Agenda MEMORANDUM

Finance Department

To: City Council

From: Gary Young, Director

Date: March 26, 2021

Workshop Meeting Date: April 5, 2021

SUBJECT:
Discussion on unfunded pension obligation and receive direction from Council as it relates to: target funding ratio; potential to issue taxable pension bonds to convert the unfunded pension obligation to bonds and capitalize on potential savings from current low interest rates to achieve funding ratio; make additional lump sum contributions to achieve funding ratio; continue using higher contribution rates (Budget Cycle) to achieve funding ratio; and/or use a combination of all of the above to achieve the desired funding ratio. If Council chooses to issue taxable pension bonds, Council must consider amount and duration to achieve objective. Council must also consider other factors impacting target ratio including assumed rate of return and plan changes when contemplating any decision of the goal of achieving their target funding ratio.

BACKGROUND:
Naples City Council members have asked staff to coordinate a discussion of the unfunded pension liability of the City.

The following table compares the funded pension ratios and total unfunded pension liability from the pension actuarial report for 10/1/2010 to the same data as of 10/1/2020.

10 Year Analysis

Assumed Rate	7.50%			7.00%	
	10/1/2010	Ratio		10/1/2020	Ratio
Police Pension	$ 22,680,232	57.67%		$ 17,386,290	76.70%
Fire Pension	$ 19,767,031	58.86%		$ 14,396,587	81.20%
General Pension	$ 22,555,900	64.30%		$ 13,111,464	82.70%
Total	$ 65,003,163			$ 44,894,341	

The unfunded actuarial accrued liability, which totals $44.89 million as of 10/1/2020, is the difference between the actuarial accrued liability and the actuarial value of assets. The funded ratio is the actuarial value of the plan's assets divided by the actuarial accrued liability as measured in the actuarial report. A fully funded plan would have a 100% ratio (great). A funded ratio 90% or greater would be very good. A funded ratio greater than 80% would be considered acceptable. Although a plan with less than 80% funded ratio may be financially sound, the public policy goal is often aimed toward a 100% funded ratio.

Funded status is only one measure of the degree to which a pension plan is on course. Other factors to consider are the financial strength of the sponsor backing the pension, the overall economy, and the trend of the funded ratios, all of which could show whether a plan is in distress. A pension plan can remain underfunded for decades without causing fiscal stress for the plan sponsor or the participants. Changes in plan assumptions may change the funded ratio, up or down. Lowering the investment return assumption would have an immediate impact of *decreasing* the funded ratio, yet then, the plan may be better situated for meeting its long-term expectations.

The trend of the funded ratios should be reviewed. Even plans that are fully funded can have their funded status increase or decrease every year, due to the changing economic environment. Plans should expect to have funding status vary from year to year, because of external events. Generally, the funded ratio of a plan increases when there has been strong economic growth and investment returns. Conversely, the funded ratios would be expected to decrease when there had been several years of weak investment returns.

The following table provides an analysis of the most recent four-years of actuarial reports. This table includes outlining the changes in the assumption rate of return on investment, value of the unfunded liability, and the ratio of funding for each pension plan.

Assumed Rate	7.50%		7.40%		7.30%		7.00%	
	10/1/2017	Ratio	10/1/2018	Ratio	10/1/2019	Ratio	10/1/2020	Ratio
Police Pension	$ 18,577,751	72.40%	$ 16,808,352	75.60%	$ 16,882,168	76.30%	$ 17,386,290	76.70%
Fire Pension	$ 12,542,920	80.80%	$ 12,232,829	82.40%	$ 12,771,082	82.10%	$ 14,396,587	81.20%
General Pension	$ 13,452,854	80.30%	$ 11,850,381	83.00%	$ 11,209,942	84.20%	$ 13,111,464	82.70%
Total	$ 44,573,525		$ 40,891,562		$ 40,863,192		$ 44,894,341	

The Naples pension plans have undergone measured and methodical changes since 2017 including: the assumed rate of return from 7.50% to 7.00%; changed the amortized length for the unfunded actuarial accrued liability from 30yrs to 15yrs. Changed the amortized length for: experience gains and losses from 30yrs to 10yrs, assumption/method changes from 30yrs to 20yrs, while leaving the benefit changes at 30 years. In addition, the FY 2020 budget included adding an employer contribution rate in-excess-of the required actuarial contribution rate. This contribution rate change for FY 2020, resulted in an additional $704,290 contribution, across all plans, greater than the required contribution.

The following table provides the FY 2021 actuarial required contribution rate, the additional contribution outlined in the budget, and the total contribution rate for FY 2021.

FY 2021 Actuarial -vs- Actual Contribution Rate

	Actuarial Contribution Rate Employer	Additional Contribution Rate Employer	Budgeted Contribution Rate Employer
Police Pension	37.01%	8.99%	46.00%
Fire Pension	42.98%	5.02%	48.00%
General Pension	11.32%	1.68%	13.00%

The additional contribution rate outlined in the table above is expected to yield an extra $750,000 across all pension plans in FY 2021.
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Council has many factors to consider. It is the hope that the presentation, the actuarial reports for each plan, the costs analysis for issuing taxable pension bonds, and insight into how Naples funding ratios compare across the State of Florida assist you in your discussion and deliberation.