Pension Liability Funding Options and OPEB Status Update

NapaSan

Finance Committee Meeting

January 16, 2018

Pensions

- Definitions

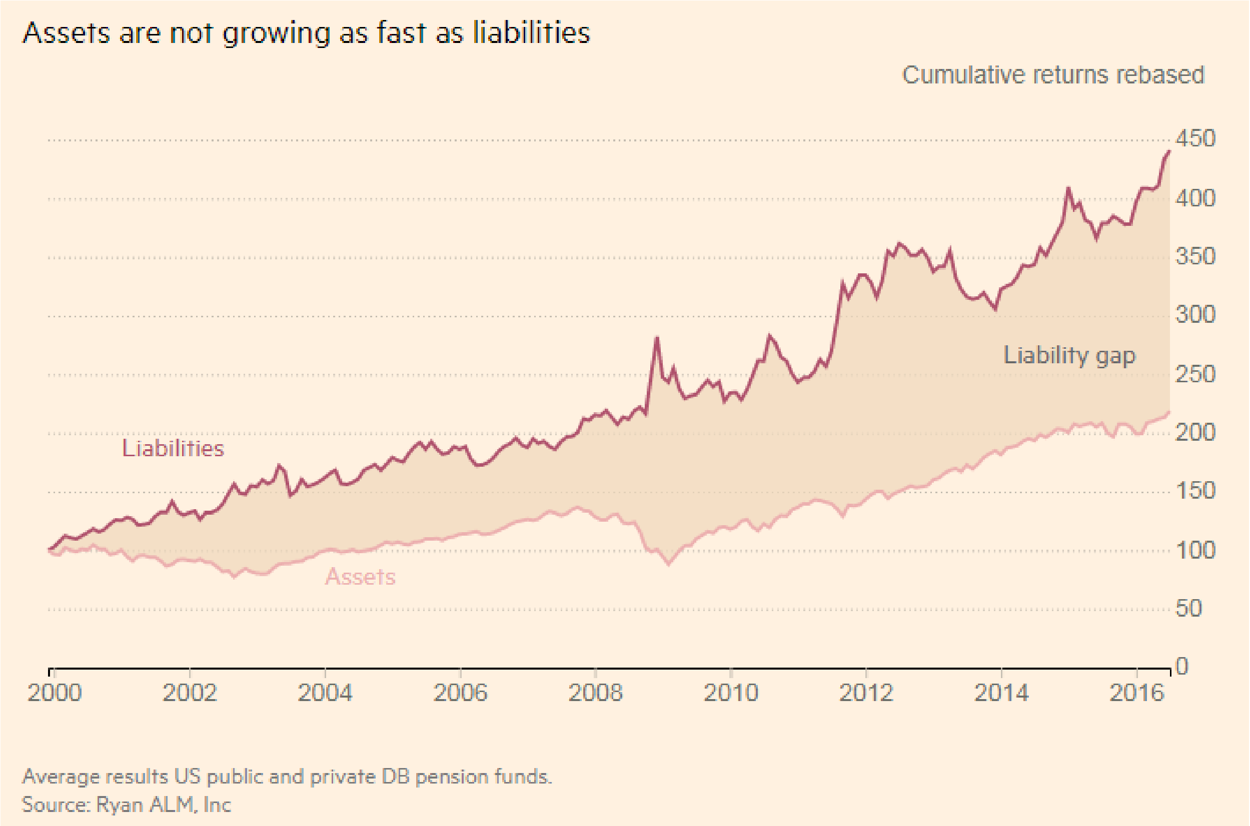
Normal Cost – The cost of the retirement benefits that accrue for the plan year.

Unfunded Actuarial Liability (UAL) – This is the past service costs that have not yet been funded.

Discount Rate – The assumed rate of return on plan investments.

