



# STAFF REPORT

TO: Mayor and Members of the City Council  
FROM: Pak Lin, Administrative Services Director  
VIA: Brian Dossey, City Manager  
MEETING DATE: October 24, 2018  
SUBJECT: Unfunded Liabilities Funding Strategy

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## RECOMMENDATION

Staff recommends that the City Council make the following motions:

MOTION APPROVING THE 2018 UNFUNDED LIABILITIES FUNDING STRATEGY

MOTION TO ADOPT RESOLUTION TO AMEND THE 2018-19 BUDGET TO PAY IN AN AMOUNT NOT TO EXCEED \$1.05 MILLION TO CALPERS, PAY \$1.0 MILLION TO PARS PENSION TRUST, DESIGNATE \$650,000 IN ACCRUED LEAVE LIABILITY RESERVE, AND REDUCE THE BUDGET STABILIZATION BUDGET TO \$12.0 MILLION.

## EXECUTIVE SUMMARY

The attached 2018 Unfunded Liabilities Funding Strategy (Attachment B) reflects the financial plan in addressing the rising pension, OPEB, and accrued leave payout costs as determined by the City Council on study sessions held on September 26, 2018 and October 10, 2018. This financial plan is also part of the Town's Strategic Plan and was identified as a priority program in the 2017-2019 Strategic Plan. The 2018 Unfunded Liabilities Funding Strategy has elements that has fiscal impact in 2018-19, as described below. It balances overall savings with annual impact to the Town's budget.

## FISCAL IMPACT

Implementation of the 2018 Unfunded Liabilities Funding Strategy will require City Council authorize through resolution to reduce Budget Stabilization Reserve from \$15.0 million to \$12.0 million, designate \$650,000 to the Accrued Leave Liability Reserve, transfer \$1.0 million to PARS Pension Trust, and make \$1.0 million to CalPERS. Given CalPERS records each year's investment earnings/losses like a separate credit card bill, Town Staff will work with CalPERS to select the most cost-effective "credit card bill" to eliminate and the final transfer will not exceed \$1,050,000. Town Staff will schedule this transfer in January 2019.

## BACKGROUND

The Town held two study sessions on September 26, 2018 and October 10, 2018 to discuss funding strategies to address the Town's pension, OPEB, and accrued leave liabilities. Based on the most recent actuarial reports and analysis, the Town has \$26.2 million in unfunded liabilities:

Pension	\$10,199,600
Retiree Medical/Dental (OPEB)	\$14,038,976
Accrued Leave	\$1,951,242

## ANALYSIS

The strategies include paying \$1.0 million to CalPERS as supplemental contribution, transferring \$1.0 million to PARS Pension Trust as budget stabilization, transferring \$650,000 into an Accrued Leave Liability Reserve as budget stabilization and reducing the \$15.0 million Budget Stabilization Reserve to \$12.0 million in 2018-19. Town Staff will work with CalPERS in making the \$1.0 million supplemental contribution.

The 2018 Unfunded Liability Funding Strategy also addresses the ongoing contribution for pension, OPEB, and accrued leave, where annual contributions will be part of the annual budget process and the contributions will be allocated to each department proportionately. Pension contribution will be budgeted at 6.0 percent or 6.5 percent discount rate dependent on budget constraint, OPEB will be budgeted based on the most current valuation report, and accrued leave will be budgeted at \$61,000.

The report also documents the funding goal for each liability.

- The goal for pension is to be fully funded (100 percent). As long as the Town continues to offer pension benefits, there is no risk of overfunding.
- The funding goal for OPEB is to reach 80 percent funding status because there is a risk of overfunding. The Town has instituted a Tier C for unrepresented and Tier D for represented employees where these employees will not be receiving retiree medical benefits in excess of the CalPERS PEMHCA (Public Employees' Medical & Hospital Care Act) minimum, which is currently at \$133 per month per employee. There is a risk where the OPEB Trust investment earnings will exceed the annual PEMHCA contribution resulting in a balance in the PARS OPEB Trust that the Town cannot utilize.
- The accrued leave liability goal is to meet minimum payout for all existing employees. This will require biennial assessment of the accrued leave payout and calculation of the average minimum contribution necessary to maintain a positive reserve balance.

