City Council Policy Session

City of Phoenix

City Council Report

Agenda Date: 3/19/2019, **Item No.** 3

Proposed Pension Plans Funding Policy

This report provides City Council information about a Pension Funding Policy applicable to City of Phoenix Employee Retirement System (COPERS) and Public Safety Personnel Retirement System (PSPRS). A policy to clearly communicate the City's pension funding objectives is a new requirement adopted by the State Legislature in 2018 as A.R.S. 38-863.01(**Attachment A**) to be implemented by July 1, 2019. While the State law only applies to PSPRS, City staff recommends also adopting a COPERS funding policy as a transparent sound financial practice.

The State law requires the City to:

1) Adopt a Pension Funding Policy;

2) Formally accept the Employer's share of the assets and liabilities under each pension system based on the actuarial valuation report; and

3) Post the Policy on the City's website.

For review and discussion purposes, proposed pension funding policies for both PSPRS and COPERS, adapted from the State's Pension Funding Policy for PSPRS, can be found in **Attachments B and C**. A final City Pension Funding Policy must be adopted and posted on the website by July 1, 2019 and every year thereafter. Staff seeks Council input and direction to prepare the required documents to be posted on the City's website by July 1, 2019.

THIS ITEM IS FOR DISCUSSION AND POSSIBLE ACTION.

Background Information on City Pensions

Over the last several years the Phoenix City Council and voters have taken responsible actions to ensure financially stable pension plans while maintaining services to the public. Increases in net pension liabilities (**Attachment D**) and annual pension costs (**Attachment E and F**) have placed significant budgetary constraints on the City's ability to provide employee wage and non-pension benefit increases, public services and infrastructure maintenance. While currently manageable, this pressure will continue into the foreseeable future. Further, credit rating agencies and lenders place strong consideration on the funding plan and funding levels of the City's pension systems when determining their view of the overall financial health of the City.

As part of the 2018-19 budget process, the City Council asked management for various pension funding options, resulting in the following actions.

1) Maintained our legal commitment to employees and retirees to pay at least 100 percent of the actuarially required contribution (ARC) to each plan;

2) Adopted a balanced budget based on 25-year amortization schedule for PSPRS, which is more aggressive that the 30-year amortization adopted through State law. However the 25-year amortization schedule allows capacity to continue providing quality services and fair compensation for employees;

3) Established a Pension Reserve Fund currently at $35 million to stabilize future annual PSPRS payments; and

4) Advanced $70 million in Wastewater enterprise funds to pay down the COPERS liability.

These actions are in addition to the COPERS pension reform that the City Council and voters have implemented since 2013, saving the City more than $1 billion over 25 years, and the statewide PSPRS pension reform passed by the voters in 2016. Some of the City's reforms on employee vacation and sick leave pension spiking are still being litigated in the Arizona Court of Appeals.

Results to Date

Implementation of the City Council's direction has resulted in improvements to the funded position of the plans, including an increase in the funded ratio for COPERS to 60.64 percent for fiscal year ending 2018, up from 58 percent in fiscal year ending 2017. The funded ratio for PSPRS has decreased slightly to 41.23 percent for fiscal year 2018 from 42.32 percent for fiscal year 2017 (**Attachment G**). The City's total Unfunded Actuarial Accrued Liability increased to $4.6 billion. This high level of pension liability is a concern that requires ongoing attention and must be considered in balance with the current needs of the community and employees.

Looking Ahead

In accordance with State law, the Council must formally accept the assets, liabilities, and current funding ratio of the City's pension funds as stated in the annual actuarial valuations for the City of Phoenix (**Attachments H and I**) and must approve funding goals (**Attachment B and C**) by July 1, 2019.

While the pension systems are not currently 100 percent funded, the strategy to pay the ARC and pay down the liability over a set period (currently 23 years for PSPRS and 21 years for COPERS) allows flexibility in providing services to the public while spreading the liability to our residents over a period of time.

Under current actuarial calculations and amortization periods, PSPRS will be 100 percent funded by June 30, 2041 and COPERS will be 100 percent funded by June 30, 2039 (**Attachment J**). Under the leadership of the City Council, the City can continue to take steps to ensure the current actuarial determined funding expectations are achieved on this schedule, or even reach 100 percent funded within a shorter timeframe.

Next steps to address pension liabilities include:

1) Continuing to balance the budget and pay the annual contribution required by actuaries;

2) Using a portion of excess cash each year to fund the pension reserve fund or directly pay down the liability;

3) Continuing to seek opportunities to advance payments from enterprise and/or special revenue funds;

4) Evaluating appropriate timing and feasibility of Pension Obligation Bonds;

5) Adding even more resources to the current pension funding plan through one or more of the following strategies:
    a. Reduced employee compensation;
    b. Reduced services;
    c. Additional dedicated revenue; or
    d. Diversion of revenue growth from services or compensation to extra pension payments.

Conclusion and Next Steps
Over the past decade, the City Council has diligently managed the financial stability of the pension systems through the worst financial crisis since the Great Depression. However, pension funding is a long-term issue requiring constant evaluation until plans are fully funded. The City of Phoenix has successfully balanced its obligations to residents, retirees and employees to keep Phoenix a desirable community. The proposed Pension Funding Policy for COPERS and PSPRS provides a roadmap for regular review and assessment of the City's pension obligations. Staff recommends adopting the attached policies in compliance with State law.

