sought to understand the financial impact of this more prudent discount rate on the City's ongoing pension costs. Thanks to GASB rules, agencies are required to report the impact of a one percentage point reduction (or increase) in the discount rate on both the normal cost rate (NCR) and unfunded accrued liability (UAL). The data for fiscal year end June 30, 2019 are shown in the table below. CalPERS calculates contribution rates based on funded status two years prior, so the June 30, 2019 valuations provide the correct numbers for the upcoming 2021-22 fiscal year.

Annual required contribution (ARC) = Normal cost rate (NCR) + Annual UAL payment

Table 1: Impact of 6.0% Discount Rate on Belvedere's Pension Metrics

	7.0% Discount Rate	6.0% Discount Rate	Change
Accrued Liability (US$ mn)	23.88	26.81	2.94
Market Value of Assets (US$ mn)	22.30	22.30	-
UAL (US$ mn)	**1.58**	**4.52**	**2.94**
Funded Ratio (%)	93.38%	83.15%	10.23%
Employer NCR (%)	11.63%	16.40%	4.76%
Employer NCR (US$)[1]	**249,882**	**352,208**	**102,325**

[1]Based on estimated payroll and assumes no change in employee contribution rates. Note: The sensitivity data reported in agencies' CAFR differ from those presented above (which draw from CalPERS' Annual Valuation Reports) because CAFR data are based on a higher discount rate (equal to CalPERS' discount rate plus 15 basis points of administration expenses). Source: CalPERS

Unfortunately, the GASB-required sensitivity analysis does not show how to amortize the higher UAL created by a 6.0% discount rate. The City asked CalPERS if it could assist, but it declined. The taskforce therefore reviewed various options for calculating an appropriate annual UAL payment, including relying on CalPERS' Pension Outlook tool, using an off-the-shelf tool called GovInvest, applying closed-period, dollar-flat amortization, or scaling up CalPERS suggested UAL payments in proportion to the higher UAL. All four options have shortcomings (see box on page 3) but produce broadly similar results in terms of dollar impact. The taskforce ultimately settled on using CalPERS' Pension Outlook tool and recommends that the dollar cost implied by the tool (over and above CalPERS' scheduled payments) be smoothed and fixed in nominal terms for a period of 3-5 years to allow sensible budget planning.

Affordability

Next the taskforce sought to establish the affordability of a 6.0% discount rate from a budgetary perspective. City staff reviewed the scope of "free funds" within the budget to allocate to pensions, over and above CalPERS' ARC payments. They identified approximately $300,000 of available funds on a recurring basis, $100,000 from terminating the annual pension fund reserve payment and $200,000 from deferring the hiring of a police officer for at least the next three years. The taskforce also reviewed the City's current financial statements, as of June 30, 2020, and identified $1.2 million of excess reserves (leaving a residual excess of $100,000) and $300,000 of pension fund reserves that could immediately be used to fund pensions and lower ongoing amortization costs.

Using CalPERS' Pension Outlook tool, the cost of amortizing the 6.0% UAL adjusted for a $1.5 million upfront payment was calculated. The additional cost in terms of UAL payment ranged from $180,000 to $190,000 p.a. over the following five years. Coupled with a $100,000 higher NCR, the total annual impact of adopting a 6.0% discount rate, adjusted for a $1.5 million extraordinary payment, stands at about $300,000, allowing the policy to be implemented with limited budgetary stress whilst honoring the City's generous reserve policy.

Box 1: UAL Amortization Methodologies

Option 1: CalPERS Pension Outlook Tool

The tool allows agencies to make changes to discount rate and investment return assumptions as well as make additional discretionary payments and model their impacts on UAL payments (and the NCR) over a 30-year period versus the current payment profile. The advantage of this tool is that it lays out the impacts over multiple years and relies on the intricacies of CalPERS plan-specific actuarial data and amortization rules. The downside is that it produces results that are one year off cycle i.e., changing inputs today (related to FY19-20) produces results that affect required contributions starting FY22-23, not FY21-22. Furthermore, it does not allow the application of a lower discount rate to "stick", so the amortization clock starts again every time the model is run.

