

City of Flagstaff Public Safety Personnel Retirement System Pension Funding Policy

Section 1: Introduction

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 Arizona Revised Statute Title 38-863.01. The City of Flagstaff maintains two Public Safety Personnel Retirement Systems (PSPRS), one for police employees and one for fire employees. The PSPRS trust funds represent only the City of Flagstaff's liability. This policy will demonstrate how the city will maintain stability for the contributions to the systems, explain how and when funding requirements for the system will be met, and define the funded ratio targets and timelines for reaching the ratio for the systems.

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.

Intergenerational equity – Ensures that no generation is burdened by substantially more or less pension costs than past or future generations.

The City's police and fire employees who are regularly assigned hazardous duty participate in the Public Safety Personnel Retirement System (PSPRS).

Section 2: Public Safety Personnel Retirement System (PSPRS)

PSPRS is administered as an agent multiple-employer pension plan. An agent multiple-employer plan has two main functions: 1) to commingle assets of all plans under its administration, thus achieving economy of scale for more cost efficient investments, and

invest those assets for the benefit of all members under its administration and 2) serve as the statewide uniform administrator for the distribution of benefits.

Under an agent multiple-employer plan each agency participating in the plan has an individual trust fund reflecting that agencies' assets and liabilities. Under this plan all contributions are deposited to and distributions are made from that fund's assets, each fund has its own funded ratio and contribution rate, and each fund has a unique annual actuarial valuation. The City of Flagstaff has two trust funds, one for police employees and one for fire employees.

Council formally accepts the assets, liabilities, and current funding ratio of the City's PSPRS trust funds from the June 30, 2018 actuarial valuation, which are detailed below.

| Trust Fund | Assets | Accrued Liability | Unfunded Actuarial Accrued Liability | Funded Ratio |
|---------------------------------|----------------------|--------------------------|---|---------------------|
| Flagstaff Police | \$ 30,522,417 | \$ 79,472,686 | \$ 48,950,269 | 38.4% |
| Flagstaff Fire | \$ 31,950,208 | \$ 90,720,113 | \$ 58,769,905 | 35.2% |
| City of Flagstaff Totals | \$ 62,472,625 | \$ 170,192,799 | \$ 107,720,174 | 36.7% |

Section 3: PSPRS Funding Goal

Pensions that are less than fully funded place the cost of service provided in earlier periods (amortization of UAAL) on the current taxpayers. Fully funded pension plans are the best way to achieve taxpayer and member intergenerational equity.

At a minimum, the Council will maintain minimum Annual Required Contribution (ARC) for PSPRS for both Flagstaff Police and Flagstaff Fire. Council is committed to maintaining the full ARC payment (normal cost and UAAL amortization) from ongoing operating revenues. The estimated ARC for FY20 and fully funded goal:

- PSPRS-Police = \$3,332,238, June 30, 2047
- PSPRS-Fire = \$4,998,955, June 30, 2036

Council will take additional fiscal measures to reduce the UAAL:

- The City will make an annual payment for the City's share of PSRPS contributions in July of each fiscal year. They payment will be based on the Adopted Budget for the City for both plans. During the fiscal year, if the ARC exceeds the prepayment amount, the City will pay additional ARC as required. If at June 30 the prepayment exceeds the actual minimum ARC, the City will leave the overpayment with the pension plan, thus providing excess contributions.
- For public safety employees which are in the Deferred Retirement Option Plan (DROP), the City will budget for and pay the City's share of pension contributions. While the City is not required to make these contributions, this would be a contribution in excess of the ARC.

- In a year with the minimum contribution rate is calculated to be lower than prior year, the City will maintain contributions rates at least equal to the prior year's contribution rate. This would be a contribution in excess of the ARC.

Council will consider additional payment above the ARC to lower the UAAL:

- For FY 2019, Council adopted a maximum amortization period for the PSPRS-Police plan. While this reduced our ARC by \$975,000, the City continued to pay \$630,000 in excess contributions for FY 2019. For years forward we will maintain providing the excess contribution annually above the ARC.

Council will consider additional revenue sources to assist in paying down the UAAL:

- The Council provided direction to increase the Use Tax rate from 1% currently to 2.281% effective July 1, 2019. This rate will align the Use Tax rate with the Retail Tax rate for the City. The amount collected above the 1% will be used to provide excess contributions to the police and fire pension plans. FY 20 is estimated to provide \$900,000 toward the UAAL.

Based on these pension funding policy decisions by the Council, the City PSPRS plans are expected to a achieve a goal of 100% funding by June 30, ~~2039~~ 2036. The change in the funding ratios are outlined below.

- PSPRS-Fire
 - 80% funded ratio in FY ~~2032~~ 2031 versus FY 2034
 - 100% funded ratio in FY ~~2036~~ 2035 versus FY ~~2037~~ 2036
- PSPRS-Police
 - 80% funded ratio in FY ~~2034~~ 2031 versus FY 2044
 - 100% funded ratio in FY ~~2039~~ 2036 versus FY 2047