PSPRS

CITY OF FLAGSTAFF
APRIL 23, 2020

SERVING THOSE WHO SERVE OTHERS

UNDERSTANDING PENSIONS

1. Unfunded liabilities
2. Funded status/rate
3. Pension funding formula

Starting Thoughts

- Critical financial issue facing taxpayers
  - 6/30/18 unfunded pension liability = $8.8 billion
  - 46% funded
- It's debt
- It's not **IF** the unfunded liability will be paid off, it is **WHEN AND BY WHOM**
- Depending on other factors, such as payroll growth, annual required contributions (ARC) may not be enough to reduce employer unfunded liabilities

Starting Thoughts

Reform **DOES NOT** reduce current Tier 1 and 2 unfunded pension liability (legacy costs)

- Reforms created tier 3 membership that has lower employer costs than tiers 1 and 2
- Prop 124 in 2016 replaced costly investment return-based permanent benefit increase (PBI) with simple annual cost-of-living-increase capped at 2 percent
- COLA savings already factored into actuarial valuations and contribution rates
  - System-wide savings of estimated $475 million

Defined Benefit

What the numbers are ***AND*** how the numbers are calculated. Basic example:

- Actual liability, at retirement it will be paid
  - Years of service x % multiplier
    - Tier 1, 25 years of service = 62.5%
  - 62.5% x average compensation
    - 62.5% x $80,000 = $50,000 annual pension

- Estimated liability
  - Estimated present value of the future liabilities
  - Based on actuarial assumptions

Unfunded Liability

Assets

- Market value of assets are the assets as of TODAY!

Liabilities

- All future pension benefits earned as of today
- Considers all future pension payments to be paid
- Discounted to present value
  - Discounted at the assumed rate of return on assets

- The difference is the over funded or unfunded liability.

Funded status (funded ratio)

$$\frac{\text{Market value assets}}{\text{Liabilities (present value)}}$$

- Identifies the assets available to fund the liabilities (***in today's dollars***)
- Goal: 100% funded

Pension funding equation

$$C + I = B + E$$

Contributions Interest Benefits Expenses

Unfunded liability (debt)

- PSPRS liabilities are not pooled (256 plans)
  - Unfunded liabilities have been ***earned*** and cannot be diminished or impaired
    - Pension clause and Field's decision

- A more appropriate term for unfunded liabilities is *debt, it is owed!*

  The ***amount and timing*** of your contribution directly impacts the funded status of your plan
  - Every additional dollar contributed today, can earn investment returns
  - Every additional dollar not paid is a lost opportunity to earn investment returns