Responsible Department
This item is submitted by City Manager Ed Zuercher, the Chief Financial Officer and the Budget and Research Director.

Attachment A

38-863.01. Pension funding policies; employers

A. Beginning on or before July 1, 2019, each governing body of an employer shall annually:

1. Adopt a pension funding policy for the system for employees who were hired before July 1, 2017. The pension funding policy shall include funding objectives that address at least the following:

(a) How to maintain stability of the governing body's contributions to the system.

(b) How and when the governing body's funding requirements of the system will be met.

(c) Defining the governing body's funded ratio target under the system and the timeline for reaching the targeted funded ratio.

2. Formally accept the employer's share of the assets and liabilities under the system based on the system's actuarial valuation report.

B. The governing body shall post the pension funding policy on the governing body's public website.

Attachment B
City of Phoenix
Public Safety Personnel Retirement System
Pension Funding Policy

The intent of this policy is to clearly communicate the City of Phoenix pension funding objectives and commitment to our employees and the sound financial management of the City and to comply with new statutory requirements of Laws 2018, Chapter 112.

Several terms are used throughout this policy:

Unfunded Actuarial Accrued Liability (UAAL) – Is the difference between trust assets and the estimated future cost of pensions earned by employees. This UAAL results from actual results (interest earnings, member mortality, disability rates, etc.) being different from the assumptions used in previous actuarial valuations.

Annual Required Contribution (ARC) – Is the annual amount required to pay into the pension funds, as determined through annual actuarial valuations. It is comprised of two primary components: normal pension cost – which is the estimated cost of pension benefits earned by employees in the current year; and, amortization of UAAL – which is the cost needed to cover the unfunded portion of pensions earned by employees in previous years. The UAAL is collected over a period of time referred to as the amortization period. The ARC is a percentage of the current payroll.

Funded Ratio – Is a ratio of fund assets to actuarial accrued liability. The higher the ratio the better funded the pension is with 100% being fully funded.

The City's police and fire employees who are regularly assigned hazardous duty participate in the Public Safety Personnel Retirement System (PSPRS).

Public Safety Personnel Retirement System (PSPRS)

PSPRS is administered as an agent multiple-employer pension plan. An agent multiple-employer plan has two main functions: 1) to comingle assets of all plans under its administration, thus achieving economy of scale for more cost efficient investments, and invest those assets for the benefit of all members under its administration and 2) serve as the statewide uniform administrator for the distribution of benefits.

Under an agent multiple-employer plan each agency participating in the plan has an individual trust fund reflecting that agencies' assets and liabilities. Under this plan all contributions are deposited to and distributions are made from that fund's assets, each fund has its own funded ratio and contribution rate, and each fund has a unique annual actuarial valuation. The City of Phoenix has two trust funds, one for police employees and one for fire employees. The Elected Official Retirement Plan (EORP) is also administer by PSPRS and as of June 30, 2018 the net pension liability was $8.7 million. Given EORP is relatively minimal dollars, only Police and Fire are included in the actuarial valuation below.

The City Council formally accepts the assets, liabilities, and current funding ratio of the City's PSPRS trust funds from the June 30, 2018 actuarial valuation, which are detailed below.

Trust Fund	Assets	Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio
Phoenix Police	1,344,454,164	3,303,680,881	1,959,226,717	40.7%
Phoenix Fire	750,476,360	1,777,382,882	1,026,906,522	42.2%
City of Phoenix Totals	2,094,930,524	5,081,063,763	2,986,133,239	41.23%

The amounts above represent Tier 1 and Tier 2. There are no unfunded liabilities for Police Tier 3 members. The unfunded liability for Fire Tier 3 members is $7.5 million, making the plan 95.5% funded.

PSPRS Funding Goal

Fully funded pension plans are the best way to achieve taxpayer equity. However, most funds in PSPRS are significantly underfunded due to historical low returns on plan assets, people in general living longer and decreases in governmental workforces. As shown above, the UAAL for the City of Phoenix plans is $2.98 billion which should be paid over time to avoid a significant burden to current taxpayers by either significantly decreasing municipal services or increasing taxes. This taxpayer burden must be balanced between being fiscally responsible and being committed to providing pensions to retirees over the long-term. The fluctuating cost of the UAAL affects our ability to provide services and employee wage compensation.

The City of Phoenix PSPRS funding ratio goal is 100% (fully funded) by June 30, 2041.

The adopted amortization period allows for the date to be June 30, 2041 based on a 23 years remaining amortization period. Council adopted the 2041 amortization date goal for the following reasons:

- The PSPRS trust funds represent the City of Phoenix's liability
- The fluctuating cost of an UAAL affects our ability to provide services and employee wage compensation
- A 2041 date allows us to meet our pension funding obligations while still having resources available for community services and employee wage compensation.

The City Council has taken the following actions to achieve the June 30, 2041 goal:

- Maintained ARC payment from operating revenues – Council is committed to maintaining the full ARC payment (normal cost and UAAL amortization) from operating funds. The estimated combined ARC for FY19 is $235 million and for FY 20 is $257 million. This will be paid from operating funds without diminishing City services.
- Established the Pension Reserve Fund for PSPRS currently at $35 million to stabilize and ensure future pension payments.
- Evaluated prior year budget compared to actual expenditures and made an excess payment to either the Pension Reserve fund or directly to PSPRS to accelerate pension payments.

