AGENDA

‣ Current Issues and Roadmap to PVE Long Range Plan
‣ Financial State of the City
‣ Civic Engagement Process
‣ The Pension Challenge
‣ Impact on the Budget
‣ Debt & Budget Management Strategy Recommendations
‣ A Call To Action!
‣ Committee Recommendations
‣ Questions & Next Steps
PENSIONS

PUBLIC SAFETY

PARKLAND MAINTENANCE

TRAFFIC MITIGATION

INFRASTRUCTURE PUBLIC WORKS
ROAD MAP TO PVE LONG-RANGE PLAN

RESERVES

PENSIONS

OPERATIONS
- Admin / Finance
- Planning, Public Works
- Parkland Maintenance
- Police / Public Safety
- Fire / Emergency Services

TECHNOLOGY AND RISK MANAGEMENT

INFRASTRUCTURE
- Streets / Sewage / Maintenance
- Building Structures

CONTINGENCIES
FINANCIAL STATE OF THE CITY

- Palos Verdes Estates’ financial model relies primarily on property taxes for general fund revenue
- The growth of these taxes is generally between 2%-3% annually
- The City is continually pressured to reduce services in order to accommodate increases in pension, fire and insurance
- Capital needs continue to be deferred
FINANCIAL STATE OF THE CITY

The Unfunded Actuarial Liability (using CalPERS default 7% Discount Rate) has more than doubled between 2011 and 2019.

Unfunded Actuarial Liability as of June 30

UNRACK data from CalPERS valuation reports
FINANCIAL STATE OF THE CITY

The City’s required pension contributions have more than doubled over the last decade.

ANNUALLY REQUIRED CITY CONTRIBUTION

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Miscellaneous</td>
<td>11.031%</td>
<td>$208,842</td>
<td>10.221%</td>
<td>$171,284</td>
<td>9.409%</td>
<td>$119,373</td>
</tr>
<tr>
<td>PEPRA Miscellaneous</td>
<td>7.732%</td>
<td>$2,605</td>
<td>6.985%</td>
<td>$2,280</td>
<td>6.842%</td>
<td>$362</td>
</tr>
<tr>
<td>PEPRA Safety Police</td>
<td>13.044%</td>
<td>$1,505</td>
<td>13.034%</td>
<td>$1,347</td>
<td>12.141%</td>
<td>$567</td>
</tr>
<tr>
<td>Safety</td>
<td>23.674%</td>
<td>$844,049</td>
<td>21.927%</td>
<td>$739,444</td>
<td>20.556%</td>
<td>$599,344</td>
</tr>
</tbody>
</table>

Chart data from CalPERS valuation reports and website
https://www.calpers.ca.gov/page/employers/actuarial-resources/employer-contributions/public-agency-contributions
CIVIC ENGAGEMENT PROCESS
PENSION AD HOC COMMITTEE AND WORKING GROUP

The Palos Verdes Estates City Council appointed Councilmember Victoria Lozzi and Mayor Pro Tem Michael Kemps to lead an ad hoc committee.

Pete Constant, CEO of Retirement Security Initiative provided guidance and assistance with this effort. Feedback and review was also sought from the GovInvest team, with whom the City has an active subscription for software that visualizes complex actuarial information.

This committee and working group held over a dozen meetings, with over 120 people participating. All ideas were compiled in a single document for distribution, without attribution and were uploaded to the City’s website: Working Group Ideas.
From these attendees, the committee invited numerous individuals to join a series of meetings to delve deeper into the issues; clarify community interests, aspirations, and concerns; help brainstorm and identify desired outcomes and potential solutions.

The working group settled on twelve strategies to combat pension and budget issues.
THANK YOU

to all who invested and collaborated with us!

