RESOLUTION NO. 23-151

A RESOLUTION OF THE COUNCIL OF THE CITY OF SANTA BARBARA APPROVING A PENSION MANAGEMENT POLICY

WHEREAS, Governmental Accounting Standards Board (GASB) issued GASB Statement No. 68, Accounting and Financial Reporting for Pensions, which required governmental employers to recognize a Net Pension Liability on their balance sheet, which is the difference between the City's total pension liability (actuarial accrued liability) and actual plan assets; and

WHEREAS, inadequate assets exist to meet the future expected costs of the promised retirement benefits of existing and retired City employees; and

WHEREAS, an important step to controlling and managing pension related expenses and liabilities is the establishment of a Pension Management Policy that establishes guidelines, standards, and procedures for the management and effective controls of pensions; and

WHEREAS, by establishing set standards, the City can address immediate and long-term pressures related to meeting required minimum contributions, servicing its unfunded liability, providing competitive compensation to employees while continuing to provide essential services to the community; and

WHEREAS, the Finance Committee of the Council of the City of Santa Barbara reviewed the Pension Management Policy on October 24, 2023, and voted unanimously to recommend approval.

NOW, THEREFORE, BE IT RESOLVED BY COUNCIL OF THE CITY OF SANTA BARBARA THAT:

1. The above recitations are true and correct.

2. The Pension Management Policy, attached hereto as Exhibit A and incorporated herein by this reference, is hereby approved.

3. The Finance Director, or his or her designee, is directed to implement the Pension Management Policy as directed therein.

4. This Resolution shall take effective on the date of its passage and adoption.

City of Santa Barbara
Pension Management Policy

Approved By:	Rebecca Bjork, City Administrator	Policy Effective:	December 5, 2023

Purpose

This policy establishes guidelines, standards, and procedures for the management and effective controls of employee pension, including associated unfunded liability (long-term debt). By establishing set standards, the City can address immediate and long-term pressures related to meeting required minimum contributions, servicing its unfunded liability, providing competitive compensation to employees while continuing to provide essential services to the community.

Statement of City Policy

The Pension Management Policy covers methods currently in place and options to be considered for the effective management of employee pensions. While there are many ways to manage pension liability, several methods include, but are not limited to discretionary payments to the California Public Employees' Retirement System (CalPERS), fresh-starts, Section 115 Trusts, employee cost sharing, limiting pay increases, or the issuance of Pension Obligation Bonds (POB). All pension management activities serve the purpose of reducing unfunded pension liability obligations while continuing to provide high levels of service with the best interest of the public in mind.

It is a financial health goal of the City to maintain a minimum funding level of 90% in its defined pension plan. Decisions and strategies made regarding the management of City pensions are ultimately the decision of City Council and must be adopted by Resolution to be made effective. It is the objective of this policy to demonstrate prudent financial management and long-term fiscal and budgetary sustainability.

Background

The City has three main pension plans with CalPERS for Miscellaneous, Police, and Fire employees with varying rates of contribution required based on the benefits offered for each bargaining unit. Each plan has both Classic and new members (Public Employees' Pension Reform Act/PEPRA) associated. An unfunded pension liability (UAL) exists on the City's balance sheet, representing the present value of future payments being greater than the present value of current assets and assumed investment returns at the CalPERS discount rate. There are not enough current assets to meet future expected costs of the promised retirement benefits. In addition to UAL, the City has seen increases in normal cost rates, which only perpetuates the UAL growth in future fiscal years.

The City sends CalPERS payments in the following two ways:

1. Bi-weekly payroll process whereby a CalPERS determined Normal Cost percentage is deducted from the employee (EE contribution) and from the employee's associated department (ER contribution), and

2. Annual payment towards the UAL. UAL payments do not have to be paid in one lump sum, but can be spread over 12 monthly payments, albeit at a cost to the City.

By paying the annual UAL required payment in advance for the fiscal year ahead, the City can take advantage of the discount rate applied. There is an investment benefit to paying ahead as CalPERS assumes to make higher rates of return. If CalPERS makes less than 6.8% annual returns in any given year(s), CalPERS will likely reflect additional UAL over a longer duration compared to the current actuarial report projections.

The UAL payment is calculated using CalPERS' methodology and is impacted by numerous variables where actual events can be different to the actuarial assumptions. Some key inputs to consider that impact pension liability include, but are not limited to, the discount rate used to assume investment return; salary growth requires higher contributions (MOU contracts); mortality rates, living longer means longer draw on pension; maturity measures based on ratio of active employees supporting retirees; amortization schedule changes; inflation; and pension policy. Pension policy implementation can help guide proactive pension contributions while preventing service delivery challenges related to increased costs of pension obligations.