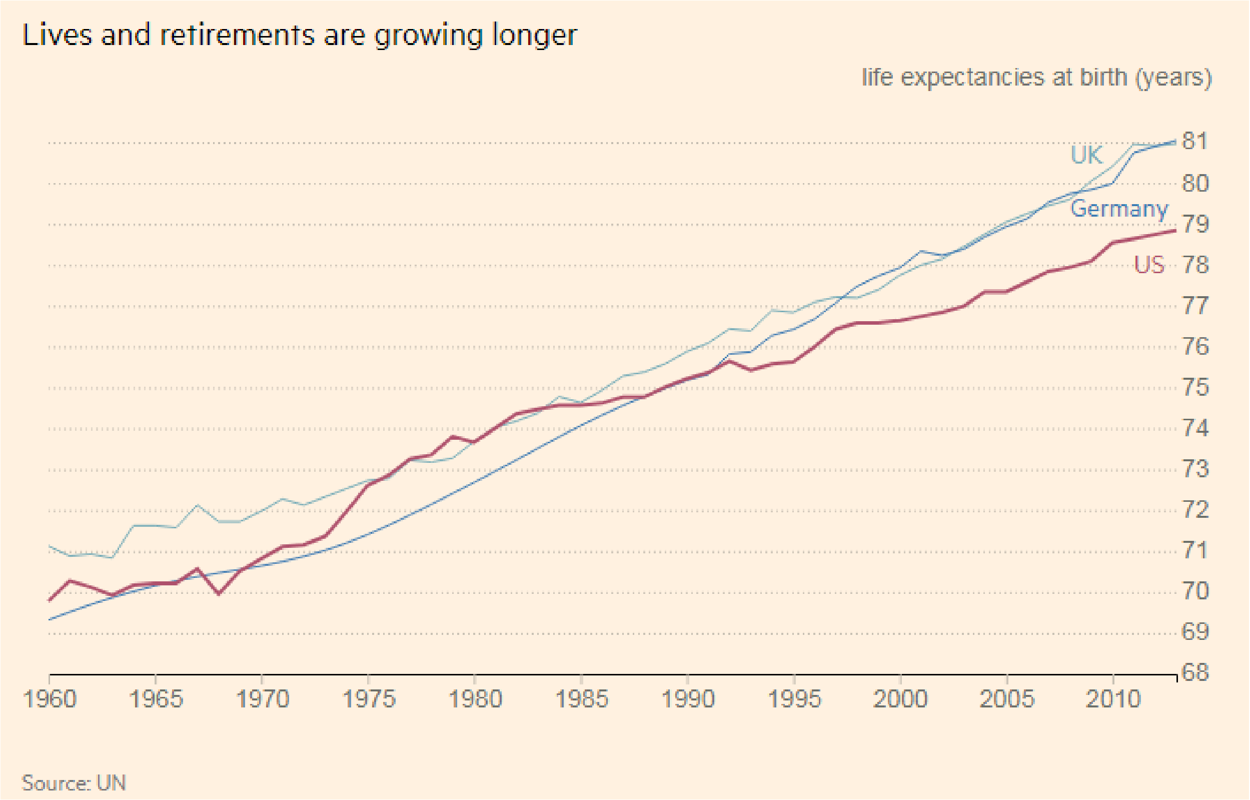
Pensions

- Pension Plans, Generally



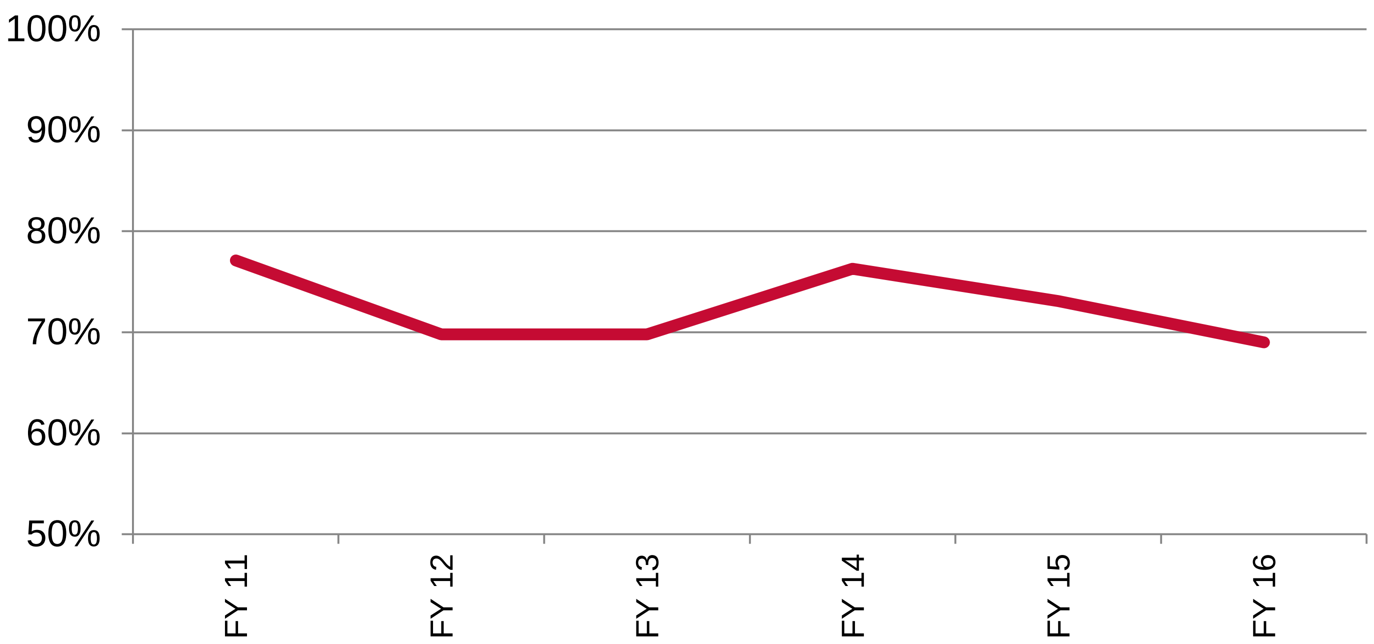
Pensions

- Pension Plans, Generally



CalPERS

- CalPERS Pension Plan Funding Status



CalPERS

- CalPERS Response

  2013 – Changed amortization and smoothing policies (5 years)

  2014 – Updated mortality tables

  2015 – Funding Risk Mitigation policy (when investment returns are above discount rate, lowers discount rate and changes asset allocation)

  2017 – Evaluating asset allocation mix (study concludes February 2018)

CalPERS

- CalPERS Response

Reduced Discount Rate:

FY 16-17	7.50%
FY 17-18	7.375%
FY 18-19	7.25%
FY 19-20	7.00%

Impact: Increases Normal Cost <u>AND</u>
Increases unfunded liability

CalPERS

- CalPERS Response

Risk Mitigation Policy:

Investment Returns over Discount Rate (DR)	Reduction to DR
2% over	0.05%
7% over	0.10%
10% over	0.15%
13% over	0.20%
17% over	0.25%

½ of “extra revenues” from investment returns used to lower the DR, and ½ used to lower agency payments

CalPERS

- Result of Changes

Normal Cost: Increase of 1-3% as percentage of payroll (e.g., increase cost from 13% of payroll to 14-16% of payroll)

Unfunded Liability: 30-40% increase

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- 3 Tiers of CalPERS Plans at NapaSan

	Tier 1	Tier 2	PEPRA
Effective Date		Sept. 2009	Jan. 2013
Plan	2.7% @ 55	2.0% @ 55	2.0% @ 62
# of Employees (Active)	34	6	13
# of Retirees	60	0	0
Normal Cost (% of payroll)	13.7%	9.6%	6.9%
Employee Contribution (% of payroll)	4.25%	4.25%	6.5%
Annual Payment of Unfunded Liability	$1,111,132	$3,234	$496

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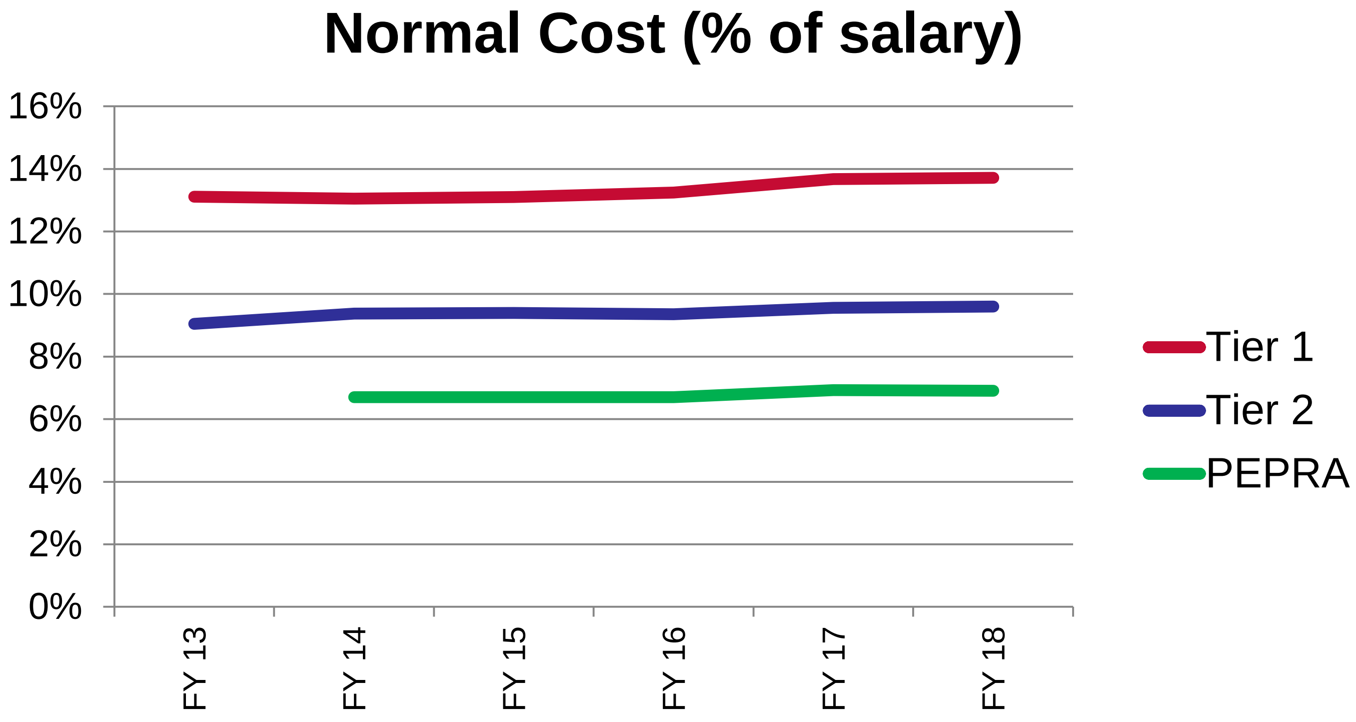
- NapaSan Normal Cost