Representatives from POA, PSE,
General Employees and Executive Staff

Robert Park, Dawn Murdock, Desiree Myers,
George Kay and other participating residents
Pete Constant, Retirement Security Initiative
Charlie Francis, Ira Summer, and the GovInvest team
THE PENSION CHALLENGE
OVERVIEW OF PENSION BENEFITS

As part of its benefit and compensation package, the City of Palos Verdes Estates provides a defined benefit retirement plan to its employees. Retirement benefits are a form of deferred compensation in which an employee and employer agree to set aside a portion of the employee’s salary payable upon retirement.

There are four pension plans for employees administered by CalPERS:

<table>
<thead>
<tr>
<th>City of Palos Verdes Estates Pension Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Classic Public Safety</strong></td>
</tr>
<tr>
<td>3% multiplier at 50 years, 1 year Final Average Salary, 2% COLA</td>
</tr>
<tr>
<td><strong>PEPRA Public Safety</strong></td>
</tr>
<tr>
<td>2.7% multiplier at 57 years, 3 year Final Average Salary, 2% COLA</td>
</tr>
<tr>
<td><strong>Classic Misc. Employees</strong></td>
</tr>
<tr>
<td>2% multiplier at 55 years, 1 year Final Average Salary, 2% COLA</td>
</tr>
<tr>
<td><strong>PEPRA Misc. Employees</strong></td>
</tr>
<tr>
<td>2% multiplier at 62 years, 3 year Final Average Salary, 2% COLA</td>
</tr>
</tbody>
</table>
HOW RETIREMENT BENEFITS ARE CALCULATED

Defined Benefit plans provide a specified amount of monthly retirement income, based on an employee’s salary, years of work, and age at retirement

\[
\text{Benefit Multiplier} \times \text{Years of Service} \times \text{Final Average Salary} = \text{Annual Retirement}
\]

- Benefit Multiplier: 2.5%
- Years of Service: 25 Years
- Final Average Salary: $100,000
- Annual Retirement: $62,500
**CALPERS RETURNS & DISCOUNT RATE**

**CalPERS** sets the discount rate and rate of return to the same rate, and if they match both, the plan is fully funded. The city's plan funding ratios are eroding.

**DEBT** is created by negative amortization when CalPERS performance is less than the expected rate of return. Each year CalPERS adds **new debt** to the plan when their performance and plan experience repeatedly fails to meet actuarial assumptions.
Despite a decade-long-bull-market, CalPERS pension assets consistently underperform, trailing S&P 500 Annual Returns, while increase risk in its portfolio. Reaching 7% will be even more difficult with the Federal Reserve interest rates with longer-term guidance.

Meanwhile, local governments understate contributions needed to pre-fund promised pension benefits.
CALPERS PERFORMANCE PROJECTIONS & RISKS

- **CalPERS** has publicly stated their concerns about lower returns over the near-term investment horizon ([2019 Annual Review of Funding Levels and Risks, Nov. 2019](#))

- **Wilshire Associates**, an investment advisor to CalPERS, has estimated only a 17% probability that CalPERS would earn its 7% discount rate over the next decade

- **Because the risk associated with CalPERS assumptions being unreasonably inflated is simply too high, the ad hoc committee recommends that plan contributions be funded using lower risk assumptions that have a higher probability of coming to fruition**
WHAT COMPONENTS MAKE UP PENSION COSTS?

The employer’s annual contribution, called the Annual Required Contribution (ARC) is made up of two pieces: the normal cost and the unfunded liability payment.

**Normal Cost:** The cost attributed to the current year of service by active employees; A portion of this is paid by employees through payroll deductions.

**Unfunded Liability Payment:** If the market value of assets is less than Actuarial Liability, an additional payment is required to pay off the debt by the end of the amortization schedule. This difference is referred to as the Unfunded Actuarial Liability (UAL).
THE UAL PROBLEM

- Over the years, the normal cost has risen gradually
- Debt payments on the UAL have skyrocketed over the last two decades

Chart data from GovInvest
THE UAL PROBLEM

CalPERS projected payments, provided via annual valuation reports have historically been inaccurate.

Over five years ago, in October of 2014, CalPERS projected the City’s combined debt payments to be $1/3 less than they are today, with FY2020-21 is now projected to be $449,000 more than projected.

