

City of Flagstaff



Public Safety Personnel Retirement System (“PSPRS”) Contingency Reserve Fund (“CRF”) Policy June 2020

1. Background

- a. The City desires to fully fund its PSPRS Flagstaff Police and Fire Plans (“Plans”). As of June 2020, Plans constitute a debt of the City. The City has determined it is financially prudent to appropriately fund these pension plans and help improve the long term finances of the City.
- b. The City is issuing Pension Certificates of Participation (COPS) encumbering certain City real properties and will deposit a portion of the proceeds in the PSPRS Flagstaff Police and Fire pension funds and a portion for two Contingency Reserve Funds.
- c. The City has the goal to be at or near 100% funded for both Plans.

2. Purpose of the Contingency Reserve Funds

- a. The purpose of this policy is to set forth the rules of managing the CRF effectively. The goal is to mitigate the impact of 1) investment return volatility and 2) changes in select actuarial assumptions (as defined herein) made within the PSPRS plans for Flagstaff Police and Flagstaff Fire (“Plans”).

3. Establishment of Contingency Reserve Funds and Initial Deposits

- a. The City is establishing separate contingency reserve funds for Police and Fire, because each Plan is independently managed by PSPRS.
- b. The initial deposit for the Police CRF and the initial deposit for the Fire CRF will be funded with COPS proceeds. Sizing of the Contingency Reserve Funds is discussed further below in this policy.
- c. The City will manage each CRF separately and the deposits and draws will be managed based on each Plan’s changes. Each Plan’s changes are summarized by PSPRS actuaries on an annual basis at the end of the fiscal year, and the City receives a copy of the annual report.

4. Rules for Investments

- a. The City will be managing and investing the CRFs. Investments made by the must comply with the requirements found in Arizona Revised Statutes Section 35-323 and the City’s Investment Policy.
- b. Investments shall be principal protected so that the City does not lose value in the deposited amounts.
- c. Gross funded by principal deposits, not to include expected investment earnings.
- d. Investments shall be invested in no more than one-year increments to allow for liquidity in the 1st quarter of each calendar year.

- e. Proceeds should only be invested in liquid and/or short-term products to ensure prompt availability of funds.
- f. The City will prioritize the investments of these funds with a local bank.
- g. City may have the opportunity to utilize a pension stabilization trust to manage investment of CRF proceeds. These are irrevocable trusts created under Internal Revenue Service Section 115.

5. Rules for Contingency Reserve Funds Draws

- a. The City will establish a minimum fund balance threshold based on the initial deposit into the CRF.
- b. Draws will first be made from investment income only, while the principal balance remains untouched.
- c. Establish a funded ratio threshold, where if the CRF balance rises 5% above the minimum fund balance and the pension plan is fully funded, the City may draw all or a portion of the 5% to supplement the City's annual required employer contribution for the Plans.
- d. Market Draw: The City may draw from a CRF when investment return for the Plans for the prior fiscal year is below the actuarial rate of return.
- e. Actuarial Draw: The City may draw from a CRF when the PSPRS annual report for the Plans show a revision of the assumed earnings rate assumption, changes to payroll growth assumption, and/or revisions to mortality assumption occur and cause an impact on Unfunded Actuarial Accrued Liability for the Plans in excess of a defined threshold.

6. Rules of Replenishment for the Contingency Reserve Funds

- a. After the fiscal year of bond issuance and for the following five fiscal years of the bonds, the City shall only commit savings derived from the issuance of the COPS to help pay one time operational costs of the General Fund so that should the CRF fall below minimum fund requirements in a given fiscal year, savings may be used to replenish the CRF.
- b. The City will review unspent budget appropriations for PSPRS pension expenditures annually and may consider adding to the CRF.
- c. Should the CRF balance fall below the minimum fund balance, the City will prioritize making replenishments over no more five years.

7. Sizing of Contingency Reserve Funds

- a. The City will review the CRF funding levels at least every five years to assure adequate reserves.
- b. Police CRF
 - i. Size initial deposit to manage "worst case" scenario of all permitted draw events (market volatility and actuarial changes) occurring in one valuation
 - ii. Market. \$2,836,000; size initial deposit to calculated on the average of a 10% market loss and up to three years of new Unfunded Actuarial Accrued Liability ("UAAL") payments that would be created if PSPRS experienced 20% loss

compared to the average earnings rate in year 1 of issuing pension bonds.

- iii. Actuarial. \$4,014,000; size initial deposit to manage up to three years of new UAAL payments that would be created if the assumed earnings rate was revised to 7%, payroll growth increased and/or PSPRS adopted a new mortality table.

c. Fire CRF

- i. Size initial deposit to manage “worst case” scenario of all permitted draw events (market volatility and actuarial changes) occurring in one valuation
- ii. Market. \$3,170,000; size initial deposit to calculated on the average of a 10% market loss and up to three years of new UAAL payments that would be created if PSPRS experienced 20% loss compared to the average earnings rate in year 1 of issuing pension bonds.
- iii. Actuarial. \$4,219,000; size initial deposit to manage up to three years of new UAAL payments that would be created if the assumed earnings rate was revised to 7%, payroll growth increased and/or PSPRS adopted a new mortality table.

8. Rules to Dissolve Contingency Reserve Funds

- a. Upon the repayment of the final debt service payment for the Pension COPS, staff will seek Council direction to dissolve or continue the CRF. The City could dissolve the CRF and apply the remaining balance of funds to other retiree benefits, other post-employment benefits (OPEB), annual required contributions or General Fund.