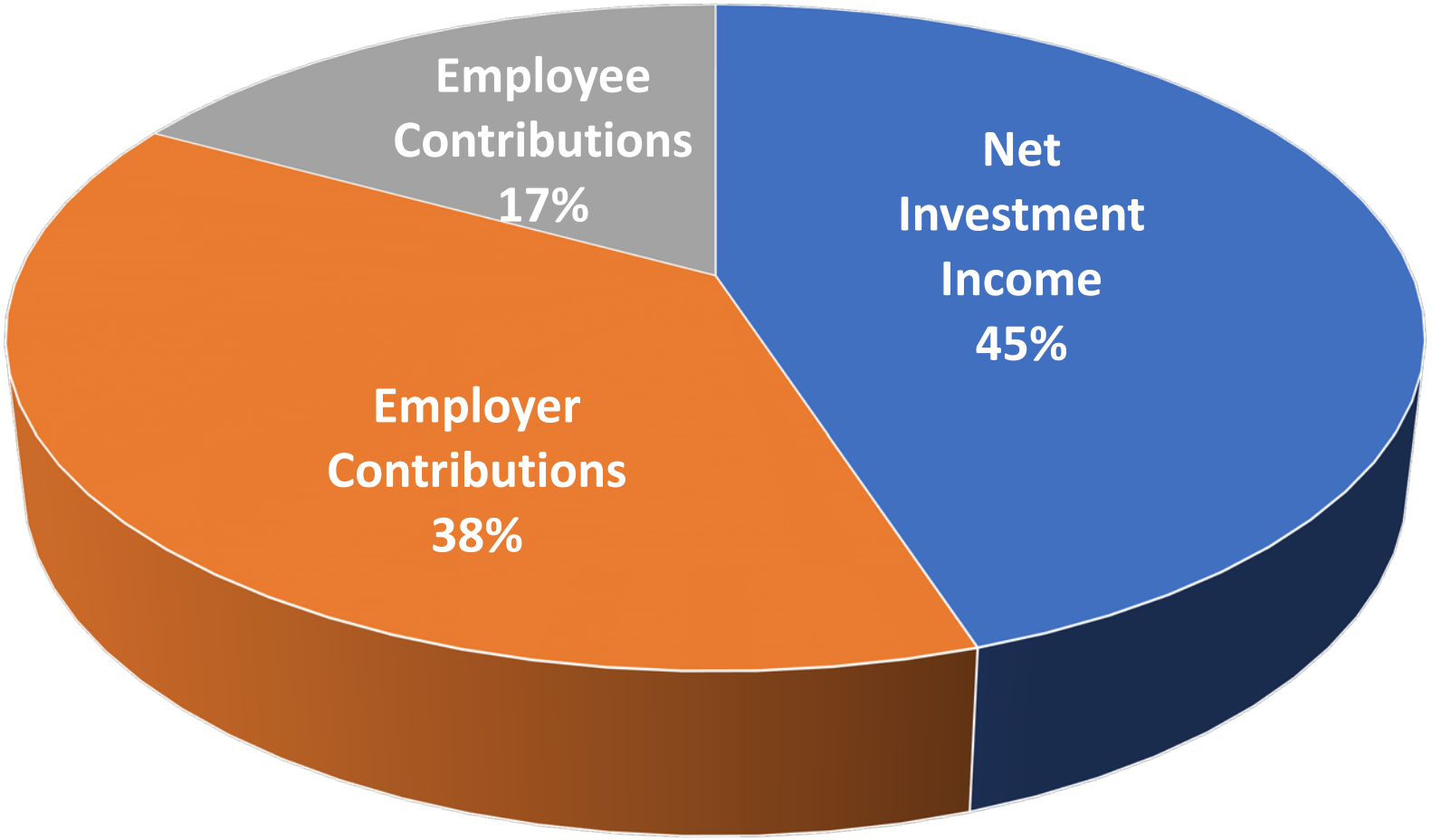
Contributions have 2 components

1. Normal cost: Annual cost of pension benefits *"earned"* in the current year
2. Unfunded liability: Cumulative effect of *previous* normal costs not funded
   - Amortized similar to a mortgage

- The present value of liabilities "earned" in the current year equate to normal cost

Where does the money come from?