Normal Cost – The cost of the retirement benefits that accrue for the plan year.



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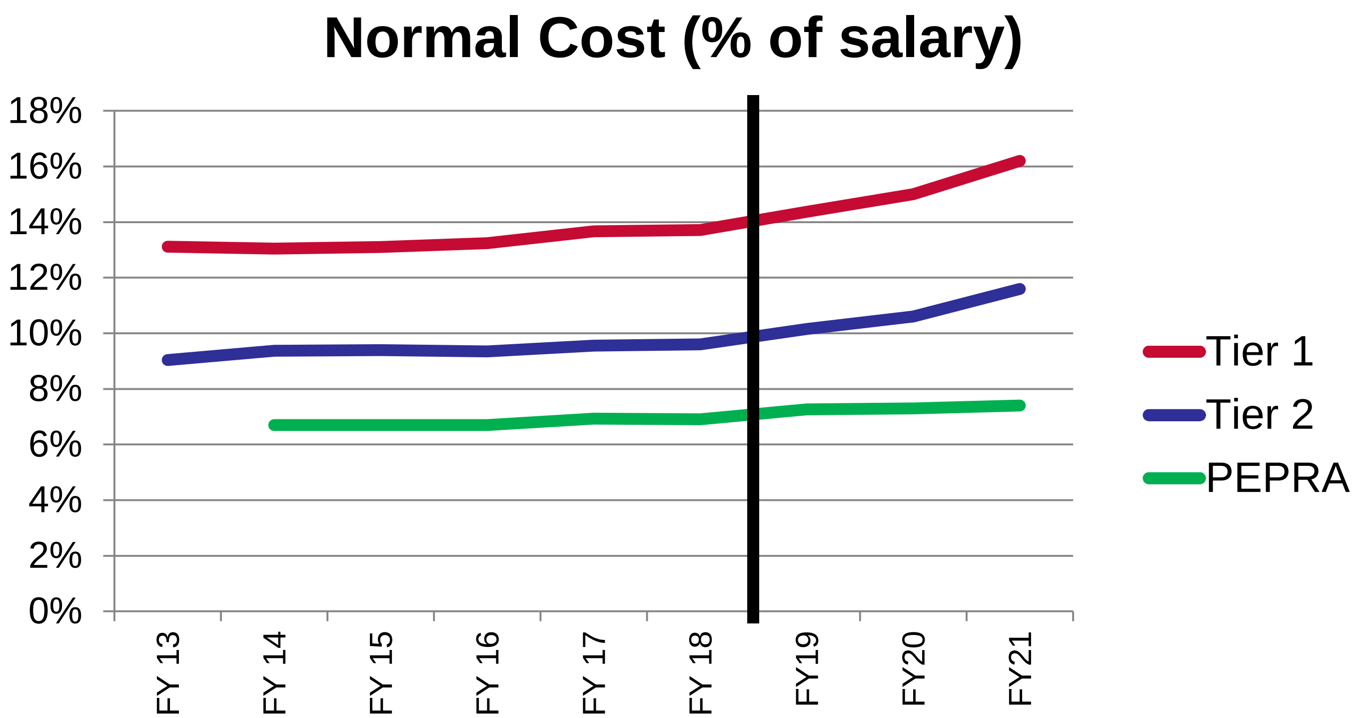
- NapaSan Normal Cost



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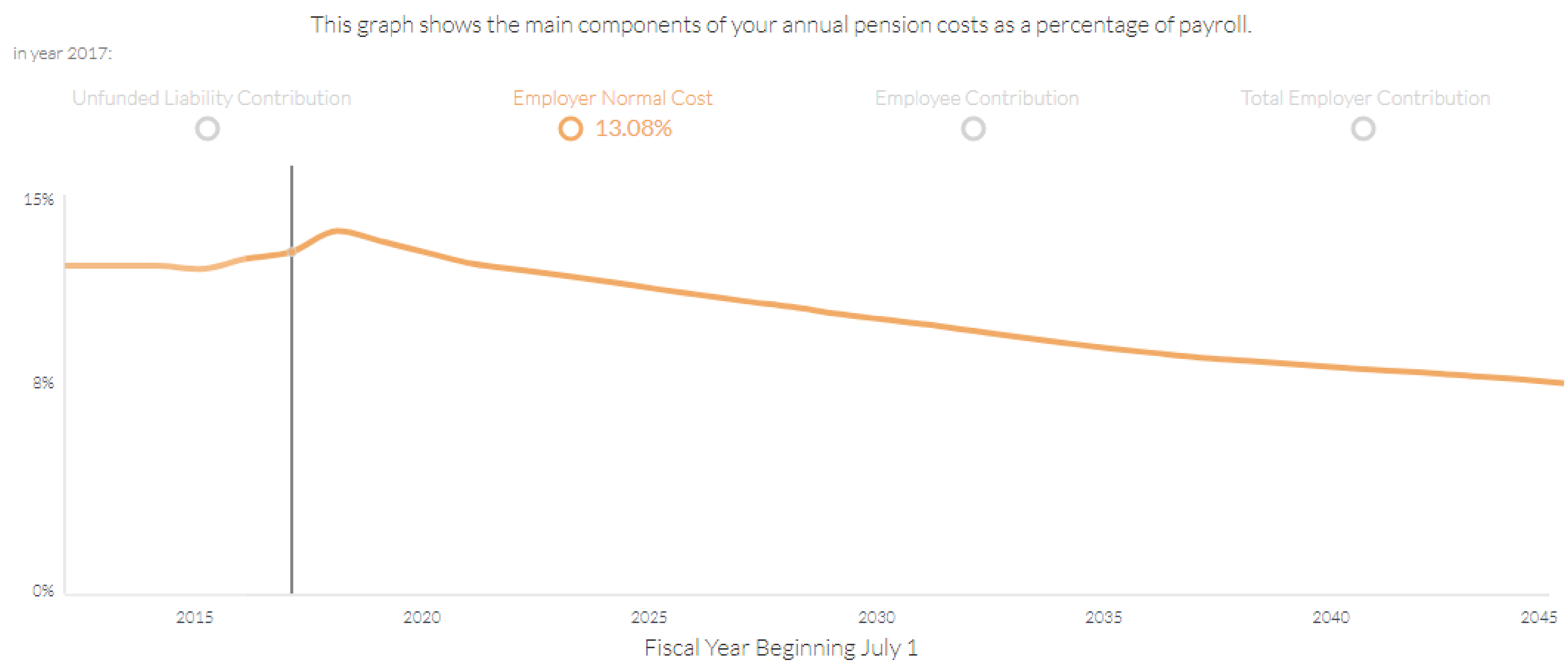
- Normal Cost Projection



