

# PSPRS Unfunded Liability Talking Points

## Function

- The PSPRS (Public Safety Personnel Retirement System) provides a statewide retirement system for public safety personnel.<sup>1</sup>

## Management

- The Board of Trustees oversee the system's policies, operations, and investments.
- The board consists of nine members, each serving five-year terms.<sup>2</sup>

## Funding

- PSPRS money comes from employee contributions, employer contributions, and net investment income.<sup>3</sup> The equation is as follows:

**Contributions + Investment Earnings = Benefits Payments + Expenses in Administration**

## Funding Ratios of PSPRS across AZ

- An employer's funding ratio indicates the amount of assets that are already available in the trust to present value of future benefits.
- For example, a funding ratio of 100% (commonly called being "fully funded") means there are enough assets in the trust to pay 100% of future expected benefits.<sup>4</sup>
- The majority of employers participating in the PSPRS within AZ are not fully funded.<sup>5</sup>
- As of June 30, 2019, Flagstaff's Fire Department was funded at 36.5% (there are enough assets to pay for 36.5% of present value of future expected benefits).<sup>1</sup>
- As of June 30, 2019, Flagstaff's police department was funded at 38.5% (there are enough assets to pay for 38.5% of present value of future expected benefits).<sup>6</sup>
- Other cities also experience this problem:
  - The Bisbee Fire Department was funded in 2019 at 8.1% and its Police Department at 14.3%

## Unfunded Liabilities across AZ

- Funding ratios of less than 100% create to unfunded liabilities.
- Unfunded liability is debt.
- Flagstaff's PSPRS unfunded liability in 2019 (police and fire) approx. \$112 million.<sup>7</sup>

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<sup>1</sup> <http://www.psprs.com/investments--financials/funding-ratios>

- Other cities around AZ have higher unfunded liabilities:
  - For example, Mesa’s is \$599 million as of 6/30/18.<sup>8</sup>
  - Tempe’s is \$496 million as of 6/1/2017<sup>9</sup>

Paying down Unfunded Liabilities (increased contributions)

- Some jurisdictions have successfully contributed toward paying down the unfunded liability to reach a higher funding ratio:
- Coconino County has paid \$20M into the fund to lower its unfunded liability and is now subject to a funding ratio of 80%. The County used cash balances from Jail District and Capital Facilities Fund.<sup>10</sup>
  - In paying down the unfunded liability, jurisdictions are able to realize more investment earnings; Coconino County has realized \$5M in investment earnings subsequent to paying down the unfunded liability
  - Paying down the unfunded liability can free up monies otherwise encumbered in the General Fund
    - The City of Flagstaff’s PSPRS employer contributions of \$11.3M currently equals 19% of total labor costs in the General Fund; see below matrix

General Fund	Expense	Percentage
Total Labor	59,326,283.00	
Total Pension	13,897,209.00	23%
Total PSPRS	11,277,607.00	19%
Unfunded Portion of PSPRS	8,800,000.00	15%

How Did We Get Here?

- The PSPRS Board of Trustees gives several reasons for the fund’s problems
  1. The 2008 financial market crash greatly reduced the value of PSPRS assets.<sup>111213</sup>
  2. Up until 2016, the Pension Benefit Increase (PBI) formula used was financially unsustainable.<sup>141516</sup>
    - i. When PSPRS produced a positive return greater than 9%, retirees received a PBI. This was basically using one-time money for compounding, permanent ongoing benefits for retirees.
    - ii. This caused the system to lose money.
    - iii. Arizona voters passed a 2016 proposition that changed this formula to make it more sustainable.<sup>17</sup>
  3. PSPRS lost two lawsuits that were filed in response to pension reforms where judges ruled that states can’t change a person’s retirement benefits after their hiring.