Attachment C
City Of Phoenix Employee Retirement System (COPERs)
Pension Funding Policy

The intent of this policy is to clearly communicate the City of Phoenix pension funding objectives and commitment to our employees and the sound financial management of the City and to comply with new statutory requirements of Laws 2018, Chapter 112.

Several terms are used throughout this policy:

Unfunded Actuarial Accrued Liability (UAAL) – Is the difference between trust assets and the estimated future cost of pensions earned by employees. This UAAL results from actual results (interest earnings, member mortality, disability rates, etc.) being different from the assumptions used in previous actuarial valuations.

Annual Required Contribution (ARC) – Is the annual amount required to pay into the pension funds, as determined through annual actuarial valuations. It is comprised of two primary components: normal pension cost – which is the estimated cost of pension benefits earned by employees in the current year; and, amortization of UAAL – which is the cost needed to cover the unfunded portion of pensions earned by employees in previous years. The UAAL is collected over a period of time referred to as the amortization period. The ARC is a percentage of the current payroll.

Funded Ratio – Is a ratio of fund assets to actuarial accrued liability. The higher the ratio the better funded the pension is with 100% being fully funded.

City Of Phoenix Employee Retirement System (COPERS)

COPERS is a single-employer defined benefit pension plan, covering all full-time general employees of the City except sworn police and fire employees. COPERS is governed by a separate Board, established in the City Charter.

The City Council formally accepts the assets, liabilities, and current funding ratio of the City's COPERS trust funds from the June 30, 2018 actuarial valuation, which are detailed below.

Trust Fund	Assets	Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio
Phoenix	2,562,847,008	4,226,045,811	1,663,198,803	60.64%

COPERS Funding Goal

Fully funded pension plans are the best way to achieve taxpayer equity. However, COPERS is currently underfunded due to historical low returns on plan assets, people in general living longer and decreases in governmental workforce. As shown above, the UAAL for the city is $1.66 billion which should be paid over time to avoid a significant burden to current taxpayers by either significantly decreasing municipal services or increasing taxes. This taxpayer burden must be balanced between being fiscally responsible and being committed to providing pensions to retirees over the long-term. The fluctuating cost of the UAAL affects our ability to provide services and employee wage compensation.

The City of Phoenix COPERS funding ratio goal is 100% (fully funded) by June 30, 2039.

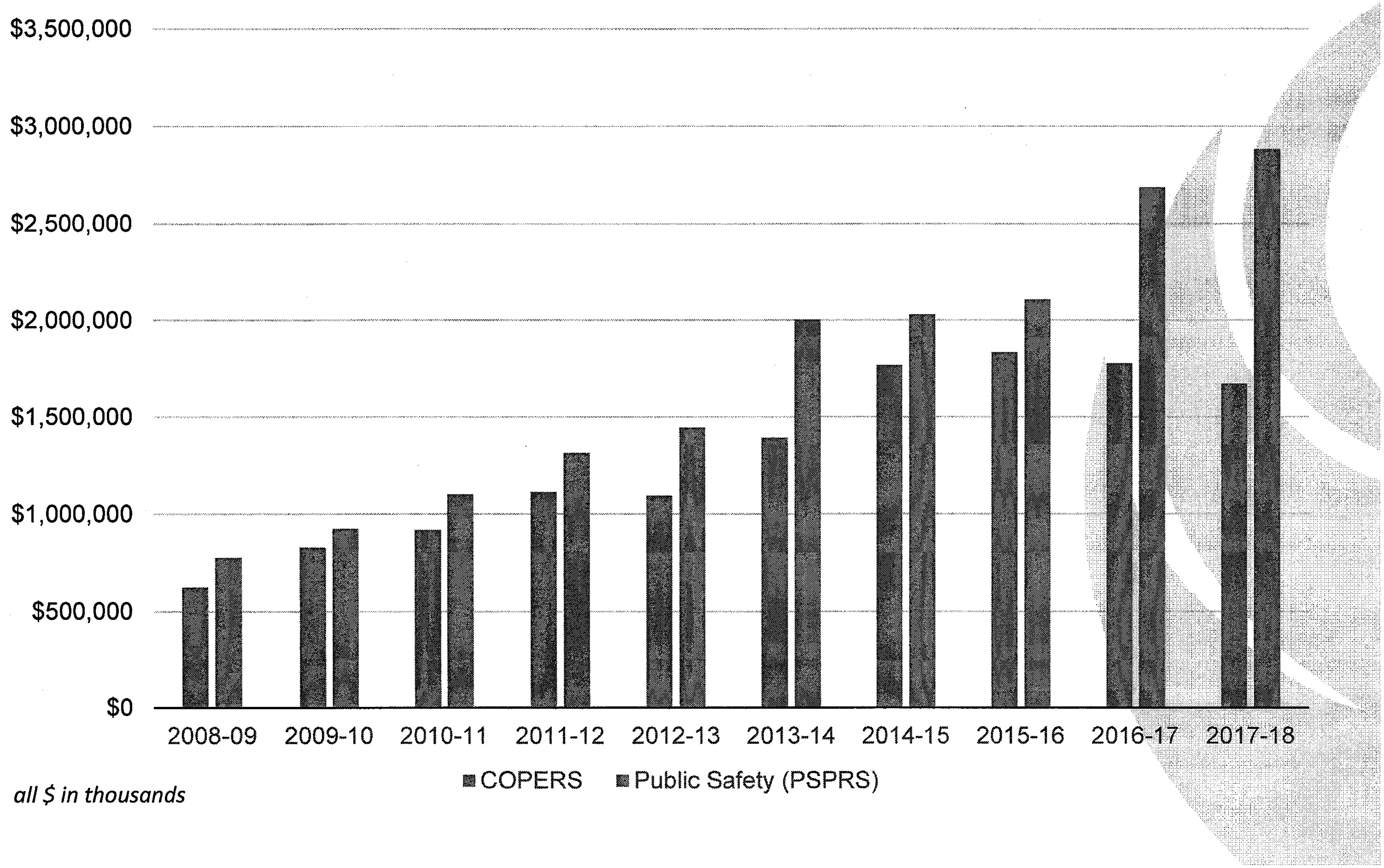
The adopted amortization period allows for the date to be June 30, 2039 based on a 21 years remaining amortization period. The City Council adopted the 2039 amortization date goal for the following reasons:

