RESOLUTION NO. 6558-2023

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF SEBASTOPOL
APPROVING AND ADOPTING A PENSION FUNDING POLICY

WHEREAS, the CITY OF SEBASTOPOL, a municipal corporation, hereinafter called CITY, provides pension benefits to eligible employees and retirees as a participant in the California Public Employees Retirement System ("CalPERS"); and

WHEREAS, the City, like most cities in California, has an unfunded accrued liability ("UAL") associated with its CalPERS pension plans; and

WHEREAS, the annual UAL payment has been, and will continue to be, a significant impact on the City's budget; and

WHEREAS, the City has worked with its Municipal Advisor, NHA Advisors, LLC ("NHA") to evaluate and select a Section 115 Trust provider as a strategy to manage the City's pension costs; and

WHEREAS, the City expressed interest in establishing a formal Pension Funding Policy as part of a comprehensive pension cost management strategy that includes implementation of the Section 115 Trust; and

WHEREAS, together with NHA, City staff has drafted a Pension Funding Policy for City Council consideration to ensure that there are guidelines and goals regarding its pension funding going forward.

NOW, THEREFORE, BE IT RESOLVED that the City of Sebastopol City Council hereby adopts a Resolution approving the proposed Pension Funding Policy.

The above and foregoing Resolution was duly passed, approved, and adopted at a meeting by the City Council on the 17th day of October, 2023.

I, the undersigned, hereby certify that the foregoing Resolution was duly adopted by City of Sebastopol City Council following a roll call vote:

<u>VOTE:</u>

Ayes:	Councilmembers McLewis, Maurer, Zollman, Vice Mayor Rich and Mayor Hinton
Noes:	None
Absent:	None
Abstain:	None

APPROVED: Neysa Hinton
Mayor Neysa Hinton

ATTEST: Mary C Gourley
Mary Gourley, Assistant City Manager/City Clerk, MMC

APPROVED AS TO FORM:

Larry McLaughlin, City Attorney

City of Sebastopol

Pension Funding Policy

Introduction:

The City of Sebastopol ("City") provides its permanent employees with a defined benefit pension through the California Public Employees' Retirement System ("CalPERS"). Recent investment returns and assumption changes at CalPERS have increased the City's required payments to the pension plan and decreased the plan's funded status. The City is anticipating that CalPERS may enact more conservative changes and assumptions in the future to increase the financial stability of its pension program, and that those future changes and assumptions will result in higher City contributions. The City has assessed options to help address the increased pension costs and their volatility and has determined that it would be beneficial to adopt a Section 115 Trust in which to set aside City funds for future pension payments.

Purpose:

The purpose of this Pension Funding Policy ("Policy") is to establish a plan, methodology and a process for funding current and future costs associated with the City's contractual obligations to provide pension benefits as set forth in the City's labor agreements.

Background:

A pension is a retirement account that an employer maintains to give employees a fixed payout when they retire. The City's plan is a defined benefit plan. The payout typically depends on how long the employee works for the employer, the employee's benefit factor, and the employee's salary.

Investment earnings, employee contributions and employer contributions fund the total pension cost, including benefits and expenses. Employer contributions are set by actuaries using an assumed investment rate of return (also known as the discount rate), and other assumptions related to salary, payroll, cost of living, mortality rate, disabilities, terminations and retirements. The employer contributions are determined by periodic actuarial valuations under state law.

Policy:

It is the policy of the City to fulfill its obligation to maintain fiscally responsible management practices and to ensure that promised pension benefits are funded. To that end, the City will meet its pension funding obligations as follows:

1. **Actuarially Determined Contributions:** Each fiscal year, the City will contribute to CalPERS the amount determined by CalPERS actuaries to be the minimum required employer contribution for that year. The minimum contribution consists of two components, normal cost and unfunded accrued liability (“UAL”). The normal cost is expressed as a rate that is applied to pensionable payroll costs and reflects the cost of pension benefits earned by employees in the current fiscal year. The UAL payment is a flat dollar amount that represents a portion of the cost of past benefits earned by employees, but for which, because of deviations in actual experience and changes in assumptions about investment performance, the normal cost rates established for those prior years have been determined to be insufficient to provide the promised retirement benefit. The CalPERS actuaries recalculate the total UAL each year and an updated multi-year amortization schedule is provided to show the projected annual minimum payments.
2. **Annual UAL Prepayment:** CalPERS offers the option to make monthly payments on the UAL or prepay the entire annual UAL amount at a discounted level by the end of July. Assuming the City’s current reserves meet their respective reserve policies, at that point the City will prepay its annual UAL payment each July to achieve budgetary savings.
3. **Funded Ratio Goal:** The City’s goal is to achieve and maintain a funded ratio ranging from 85% to 100% for each of its pension plans. A funded ratio of 100% signifies that the City’s assets held with CalPERS, in addition to assets held in other pension accounts, match its accrued liabilities for pension. If the City has assets in a Section 115 Trust, these assets should be included in the City’s funded ratio calculation.
4. **Section 115 Pension Trust:** The City will establish and maintain a pension stabilization fund in the form of a Section 115 Pension Trust (“Trust”). Assets in the Trust may be used only for pension related costs and at the direction of the City Council. The City’s objective with the Trust is to accumulate assets to fund its CalPERS pension costs, as well as mitigate the budget impact of costs associated with future UAL. The City will strive to meet the following guidelines:
    - *Initial Deposit:* It is recommended that a portion of the City’s internal pension reserve be transferred to the Trust in FY 2023-24 to initially fund the Trust.
    - *Investment Portfolio Selection:* City staff will work with its advisory team, including the Trust’s investment advisor, to select investment portfolios based on the City’s risk tolerance and projected withdrawal schedule from the Trust.
    - *Ongoing Deposits:* At the end of each fiscal year, the City will evaluate the economic feasibility of an additional annual contribution to the Trust. Additional annual contributions will be made from surplus remaining after all other City reserve policies have been met.
    - *Enterprise Funds:* A portion of the City’s pension costs within its CalPERS Miscellaneous Plan are attributable to employees within the City’s Enterprise Funds. Therefore, the City will ensure that any deposits to the Trust and withdrawals from the Trust are made in consideration of this fact to ensure equitable cost/benefit between City funds and CalPERS Plans. In years when Enterprise Funds have met their minimum reserve policy goals, such Enterprise Funds can contribute a portion of remaining surplus to the Trust. The City will strive to ensure that any withdrawals from the Trust benefit the Enterprise Funds equitably.
    - *Use of Trust Funds:* The funds in the Trust may be used for any of the following purposes at the City’s discretion: (1) City’s annual UAL payment to CalPERS, (2) City’s annual normal

cost payment to CalPERS, (3) reimbursement to the City for CalPERS pension costs, and (4) Additional Discretionary Payments to CalPERS.

- *Funding Goals:* As stated above, the City is targeting a funded ratio ranging from 85% to 100% for each of its pension plans. When measuring its funded ratio, the City should incorporate assets in the Trust, in addition to the assets under management by CalPERS. The City may consider foregoing contributions to the Trust if its funded ratio is determined to be too high, or if the current assets on deposit in the Trust are projected to be sufficient to cover budgetary fluctuations in the future.

5. **Additional Discretionary Payments:** CalPERS allows member agencies to make Additional Discretionary Payments ("ADPs") at any time and in any amount, which would serve to reduce the City's UAL and future required contributions. Once the City's Trust is established, the City has the option to make ADPs to CalPERS using the assets held in the Trust, if desired. The City will consider ADPs within the context of its annual evaluation of reserve levels, budgetary requirements, funded ratio, and other timing considerations unique to CalPERS' investment performance. ADPs may prove to be advantageous in the future once Trust levels are funded to sufficient thresholds to stabilize budgetary volatility.

6. **Fresh Start:** CalPERS member agencies can voluntarily opt into a shorter UAL amortization with level annual payments, called a Fresh Start. A Fresh Start allows the agency to pay off its UAL faster and with level payments, which generates lower cumulative payments and aids in budgeting. However, annual Fresh Start payments are typically higher in the near term and there is no flexibility to undo the Fresh Start. The City will annually evaluate the pros and cons of a Fresh Start after the latest CalPERS actuarial valuation report containing the Fresh Start amortization schedule is released.

7. **Pension Obligation Bonds:** Pension Obligation Bonds ("POBs") are a tool that can be used to provide an ADP to CalPERS upon the determination that the cost to borrow the funds for the payment is less than continuing to make the projected prescribed UAL payments at the current discount rate. If the City considers issuing POBs, the following guidelines will apply:

   - Expert advice and analysis by actuaries and municipal advisors will be utilized to quantify the risk of CalPERS investment underperformance (including discount rate reductions, stock market crashes, or sustained investment underperformance) and the threshold at which the City would be worse off issuing POBs versus not.
   - Significant education and evaluation will occur at the City staff and Council level given the complexity of POBs.
   - The interest rate on the POBs shall be at least 2.5% less than the current CalPERS discount rate.
   - The final maturity date on the POBs will be no greater than the final projected payment date of the UAL at the time the POBs are issued.
   - The POBs structure will contain an early call provision.
   - The POBs shall not finance normal cost and shall only be used to refinance UAL.
   - The POBs should provide significant demonstrated cash flow savings.

- The City shall budget and transfer at least 25% of projected cash flow savings to the Trust to mitigate against future UAL likely to occur. Any cash flow savings not transferred to the Trust shall be transferred to the City's other reserves.

8. **Policy Review:** The City will review this policy periodically to determine if changes to this policy are necessary to ensure progress is being made towards funding the City's CalPERS pension costs and mitigating the impact of the costs associated with future UAL.