- i. This meant that PSPRS had to refund about a quarter of a billion dollars, which negatively impacted municipalities' unfunded liabilities.<sup>18</sup>
4. The assumed earnings rate calculated by PSPRS has decreased over past years; It is currently at 7.3%.
5. There has been a change in mortality assumptions with public safety specific mortality table which show retirees living longer.<sup>19</sup>
6. Payroll growth is another assumption that is changing, with a downward adjustment being anticipated in the months ahead. It is currently at 3.5%. The City of Flagstaff falls significantly short of this.

#### What Flagstaff is Doing – Council PSPRS Funding Policy

- Flagstaff only controls the contribution part of the equation, not how the resources are invested and how benefits are paid out.<sup>20</sup>
- Flagstaff City Council has a PSPRS Pension Funding Policy (Resolution 2019-32)
  - In addition to paying its Annual Required Contribution, Council is also taking additional measures to reduce its unfunded liability, including:
    - Pre-paying the annual contribution at the beginning of each fiscal year to maximize interest payments
    - Making extra contributions when possible:
      - Use tax revenues approved in 2019 will be used as increased contributions starting this year; these increased annual contributions are estimated to be \$ 850,000.
      - If, at the end of the year, the required annual contribution is lower than the pre-paid amount, the City will leave the overpayment with PSPRS (an extra contribution).
      - In a year with the minimum contribution rate is calculated to be lower than prior year, the City will maintain contribution rates at least equal to the prior year's contribution rate.
    - Flagstaff pays the employer contribution for the deferred retirement option plan (DROP) even though not required by PSPRS.
    - Flagstaff pays excess contributions of approximately \$630,000 for the PSPRS Police plan to reduce the amortization period.

#### What Are Other Municipalities Doing?

- City of Prescott - Dedicated 0.75% sales tax to pay down PSPRS, lasts for about 10 years.<sup>21</sup>
- Some cities, such as Oro Valley, Wilcox, are looking at Pension Bonds<sup>22</sup>

## What additional steps should the City of Flagstaff consider

- City staff are consulting with financial advisers to develop funding strategies for the City Council to consider
- City staff are looking at financially prudent measures to pay down the unfunded liability with bond opportunities.
  - There is opportunity with historically low interest rates that make a bond issuance highly favorable to pay down our unfunded liability with lower risk at this time.
  - Bond issuance does not have to be predicated upon increased taxes; other tools may be available such as the issuance of certificates of participation

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<sup>1</sup> [https://azlibrary.gov/sla/agency\\_histories/public-safety-personnel-retirement-system-psprs](https://azlibrary.gov/sla/agency_histories/public-safety-personnel-retirement-system-psprs)>

<sup>2</sup> <http://www.psprs.com/about/board-of-trustees>

<sup>3</sup> [http://cityweb.flagstaffaz.gov/agendaquick/docs/2020/CCWS/20200203\\_988/4491\\_Budget\\_Retreat\\_Presentation\\_February\\_2020.pdf](http://cityweb.flagstaffaz.gov/agendaquick/docs/2020/CCWS/20200203_988/4491_Budget_Retreat_Presentation_February_2020.pdf)

<sup>4</sup> <http://www.psprs.com/investments--financials/funding-ratios>

<sup>5</sup> *ibid*

<sup>6</sup> *ibid*

<sup>7</sup> [http://cityweb.flagstaffaz.gov/agendaquick/docs/2020/CCWS/20200203\\_988/4491\\_Budget\\_Retreat\\_Presentation\\_February\\_2020.pdf](http://cityweb.flagstaffaz.gov/agendaquick/docs/2020/CCWS/20200203_988/4491_Budget_Retreat_Presentation_February_2020.pdf)

<sup>8</sup> <https://www.mesaaz.gov/Home/ShowDocument?id=34449>

<sup>9</sup> <http://documents.tempe.gov/sirepub/cache/1207/tspiqhiewr2cwts4dhmvjhek/2478314903102020035403879.PDF>

<sup>10</sup> <https://www.flagstaffbusinessnews.com/addressing-the-public-safety-personnel-retirement-system/>