- The COPERS trust funds represent the City of Phoenix's liability
- The fluctuating cost of an UAAL affects our ability to provide services and employee wage compensation
- A 2039 date allows us to meet our pension funding obligations while still having resources available for community services and employee wage compensation

The City Council has taken the following actions to achieve the June 30, 2039 goal:

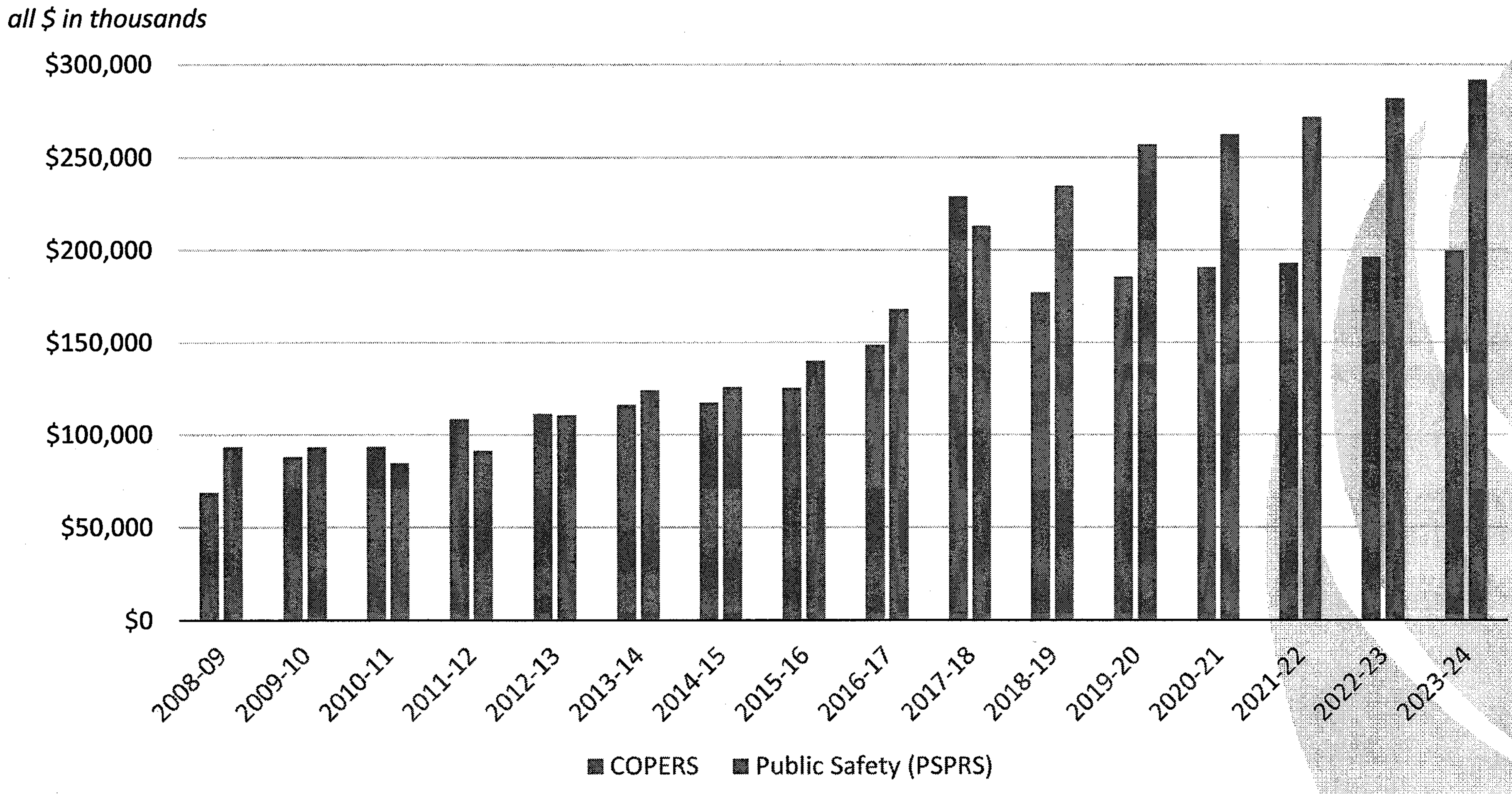
- Maintained ARC payment from operating revenues – Council is committed to maintaining the full ARC payment (normal cost and UAAL amortization) from operating funds. The estimated ARC for FY19 is $177.2 million and for FY20 is $185.7. This will be able to be paid from operating funds without diminishing City services.
- Advanced enterprise funds to pay down pension liability.
- Annually evaluated prior year budget compared to actual expenditures and made an excess payment to COPERS after PSPRS payments have been taken into consideration.