To ensure the Town will meet its long-term financial goal, an annual status update will be provided along with the annual audited report. Additionally, the funding strategies will be reassessed and the funding schedule will be recalculated every two years with most current data.

## **Council Adopted Values**

The adoption of the 2018 Unfunded Liabilities Funding Strategy is in alignment with the Town's Responsibility and Vision attributes in the Town's Value-Based Code of Conduct.

## **Alternatives**

The Council may direct Staff to make alterations to the funding strategies.

## **CONCLUSION**

Staff recommends the City Council approves the 2018 Unfunded Liabilities Funding Strategy and to amend the 2018-19 Budget as stated in the Resolution.

## **ATTACHMENTS**

- A. Resolution
- B. 2018 Unfunded Liabilities Funding Strategy

**RESOLUTION NO. 2018-##  
of the City Council of the Town of Colma**

**RESOLUTION AMENDING THE 2018-19 BUDGET TO PAY IN AN AMOUNT NOT TO EXCEED \$1.05 MILLION TO CALPERS, PAY \$1.0 MILLION TO PARS PENSION TRUST, DESIGNATE \$650,000 IN ACCRUED LEAVE LIABILITY RESERVE, AND REDUCE THE BUDGET STABILIZATION BUDGET TO \$12.0 MILLION.**

The City Council of the Town of Colma does resolve as follows.

**1. Background**

- (a) The Town of Colma offers guaranteed benefits at employees' retirement, which created unfunded liabilities;
- (b) The City Council identified the Town's unfunded liabilities as its 2017-2019 Strategic Plan;
- (c) The City Council increased OPEB contributions in March 2018 to address a part of the Town's unfunded liabilities;
- (d) The City Council held two study sessions on September 26, 2018 and October 10, 2018 to discuss overall funding strategies, including alternatives recommended by the July 2018 Grand Jury Report on "Soaring Pension Costs," to address unfunded liabilities in pension, OPEB, and accrued leave benefits;
- (e) The approval of the 2018 Unfunded Liability Funding Strategy requires immediate actions in 2018-19 and therefore requires a budget amendment.

**2. Order**

- (a) The City Council hereby approves to amend the Fiscal Year 2018-19 Budget as followed:
  - Transfer of \$2.05 million from General Fund Reserve (Fund 12) to PARS Pension Trust (Fund 72) – \$1.05 million to CalPERS and \$1.0 million to PARS Trust;
  - Designate \$650,000 to Accrued Leave Liabilities Reserve (Fund 12); and
  - Reduce Budget Stabilization Reserve (Fund 12) from \$15.0 million to \$12.0 million; and
  - Transfer excess reserves back to Unassigned General Fund Reserve (Fund 11).
- (b) The City Manager is hereby authorized to execute the agreement to pay an amount not to exceed \$1,050,000 to CalPERS to reduce the Town's pension liabilities.

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**ARTICLE 1. SEVERABILITY.**

Each of the provisions of this resolution is severable from all other provisions. If any article, section, subsection, paragraph, sentence, clause or phrase of this resolution is for any reason held by a court of competent jurisdiction to be invalid, such decision shall not affect the validity of the remaining portions of this ordinance.

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**ARTICLE 2. NOT A CEQA PROJECT.**

The City Council finds that adoption of this resolution is not a "project," as defined in the California Environmental Quality Act because it does not have a potential for resulting in either a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment and concerns general policy and procedure making.

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**ARTICLE 3. EFFECTIVE DATE.**

This resolution shall take effective immediately upon adoption.