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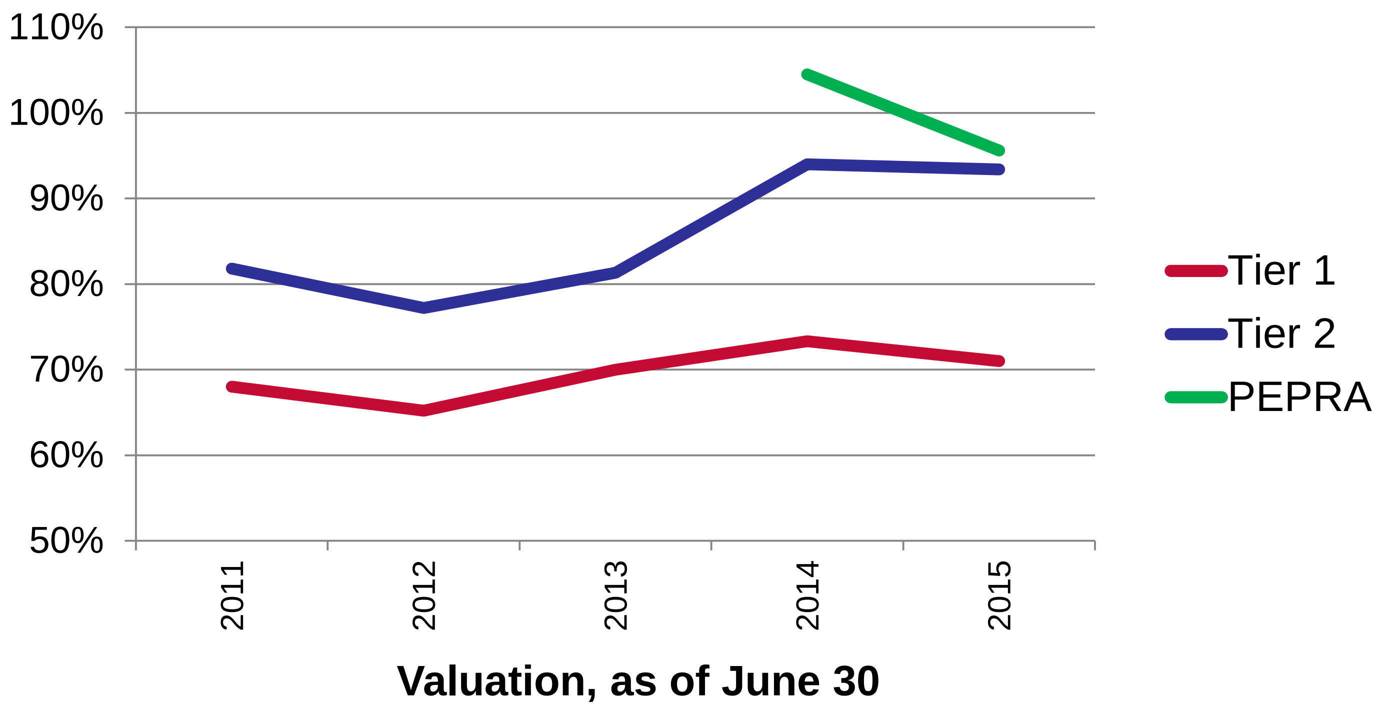
- NapaSan Pension Liability

(% Funded Status)

Unfunded Actuarial Liability (UAL) – This is the past service costs that have not yet been funded.



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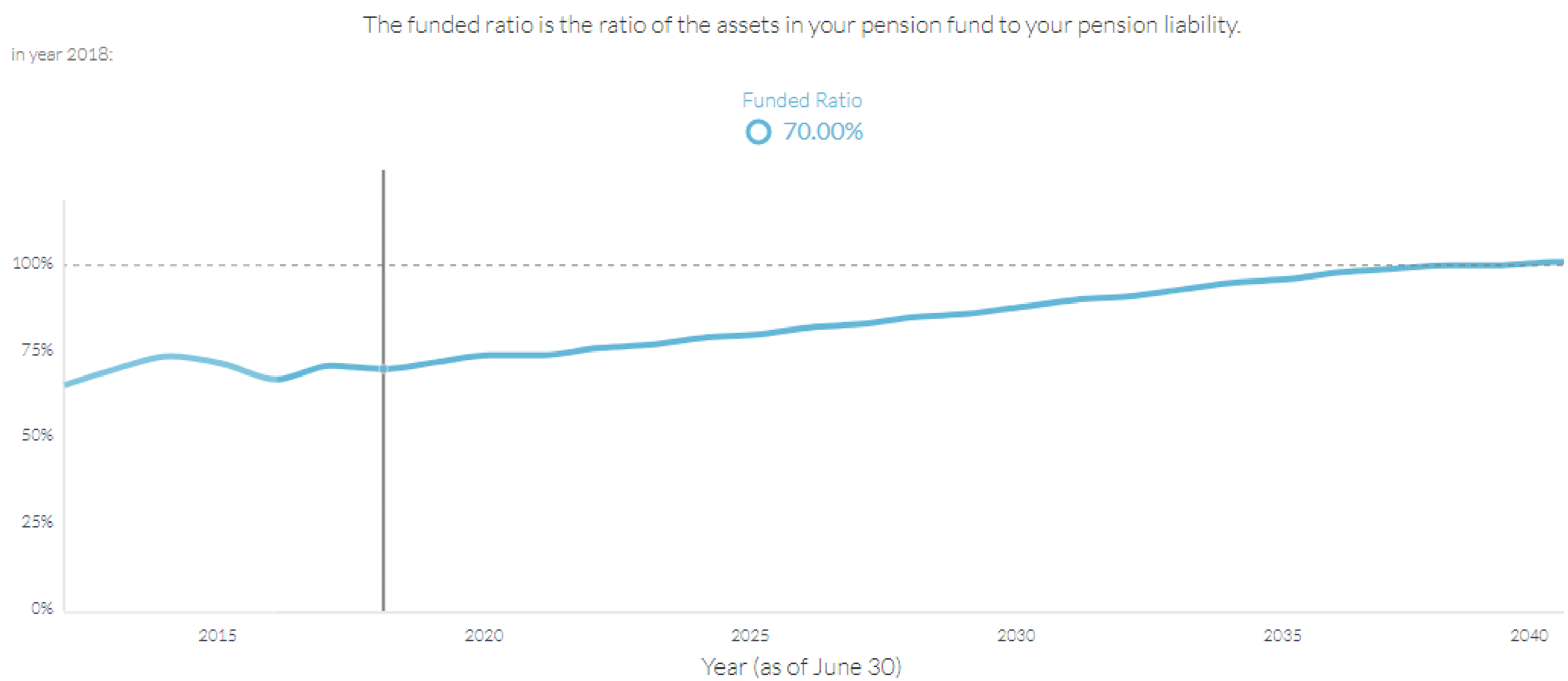
- Funded Ratio Projection