Attachment D: Total Unfunded Net Pension Liabilities



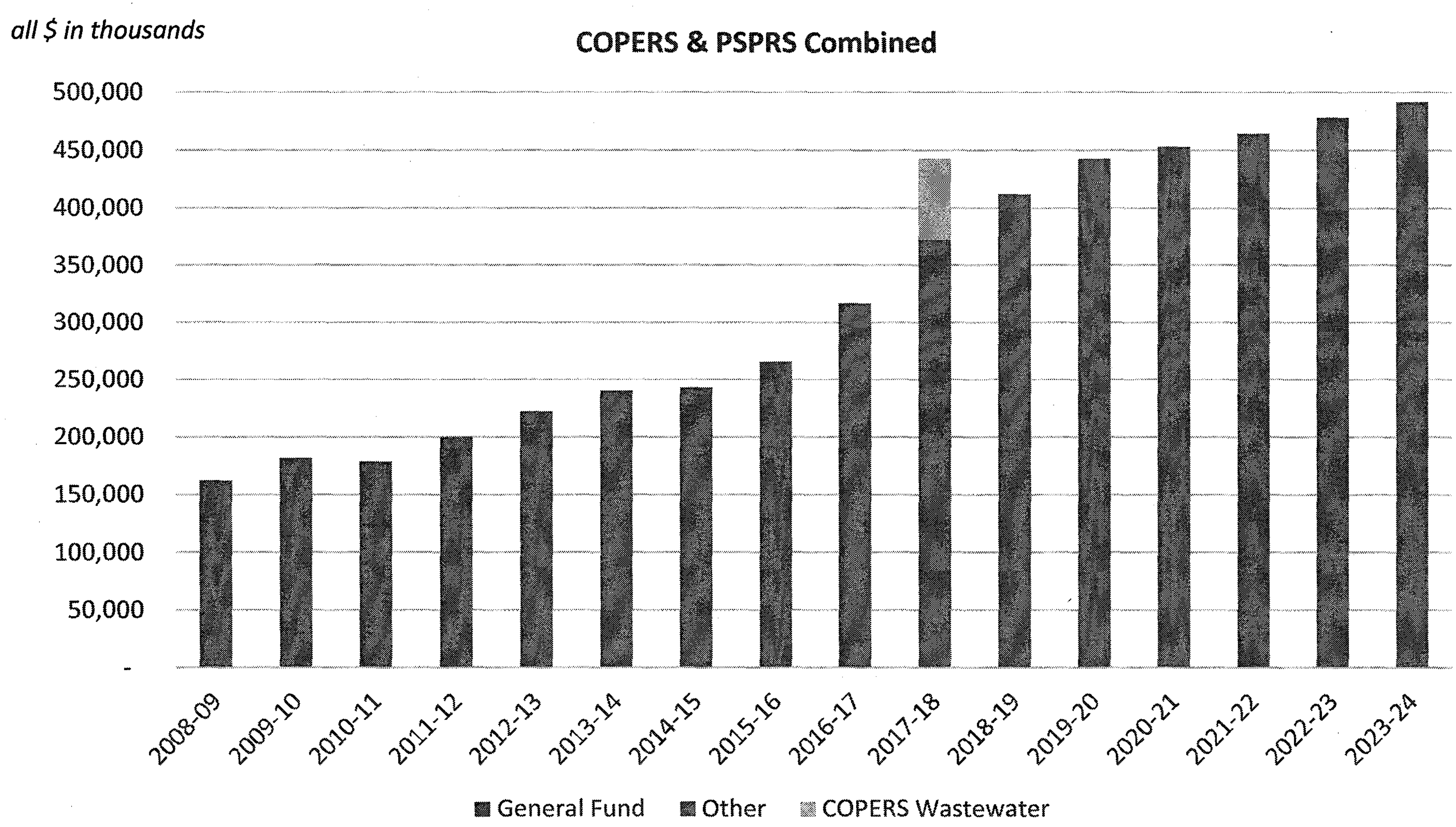
all $ in thousands

Attachment E: Total Pension Annual Required Contributions by Plan

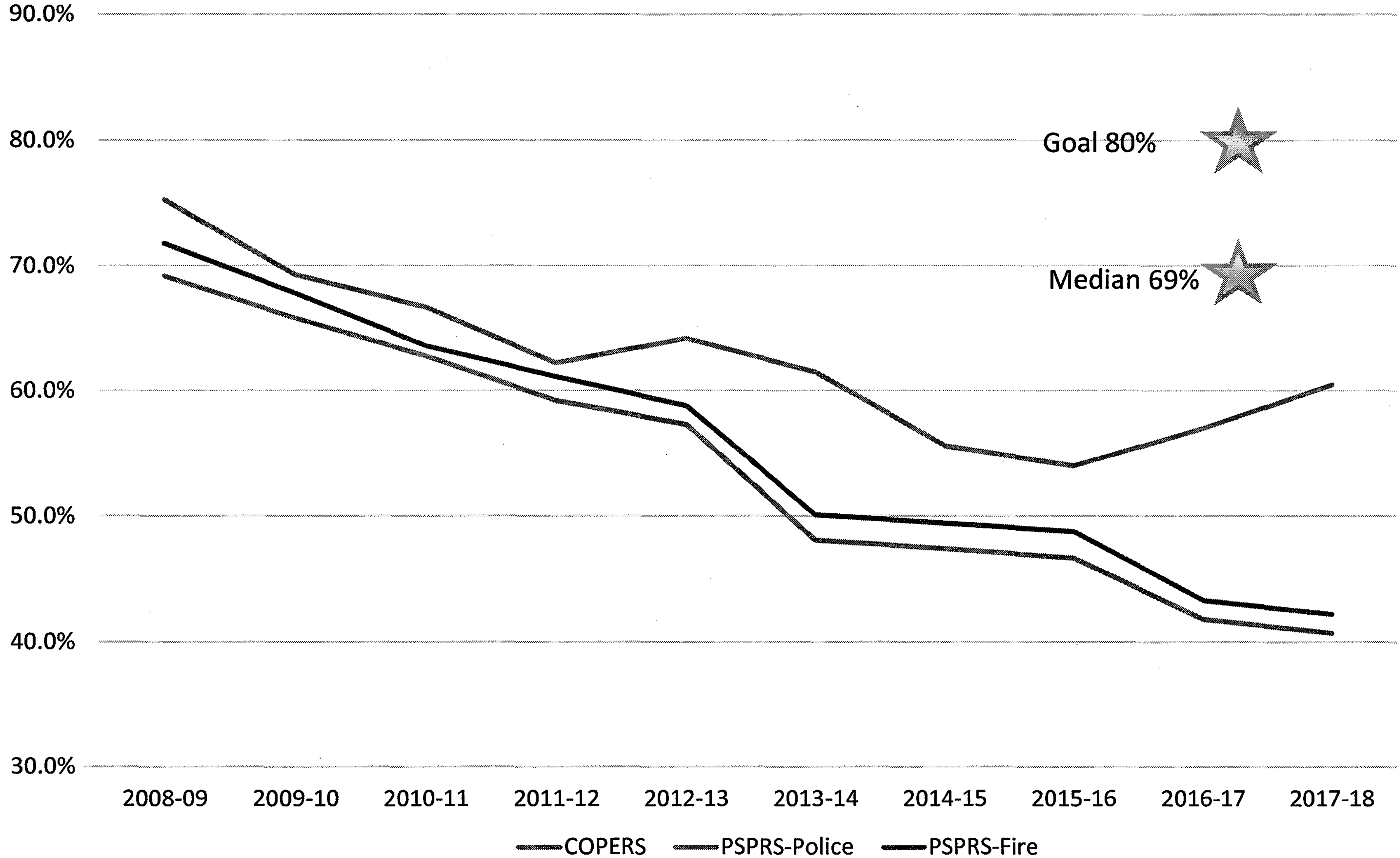


In 2017-18, an additional $70 million payment was made to COPERs to pay off the pension liability for Wastewater Enterprise Fund.

Attachment F: Total Pension Annual Required Contribution by Payment Source



Attachment G: Historical Total Funded Percentage of Pension Plans



Attachment H

Phoenix Police Dept.
(022)
Arizona Public Safety Personnel Retirement System

June 30, 2018

GRS

Present Value of Future Benefits and Accrued Liability – Tier 1 & 2

	June 30, 2017	June 30, 2018
Pension		
A. Accrued Liability		
1. For retirees and beneficiaries	$1,767,046,136	$1,843,482,422
2. For DROP members	424,006,690	501,043,612
3. For inactive/vested members	4,498,119	4,853,725
4. For present active members		
a. Value of expected future benefit payments	1,380,005,791	1,306,703,308
