FY 20
BUDGET MEMO # 16

DATE: April 19, 2019

TO: The Honorable Mayor and Members of the City Council

THROUGH: Robert Stalzer, City Manager RAStalzer

FROM: David Hodgkins, Assistant City Manager/Director of Finance

SUBJECT: Supplemental Retirement Plan – Cost Analysis

Summary: Council has requested information on cost increases relating to the City's Supplemental Retirement Plan (Plan). Following are the Council questions with staff's general responses:

1. ***Question:*** What caused the FY 2020 increase ($1.4m) in Plan costs to the City? ***Response:*** The main contributors to the increase in Plan costs (Actuary's recommended employer contribution) are **lower than assumed return on investments** over the past 5 years and a reduction in future assumed investment return rates (from an annual 6.75% rate of return to 6.25%). See "**FY 2018 Plan Results"** on page 2.
2. ***Question:*** Will plan costs continue to increase in the future? ***Response:*** In any given year it is not always possible to predict if the Actuary's recommended employer contribution will increase or decrease because of a number of uncontrollable factors. The most difficult to predict and most impactful factor is typically the Plan's return on investment. However, the Plan is designed where average Plan costs to the City will **decrease** over time. See "**Future Expected Plan Contributions and Funded Status**" on page 2.

Supplemental Retirement Plan General Financial Objective: To establish and maintain a retirement fund contribution rate (measured as a % of payroll) that will remain approximately level from generation to generation of citizens.

Funding Background: Over the past decade the objective of level-contribution-percent employer funding has been difficult to achieve. Investment returns in excess of the assumed rate in the mid to late 90s acted as a credit against the ongoing annual cost of the Plan. This resulted in contribution rates declining to zero during the period and remaining at zero for a number of years (12 years for the General Employee portion of the plan and 7 years for Public Safety). The market downturn in late 2008 and 2009 significantly affected the Retirement Fund's asset value and as a result increased the actuary's recommended employer contribution rates. The current actuarial recommended contribution rate for FY 2019 (based on the FY 2017 plan valuation) was 5.36% for General Employees and 13.15% for Public Safety.

FY 2018 Plan Results: The key valuation results are; 1) a recognized investment return of about 5.5% compared to the assumed return of 6.75%, a shortfall of 1.25%, 2) the recognition of prior years net investment losses, these losses for the 5 year "smoothing" period outweighed the gains, and 3) the Unfunded Actuarial Accrued Liability increased \$4.3m (from \$0.4m to \$4.7m) for the General Employee Plan and \$3.7m (from \$6.1m to \$9.8m) for the Public Safety Plan. The increases in the Unfunded Liability funds were driven by the FY 2018 shortfall in investment returns, the recognition of net prior years' losses, and changes in actuarial assumptions. The changes in actuarial assumptions alone account for about 40% of the increase in the actuary's recommended employer contribution. The most impactful change affected the investment return assumption, it was reduced from 6.75% to 6.25%.

Recommendation: The actuary's FY 2020 recommended employer contribution rate is based on the results from the FY 2018 Actuarial Valuation Report. The recommended contribution rates are 9.12% (5.92% Normal Cost and 3.2% applied to the Unfunded Liability) for General and 18.6% (9.06% Normal Cost and 9.54% applied to the Unfunded Liability) for Public Safety. The Plan requires a fixed employee contribution to the Plan (as a percentage of employee wages), 3.0% for General Employees and 7.0 for Public Safety. The employee contribution rates do not fluctuate from year to year.

Future Expected Plan Contributions and Funded Status: Based on the Plan's funding policy, it is expected that the annual recommended employer contributions as a percentage of pay will decrease over time to the Normal Cost "rate" (about 6% for general employees and 9% for public safety employees) approximately a \$1.7m reduction in annual cost; and the funded status of the plan will increase gradually towards 100%.

Plan Administration and Oversite (Summary): (1) Management - The City Council has appointed a Retirement Committee to administer and operate the City's Supplemental Retirement Plans. The committee consists of: City Manager, Director of Finance, City Council Representative, general employee, public safety employee, retiree, and a taxpaying resident. The Committee meets at least 4 times a year and all actions and records are preserved. (2) – Operations/Expertise – The City contracts with a Trustee (Suntrust Bank), Plan Attorney (Whiteford, Taylor & Preston) and Investment Advisor (NEPC) to receive, invest and administer Plan contributions and funds. (3) Plan Oversite – Oversite is primarily performed by the Committee, City Auditors, Rating Agencies and City Management.

Retirement Plan operations and benefit plans are reviewed by City Staff annually and by the Committee quarterly. The last major change to Plan operations was about 3 years ago. An actuarial valuation of the Plan is performed annually. The actuarial assumptions and investment policies are typically reviewed and updated every 5 years, or sooner if needed.