

**CITY OF DANA POINT
COUNCIL POLICY**

SUBJECT: Pension Funding Policy	PAGE: 1 of 4	EFFECTIVE DATE: 5/3/2022	POLICY NO.: 235
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PURPOSE

The purpose of this Pension Funding Policy (“Policy”) is to provide procedures related to fiscal protocols for the City regarding a process to address any Unfunded Accrued Liabilities (“UAL”) that develops, as calculated annually by CalPERS, and maintain a healthy funded status. The UAL is the difference between plan assets and the estimated current and expected future cost of pension obligations (accrued liability). Changes in UAL occur when the actual results of fund activity (interest earnings, member mortality, disability rates, etc.) is different from the assumptions used in previous actuarial valuations.

This Policy outlines the City Council’s position on pension funding goals and methods to fund UAL cost. Funding a defined benefit pension plan requires a long-term horizon. As such, the City will review this policy at least annually to determine if changes to this policy are needed to ensure adequate resources are being accumulated.

BACKGROUND

The City provides defined benefit retirement benefits through the California Public Employees’ Retirement System (CalPERS). CalPERS is a multiple-employer public employee defined benefit pension plan. The City participates in a risk pool of other agencies with less than 100 employees. For employees hired prior to January 1, 2013, the City participates in a 2% at 55 Risk Pool (Classic Miscellaneous Plan). For new CalPERS employees hired after December 31, 2012, the City participates in a Miscellaneous 2% at 62 Risk Pool (PEPRA Miscellaneous Plan).

All full-time and certain part-time City employees are eligible to participate in CalPERS. CalPERS provides retirement and disability benefits, annual cost of living adjustments and death benefits to plan members and their beneficiaries. CalPERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by State statute.

The financial objective of a defined benefit pension plan is to fund the long-term cost of benefits provided to the plan participants. In order to assure that the plan is financially sustainable, the plan should accumulate adequate resources in a systematic and disciplined manner over the active service life of benefitting employees.

**CITY OF DANA POINT
COUNCIL POLICY**

SUBJECT: Pension Funding Policy	PAGE: 2 of 4	EFFECTIVE DATE: 5/3/2022	POLICY NO.: 235
---	------------------------	------------------------------------	---------------------------

FUNDING GOAL/TIMELINE

To recognize that a responsibly funded plan can easily have its funded status vary significantly from one year to the next solely because of external events that do not always meet actuarial assumptions, it is the overall objective to fund the City's CalPERS pension plan up to 100% of the total accrued liability, but no less than 90%. By using funding components outlined in this policy, it is the City's intent to achieve its overall funding objective by FY 2027-28.

When referring to the City's pension plan funded status, it can be inferred that funded status shall be measured to include both the Classic and PEPRA plans combined. It is estimated that the typical employer plan with CalPERS will transition to having all active employees as PEPRA members within 10-15 years. This Policy is meant to address the long-term funded status of the City's pension plan, so it is important to recognize the combined funded status to account for the future shift from Classic to PEPRA members.

The funded status, as it pertains to this policy, is a combination of plan assets held by CalPERS and the City's Section 115 Pension Trust. Section 115 Trust assets can only be used for pension related expenses and as such are truly pension related assets the City holds. *(Example: If the most recent CalPERS actuarial valuation reports the City has a funded status of 90% with a UAL of \$2 million and the City holds at least \$2 million in its Section 115 Trust, the pension liability shall be viewed as being 100% funded.)*

FUNDING STRATEGY

In order to meet its funding goals, the City may use Additional Discretionary Payments (ADP) directly to CalPERS, funds held in an IRS Section 115 Pension Trust, or a combination of both.

Additional Discretionary Payment (ADP)

Public agencies may make Additional Discretionary Payments (ADP), beyond the annually required CalPERS Actuarially Determined Contributions (ADC), at any time and in any amount to increase the plan's funded status, reduce the agency's UAL, and achieve long-term interest savings. The discount rate has the effect of being the interest rate charged by CalPERS on any unfunded liabilities. As a result, the City is, in essence, currently paying 6.8% interest on its unfunded liabilities.

The City's UAL is an accumulation of amortization bases that either carry a loss or gain for a particular prior investment. The total Unfunded Liability of a plan can be

**CITY OF DANA POINT
COUNCIL POLICY**

SUBJECT: Pension Funding Policy	PAGE: 3 of 4	EFFECTIVE DATE: 5/3/2022	POLICY NO.: 235
--	-------------------------------	---	----------------------------------

segregated by "cause," creating "bases" and each such base is separately amortized and paid for over a specific period of time. However, all bases are amortized using investment and payroll assumptions from the current valuation. Paying off or reducing the balance of a loss amortization base creates interest savings by eliminating/reducing future interest accruals.

Section 115 Pension Trust

The City has established a Section 115 Pension Trust, which is administered by Public Agency Retirement Services (PARS), to prefund pension liabilities. Vanguard provides investment management services of Trust assets. This resource is critical for providing security from changes to required contributions due to CalPERS actuarial assumption changes, actuarial methodology changes, and fund gains and losses. Section 115 funds can only be used for pension related expenses including but not limited to making ADPs and smoothing out ADCs. City Council approval is required for use of accumulated funds in the Section 115 Trust. Section 115 Trust withdrawal guidelines include the following:

- Paying off specific amortization bases by making ADPs that are anticipated to result in interest savings greater than interest earnings on the Trust Fund.
- The General Fund has a structural deficit that needs to be addressed (i.e., nondiscretionary expenditures exceed revenues). The General Fund deficit can be in the near term or identified in the City's Long-Term Financial Plan. Trust assets may be used toward required payments to CalPERS to provide relief to the General Fund.
- Other uses deemed necessary as part of the Annual Assessment process.

Once the Funded Status goal is met, additional uses of Section 115 Trust assets are as follows:

- During either the biennial budget development process or mid-year budget review, a request to use Section 115 Trust funds towards employer normal cost contributions can be made should the combined funded status reach 110% or more.
- No earlier than FY28, Section 115 Trust assets may be used to smooth out annual required UAL payments so that the annual required contribution from the General Fund does not exceed \$500,000 if the combined funded status is greater than 95.0%.

**CITY OF DANA POINT
COUNCIL POLICY**

SUBJECT: Pension Funding Policy	PAGE: 4 of 4	EFFECTIVE DATE: 5/3/2022	POLICY NO.: 235
--	-------------------------------	---	----------------------------------

ANNUAL ASSESSMENT

CalPERS completes new actuarial valuation reports which are typically provided to member agencies no later than September each year. The reports reflect actual experience as of June 30th the year prior to the publish date. The plan's UAL may increase or decrease from year to year due to the plan's investment returns, actuarial assumption, and/or methodology changes. An annual review shall take place after receipt of the updated CalPERS actuarial valuation to determine if the City is on course to achieve/maintain its target funded status or additional measures are needed. The results of the review and any recommendations shall be presented to the City's Financial Review Committee at its scheduled meeting in October each year for consideration to bring to the City Council.

Should the City fall below the minimum combined pension funded ratio of 90% after the funded status target is met, recommendations shall be presented to return the City's plans to a minimum 90% funded status within 5-years.