b. Value of future normal costs	(383,256,169)	(352,402,186)
c. Active member accrued liability: (a) - (b)	996,749,622	954,301,122
5. Total accrued liability	3,192,300,567	3,303,680,881
B. Present Assets (Funding Value)	1,333,397,131	1,344,454,164
C. Unfunded Accrued Liability: (A.5) - (B)	1,858,903,436	1,959,226,717
D. Stabilization Reserve	-	-
E. Net Unfunded Accrued Liability: (C) + (D)	$1,858,903,436	$1,959,226,717
F. Funding Ratio: (B) / (A.5)	41.8%	40.7%
Health		
A. Accrued Liability		
1. For retirees and beneficiaries	$ 19,456,627	$ 19,176,630
2. For DROP members	5,912,622	7,205,437
3. For present active members		
a. Value of expected future benefit payments	27,563,968	26,282,033
b. Value of future normal costs	(5,142,232)	(4,680,922)
c. Active member accrued liability: (a) - (b)	22,421,736	21,601,111
4. Total accrued liability	47,790,985	47,983,178
B. Present Assets (Funding Value)	68,041,337	68,582,403
C. Net Unfunded Accrued Liability: (A.4) - (B)	$ (20,250,352)	$ (20,599,225)
D. Funding Ratio: (B) / (A.4)	142.4%	142.9%