Pension Funding Guide

A Guide for Elected Officials, issued by eleven national groups including the U.S. Conference of Mayors, the International Agency/County Management Association, and the Government Finance Officers Association, established the following five general policy objectives for a pension funding policy:

1. *Actuarially Determined Contributions (ADC):* A pension funding plan should be based upon an ADC that incorporates both the cost of benefits in the current year and the amortization of the plan's unfunded actuarial accrued liability.

2. *Fund discipline: A* commitment to make timely, actuarially determined contributions to the retirement system is needed to ensure that sufficient assets are available for all current and future retirees.

3. *Intergenerational equity:* Annual contributions should be reasonably related to the expected and actual cost of each year of service so that the cost of employee benefits is paid by the generation of taxpayers who receives from those employees.

4. *Contributions as a stable percentage of payroll:* Contributions should be managed so that employer costs remain consistent as a percentage of payroll over time.

5. *Accountability and transparency:* Clear reporting of pension funding should include an assessment of whether, how, and when the plan sponsor will ensure sufficient assets are available for all current and future retirees.

UAL Reduction Strategies

Paying Normal Costs (rate of contributions) alone will not address the present value of current and future pension benefits exceeding the market value of the assets (lower investment returns than discount rate). The Public Employees' Pension Reform Act (PEPRA) has provided some relief by limiting the maximum annual compensation eligible for pension calculations and it mandates a different retirement formula (reduced employee benefits for hires after January 1, 2013), however, additional pension management strategies are needed. Uncertainty is inevitable and generally understated, but with diligent assessment and action backed with facts and figures, pension stabilization can occur and reduce cost while maintaining fair compensation for employees and vital City services.

Prepayment of Annual UAL: The City will continue to make prepayments to the annual UAL when financially able and will budget adequate expenditure appropriation in each budget cycle to prepay the UAL.

Additional Discretionary Payments (ADP): When making additional payments to CalPERS, the City shall be required to select which base these monies should be applied. The City should select a shorter-term base to have the maximum impact on budgetary savings, and a longer-term base to maximize total UAL savings. To the extent that CalPERS discount rate (expected rate of return) exceeds the City's expected investment returns, the City shall apply a portion of its excess reserves, above stated policy goals/objectives, to pay unfunded liabilities.

Cost Sharing Opportunities: The City will continue to negotiate with labor units to address pension contributions and cost sharing strategies in the event of significant or unexpected changes.

Amortization Schedule Adjustment: The City shall consider the pros and cons of selecting an alternative amortization schedule than currently offered by CalPERS as an alternative to ADP when evaluating ADPs.

Pension Stabilization Reserve: At the end of each fiscal year, 50% of any General Fund, Enterprise Funds, and Internal Service Funds surplus realized from actual revenues exceeding actual expenditures including the annual capital program will be used to address pension-related expenses and future liabilities (Resolution 22-126). Annual contributions need to be enough to accumulate earnings and reduce UAL, but contributions should not be done in a way that operating budgets are impacted. Funds within the Pension Stabilization Reserve will be transferred annually to the Section 115 Trust for future ADP payments.

Section 115 Trust: A Section 115 Trust helps invest cash at higher rates of return, while diversifying investment assets and strategies that are separate from CalPERS. Cash invested into a Section 115 Trust is irrevocable and must be used for pension liability only. Action is required to direct funds from the trust to CalPERS to reduce pension liability. The amount to be transferred to a Section 115 Trust to address pension-related expenses and future liabilities will be determined based on the proportional burden of expenses and liabilities in each fund. Maintaining healthy citywide fund balances will be the highest priority, followed by addressing pension-related expenses and future liabilities.

The City, in partnership with a selected financial advisor that specializes in pension/OBEB issues, will manage the Section 115 Trust investments and annually report trust earnings. The management and administration of the Section 115 Trust will be contracted out to a professional and competent fiduciary, but direction of resources must be agreed to by the City. The firm to manage the trust will be a full-service program, including administration, management, and trustee. The selected firm will create and manage the City's pension investment policy, asset allocation guidelines, and funding strategies (based on risk tolerance), and will provide periodic reporting (quarterly and annually). The selected firm will also coordinate contributions and process distribution requests, educate on the trust program, complete GASB 74/75 reporting, and will remain in full compliance with the related contract and state/federal laws.

Pension Obligation Bond (POB): The City may consider use of pension obligation bonds (formal debt agreement to pay bond holders a fixed percentage over the lifetime of the bond), given the right economic circumstances. POBs can help reduce the short term and overall cash outflows for the City, while enhancing long-term sustainability and predictability (lower/fixed annual costs). Any POB issuance requires market consideration and majority vote from City Council prior to adoption. A POB should be used only for strategic management of pension liabilities and not under financial duress. Before POBs are considered, a complete risk analysis should be conducted and presented in a public meeting. Any POB issuance shall be consistent with the City's debt management policy.