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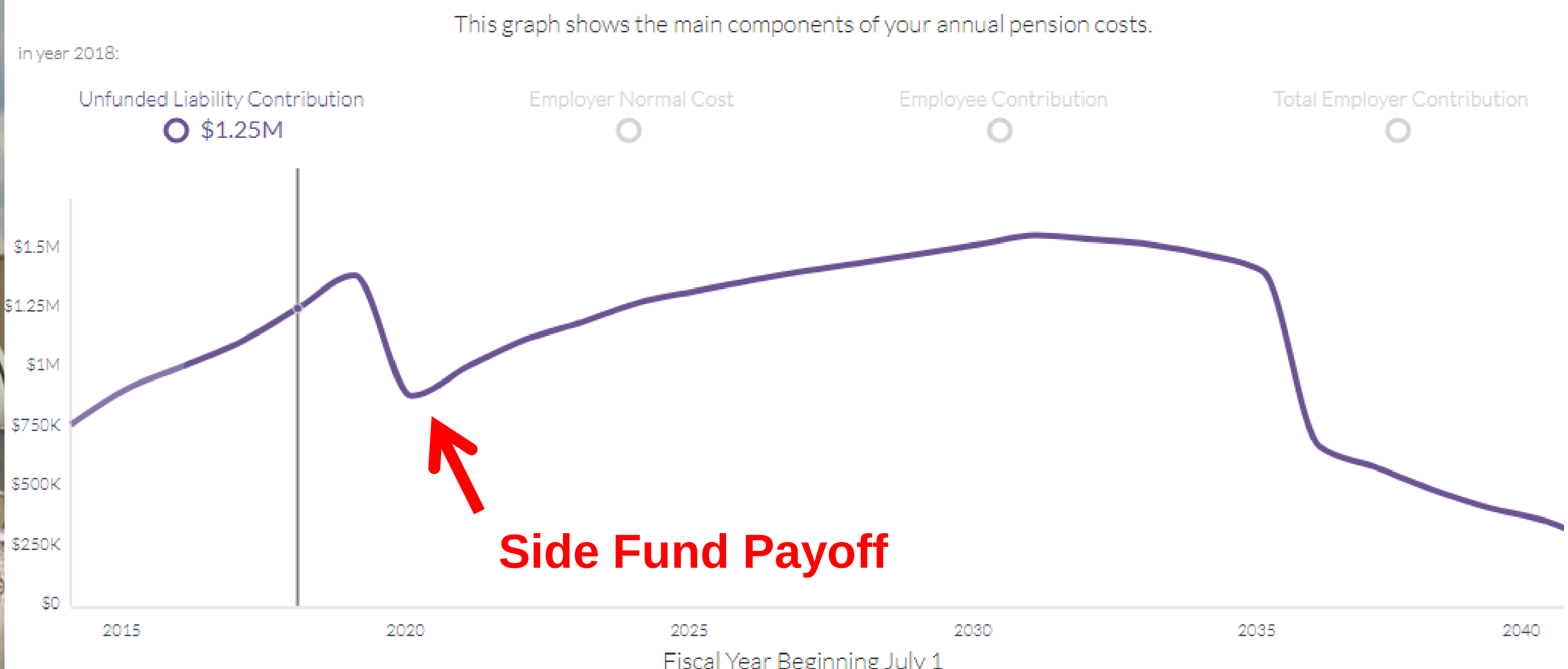
- Liability Cost Projection

2018 = $1.25M 2020 = $0.89M 2031 = $1.56M



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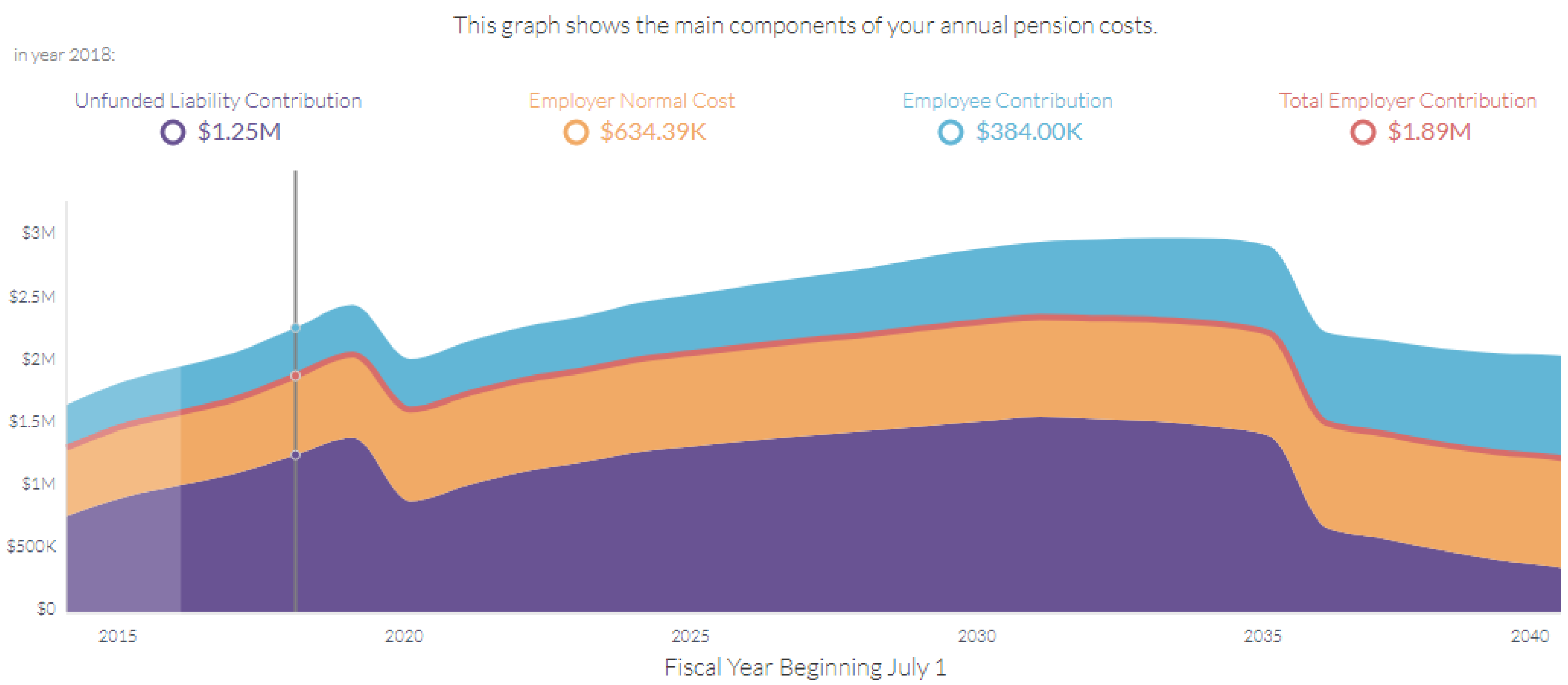
- Total Cost Projection