Present Value of Future Benefits and Accrued Liability – Tier 3*

	June 30, 2017	June 30, 2018
Pension		
A. Accrued Liability		
1. For retirees and beneficiaries	$ -	$ -
2. For inactive/vested members	-	11,199
3. For present active members		
a. Value of expected future benefit payments	-	15,838,000
b. Value of future normal costs	-	(15,392,189)
c. Active member accrued liability: (a) - (b)	-	445,811
4. Total accrued liability	-	457,010
B. Present Assets (Funding Value)	-	460,524
C. Unfunded Accrued Liability: (A.4) - (B)	$ -	$ (3,514)
D. Funding Ratio: (B) / (A.4)	-	100.8%
Health		
A. Accrued Liability		
1. For retirees and beneficiaries	$ -	$ -
2. For present active members		
a. Value of expected future benefit payments	-	281,119
b. Value of future normal costs	-	(270,938)
c. Active member accrued liability: (a) - (b)	-	10,181
3. Total accrued liability	-	10,181
B. Present Assets (Funding Value)	-	10,934
C. Unfunded Accrued Liability: (A.3) - (B)	$ -	$ (753)
D. Funding Ratio: (B) / (A.3)	-	107.4%

** The liabilities shown on this page are the liabilities for Phoenix Police Dept. Tier 3 members only.*

Phoenix Fire Dept.
(021)
Arizona Public Safety Personnel Retirement System
June 30, 2018

GRS

Present Value of Future Benefits and Accrued Liability – Tier 1 & 2

	June 30, 2017	June 30, 2018
Pension		
A. Accrued Liability		
1. For retirees and beneficiaries	$ 865,070,291	$ 891,269,434
2. For DROP members	287,901,027	322,599,100
3. For inactive/vested members	1,410,672	1,455,925
4. For present active members		
a. Value of expected future benefit payments	800,638,668	823,291,401
b. Value of future normal costs	(262,796,535)	(261,232,978)
c. Active member accrued liability: (a) - (b)	537,842,133	562,058,423
5. Total accrued liability	1,692,224,123	1,777,382,882
B. Present Assets (Funding Value)	733,496,847	750,476,360
C. Unfunded Accrued Liability: (A.5) - (B)	958,727,276	1,026,906,522
D. Stabilization Reserve	-	-
E. Net Unfunded Accrued Liability: (C) + (D)	$ 958,727,276	$1,026,906,522
F. Funding Ratio: (B) / (A.5)	43.3%	42.2%
Health		
A. Accrued Liability		
1. For retirees and beneficiaries	$ 10,358,309	$ 10,073,265
2. For DROP members	3,428,318	3,849,307
3. For present active members		
a. Value of expected future benefit payments	13,637,302	13,592,345
b. Value of future normal costs	(2,993,670)	(2,876,609)
c. Active member accrued liability: (a) - (b)	10,643,632	10,715,736
4. Total accrued liability	24,430,259	24,638,308
B. Present Assets (Funding Value)	38,343,243	38,722,196
C. Net Unfunded Accrued Liability: (A.4) - (B)	$ (13,912,984)	$ (14,083,888)
D. Funding Ratio: (B) / (A.4)	156.9%	157.2%

Present Value of Future Benefits and Accrued Liability – Tier 3*

	June 30, 2017	June 30, 2018
Pension		
A. Accrued Liability		
1. For retirees and beneficiaries	$ -	$ -
2. For inactive/vested members	-	-
3. For present active members		
a. Value of expected future benefit payments	-	9,488,325
b. Value of future normal costs	-	(9,323,252)
c. Active member accrued liability: (a) - (b)	-	165,073
4. Total accrued liability	-	165,073
B. Present Assets (Funding Value)	-	157,566
C. Unfunded Accrued Liability: (A.4) - (B)	$ -	$ 7,507
D. Funding Ratio: (B) / (A.4)	-	95.5%
Health		
A. Accrued Liability		
1. For retirees and beneficiaries	$ -	$ -
2. For present active members		
a. Value of expected future benefit payments	-	142,316
b. Value of future normal costs	-	(138,557)
c. Active member accrued liability: (a) - (b)	-	3,759
3. Total accrued liability	-	3,759
B. Present Assets (Funding Value)	-	2,786
C. Unfunded Accrued Liability: (A.3) - (B)	$ -	$ 973
D. Funding Ratio: (B) / (A.3)	-	74.1%