**Certification of Adoption**

I certify that the foregoing Resolution No. 2018-## was duly adopted at a regular meeting of the City Council of the Town of Colma held on October 24, 2018, by the following vote:

Name	Counted toward Quorum			Not Counted toward Quorum	
	Aye	No	Abstain	Present, Recused	Absent
Raquel Gonzalez, Mayor					
Joanne del Rosario, Vice Mayor					
John Goodwin					
Diana Colvin					
Helen Fisicaro					
<i>Voting Tally</i>					

Dated \_\_\_\_\_

\_\_\_\_\_  
Raquel Gonzalez, Mayor

Attest: \_\_\_\_\_  
Caitlin Corley, City Clerk

# Unfunded Liabilities Funding Strategy

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## EXECUTIVE SUMMARY

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The Town's unfunded liabilities have grown in recent years due to poor investment returns, longer benefit payment period, rising medical premium costs, and faster salary escalations. To curb unfunded liabilities, the Town reduced pension benefits for new hires in 2012, established designated reserves in 2014, and participated in an Internal Revenue Service (IRS) recognized Section 115 Trusts in 2015. The Town also conducted two study sessions to discuss the funding strategies to address the three primary unfunded liabilities: pension costs, Other Post-Employment Benefit (OPEB) costs, and accrued leave payouts when an employee retires from the Town. Based on the most recent valuation reports and internal analysis, the total unfunded liability as of June 30, 2018 is \$26,189,818.

Benefits	Source	Amount
Pension	CalPERS Valuation Report as of June 30, 2017	\$10,199,600
Retiree Medical/Dental (OPEB)	GovInvest Valuation Report as of June 30, 2017	\$14,038,976
Accrued Leave Payout	In-house estimate as of June 30, 2018	\$1,951,242

From the outcome of the two study sessions, held on September 26, 2018 and October 10, 2018, the funding strategies are as followed. Detailed analysis and payment schedules are in the subsequent sections of this document:

- The pension funding strategy includes paying a \$1.0 million of supplemental contribution to CalPERS and a \$1.0 million into the Town's Section 115 Trust in 2018-19 from the Budget Stabilization Reserve. Dependent of budget constraint, the Town will make annual contributions (net of annual payments to CalPERS) into the Section 115 Trust based on either 6.0 percent or 6.5 percent discount rate or as directed by the City Council. The goal of the pension strategy is to reach 100 percent funded status.
- For OPEB, the Town will make annual contributions (net of out-of-pocket retiree medical and dental costs), into the Town's Section 115 Trust based on the most recent OPEB Valuation Report. The goal of the OPEB funding strategy is to reach 80 percent funded status, to avoid overfunding.
- Accrued Leave Liability Reserve will be created and committed to pay for vacation leave payout at employment separation. Sick leave payout are includes for employees who meet requirement sets in the Colma Administrative Code Section 3.06.130 Conversion or Payment

# Unfunded Liabilities Funding Strategy

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for Unused Sick Leave. An initial designation of \$650,000 from the Budget Stabilization Reserve to Accrued Leave Liability Reserve. Annual contribution of \$61,000 will be allocated to departmental annual budget beginning 2019-20.

- Budget Stabilization Reserve will be reduced from \$15.0 million to \$12.0 million in 2018-19. Beginning 2019-20, Budget Stabilization Reserve calculation will exclude annual contributions to pension, OPEB, and Accrued Leave Liability Reserve.

This document is part of the Town's Strategic Plan and was identified as one of the priority projects in the 2017-19 Strategic Plan. This financial plan should be reassessed every two years to ensure the Town will meet its financial goals.

## PENSION

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### BACKGROUND

The Town participates in California Public Employee Retirement System (CalPERS) for its pension benefits. Unlike the better known 401(k) retirement account, or the government equivalent 457(b), pension benefits guarantee retirement income that is based on set pension formulas. Currently, the Town has six pension formulas – three for sworn officers and three for non-sworn employees. The formulas are as followed:

Formula	Hire Date	Misc	Safety
Tier 1	Prior to 8/1/2012	2.5% @ 55	3.0% @ 50
Tier 2	After 8/1/2012	2.0% @ 60	3.0% @ 55
Tier 3	After 1/1/2013	2.0% @ 62	2.7% @ 57

In addition to the formulas, retirement income is a function of annuitant's years of service and final earnings. Annually, employees and employers make contributions to CalPERS to be managed and invested such that when the employee retires, there are sufficient funds for the remainder of the annuitant's life. To determine the appropriate level of required annual contributions, CalPERS actuaries calculate the minimum contributions based on set assumptions. When an employee retires, CalPERS administers the pension payments and assess cost of living adjustments on the pension payments.