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15% of governments pay more than CalPERS requires annually

Funding Options

1. Pay-Go (current strategy)
2. One-time salary savings payments
3. Utilize side fund payments
4. Use savings from debt refinancing
5. New 15-Year amortization schedule
6. Pension Bonds

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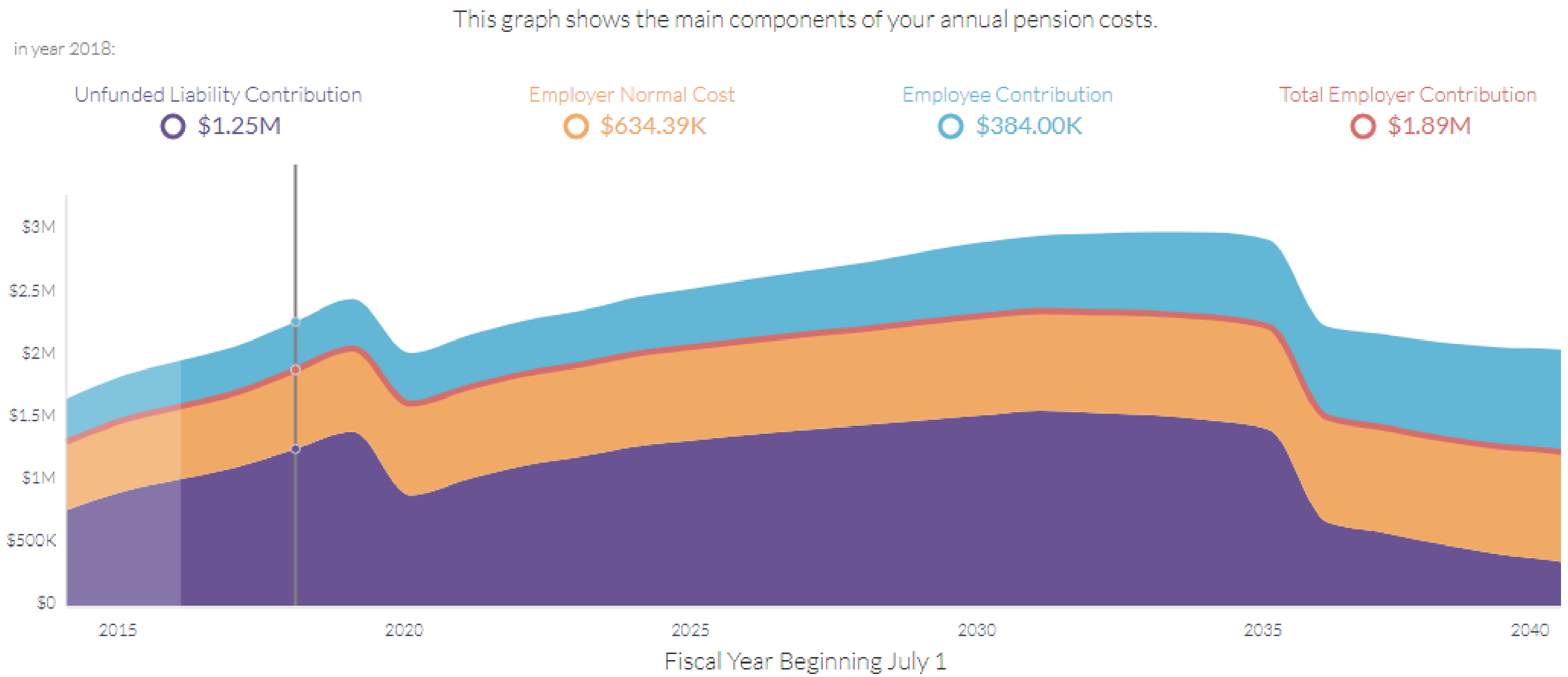
Funding Options

1. Pay-Go (current strategy)



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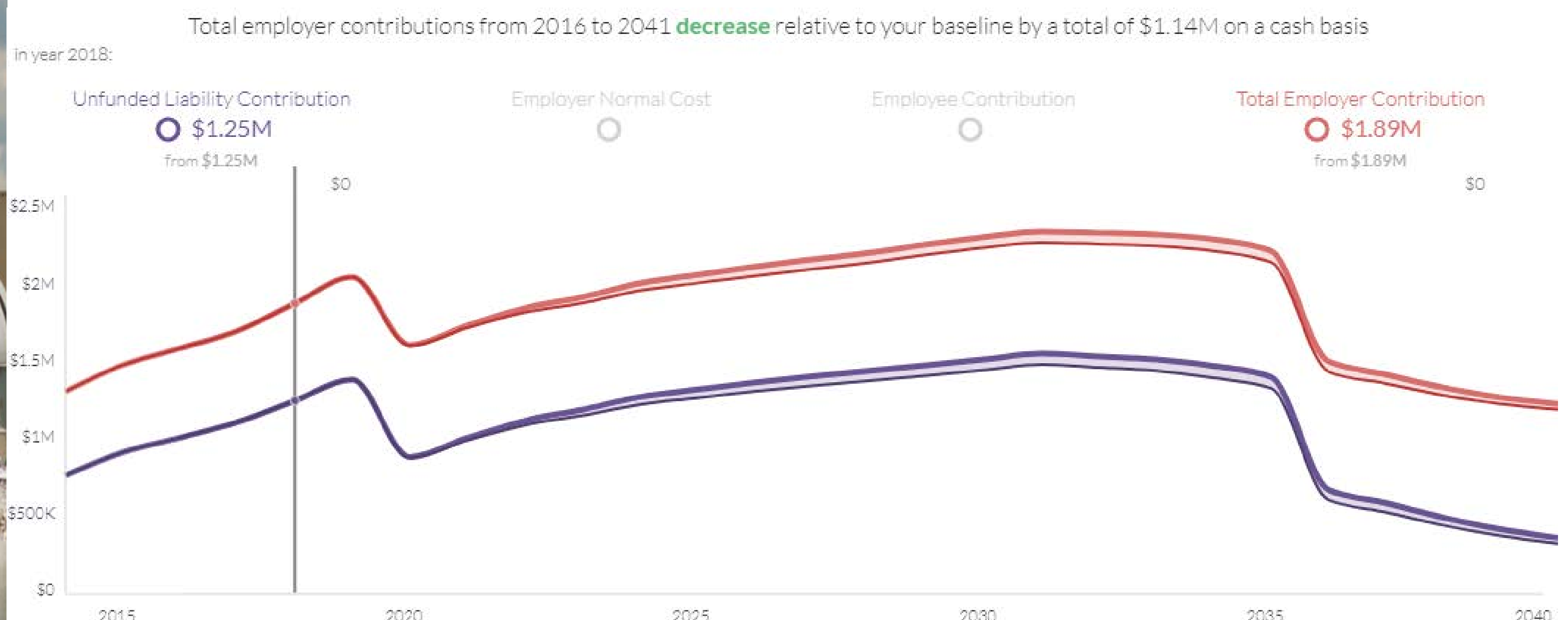
Funding Options