** The liabilities shown on this page are the liabilities for Phoenix Fire Dept. Tier 3 members only.*

Attachment I

City of Phoenix Employees' Retirement System

ACTUARIAL VALUATION REPORT AS OF

June 30, 2018

Financial Position and Summary of Results

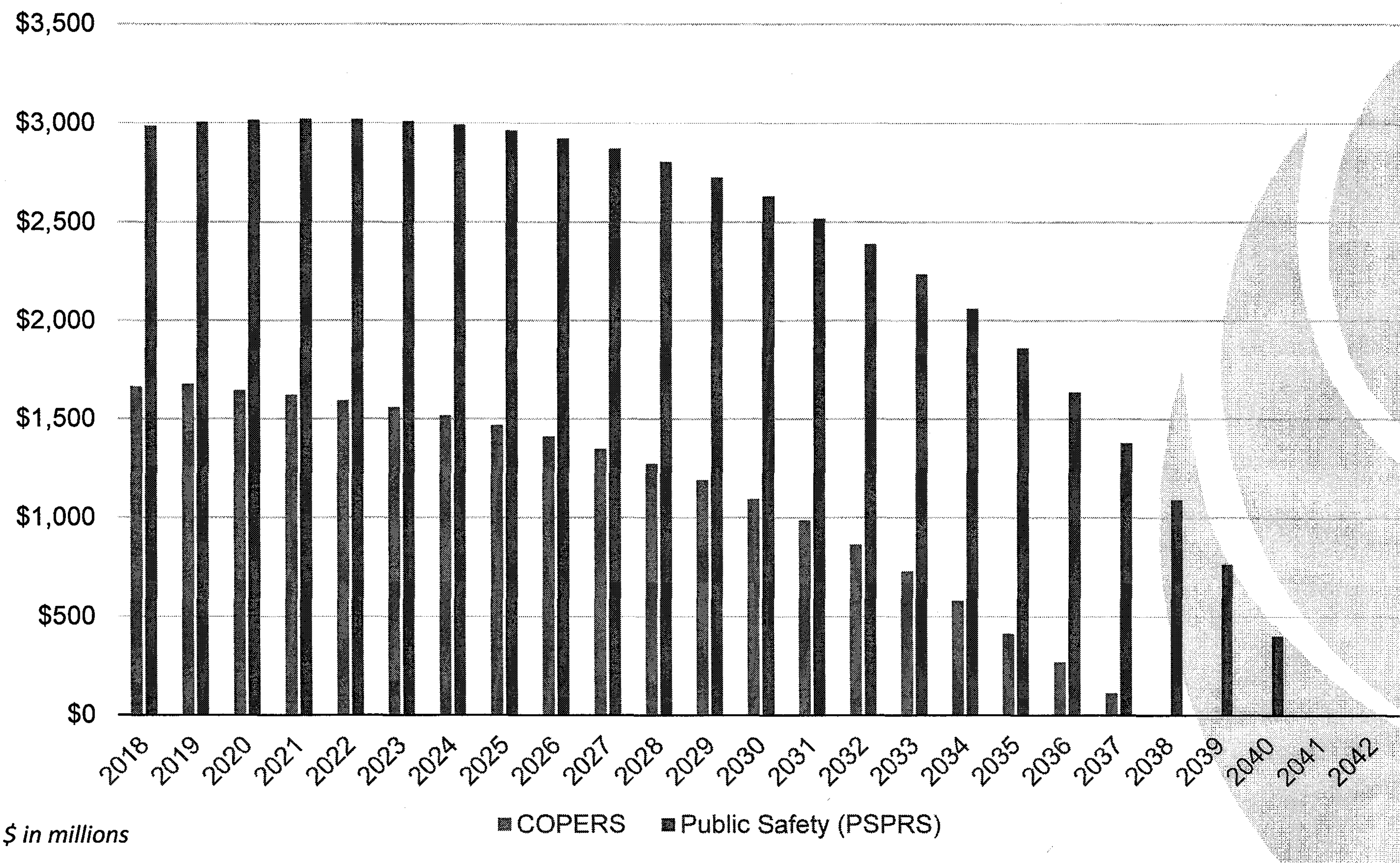
The funded ratio on an actuarial value of assets basis increased from June 30, 2017 to June 30, 2018. On a market value of assets basis, the funded ratio also increased from June 30, 2017 to June 30, 2018.

Exhibit A.1
City of Phoenix Employees' Retirement System
Executive Summary

	June 30, 2018	June 30, 2017
1. **Total Actuarially Determined Contribution**		
a. Dollar Amount	$ 208,889,903	$ 203,958,677
b. As a % of Payroll	38.51%	37.99%
2. **Funded Status**		
a. Actuarial Accrued Liability	$ 4,226,045,811	$ 4,129,452,386
b. Actuarial Value of Assets (AVA)	2,562,847,008	2,402,707,329
c. Unfunded Liability (AVA-basis)	1,663,198,803	1,726,745,057
d. Funded Ratio (AVA-basis)	60.64%	58.18%
e. Market Value of Assets (MVA)	$ 2,554,513,709	$ 2,353,607,330
f. Unfunded Liability (MVA-basis)	1,671,532,102	1,775,845,056
g. Funded Ratio (MVA-basis)	60.45%	57.00%
3. **Summary of Census Data**		
a. Actives		
i.(a) Tier 1 Count	5,638	6,030
i.(b) Tier 2 Count	737	823
i.(c) Tier 3 Count	1,602	1,177
i.(d) Total Active Count	7,977	8,030
ii. Total Annual Compensation	$ 527,160,824	$ 521,709,266
iii. Average Projected Compensation	66,085	64,970
iv. Average Age	46.6	46.5
v. Average Service	12.4	12.3
b. Deferred Vested Member Counts	943	925
c. Retiree Counts	5,813	5,661
d. Beneficiary and Alternate Payee Counts	1,076	1,072
e. Disability Counts	249	247
f. Total Members Included in Valuation	16,058	15,935

The funded ratio may not be appropriate for assessing the need for future contributions. The funded ratio is not appropriate for assessing the sufficiency of plan assets to cover the estimated cost of settling the plan's benefit obligations.

Attachment J: Total Unfunded Net Pension Liabilities



all $ in millions