PSPRS system wide



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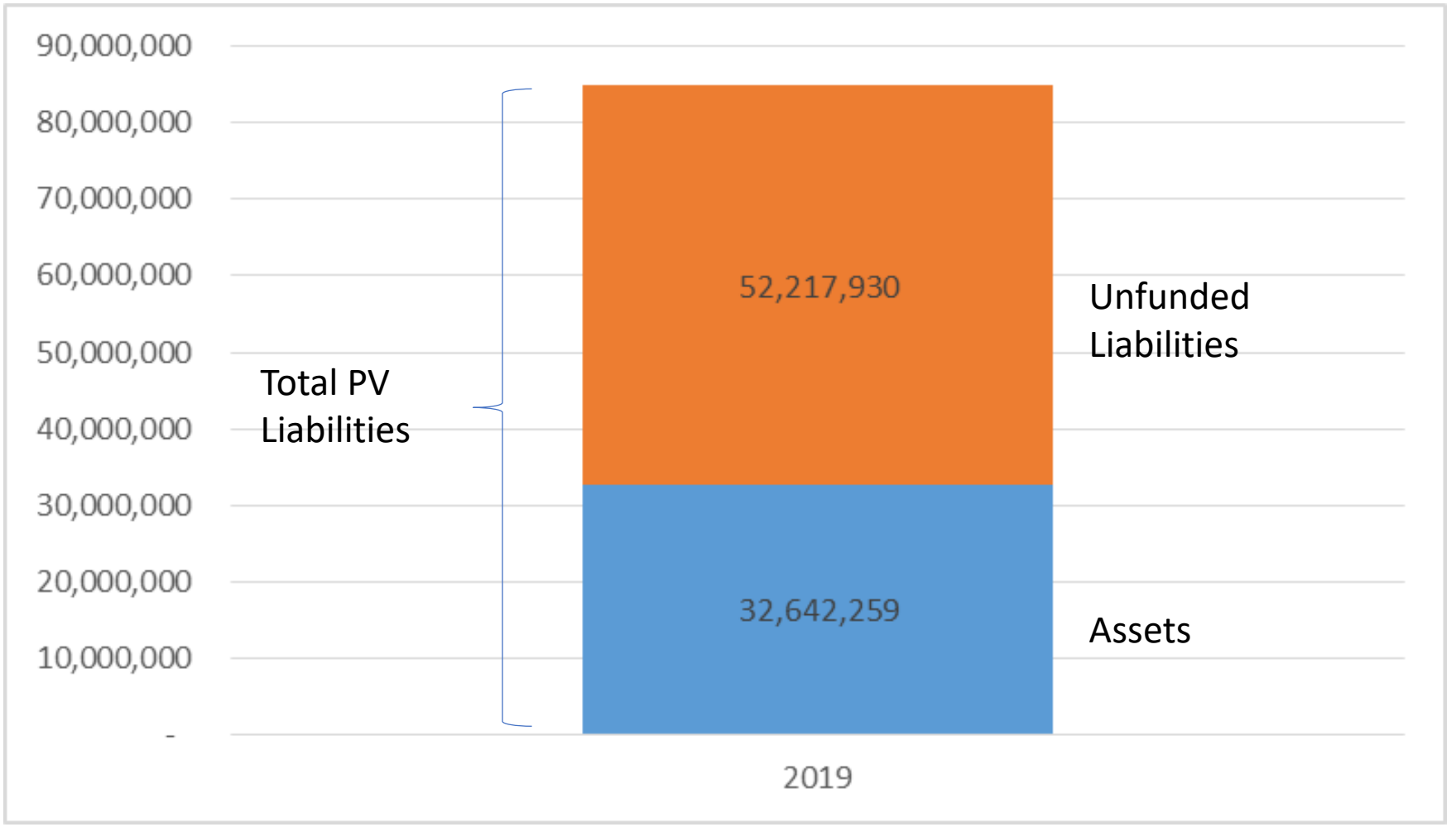
Actual numbers from the police plan, the fire plan would use the same math

City of Flagstaff - Police



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- Investment returns are earned on the $32.6 million in assets
- If this plan were 100% funded, investment returns would be earned on $85 million in assets
- Regardless of the funded status, the total $85 million liabilities will be discounted one less year in FY 2020

City of Flagstaff – Police

- Increased assets
- Investments + contributions = $6,298,730
- Increased liabilities
- Present value of liabilities discounted one less year

	Assets
Begin FY19	32,642,259
Investments	2,382,885
Conribution	3,915,845
Ending FY19	38,940,989