<sup>11</sup> [https://www.tucsonlocalmedia.com/news/article\\_95185368-86f2-11e9-b9b6-eb53585dc6b1.html](https://www.tucsonlocalmedia.com/news/article_95185368-86f2-11e9-b9b6-eb53585dc6b1.html)

<sup>12</sup> [https://www.paysonroundup.com/news/arizona\\_state/police-fire-pensions-pose-a-fiscal-hazard-for-counties-towns/article\\_f7a63c0e-c659-52c3-9c90-00ac16488ded.html](https://www.paysonroundup.com/news/arizona_state/police-fire-pensions-pose-a-fiscal-hazard-for-counties-towns/article_f7a63c0e-c659-52c3-9c90-00ac16488ded.html)

<sup>13</sup> [https://www.pewtrusts.org/-/media/assets/2015/07/pewstates\\_statepensiondebttbrief\\_final.pdf?la=en&hash=F1A74DF4CF2CF0B0F272C986B48101A30BD65E3A](https://www.pewtrusts.org/-/media/assets/2015/07/pewstates_statepensiondebttbrief_final.pdf?la=en&hash=F1A74DF4CF2CF0B0F272C986B48101A30BD65E3A)

<sup>14</sup> [https://www.tucsonlocalmedia.com/news/article\\_95185368-86f2-11e9-b9b6-eb53585dc6b1.html](https://www.tucsonlocalmedia.com/news/article_95185368-86f2-11e9-b9b6-eb53585dc6b1.html)

<sup>15</sup> [https://www.paysonroundup.com/news/arizona\\_state/police-fire-pensions-pose-a-fiscal-hazard-for-counties-towns/article\\_f7a63c0e-c659-52c3-9c90-00ac16488ded.html](https://www.paysonroundup.com/news/arizona_state/police-fire-pensions-pose-a-fiscal-hazard-for-counties-towns/article_f7a63c0e-c659-52c3-9c90-00ac16488ded.html)

<sup>16</sup> [https://www.pewtrusts.org/-/media/assets/2015/07/pewstates\\_statepensiondebttbrief\\_final.pdf?la=en&hash=F1A74DF4CF2CF0B0F272C986B48101A30BD65E3A](https://www.pewtrusts.org/-/media/assets/2015/07/pewstates_statepensiondebttbrief_final.pdf?la=en&hash=F1A74DF4CF2CF0B0F272C986B48101A30BD65E3A)

<sup>17</sup> [https://www.tucsonlocalmedia.com/news/article\\_95185368-86f2-11e9-b9b6-eb53585dc6b1.html](https://www.tucsonlocalmedia.com/news/article_95185368-86f2-11e9-b9b6-eb53585dc6b1.html)

<sup>18</sup> *ibid*

<sup>19</sup> *ibid*

<sup>20</sup> [http://cityweb.flagstaffaz.gov/agendaquick/docs/2020/CCWS/20200203\\_988/4491\\_Budget\\_Retreat\\_Presentation\\_February\\_2020.pdf](http://cityweb.flagstaffaz.gov/agendaquick/docs/2020/CCWS/20200203_988/4491_Budget_Retreat_Presentation_February_2020.pdf)

<sup>21</sup> [https://www.tucsonlocalmedia.com/news/article\\_95185368-86f2-11e9-b9b6-eb53585dc6b1.html](https://www.tucsonlocalmedia.com/news/article_95185368-86f2-11e9-b9b6-eb53585dc6b1.html)

<sup>22</sup> [http://cityweb.flagstaffaz.gov/agendaquick/docs/2020/CCWS/20200203\\_988/4491\\_Budget\\_Retreat\\_Presentation\\_February\\_2020.pdf](http://cityweb.flagstaffaz.gov/agendaquick/docs/2020/CCWS/20200203_988/4491_Budget_Retreat_Presentation_February_2020.pdf)