Since these bonds are issued on a taxable basis, they carry a higher interest rate than traditional municipal "tax-exempt" debt. The City shall adhere to the following general criteria:

1. Unfunded liabilities should not exceed the 95% funding level, after the application of bond proceeds.

2. Bonds shall not be structured to defer payments or extend the final maturity date.

3. Bonds shall be structured with standard call provisions (e.g., 100%-102% in 10 years).

4. Bonds shall not finance current or normal costs; they shall only be used to refinance unfunded pension and other post employee benefit (OPEB) liabilities.

5. Interest rate on bonds shall be at least 2.0-2.5% less than the current /projected CalPERS Discount Rate.

6. Bonds should provide demonstrated cash flow savings - a target minimum of 10% NPV savings (except for refunding bonds).

7. To maximize the benefit of POBs, the City shall seek the reinvestment of cash flow savings into other liability reduction strategies, such as additional payments into a Section 115 Trust.

Tax-Exempt Exchange: When it is fiscally prudent and responsible under the prevailing economic conditions, and in compliance with the City's debt management policy, the City may seek a tax-exempt exchange by utilizing debt proceeds from typical pay-go capital improvement projects to apply to the UAL.

Superfunded Status: If the City achieves "superfunded" status, where asset values exceed the accrued liability (i.e., funding level exceeds 100%), any excess amount shall be reported to City Council and staff will provide a recommendation on the handling of these excess funds.

Fresh Start: A Fresh Start is the re-amortization of one or more of the Unfunded Accrued Liability amortization bases over a shorter period. The goal of a Fresh Start is to reduce the UAL more quickly and provide significant long-term savings.

Other: As alternative methods are determined to help reduce the City's pension liability; it will be the responsibility of the Finance Department to complete due diligence to ensure the selected method will achieve the desired outcome of reducing the City's overall liability.

Responsible Parties

The Finance Department will be responsible for coordinating all pension-related payments and reduction strategies in conjunction with this policy and CalPERS requirements. It shall also be their responsibility to identify budgetary savings and recommend allocations as deemed necessary with consideration to impending General Fund and other fund obligations. After the release of the most current CalPERS actuarial report, staff shall present a summary of each plan's funding status. New amortization levels shall be specifically addressed. This information shall be presented during a Finance Committee meeting, which shall include a summary of funding status, funding progress compared to prior years, as well as any recommended actions and/or budget adjustments to address areas of concern.

It shall be the responsibility of the City Council to understand pension liability obligations and make decisions necessary to protect the health and vitality of the City. It shall be the responsibility of the investment authority to purchase, sell, exchange, invest, reinvest, and manage the designated assets held in the Section 115 Trust in coordination with the City and in alignment with their contract and this policy.

It shall be the responsibility of all authorized individuals to prevent service delivery challenges related to the increased costs of pension obligations and to proactively identify impacts and recommend mitigation strategies, as appropriate, through the budget development process.

Policy Amendments

This policy is intended to provide general guidelines. Each individual decision shall require analysis and review on a case-by-case basis. This policy document requires periodic review and update to consider changes in the City's financial position and funding status. Any amendments to this Policy shall be made by Resolution during a City Council meeting to provide transparency to the public and the opportunity for input. Nothing in this funding policy shall constitute an obligation upon the City, nor an implied contract. The City Council may revoke or amend this policy in the best interests of the City.

Reporting

The Finance Director shall submit Section 115 Trust investment reports to the Finance Committee and the City Council that provide a clear picture of the status of the current investment portfolio and shall contain sufficient information to permit an independent organization to evaluate the performance of the Section 115 Trust. Based on the discretion of the Finance Committee, an independent advisor may be contracted, from time to time, to perform one or more of the following functions: confirm that the Section 115 Trust is in compliance with the Government Code of the State of California and with the Statement of the Pension Management Policy of the City of Santa Barbara; present an evaluation of the Section 115 Trust and recommendations; and, provide any other information that may be helpful to the Finance Committee in review of the Section 115 Trust and related UAL.

RESOLUTION NO. 23-151

STATE OF CALIFORNIA)
)
COUNTY OF SANTA BARBARA) ss.
)
CITY OF SANTA BARBARA)

I HEREBY CERTIFY that the foregoing resolution was adopted by the Council of the City of Santa Barbara at a meeting held on December 5, 2023, by the following roll call vote:

AYES: Councilmembers Eric Friedman, Alejandra Gutierrez, Oscar Gutierrez, Meagan Harmon, Mike Jordan, Kristen W. Sneddon, Mayor Randy Rowse.

NOES: None

ABSENT: None

ABSTENTIONS: None

IN WITNESS WHEREOF, I have hereto set my hand and affixed the official seal of the City of Santa Barbara on December 6, 2023.

Sarah Gorman, MMC
City Clerk Services Manager

I HEREBY APPROVE the foregoing resolution on December 6, 2023.

Randy Rowse
Mayor