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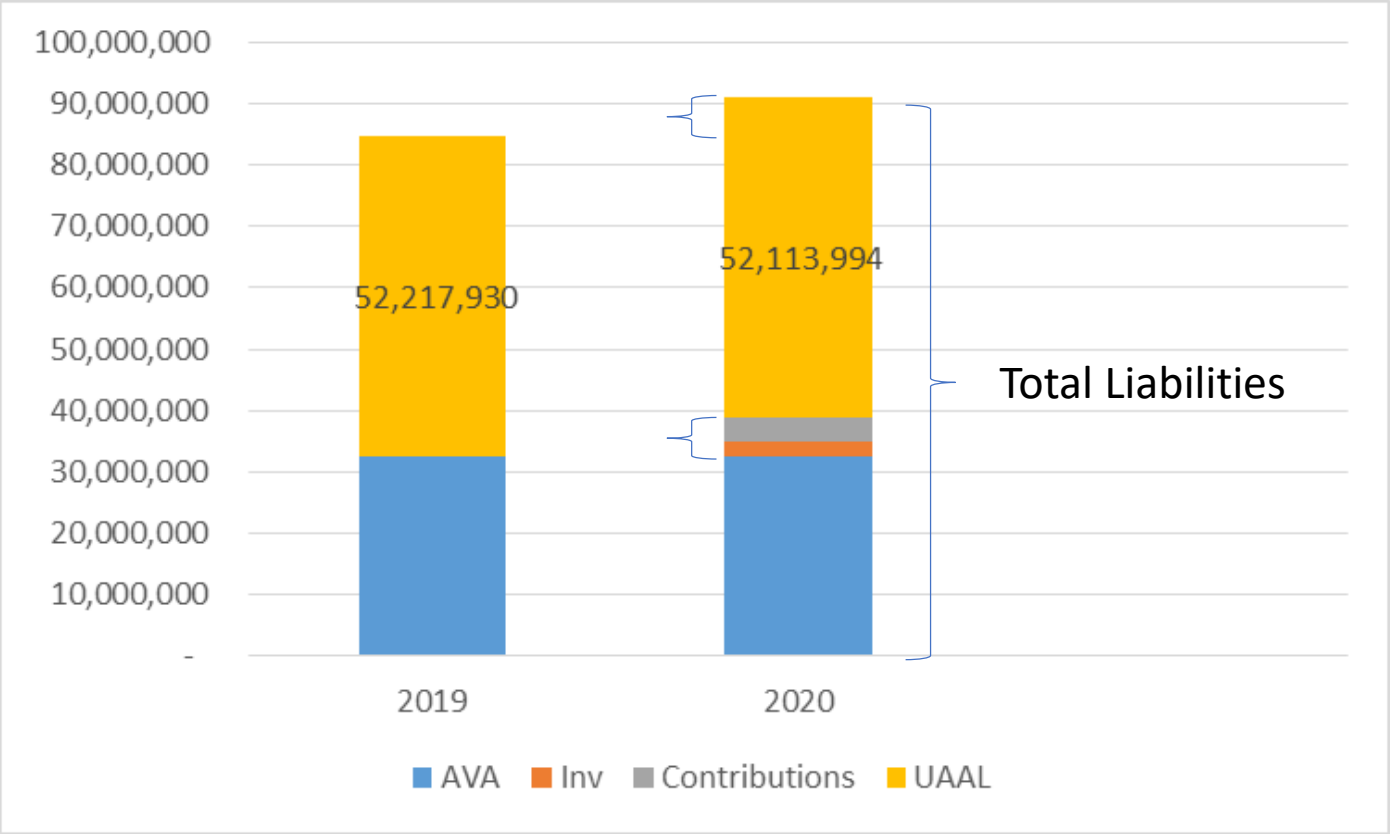
2019	84,860,189
2020	91,054,983
Change	6,194,794

