Item No. 4
Town of Atherton

FINANCE COMMITTEE STAFF REPORT

TO: FINANCE COMMITTEE

FROM: ROBERT BARRON III, FINANCE DIRECTOR

DATE: NOVEMBER 12, 2019

SUBJECT: REVIEW, DISCUSSION AND IF APPROPRIATE, MAKE RECOMMENDATION TO CITY COUNCIL REGARDING CONTRIBUTION TO THE TOWN PENSION RATE STABILIZATION FUND IN AN EFFORT OF ADDRESSING FUTURE PENSION LIABILITIES ONCE THE CIVIC CENTER PROJECT IS COMPLETE

RECOMMENDATION

Review, discussion, and if appropriate, make a recommendation to City Council regarding contribution to the Town Pension Rate Stabilization fund in an effort of addressing future pension liabilities once the Civic Center Project is complete.

BACKGROUND

At its October 10, 2019 Special Finance Committee meeting, the Committee reviewed the CalPERS actuarial reports as of June 30, 2018. We discussed the changes that CalPERS implemented over the years that were impactful in pension liabilities. These included the discussion of CalPERS rate smoothing policy, demographic changes in actuary assumptions, new investment asset allocations and especially changes in the discount rate. This Committee over the years has reviewed and discussed strategies in helping the Town reduce its long-term liabilities. Strategies included efforts to reduce future pension payments by paying down unfunded liabilities and managing future increases by creating reserves. In the past several years there have been increased discussion regarding public pension costs and how much these costs are impacting annual budgets.

FINDINGS

With the recent changes in CalPERS assumptions on discount rates and demographics there is belief that within the next ten years pension costs could significantly increase. It is important that we continue to analyze pension liabilities and ensure we are prepared to mitigate any increases in future pension costs. In review of the actuarial reports as of June 30, 2018, it was illustrated that the Town's unfunded pension liability increased. The market Value of Assets (MVA) for Miscellaneous Employees is $14,011,196 and an unfunded liability of$5,107,391. For Public Safety Employees the MVA is $30,918,059 with an unfunded liability of $13,037,296. This calculates to a total unfunded liability of $18,144,687. This is a total increase of $2,432,945 from previous year valuation reports. It was presented during the meeting that the $18 Million unfunded liability was significant. Discussion ensued that currently Town funds were being allocated to the construction of the new Civic Center.

It was recommended within the Finance Committee that a recommendation be sent to the City Council that once the Civic Center project was completed, funding towards paying down unfunded pensions liabilities would be implemented. It was conferred that it makes sense once the Civic Center is completed. The Committee supported and recommended that a formal statement be made to the Council for contributions toward pension liabilities via Pension Rate Stabilization Trust (PARS Trust). The Committee does not support putting any money aside currently into the PRST. *Attached for review is a statement for consideration as a formal recommendation to the Council. The Committee can review, discuss and recommend any changes to the statement. Town staff will then present this as a formal recommendation to the Council.*

One suggested recommendation is to direct a portion of ERAF funds toward pension obligations. The City Council in previous years developed a policy to direct ERAF funds over time toward pension obligations or capital project needs consistent with other budget priorities. It is not the current philosophy to contribute to CalPERS any more funds than our required normal cost and unfunded liability requires.

Once the Town Center is complete, paying down long-term pension liabilities will be a suitable goal in a similar manner as the Town contributed in previous years to its OPEB liabilities.

FISCAL IMPACT

None

PUBLIC NOTICE

Public notification was achieved by posting the agenda, with this agenda item being listed, at least 72 hours prior to the meeting in print and electronically. Information about the project is also disseminated via the Town's electronic News Flash and Atherton Online. There are approximately 1,200 subscribers to the Town's electronic News Flash publications. Subscribers include residents as well as stakeholders – to include, but be not limited to, media outlets, school districts, Menlo Park Fire District, service provides (water, power, and sewer), and regional elected officials.

ATTACHMENTS

Statement recommendation on Pension Liability funding to City Council

Draft Memo from Chair Polito
RE: Communication from Finance Committee to City Council Town Pension Liabilities

The Finance Committee has reviewed the most recent CalPERS Actuarial Valuation Reports for the Town's Pension Plans as of June 30, 2018. Excluding the PEPRA accounts, which are small and near full funding, the reports show the market value of Plan assets to be $44,929,255 against accrued liabilities of $63,073,942. The Town is 71% funded, leaving an unfunded accrued liability of $18,144,687, an amount that is troubling to say the least. To better understand how this significant liability developed, we assumed historical data would be helpful.

The Town, with most other local government entities, merged our Plan assets into CalPERS in 2005. As a requirement to do so, a "Side Fund" obligation was created which, when fully paid, was supposed to eliminate the Town's UAL through the 2005 FY. The Town made payments in the 2012 and 2013 fiscal years totaling $1,871,971 to satisfy our Side Fund obligation. Therefore, in theory, the Town was fully funded as of FYE 05.

In addition to the Side Fund payments above, the town each year makes the Annual Required Contribution as determined by CalPERS. This is the amount necessary to fund the pension obligations which are realized in each fiscal year. By making those payments, in theory, the pension obligations for those years should be fully funded. The Town made ARC payments in FY11-12 through FY 17-18 totaling $5,769,228.

Finally, in FY15-16, CalPERS began requiring an annual payment intended to eliminate any Unfunded Liability over a thirty-year period. The Town made payments for FY15-16 through FY17-18 totaling $1,629,624. These payment requirements have increased dramatically each year, starting at $442,229 in FY15-16, and reaching $838,215 in FY18-19. Even more concerning, CalPERS plans to reduce the amortization period to 20 years, possibly adding to the size of our future required payments!

According to CalPERS, at the end of FY2011 the Town's pension obligations totaled $43,045,603, and we were 76% funded with the market value of plan assets totaling $32,666,262. Our UAL stood at $10,379,341. In the ensuing seven years (through FY17-18), despite the Town making contributions to the Plan totaling $9,270,823, CalPERS now claims our total obligations have increased 50% and our UAL has nearly doubled to over $18 million!

We realize the actuarial calculations involved here are very complex, involving many ever-changing factors, but how can payments of $9M on a $10M debt result in $18M of debt?? Assuming the Side Fund calculations were proper, and that the Town fully funded each year's ARC, then the problem must lie with CalPERS. Some combination of actuarial errors, bad management decisions and investment shortfalls have created a never-ending funding requirement that defies imagination and is completely out of the Town's control.

The pension payments made to CalPERS by the Town in FY18-19 totaled $1,439,309. In FY19-20, the required payments will again be a big number. While the Committee recommends continuing (for now) to make both the ARC and UAL payments, we strongly advise against any “extra” contributions to CalPERS, as we believe our funds could be in jeopardy should CalPERS’ problems get any further out of hand.

Pension shortfalls are a serious problem everywhere, not just in Atherton. In fact, Atherton is in relatively good shape compared to many municipalities in California and beyond. We can and will meet our pension obligations. However, given the funding requirements of the Civic Center project, it is unlikely that we will have excess funds available over the next few years to address this issue. Once funds are available, prudent amounts should be directed toward our pension obligation via the Trust we established last year for this purpose. That allows us to maintain control and isolate that money from any disruptions that may occur in the CalPERS domain. Meanwhile, we can hope that their management decisions and investment performance begin to reflect positively in the coming years’ Valuation Reports.