In the early 2000s, CalPERS' investment earnings performed better than expected and the savings were shared with the member agencies. However, the 2008 Housing Crisis and the Lehman Brothers loss created a funding gap, also known as the unfunded pension liability. Additionally, the growing "baby boomer" retirement forced CalPERS to liquidate investments prior to maturity, resulting in investment losses and withdrawal fees. To address the growing funding gap, CalPERS increased the required annual contribution from its the member agencies by adjusted their asset management plans towards more conservative investment types, lowered the expected investment return from 7.5 percent to 7.0 percent (discount rate), and adjusted their mortality and salary growth rates. There were discussions of reducing the discount rate further, which is on hold due to public agencies outcry.

To compact the growing pension cost, the Town negotiated and implemented the lower pension formulas for Town employees hired after August 1, 2012 and who are classified by CalPERS as

# Unfunded Liabilities Funding Strategy

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“classic members”. The benefit of a lower formula reduces the Town’s total pension liabilities as positions are filled by new employees. In 2013, the PEPR tier was added per State regulation, which further reduces the Town’s overall pension cost.

As of June 30, 2017, the Town’s total unfunded pension liability is \$10.2 million. This is based on the current discount rate of 7.25 percent. At 7.00 percent, the unfunded pension liability would be \$11.4 million, which will be the new discount rate effective June 30, 2018 Valuation Reports.

## FUNDING STRATEGY

To address unfunded pension liabilities, the Town will make a \$1.0 million supplemental contribution to CalPERS and a \$1.0 million to Public Agency Retirement Services (PARS) Pension Trust in FY 2018-19. Beginning FY 2019-20, as part of the annual budget process, the Town will make additional contribution into the PARS Pension Trust, net of required contributions to CalPERS, with a discount rate of 6.0 percent or 6.5 percent. The level of contribution will be based on economic conditions, Town priorities, and City Council direction. The goal will be to set to contribute at the 6.0 percent rate whenever possible. The estimated annual contribution, calculated using GovInvest, is as followed:

Discount Rate	Pay to	Contribution into PARS	
	CalPERS	Pension Trust	
	7.0%	6.0%	6.5%
2018-19	2,531,562		1,000,000
2019-20	1,678,496	343,815	154,624
2020-21	1,749,795	405,748	205,969
2021-22	1,574,501	499,943	264,338
2022-23	1,539,122	604,659	327,800
2023-24	1,595,773	712,948	393,397
2024-25	1,605,070	726,137	400,470
2025-26	1,646,923	753,971	413,817
2026-27	1,653,368	767,150	420,884
2027-28	1,676,858	784,247	429,702
2028-29	1,699,458	805,440	440,315
2029-30	1,719,368	823,427	449,628
2030-31	1,753,715	848,984	462,209
2031-32	1,734,403	0	476,548
2032-33	1,711,858	903,783	490,109
2033-34	1,673,467	0	506,128
2034-35	1,612,637	965,077	522,115
2035-36	1,426,676	0	464,467
2036-37	1,146,819	775,347	0
2037-38	1,114,348	0	330,984
2038-39	1,108,691	528,449	252,071
2039-40	1,099,091	0	0
2040-41	1,027,271	399,066	170,514



# Unfunded Liabilities Funding Strategy

Discount Rate	Pay to	Contribution into PARS	
	CalPERS	Pension Trust	
	7.0%	6.0%	6.5%
<b>2041-42</b>	991,963	0	171,965
<b>2042-43</b>	924,266	423,020	0
<b>2043-44</b>	891,274	0	161,194

## FUNDING GOAL

The goal is to be 100 percent funded, once fully funded the PARS Pension Trust can be used to reduce the Town's unfunded liabilities and to pay the Town's current pension cost.