City of Flagstaff – Police



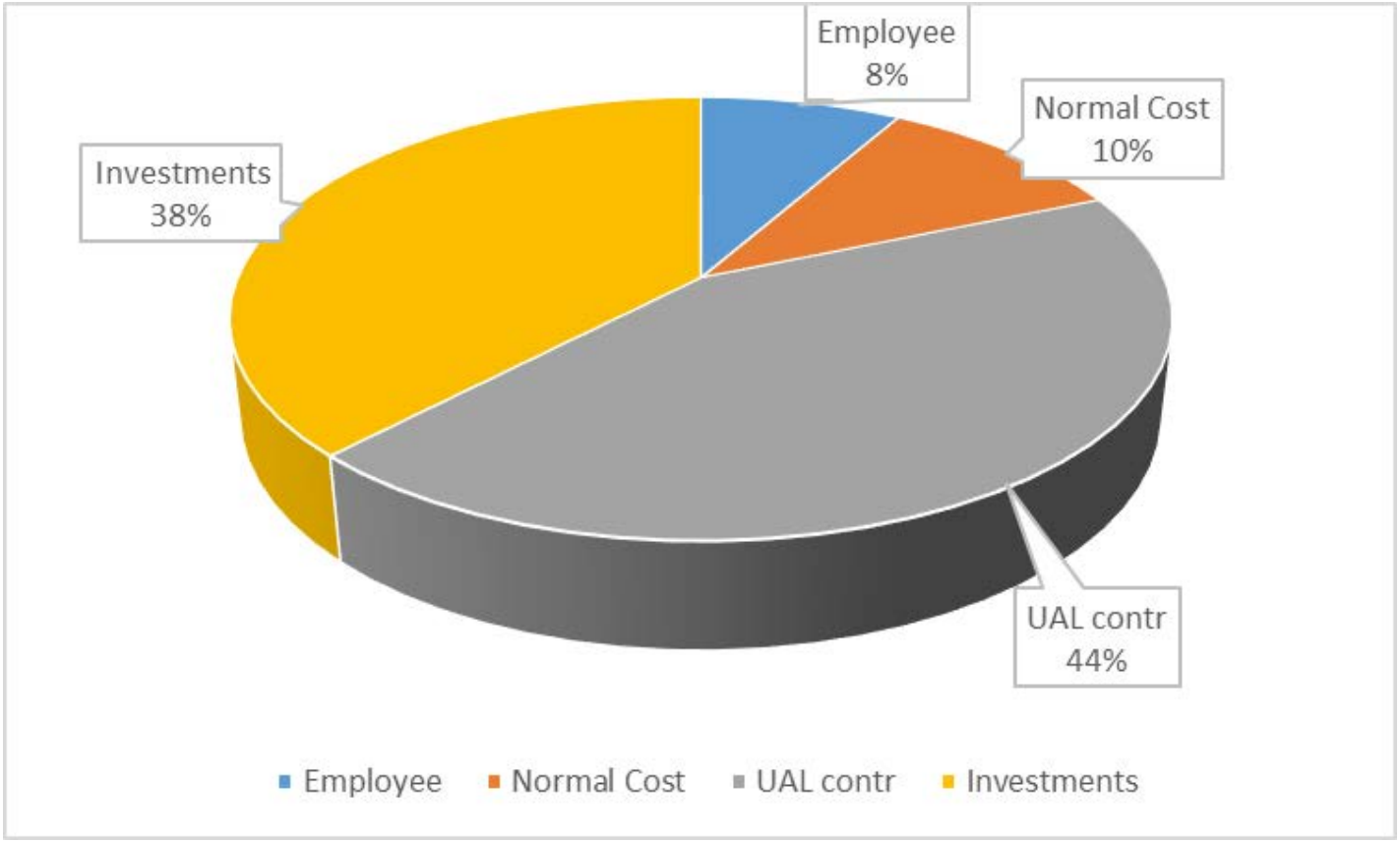
	Unfunded Liab
2019	52,217,930
2020	52,113,994
Change	(103,936)