2. One-time salary savings payments

(assumes three payments of $150k)



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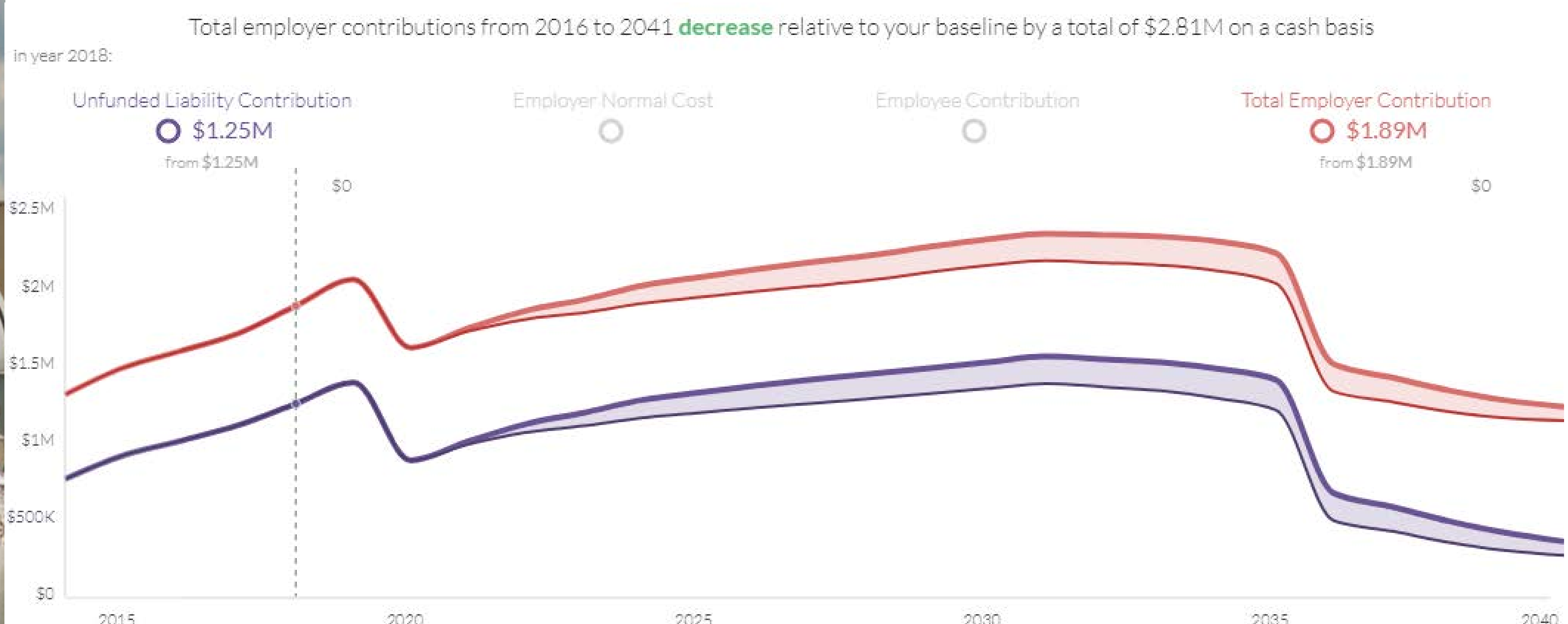
Funding Options

3. Utilize side fund payments

(Two payments of $500k, in FY 21 and FY 22)



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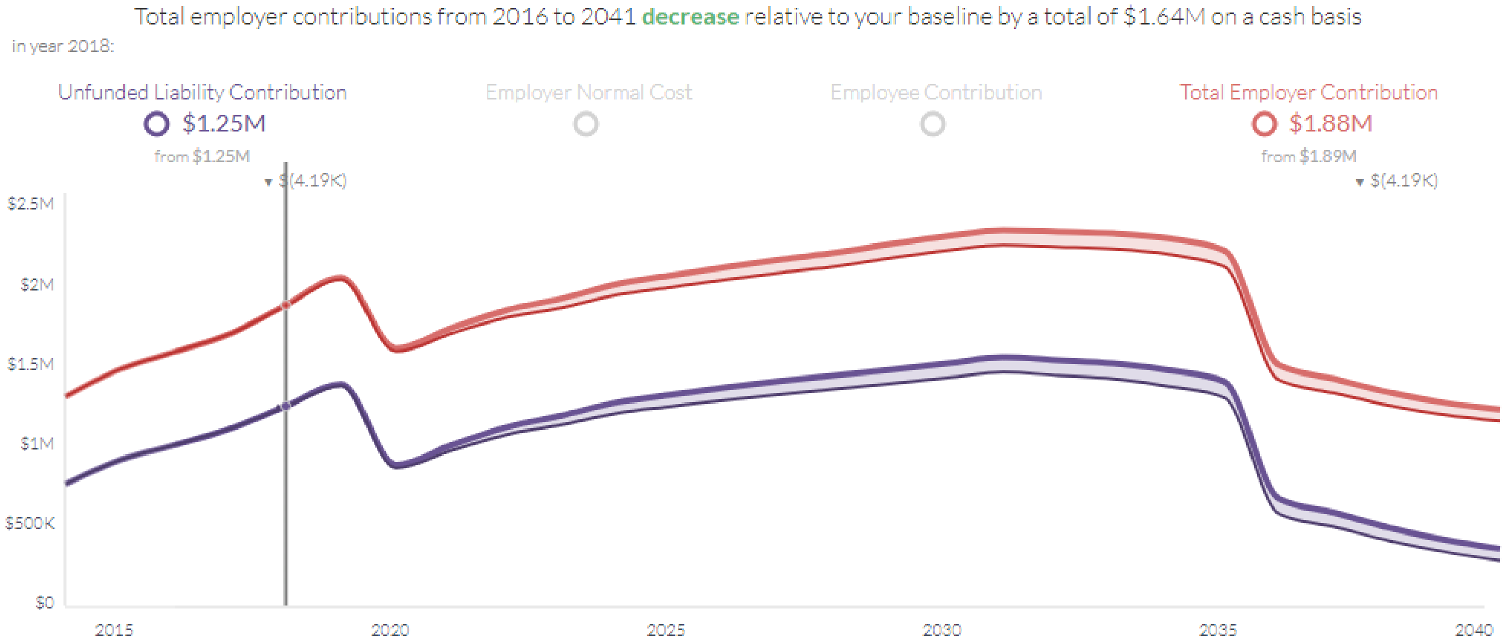
Funding Options