## OTHER POST-EMPLOYMENT BENEFITS (OPEB)

### BACKGROUND

The Town offers retiree medical and dental, also known as Other Post-Employment Benefits (or OPEB), to employees that meet certain requirements. The requirements are as followed:

Description	Unrepresented	Peace Officer and Dispatcher
Medical Coverage		
100% of selected	Tier A: Originally hired prior to 7/1/2012	Tier A: Originally hired prior to 6/1/2008.
Up to 100% of 2 <sup>nd</sup> most expensive medical plan		Tier B: Originally hired between 6/1/2008 and 6/30/2012
Percent based on years of services. See table below for the vesting schedule	Tier B: Originally hired between 7/1/2012-12/31/2016	Tier C: Originally between 7/1/2012-12/31/2016
1.5% pay into a Retirement Health Savings Program	Tier C: Hired after 1/1/2017	Tier D: Hired after 1/1/2017
Dental Coverage		
	Council: First elected before 1/1/1995	Peace Officers: Hired before 1/1/2008
	Others: Hired before 5/1/2010	Dispatchers: Hired before 1/1/2010

# Unfunded Liabilities Funding Strategy

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## Vesting Schedule

Credited Years of Services in CalPERS (minimum of 5 year with the Town)	Percent vested
10	50%
11	55%
12	60%
13	65%
14	70%
15	75%
16	80%
17	85%
18	90%
19	95%
20+	100%

The Town began making contributions into the PARS OPEB Trust beginning in 2015. In March 2018, the City Council adopted a resolution making the annual contributions based on the 2017 GovInvest valuation report.

## FUNDING STRATEGY

The Town will continue to make annual contributions into the PARS OPEB Trust, net of out-of-pocket cost, based on the schedule below.

Year	Total Required Contribution	Year	Total Required Contribution
2018-19	1,679,867	2030-31	2,395,089
2019-20	1,730,263	2031-32	2,466,941
2020-21	1,782,171	2032-33	2,540,950
2021-22	1,835,636	2033-34	2,617,178
2022-23	1,890,705	2034-35	2,695,693
2023-24	1,947,426	2035-36	2,776,564
2024-25	2,005,849	2036-37	2,859,861
2025-26	2,066,025	2037-38	1,368,968
2026-27	2,128,005	2038-39	1,410,037
2027-28	2,191,845	2039-40	1,452,338
2028-29	2,257,601	2040-41	1,495,908
2029-30	2,325,329		

## FUNDING GOAL

The goal is to be 80 percent funded. The OPEB Trust funds can only be used for retiree medical and dental cost. Once a majority of the Town's employees fall under Tier C for unrepresented and Tier D for represented, the annual out-of-pocket cost will be reduced to the PEMCHA (Public

