Authorization to Adopt Proposed Pension Funding Policy Per State Law A.R.S. 38-863.01 (Ordinance S-45679)

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 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.

Summary
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 approval to post the required documents on the City's website by July 1, 2019.

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 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.

5) As part of the 2019-20 budget process, there is a recommended $1 million annual allocation to the pension reserve and up to $4.5 million in one-time funds for potential allocation to the reserve.

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 58.00 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 20 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, 2038 (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.

Concurrence/Previous Council Action
The Proposed Pension Plans Funding Policy was presented at the City Council Policy
Session on March 19, 2019. The Council voted 4-2 to support the policy; however five
votes are necessary to pass a resolution or formal action. In order to comply with State
law by July 1, 2019, the item is being returned to the Council for further consideration.

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

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.

<table>
<thead>
<tr>
<th>Trust Fund</th>
<th>Assets</th>
<th>Accrued Liability</th>
<th>Unfunded Actuarial Accrued Liability</th>
<th>Funded Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phoenix</td>
<td>2,562,847,008</td>
<td>4,226,045,811</td>
<td>1,663,198,803</td>
<td>60.64%</td>
</tr>
</tbody>
</table>
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, 2038.

The adopted amortization period allows for the date to be June 30, 2038 based on a 20 years remaining amortization period. The City Council adopted the 2038 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
- The amortization goal is consistent with the City Charter and COPERS funding policy.
- A 2038 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, 2038 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.

Going forward the City Council will evaluate any potential new revenue sources for the purpose of paying down the pension liability.