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## *Administration and Projects Committee* **STAFF REPORT**

**Meeting Date:** February 06, 2025

<b>Subject</b>	<b>Approval of a Lump Sum Payment to the California Public Employees' Retirement System (CalPERS) to Pay Off the Authority's Unfunded Actuarial Accrued Liability (UAAL)</b>
<b>Summary of Issues</b>	The Authority contracts with CalPERS to provide pension benefits for its retirees. CalPERS determines each year, based on actuarial methods, a percentage rate of regular salary required to fund earned pension benefits. If the total amount of accumulated contributions is less than the total forecasted cost of earned pension benefits, the difference represents a UAAL. Staff has recently completed a cost savings analysis to eliminate this liability by a lump sum payment of \$2,428,000.
<b>Recommendations</b>	Staff seeks approval of Resolution 25-05-A which will allow for a lump sum payment to CalPERS in the amount of \$2,428,000 to pay off the Authority's UAAL as of June 30, 2023.
<b>Staff Contact</b>	Brian Kelleher
<b>Financial Implications</b>	The proposed lump sum payment will reduce the Authority's UAAL and represent a cost reduction on future interest based on a 15-year amortization in the amount of \$1,736,668.
<b>Options</b>	The Authority could elect not to approve this resolution and continue to finance the cost of the UAAL on an annual amortization payment plan.
<b>Attachments (See APC Packet dated 2/6/25)</b>	<b>A.</b> Resolution 25-05-A <b>B.</b> CalPERS Lump Sum Payment Request form – Classic

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<b>Changes from Committee</b>	<b>C. CalPERS Lump Sum Payment Request form – PEPR</b>  <i>None</i>
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**Background**

Public pensions are often a topic of public discussion, including concerns over the cost to fund current and future pension obligations. The Authority's track record in this regard has been proactive. For instance, the Authority has limited its pension costs by retaining its more conservative plan of 2% at 55, when many agencies in the early 2000s moved to more generous and expensive plans including 2.5% at 55, 2.7% at 55, or 3% at 60. Another example is that the Authority did not add optional "spiking" pension benefits that have since been prohibited by recent State pension reform legislation.

In May 2015, the Authority Board approved Resolution 15-17-A for the pay off amount of \$2,210,110, which eliminated the UAAL as of June 2015.

In February 2019, the Authority Board approved Resolution 19-05-A for the pay off amount of \$1,238,094 which eliminated the UAAL as of June 2018.

In December 2016, the CalPERS Board of Administration, approved lowering the CalPERS discount rate assumption, the long-term rate of return, from 7.5% to 7.0% over a three-year period starting with the valuation date of June 2016. Subsequently, in July 2021, the CalPERS Board of Administration voted to lower the discount rate from 7.0% to 6.8% due to the Funding Risk Mitigation Policy (Policy). This Policy lowers the discount rate in years of good investment returns to reduce risk in the portfolio. The Policy automatically lowered the discount rate when CalPERS achieved an investment return of 21.3% for Fiscal Year (FY) 2020-21. The next review of this Policy by CalPERS will occur in 2025.

Lowering the discount rate means plans will see increases in both normal costs (the cost of pension benefits accruing in one year for active members) and the accrued liabilities. These increases will result in higher required employer contributions. The Authority has seen an increase in employer contribution rates over the last ten years. The Authority's contribution rate has increased from 8.377% in FY 2016-17 to 11.94% scheduled for FY 2025-26.

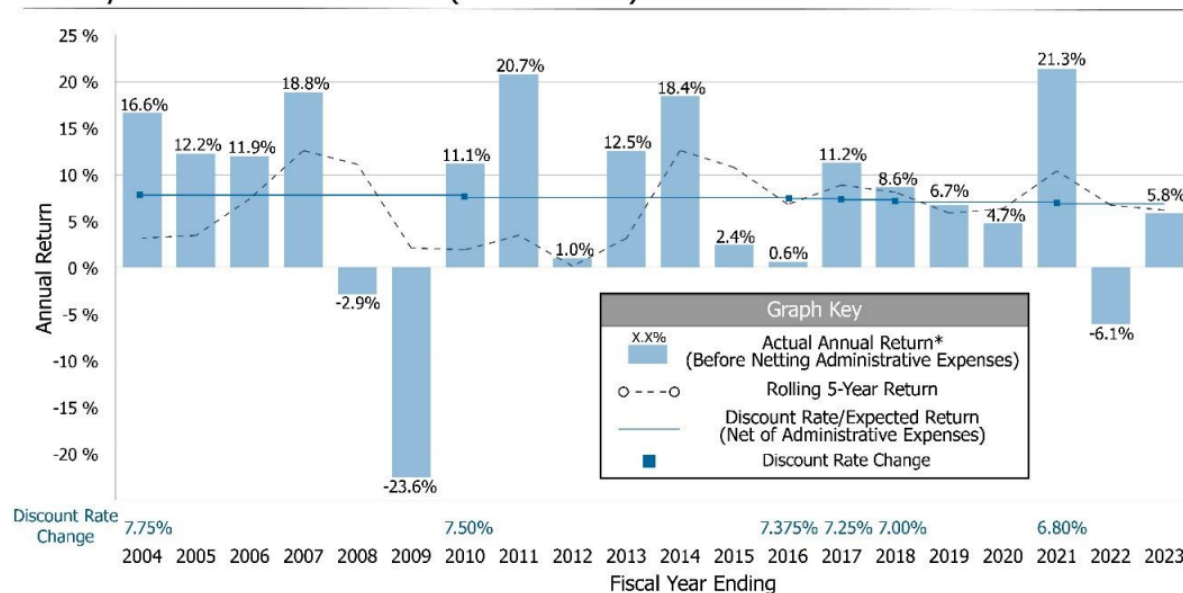
CalPERS projects the benefits of reducing the discount rate to include: strengthening the