Chart data from CalPERS valuation reports
As of June 30, 2019, the City has $17,644,887 in UAL at a 7% discount rate. This assumes CalPERS meets all assumptions.

The calculation of UAL is highly sensitive to changes in the discount rate, as seen in the table:

<table>
<thead>
<tr>
<th>Discount Rate</th>
<th>Est. Unfunded Actuarial Liability</th>
<th>Est. Funded Status</th>
<th>Est. Unfunded Actuarial Liability Per Household*</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.0%</td>
<td>$ 55.37 MM</td>
<td>45%</td>
<td>$10,254</td>
</tr>
<tr>
<td>5.0%</td>
<td>$ 39.77 MM</td>
<td>53%</td>
<td>$7,365</td>
</tr>
<tr>
<td>6.0%</td>
<td>$ 27.57 MM</td>
<td>62%</td>
<td>$4,180</td>
</tr>
<tr>
<td>7.0%</td>
<td>$ 17.90 MM</td>
<td>72%</td>
<td>$3,315</td>
</tr>
<tr>
<td>8.0%</td>
<td>$ 10.13 MM</td>
<td>82%</td>
<td>$1,876</td>
</tr>
</tbody>
</table>

*UAL Per Household = Estimated UAL / 5400 Households
UAL AMORTIZATION PAYMENTS MEASURED USING CALPERS 7% DISCOUNT RATE

- The UAL amortization payments are on a set schedule, and continue to rise for more than ten years.
- In FY 2026, UAL payments are projected to be over $2.0M, nearly $1.0M more than FY 2019’s payment.
- Total principal and interest payments will exceed $32M over the next 25 years, $15,029,387 of which is interest.
IMPACT ON THE BUDGET

› Escalating pension costs consume an increasing percentage of the budget

› These rising costs will crowd out basic city services and cripple the general fund

› In order to pass the last two fiscal budgets, the City reduced services in excess of $1M
DEBT & BUDGET MANAGEMENT STRATEGY RECOMMENDATIONS
DEBT MANAGEMENT STRATEGIES

1. Prevent or minimize the creation of new debt by increasing the accuracy and lowering the risk of normal cost calculations valued using a discount rate set at a rate that is 2.5% above a three-year rolling average of the 30-year treasury constant maturity rates.

2. Establish a 115 Pension Trust to hold normal cost contributions that exceed CalPERS required normal cost contributions. Trust assets would be used solely for pension benefits.

3. Calculate the City’s Total Pension Contribution using a shorter amortization period and a level dollar amortization to retire Legacy Debt faster with lower interest payments.
DEBT MANAGEMENT STRATEGIES

4. Consider locking in a Fresh Start with CalPERS for Legacy Debt using a shorter amortization period and a level dollar amortization to retire Legacy Debt faster with lower interest payments.

5. Consider combining a Fresh Start with CalPERS and Shortened Amortization Schedules with a Stable, Dedicated Temporary Tax.

6. Manage PEPRA Plans’ debt aggressively.
Recommended Debt Management Strategies 1 and 2
Gradually Reducing the Discount Rate from 7% to 5%

