City of Phoenix

Report

Agenda Date: 6/17/2020, **Item No.** 40

Authorization to Adopt Update to Annual Pension Funding Policy Per State Law A.R.S. 38-863.01 (Ordinance S-46748)

Request to adopt 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 requirement adopted by the State Legislature as A.R.S. 38-863.01 **(Attachment A)** to be implemented on an annual basis by June 30. While the State law only applies to PSPRS, City staff recommends also adopting a funding policy for all employee pension plans, such as COPERS, as a transparent sound financial practice. The Council first approved a plan on May 15, 2019.

Summary

On an annual basis, 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 can be found in **Attachments B and C**. A final City Pension Funding Policy must be adopted and posted on the website by June 30 and every year thereafter. The Council previously approved a Policy on May 15, 2019. The proposed City Pension Funding Policy is consistent with what was approved last year with minor additions related to actively monitoring the financial health of both plans. Staff seeks Council approval to post the required documents on the City's website by June 30, 2020.

Information

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**) 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.

In prior years, City Council has 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 than 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 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 at the Arizona Supreme Court.

Results to Date

Implementation of the City Council’s direction has stabilized the funded position of the plans. The funded ratio for COPERS was 60.43 percent for fiscal year ending 2019 and was 60.64 percent in fiscal year 2018 (**Attachment F**). The funded ratio for PSPRS was 40.34 percent for fiscal year ending 2019 and was 41.23 percent in fiscal year 2018 (**Attachment F**). However, the City's total Net Pensions Liability increased slightly to $4.8 billion. This is an indication that ongoing attention to the funded position of the plans and strategies to increase payments over a sustained period is necessary. This must be considered in conjunction 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 G and H**) and must approve funding goals (**Attachments B and C**) by June 30, 2020.

While the pension systems are not fully funded, the strategy to pay the ARC and pay down the liability over a set period (21 years remaining for PSPRS and 19 years remaining 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 (**Attachment I**) and COPERS will be 100 percent funded by June 30, 2039 (**Attachment I**). 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 time frame.

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 to fund the pension reserve fund or directly pay down the liability;

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

4) Evaluating appropriate timing and feasibility of Pension Obligation Bonds, while maintaining a structurally balanced budget;

5) Reviewing investment rate of returns on pension assets, actuary assumptions and to forecast future annual required contributions; and

6) Compiling sensitivity and scenario analyses on proposed changes to the pension plans.

Conclusion and Next Steps

Over the past decade, the City Council has diligently managed the financial stability of the pension plans and will need to continue to remain vigilant in the future to ensure the long-term viability of the pension plans. However, pension funding is a long-term problem requiring constant evaluation until plans are fully funded. The City has successfully balanced its obligations to retirees and public services 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.

Previous Council Action

A Pension Plans Funding Policy was adopted at the City Council Formal Session on May 15, 2019.

Responsible Department

This item is submitted by City Manager Ed Zuercher and Chief Financial Officer Denise Olson.

Attachment C
City of Phoenix
City of Phoenix Employee Retirement System
Pension Funding Policy

The intent of this policy is to clearly communicate the Council's pension funding objectives and its commitment to our employees and the sound financial management of the City and to comply with 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.

Council formally accepts the assets, liabilities, and current funding ratio of the City's COPERS trust funds from the June 30, 2019 actuarial valuation, which are detailed below.

Trust Fund	Assets	Accrued Liability	Unfunded Net Pension Liability	Funded Ratio
Phoenix	2,660,133,000	4,401,825,000	1,741,692,000	60.43%

For comparative purposes, the City of Phoenix total Unfunded Actuarial Accrued Liability for the prior fiscal year ending June 30, 2018 was $1.66 billion and the funded ratio was 60.45%.

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 workforces. As shown above, the UAAL for the City is $1.7 billion which should be paid over time to avoid a huge burden to current taxpayers by either significantly decreasing services or an increase in taxes. This taxpayer burden must be balanced with being fiscally responsible and committed in providing pensions to retirees.

The Council's COPERS funding ratio goal is 100% (fully funded) by June 30, 2039.

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

- Maintain ARC payment from operating revenues – Council is committed to maintaining the full ARC payment (normal cost and UAAL amortization) from operating funds.

To achieve this goal, the City may utilize the following strategies:

1. Maintaining the City's legal commitment to employees and retirees by paying at least 100% of the annual required contribution.
2. Evaluating prior year budget compared to actual expenditures and make an excess payment directly to COPERS to accelerate pension payments to directly pay down the liability.
3. Continuing to seek opportunities to advance payments from either enterprise and/or special revenue funds.
4. Developing a plan to present to City Council detailing appropriate timing and feasibility of issuing Pension Obligation Bonds.
5. Reviewing investment rate of returns on pension assets, actuary assumptions and to forecast future annual required contributions.
6. Compiling sensitivity and scenario analyses on proposed changes to the pension plan.