long-term sustainability of the fund; reducing negative cash flows; additional contributions from participating agencies will help to offset the cost to pay pensions; reducing the long-term probability of funded ratios falling below undesirable levels; improving the likelihood of CalPERS investments earning their assumed rate of return; and reducing risk of contribution increases in the future from volatile investments markets.

The change in the discount rate is only one of the factors that has impacted our Authority's UAAL. The Authority is a participant of the CalPERS Pool and shares the risks and will experience gains/losses with regard to investments and other assets based on our percentage of the pool.

The investment and assets held by CalPERS are in excess of \$530 billion and are well diversified. These investment and asset returns can fluctuate year-to-year and play a role in the current funding of the pension plan. The chart below shows the net investment return over the last ten years. The years 2004-2023 saw investments returns far below and above the discount rate assumptions, which resulted in a higher or lower UAAL for the Authority. Any future years with investment and asset returns above 6.8% will be reflected in our annual actuarial valuation.

### History of Investment Returns (2004 - 2023)



As a result of past contributions, changes in the discount rate assumptions and the long-term

rate of return on assets held by CalPERS, the Authority's current funding values as of June 30, 2023, now reflects a pension liability of \$2,639,735 or a funded status of 87%.

In January 2025, staff worked with the CalPERS Actuarial Office to determine the estimated pay off assumptions that includes the preliminary FY 2023-24 investment return of 9.3%. Including the recent fiscal year investment return which will reduce the pay off amount necessary to \$2,428,000.

CalPERS has estimated the pay off amount to be \$2,428,000 as of February 20, 2025. CalPERS applies a fifteen-year amortization schedule that outlines the annual payments necessary to pay the unfunded liability on an annual basis. If the Authority should elect to follow this schedule, current interest payment projections would total \$1,736,668 in accumulated interest over fifteen years.

Staff has evaluated the effectiveness of paying off this liability from the Authority remaining Measure C reserves. There is no guarantee the plan will remain fully-funded. Future funding status depends on a number of factors, including future actual asset returns and any additional changes in assumptions.

Paying off the Authority's unfunded pension liabilities will achieve the following benefits:

- Strategic management of fiscal resources to address future liabilities.
- Enhance the Authority's credit profile with bond rating agencies and bond investors.
- Reduce the Authority's annual cash flow requirement by eliminating the costs associated with carrying UAALs from year to year.
- Improve long term efficiency of the Authority's balance sheet by investing cash assets earning less than 4.5% with CalPERS which has a long term expected 6.8% return.
- Annual reviews of the Authority's UAAL to ensure that the future pension benefits will be there for the past, present and future employees.

The amount of savings in future years depends on actuarial adjustments and actual investment returns of pension assets. On occasion, CalPERS may change certain actuarial assumptions, for example, adopt new longevity and discount rate assumptions that may

create a new unfunded pension liability. Additionally, CalPERS will adjust employer contribution rates to account for actual investment gains and losses which may impact the Authority's funding status. In other words, the proposed lump sum payment does not preclude the Authority from ever having an unfunded or overfunded pension liability in the future.

The proposed source for the lump sum payment of \$2,428,000 is an accumulation of investment income earned in the Authority's Measure C reserve. The reserve balance is in excess of programmed amounts for remaining Measure C projects, and there are no remaining Measure C obligations.

Staff seeks approval of Resolution 25-05-A which will allow for a lump sum payment to CalPERS in the amount of \$2,428,000 to pay off the Authority's UAAL as of June 30, 2023.

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