# Unfunded Liabilities Funding Strategy

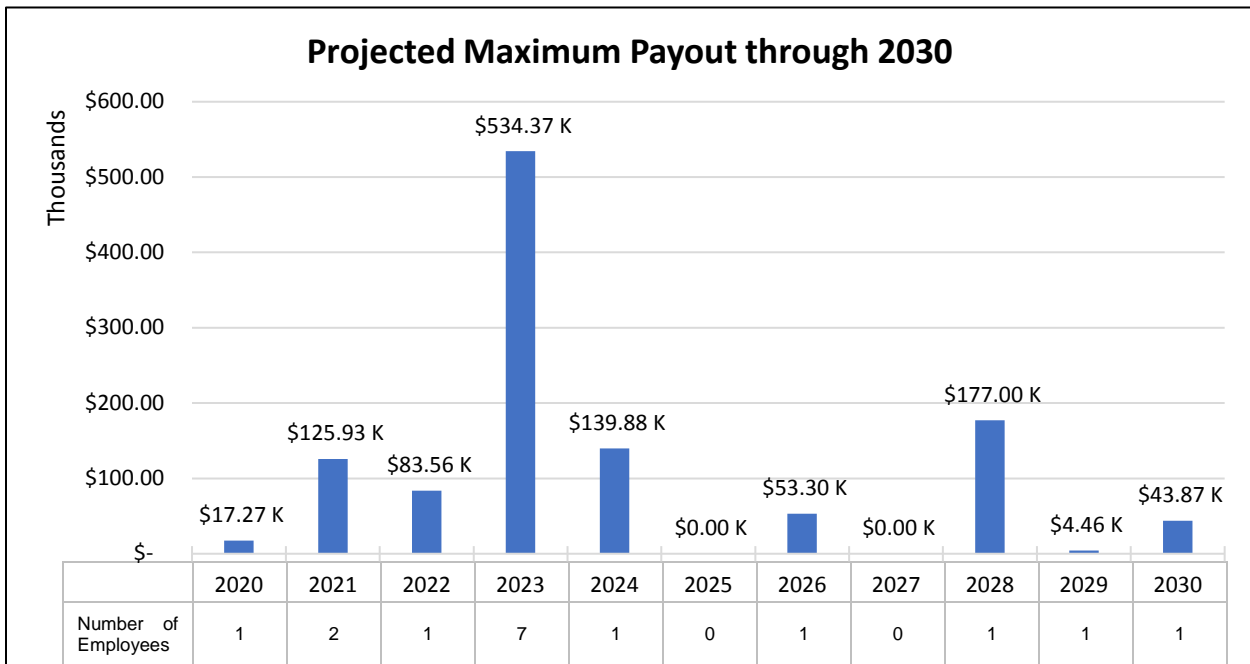
Employees' Medical and Hospital Care Act) minimum. The current CalPERS PEMCHA cost is \$133 per employee per month.

## ACCRUED LEAVE LIABILITY

The Town budgets for three types of accrued leave payouts – (1) annual vacation cash out, (2) holiday compensation to police officers, and (3) lump sum payments at separation or retirement (sick leave, vacation, compensation time). Employees who meet the criteria listed under Administrative Code § 3.06-410(f) may elect to cash out a portion of their unused vacation balance in August of each fiscal year. This allows the Town to reduce total vacation accruals and may reduce an employee's final payout cost.

Of the three types of accrued leave payouts, lump sum payments at separation or retirement poses the highest budgetary fluctuation. According to Administrative Code and MOUs, employees retiring under the CalPERS system within 60 days of separation may convert unused and accrued sick leave to additional PERS service credit or be paid for unused and accrued sick leave, not to exceed 1,092 for peace officers and 1,040 for all other employees. Additionally, employees separating from Town employment are eligible for a vacation payout. In FY2017-18, one long-time employee retired and received \$26,400. The Town anticipates two additional retirements in FY2018-19, with an estimated maximum lump sum payout of \$153,400.

Under the direction of the City Council, Staff projected retirement lump sum payments for all employees, totaling \$1.95 million. As shown in the chart below, 17 of the current employees are eligible for retirement through 2029-30. Of the 17, seven are eligible for retirement in FY 2022-23, resulting in the highest payout at \$534,000.



The assumptions used in estimating the accrued leave liabilities are (1) all employees remain with the Town until retirement; (2) all employees take 96 hours of sick a year and 80 hours of vacation

# Unfunded Liabilities Funding Strategy

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a year; (3) all employees will retire when eligible per CalPERS formula; and (4) annual salary growth will be at 3% per year.

## **FUNDING STRATEGY**

A one-time commitment of \$650,000 to an Accrued Leave Liability Reserve and an annual budgetary contribution of \$61,000, to be allocated to all departments based on payroll. The annual contribution is the average minimum payout through FY 2051-52.

## **FUNDING GOAL**

The goal is to meet the minimum payment required.

## **REPORTING REQUIREMENTS**

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An annual status update of the Town's unfunded liability will be part of the annual audited financial update. Additionally, the funding strategies will be reassessed every two years.