Pension Funding Equation

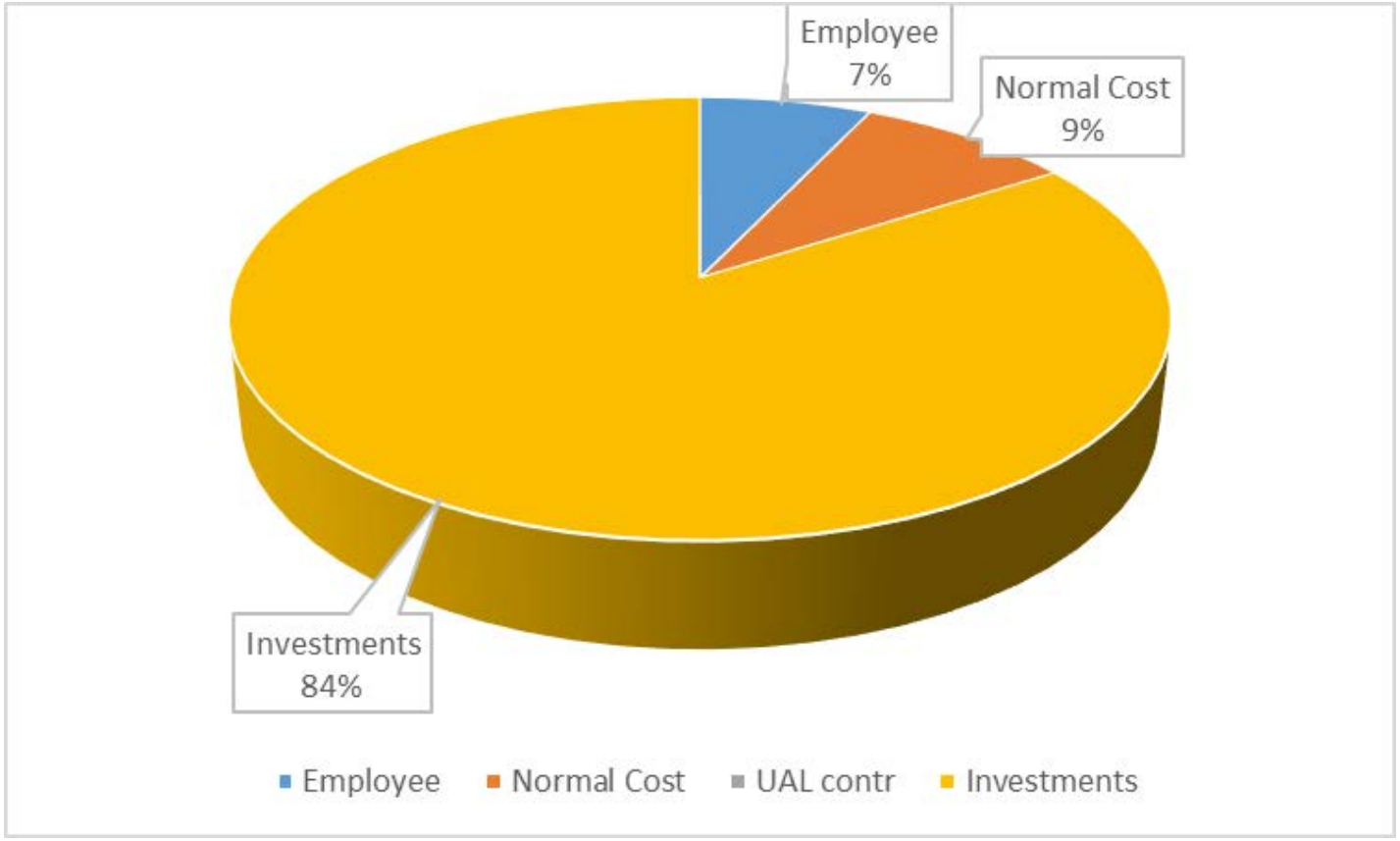
$$C + I = B + E$$

Contributions Invest Benefits Expenses

City of Flagstaff – Police FY 2020



City of Flagstaff – Police if 100% funded



City of Flagstaff – Police

Payroll growth and negative amortization

Contributions = $3,915,845

- Your actual payroll impacts actual contributions
  - Actuarial payroll growth assumption 3.5%
    - Zero payroll growth reduces contributions $137,055
  - Vacancies

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C + I = B + E

Contributions Invest Benefits Expenses

- Investment returns will not solve large unfunded liabilities.
- Additional contributions leverage investment opportunities.
- Over a 17 year amortization cycle, $1 million will save taxpayers an estimated $1.8 million, and the original $1 million will still be in the fund.

QUESTIONS, COMMENTS, AND DISCUSSION