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Discount Rate</th>
<th>Employer Normal Cost</th>
<th>Employee Cost Contribution*</th>
<th>Employer Normal Cost Projected Increase from 2020</th>
<th>Employee Normal Cost Projected Increase from 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>7%</td>
<td>$756,043.95</td>
<td>$423,242.73</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2018</td>
<td>7%</td>
<td>$725,271.09</td>
<td>$394,145.14</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2019</td>
<td>7%</td>
<td>$787,672.34</td>
<td>$409,989.53</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2020</td>
<td>6.5%</td>
<td>$870,518.94</td>
<td>$424,137.74</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2021</td>
<td>6.0%</td>
<td>$865,592.87</td>
<td>$426,730.43</td>
<td>$ (4,926)</td>
<td>$ 2,593</td>
</tr>
<tr>
<td>2022</td>
<td>5.50%</td>
<td>$1,051,121.23</td>
<td>$454,127.83</td>
<td>$ 180,602</td>
<td>$ 29,990</td>
</tr>
<tr>
<td>2023</td>
<td>5%</td>
<td>$1,257,721.24</td>
<td>$493,585.71</td>
<td>$ 387,202</td>
<td>$ 69,448</td>
</tr>
<tr>
<td>2024</td>
<td>5%</td>
<td>$1,489,781.62</td>
<td>$543,399.27</td>
<td>$ 619,263</td>
<td>$ 119,262</td>
</tr>
<tr>
<td>2025</td>
<td>5%</td>
<td>$1,730,698.92</td>
<td>$607,100.79</td>
<td>$ 860,180</td>
<td>$ 182,963</td>
</tr>
<tr>
<td>2026</td>
<td>5%</td>
<td>$1,698,756.02</td>
<td>$652,161.58</td>
<td>$ 828,237</td>
<td>$ 228,024</td>
</tr>
<tr>
<td>2027</td>
<td>5%</td>
<td>$1,670,419.29</td>
<td>$693,794.05</td>
<td>$ 799,900</td>
<td>$ 269,656</td>
</tr>
<tr>
<td>2028</td>
<td>5%</td>
<td>$1,644,925.10</td>
<td>$736,833.08</td>
<td>$ 774,406</td>
<td>$ 312,695</td>
</tr>
</tbody>
</table>

*Changes to Employee Contributions are subject to collective bargaining

Information projected to future years assuming future experience matches CalPERS demographic and economic assumptions, with the following changes:

IMPACT OF DEBT MANAGEMENT STRATEGY 3

Switching to 15 Year Level Dollar Amortization

<table>
<thead>
<tr>
<th></th>
<th>CURRENT</th>
<th>15 YEAR AMOUNT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal</td>
<td>18,097,842</td>
<td>18,097,842</td>
</tr>
<tr>
<td>Interest</td>
<td>14,986,383</td>
<td>10,716,400</td>
</tr>
<tr>
<td>Savings</td>
<td>4,269,983</td>
<td></td>
</tr>
</tbody>
</table>

Chart data from GovInvest
BUDGET MANAGEMENT STRATEGIES

1. Budget Management Strategy 1:
   Develop a clear council policy for use of one-time revenues

2. Budget Management Strategy 2:
   Develop a clear council policy for use of ending fund balances
   Priority should be given to those items that relieve budget or financial operating pressure in future periods

3. Budget Management Strategy 3:
   Create a budget-in-brief
Budget Management Strategy 4:
Disclose long-term liabilities in the budget
The City should include this information in all pertinent budget documents

Budget Management Strategy 5:
Establish a debt management policy
Debt managed under this policy should include unfunded pension liabilities

Budget Management Strategy 6:
Explore all potential revenue-enhancing activities
BUDGET MANAGEMENT STRATEGY 3: SAMPLE

Create a Budget-in-Brief

A document is intended to provide residents and employees with facts about their city such as:

- The City’s approach to balancing the budget
- The major sources of funding
- The services the City provides
- The infrastructure the City maintains and rebuilds
A CALL TO ACTION!

- Maintaining the status-quo is unacceptable
- If we do nothing, the City’s interest payments will rise to more than $2 Million annually, with debt continuing to build
- Using a more realistic discount rate will better-forecast normal cost and debt
- Forecasting future budgets to include debt will provide a more accurate assessment of the City’s financial condition
- Solutions must include all stakeholders, to create a more sustainable future
- Competing challenges must be factored to balance priorities
We recommend that Council direct staff to:

- Provide analysis on implementing Debt Strategies 1 / 2
- Provide analysis on restructuring the UAL under Debt Strategy 5
- Implement Budget Strategies 1 and 2 by updating existing policies
- Implement remaining Budget Strategies going forward
QUESTIONS & NEXT STEPS

‣ Council Clarifying Questions
‣ Public Comment
‣ Council Feedback and Discussion
‣ Direction for Staff