STAFF REPORT

SAUSALITO CITY COUNCIL

AGENDA TITLE:

CalPERS Side Fund Unfunded Accrued Actuarial Liabilities ("UAAL") for Employee Pension Plans

RECOMMENDED MOTION:

Receive Report and Provide Direction on Whether the City of Sausalito Should Issue Pension Obligation Bonds to Payoff the UAAL

SUMMARY

Each year the City of Sausalito makes contributions on behalf of its employees to fund the employee pension with the CalPERS retirement system. Because of investment market fluctuations, increased benefit packages, and other circumstances, agencies often develop an unfunded accrued actuarial liability ("UAAL") in their participating fund balance in the CalPERS retirement system. An UAAL occurs when the plan liabilities exceeds the plan assets.

Effective with Fiscal Year 2004-2005, the City of Sausalito was required by CalPERS to participate in a risk pool due to the fact that the City had less than 100 active employees as of June 30, 2003. At the time of joining a risk pool, a side fund was created by CalPERS to account for the differences between the funded status of the pool and the funded status of the three Sausalito plans (Police, Fire, and Miscellaneous). Until the UAAL is paid off through set amortization schedule as a percentage of payrolls, CalPERS currently charges a fixed interest rate of 7.75% on the UAAL.

Staff and the City's financial advisor, Mark Pressman, have been working on developing a program for the City to fund its accumulated UAAL in the most efficient and economical method possible. If the City would issue pension obligation bonds (POBs) at an interest rate lower than 7.75% with the cost of issuance taken into consideration, the City could realize a projected total net present value savings of approximately $359,000.

BACKGROUND

Based on actuarial valuation as of June 30, 2005, CalPERS projected the City's side fund UAAL at June 30, 2007 to be $5,062,116 (Police $3,186,317; Fire $1,408,657; Miscellaneous $467,142). A final UAAL payoff obligation is being obtained from CalPERS. The amortization period used in the POBs will be the same as existing CalPERS of 18, 15 and 14 years, respectively. CalPERS may, at some future date, change its policy on terms for charging local government agencies, but at present, does not anticipate any change in the amortization periods or interest rate charged.

In order to address the City's shortfall in its CalPERS funding requirement. The City has several options.

(1) The City can continue to make annual payments to CalPERS. The total expected cost to amortize its $5 million shortfall in this time frame is approximately $9,041,061.

(2) The City can negotiate decreasing pension plan benefits in a second tier for new employees hired after a date certain. This entails the process of meeting and conferring with various labor groups.

(3) The City can issue POBs at an interest rate that is lower than the interest rate charged by CalPERS. The same amortization term is maintained for all plans. The result is that the city's annual payments are reduced by approximately $40,000 and the total cost to pay off the liabilities is reduced to approximately $ 8.3 million, a savings of approximately $700,000. The net present value savings for such a transaction, at today's taxable interest rate of 6.20%, is approximately $359,000. It should be noted that the POBs interest rate is indicative of today's rates. It is not set and will fluctuate with market conditions until the POB is priced.

ISSUES

Why sell the POB at a private sale?

The City's financial advisor, staff, and the finance committee have reviewed this approach relative to other methods of sale and have concluded that the costs of issuance for a private placement transaction are substantially lower than that of either a public sale or participation in a negotiated pool of similar issues. Staff time required to assemble necessary data and documentation for the transaction is likewise significantly reduced with the private placement. Ongoing annual costs of the private placement will also be lower than the other alternatives. And lastly, timing and control of the transaction rests with the City. The reduction in costs of issuance results in a smaller new loan, and when combined with the anticipated interest rates, the annual payments are lower and savings greater for the City.

Interest rates could change, affecting savings to the City.

Interest rates cannot be locked in until required procedures are completed and bonds sold. Once procedures are completed, if rates continue to be economically advantageous to the program, it will proceed. If not, the program will be placed on hold or abandoned. The estimated cost to the City of abandoning the program after completion of the required procedures is $10,000.

Will the transaction impact the City's bond rating?
The transaction, as currently structured, actually enhances the City's financial position by reducing its fixed overhead payments, without incurring any significant additional liability. The rating agencies typically look favorably on such an adjustment in a local government agency's financial statements.

How will the POB be carried on the City's financial statements?
The POB will be shown as a liability on the City's financial statements. Currently, the City's CalPERS UAAL is shown as a footnote in the financial statements. Both obligations are general fund obligations requiring annually appropriated payments.

What if CalPERS changes its policies about the interest rate it charges participating cities?
Currently, CalPERS indicates it has no intention of changing its rates or policies. The impact of future changes cannot be predicted.

Will the POB eliminate the City's UAAL?
The issuance of POBs is to payoff the City's side fund UAAL that is the liability incurred prior to joining the risk pool. The POBs will not address the pool UAAL which is shared among all the pool small employers or the development of a future UAAL by the City.

FISCAL IMPACT

If the Council directs staff and its financial advisor to proceed with the issuance of POB, there is a projected total net present value savings of about $359,000.

STAFF RECOMMENDATIONS:

Staff recommends that the City Council receive report and provide direction to staff and financial advisor Mark Pressman on POB issuance.

ATTACHMENTS

A. CalPERS Actuarial Valuation – June 30, 2005 for Police Plan
B. CalPERS Actuarial Valuation – June 30, 2005 for Fire Plan
C. CalPERS Actuarial Valuation – June 30, 2005 for Miscellaneous Plan

SUBMITTED BY:	APPROVED BY:
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