Option 2: GovInvest Pension Tool

The GovInvest tool is a more sophisticated version of the CalPERS Pension Outlook tool, using CalPERS plan-specific inputs and amortization rules, and adding one more year of census data. Assumptions can be altered at a more granular level. Historical data can also be inputted, related to FY18-19 for example, allowing direct calculation of the appropriate UAL payment for FY21-22. The tool has other useful attributes, unrelated to calculating the UAL payment. The downside of the tool is its cost (circa $5,000 p.a.) and the unknown nature of its black box, which other cities indicate does not generate matching results to CalPERS tool.

Option 3: Ratio Formula

Application of a ratio formula involves taking the ratio of the UAL at 6.0% (less Section 115 trust assets – see later) to the UAL at 7.0% and multiplying it by the UAL payment (at 7.0%) required by CalPERS. The main downside of this methodology is that CalPERS' amortization schedule is not smooth (because of its use of annual amortization bases) and UAL costs tend to accelerate over time, in part because of negative amortization, also because investment losses ramp up over a 5-year period. Using a ratio formula will amplify this effect. Taking the average cost implied by the formula over a medium-term period will mitigate some of this effect.

Option 4: Dollar Flat Amortization Formula

Dollar-flat amortization involves taking the UAL at 6.0% (less Section 115 trust assets) and repaying the debt over a fixed period, say 20 years, in equal installments, using a 6.0% interest rate. A 20-year window fits with CalPERS new amortization rules (which shorten the amortization window from 30 to 20 years on new annual bases), and gels with the view of rating agencies that pension debt should be amortized over 20 years or less. To avoid the debt continuing to roll i.e., never being fully paid off, the formula would have to amortize the existing UAL over a closed 20-year period, with additional amortization rules applied to UAL bases created after implementation of the formula.

Source: Author

Investment Options

The taskforce was in broad agreement that monies set aside for pensions should not be used to make additional discretionary payments to CalPERS. The City already has a 93.4% funded ratio with CalPERS (using its 7.0% discount rate), although this will likely drop as of June 30, 2020, given CalPERS provisional 4.7% investment return for the year. The taskforce discussed using the funds to make accelerated payments on the City's $2.228 million of outstanding lease-leaseback debt (used to finance earlier discretionary payments to CalPERS) but the terms of the recent lease-leaseback refinancing preclude early repayment until at least 2026.

Interest therefore centered on establishing a Section 115 pension trust, which irrevocably ringfences funds for pension purposes. Section 115 trusts are commonplace among Marin municipalities and elsewhere. Although Section 115 pension fund assets cannot be used to reduce net pension debt for GASB financial reporting purposes, they are held on balance sheet as restricted assets, thereby improving the City's overall statement of net position. The credit rating impact is essentially the same.

The range of Section 115 trust providers is extremely limited. The taskforce briefly explored the option of the City securing its own private letter ruling from the IRS but determined it would be cost and time prohibitive. It therefore examined the offerings of the two main 115 trust providers: CalPERS and PARS.

PARS is a for-profit financial services firm that currently manages the City's modest retirement enhancement plan. CalPERS 115 pension trust, known as the California Employers' Pension Prefunding Trust Fund (CEPPT), has only been operational since October 2019 (although its OPEB trust has run for much longer) and offers two low-risk investment strategies. CalPERS acts both as trustee and investment manager. Under the PARS structure, PARS acts as the trustee and partners with investment managers to offer a range of fund options with different risk profiles. Investment performance between CEPPT and PARS is similar. PARS charges higher fees but offers more investment options and may provide some investment manager diversification away from CalPERS. The taskforce is looking for guidance from the Finance Committee on its preferred investment vehicle. It recommends seeding the chosen trust with the $1.5 million of excess reserves/pension reserves, using dollar-cost averaging, and then making payments of $300,000 per annum until the next pension review in 3-5 years' time.