4. Use savings from debt refinancing

(5 payments of $135k, starting in FY 19)



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Funding Options

5. New 15-Year amortization schedule

Date	Current Amortization Schedule		Alternate Schedules: 20 Year Amortization		Alternate Schedules: 15 Year Amortization	
	Balance	Payment	Balance	Payment	Balance	Payment
6/30/2018	13,014,683	1,247,230	13,014,683	972,880	13,014,683	1,183,761
6/30/2019	12,682,112	1,400,222	12,966,399	1,002,066	12,747,879	1,219,274
6/30/2020	12,166,481	882,259	12,884,310	1,032,128	12,424,600	1,255,852
6/30/2021	12,149,546	976,215	12,765,017	1,063,092	12,039,576	1,293,528
6/30/2022	12,034,002	1,050,001	12,604,841	1,094,985	11,587,117	1,332,334
6/30/2023	11,833,479	1,081,501	12,399,803	1,127,835	11,061,077	1,372,304
6/30/2024	11,585,526	1,113,946	12,145,605	1,161,670	10,454,824	1,413,473
6/30/2025	11,285,666	1,147,364	11,837,600	1,196,520	9,761,199	1,455,877
6/30/2026	10,929,063	1,181,785	11,470,766	1,232,415	8,972,480	1,499,553
6/30/2027	10,510,493	1,217,239	11,039,683	1,269,388	8,080,335	1,544,540
6/30/2028	10,024,316	1,253,756	10,538,496	1,307,469	7,075,777	1,590,876
6/30/2029	9,464,444	1,291,369	9,960,885	1,346,693	5,949,119	1,638,603
6/30/2030	8,824,306	1,330,110	9,300,031	1,387,094	4,689,916	1,687,761
6/30/2031	8,096,813	1,370,013	8,548,575	1,428,707	3,286,907	1,738,393
6/30/2032	7,274,320	1,353,573	7,698,579	1,471,568	1,727,960	1,790,545
6/30/2033	6,408,203	1,334,913	6,741,482	1,515,715		
6/30/2034	5,497,545	1,291,861	5,668,053	1,561,187		
6/30/2035	4,564,338	1,245,025	4,468,340	1,608,022		
6/30/2036	3,610,839	561,136	3,131,617	1,656,263		
6/30/2037	3,295,679	553,870	1,646,323	1,705,951		
6/30/2038	2,964,805	545,664				
6/30/2039	2,618,032	562,034				
6/30/2040	2,228,721	578,895				
6/30/2041	1,793,228	494,021				
6/30/2042	1,413,564	483,623				
6/30/2043	1,016,675	425,622				
6/30/2044	650,617	308,081				
6/30/2045	379,361	183,104				
6/30/2046	217,603	168,876				
6/30/2047	58,659	60,784				
Totals		**26,694,090**		**26,141,649**		**22,016,676**
Interest Paid		**13,679,407**		**13,126,966**		**9,001,993**
Estimated Savings				**552,441**		**4,677,414**

3% increase per year

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Funding Options

6. Pension Obligation Bonds

<u>**Pension Obligation Bonds**</u> are taxable bonds issued by a state or local government as part of an overall strategy to fund the unfunded portion of the pension liabilities by creating debt.

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Government Finance Officers Association

ADVISORY

Pension Obligation Bonds

Advisory:

GFOA Advisories identify specific policies and procedures necessary to minimize a governments exposure to potential loss in connection with its financial management activities. It is not to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.

BACKGROUND:

Pension obligation bonds (POBs) are taxable bonds[1] that some state and local governments have issued as part of an overall strategy to fund the unfunded portion of their pension liabilities by creating debt. The use of POBs rests on the assumption that the bond proceeds, when invested with pension assets in higher-yielding asset classes, will be able to achieve a rate of return that is greater than the interest rate owed over the term of the bonds. However, POBs involve considerable investment risk, making this goal very speculative.[2] Failing to achieve the targeted rate of return burdens the issuer with both the debt service requirements of the taxable bonds and the unfunded pension liabilities that remain unmet because the investment portfolio did not perform as anticipated. In recent years, local jurisdictions across the country have faced increased financial stress as a result of their reliance on POBs, demonstrating the significant risks associated with these instruments for both small and large governments.

RECOMMENDATION:

The Government Finance Officers Association (GFOA) recommends that state and local governments do not issue POBs for the following reasons:

1. The invested POB proceeds might fail to earn more than the interest rate owed over the term of the bonds, leading to increased overall liabilities for the government.
2. POBs are complex instruments that carry considerable risk. POB structures may incorporate the use of guaranteed investment contracts, swaps, or derivatives, which must be intensively scrutinized as these embedded products can introduce counterparty risk, credit risk and interest rate risk.[3]
3. Issuing taxable debt to fund the pension liability increases the jurisdiction's bonded debt burden and potentially uses up debt capacity that could be used for other purposes. In addition, taxable debt is typically issued without call options or with "make-whole" calls, which can make it more difficult and costly to refund or restructure than traditional tax-exempt debt.
4. POBs are frequently structured in a manner that defers the principal payments or extends repayment over a period longer than the actuarial amortization period, thereby increasing the sponsor's overall costs.
5. Rating agencies may not view the proposed issuance of POBs as credit positive, particularly if the issuance is not part of a more comprehensive plan to address pension funding shortfalls.

The GFOA recommends that state and local governments <u>do not</u> issue POBs for the following reasons:

Discussion

Funding Options

Payments to CalPERS

– or –

Payments to §115 Trust

Discussion

15% of governments pay more than CalPERS requires annually

Option	Up Front	25-Yr Savings
1. Pay-Go	$0	$0
2. Salary Savings	$150k/yr for 3 yrs	$1.14 million
3. Side Fund	$500k/yr for 2 yrs	$2.81 million
4. Debt Refi Savings	$135/yr for 5 yrs	$1.64 million
5. 15-Yr Amortization	3% per year increase	$4.68 million
6. POBs	Not recommended	
Combine 3 + 4	$500k for 2 yrs + $135k/yr in other years	$3.18 million

OPEB
Status Update

OPEB – Status Update

- Other Post-Employment Benefits
  - Health Care

    Hired before July 1, 2014 – family coverage
    Hired after July 1, 2014 – single coverage
  - Vision

    Same as current employees
  - Life Insurance

    $7,500 coverage

OPEB – Status Update

2009	Refinanced debt
2010	Established CERBT Trust
Annually	Use savings from refinancing to make annual trust payments

OPEB – Status Update

- Total Liability = $10.1 million
  Total Funded = $3.5 million in trust
  Total Unfunded = $6.6 million
  Percent Funded = 34.5%