Please review the separate document for a more thorough review of investment options.

Oversight and Reporting

The taskforce discussed an appropriate oversight and reporting framework. It suggests the Finance Committee conduct a standing pension funding review every 3-5 years to reset the discount rate, adjust annual funding costs and fix those payments until the next review. It may also wish to move money from the 115 trust to CalPERS, depending on circumstances, and/or making additional payments to the 115 trust or CalPERS should the City have accumulated fresh excess reserves.

The taskforce discussed valuing the City's pension liabilities at a 6.0% discount rate for financial reporting purposes but concluded this would disadvantage the City vis à vis its peer cities. Instead, it suggests staff produce an annual pension funding update describing the City's pension funding policy and funded status and include it in the City's annual budget report.

Retirement Enhancement Plan Review

The taskforce reviewed the City's retirement enhancement plan, managed by PARS, which has been closed to new entrants since 2012. It determined that its total and unfunded liabilities are small and already discounted using a 6.5% discount rate and that further review, or special funding arrangements, were not necessary at this stage.

Review of City's Reserve Policy

The taskforce discussed whether the City's generous reserve policy (reserves of no less than 6 months of general fund operating expenses, debt financing costs and fire contract costs net of fire tax revenues) should be relaxed to reflect the additional financial buffer provided by the Section 115 trust i.e., in a difficult year, trust assets can be used to finance payments to CalPERS. The consensus was that reducing reserve discipline to finance greater pension discipline would be imprudent.

The taskforce also considered how transfers to the Section 115 trust and additional discretionary payments to CalPERS should be treated for the purposes of calculating the City's reserve requirements. It recommends these items be excluded from the reserve requirement calculation (denominator) because they are discretionary in nature. This is consistent with the City's existing treatment of discretionary payments to CalPERS and internal money transfers.

Employee Contribution Rates

Finally, the taskforce discussed scope for raising employee contribution rates to help share the burden of increased costs associated with CalPERS' investment underperformance versus its ambitious target. The taskforce observed that PEPRA employees already pay 50% of their NCR, which is the maximum allowed under the law. However, classic employees pay less than recommended by the Public Employees' Pension Reform Act which provides for an increase in classic employee contribution rates to 8.0% (from 7.0%) of salary for miscellaneous staff and to 12.0% (from 9.0%) of salary for safety workers, commencing 2018. The savings to the City from implementing a higher classic employee cost share are limited (circa $15,000 p.a.) given the City's current employee mix, particularly the low number of classic safety workers. Nevertheless, the taskforce recommends increasing classic employee contribution rates to those suggested by the PEPRA reforms by no later than FY23-24, bringing the City in line with other local agencies. The taskforce does not recommend employee cost sharing of the employer portion, as the required quid pro quo, typically a pay rise or higher COLA, can increase overall employer costs, particularly given the low rate of staff turnover in Belvedere.

Summary

- Continue to make CalPERS' ARC payments (NCR + UAL payment) according to its funding formulas.
- Continue to use CalPERS discount rate for financial reporting purposes.
- Seed a Section 115 pension trust with the $1.5 million of excess reserves and pension reserves.
- Adopt a discount rate of CalPERS minus 100 basis points for internal planning purposes.
- Fix that rate, currently 6.0%, for 3-5 years, commencing FY2021-22.
- Determine the NCR and UAL at 6.0%, using CalPERS latest Annual Valuation Reports.
- Calculate the annual UAL payment at 6.0% net of Section 115 fund assets.
- Calculate the difference between the ARC at 6.0% and CalPERS ARC. Fix that amount, estimated to be $300,000 in FY2021-22, in nominal terms for 3-5 years.
- Make an annual payment of $300,000 to the Section 115 trust, commencing FY2021-22.
- Produce an annual pension funding update to be included in the City's annual budget report.
- Implement a standing pension review no less than 3 years and no more than 5 years after adoption of the policy, and every 3-5 years thereafter, led by the City's Finance Committee.