ATTACHMENT #1

PENSION MANAGEMENT POLICY

CITY OF INDIAN WELLS

Adopted by the City Council of the City of Indian Wells

September 5, 2024
City Council Draft

CITY OF INDIAN WELLS

PENSION MANAGEMENT POLICY

Section 1. Purpose

The purpose of this Pension Management Policy (the "Policy") is to strategically address the existing and any future unfunded accrued liability (the "UAL") associated with the City of Indian Well's (the "City") California Public Employees' Retirement System (CalPERS) pension plans (the "Pension Plans"). This Policy also addresses some principal elements and core parameters central to the policy objectives. In developing this Policy, the City strives to reduce its UAL and the associated financing costs in the most cost-efficient and fiscally responsible manner possible.

The City is committed to fiscal sustainability by employing long-term financial planning efforts, maintaining appropriate reserve levels, and employing prudent practices in governance, management, budget administration, and financial reporting. This Policy is intended to make all relevant information readily available to decision-makers and the public to improve the quality of decisions and transparency, identify policy goals, and demonstrate a commitment to long-term financial planning. Development of this Policy signals to rating agencies and capital markets that the City is willing to set policies that improve its ability to meet its obligations in a timely manner.

The Policy is intended to reflect a reasonable and conservative approach to managing the UAL costs associated with the Pension Plans. This Policy recognizes that the Pension Plans are subject to market volatility and that the actual economic and demographic experience of the plans will differ from the actuarial assumptions. Accordingly, it is intended to allow for adaptive responses to changing circumstances, providing flexibility to address such volatility in a financially sound manner. As such, the City is required to continually monitor its Pension Plans and the corresponding UAL.

Section 2. Policy Goals and Objectives

The overarching goals and objectives of this Policy are as follows:

- Establish, attain, and maintain targeted pension plan funding levels
- Provide sufficient assets to permit the payment of all benefits under the Pension Plans
- Seek to manage and control future contribution volatility to the extent reasonably possible
- Strive to make Annual Discretionary Payments to accelerate UAL pay-down, reduce interest costs, and stabilize future payments
- Maintain the City's sound financial position and creditworthiness
- Provide guidance in making annual budget decisions
- Create sustainable and fiscally sound future budgets

- Demonstrate prudent financial management practices
- Create transparency as to how and why the Pensions Plans are funded

Section 3. Background and Discussion

In General. Each Pension Plan is a multiple-employer defined benefit pension plan administered by the California Public Employee Retirement System ("CalPERS"). All full-time and certain part-time City employees are eligible to participate in the CalPERS retirement and disability benefits, annual cost of living adjustments, and death benefits offered 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 its financial soundness and sustainability, the plan should accumulate adequate resources in a systematic and disciplined manner to ensure sufficient resources are available to meet employee benefit requirements. This Policy outlines the practices the City will utilize to address its actuarially determined contributions to fund the long-term cost of benefits to the Pension Plan participants and annuitants.

Pension Costs and Liabilities. In order to fund its employees' pension benefits, the City is required to make contributions (a portion of which may come from the employees) to CalPERS. CalPERS then invests these contributions to generate returns to help fund the pension benefits. The regular required contributions, known as the "normal cost," are calculated as a percent of salaries and represent the annual cost of service accrual for the upcoming fiscal year for active employees. If, for any reason, the actual Pension Plan experience and/or investment performance fall short of the actuarial assumptions, the Pension Plan can become underfunded (i.e., the Pension Plan's Normal Accrued Liability exceeds the Plan's market value of assets). This shortfall is known as the Unfunded Accrued Liability. Usually, it has to be covered by the City through a series of UAL Payments, which are above and beyond the "normal cost" contributions. The UAL Payments are calculated in total dollar amounts, not as a percent of salaries.

The UAL can be caused by multiple factors, including but not limited to changes to CalPERS' actuarial amortization policy, retroactive pension benefit enhancements, investment underperformance, actuarial assumption changes, demographic factors, and discount rate reductions.

UAL is Debt. The UAL balance at any given point in time is a debt of the City owed to CalPERS, which is amortized over a set period of time with interest accruing at the then-current CalPERS discount rate (the "Discount Rate"). However, this debt can be prepaid at any time without penalties. Recognizing the UAL as debt helps the City identify proper steps to address it and minimize the associated financing costs.

Ongoing CalPERS Practices. Every year CalPERS prepares updated actuarial valuation reports for each of the City's Pension Plans wherein it calculates the City's total pension liability as of the end of the prior fiscal year (each a "Valuation Report"). If the investment performance during that fiscal year was different from the Discount Rate, or if CalPERS made any changes to its actuarial assumptions, or if the actual demographic or compensation experience within the Pension Plans was different from the actuarial assumptions, new line items, or UAL amortization "bases," may be added to the plan and result in a change to the UAL balance. Such UAL amortization bases may be positive (indicating a funding shortfall for the Pension Plans) or negative (indicating a funding surplus for the Pension Plans). Since CalPERS can add new UAL amortization bases every year, the Pension Plans must be monitored annually and managed continually – there is no one-time solution.

CalPERS has adopted the UAL amortization methods meant to help public agencies "ease into" paying for the UAL increases. New UAL amortization bases are implemented incrementally, with a five-year ramp-up period, and at times include additional small increases in subsequent years. The ramp-up period, while reducing the cash flow impact in the near term, increases the overall UAL repayment costs for the City by delaying repayment. Since the UAL balances accrue interest at the rate that is equal to the then current Discount Rate, the delayed payments prior to the commencement of the amortization and the reduced payments during the ramp-up period that do not fully cover the interest costs result in negative amortization, causing further increases to the UAL balance. To help reduce the overall costs of the UAL repayment, this Policy encourages level annual payments (i.e., no ramp-up) whenever possible.

Section 4. Policy

A. **Funding Level Objective.** It is the City's policy to strive to achieve and maintain a Pension "Funded Ratio" (the ratio by which the Market Value of Assets—as set forth in the most recently published Valuation Report—exceeds the Entry Age Normal Accrued Liability or "EANAL"—as set forth in the most recently published Valuation Report) for each Pension Plan of 95% (the "Funding Level Objective").

Funding Level Objective = 95%

Achieving and maintaining the 95% Funding Level Objective ensures that the City's and its employees' ongoing contributions are properly and adequately funding the retirement benefits of retirees and today's workers. This concept is commonly referred to as intergenerational equity. The reason for a Funding Level Objective of 95% rather than 100% is to allow some cushion for the possibility that good investment returns by CalPERS in a given year might push the Funded Ratio of a Pension Plan above 100% (commonly referred to as "superfunded status"), which means that the City and its employees had contributed into the Pension Plan more than was necessary. Thus, while the City remains committed to achieving a 100% funded level, it is not uncommon for a pension plan to be maintained at a lower percentage. The City will strive to manage the 5% differential (i.e., the difference between 95% and 100%) through its investment process by creating the "115 Trust Pension Reserve Fund" discussed below.

Guidance: To achieve the Funding Level Objective, this Policy provides the following guidance:

1. ***Pre-Pay the Entire Annual UAL Payment by July 31st of each year*.** On or before July 31st of each year, the City receives its annual CalPERS UAL invoice. The City has two payment options. The invoice can (1) be paid in equal monthly increments or (2) be fully pre-paid at the beginning of the fiscal year by July 31st. By prepaying the entire invoice amount due by July 31st, the City can concurrently save approximately 3.3% compared to making the monthly payments. As such, every effort shall be made to pre-pay the UAL payment upon receipt of the annual invoice.

2. ***Pre-Pay UAL from Reserves, One-Time Revenues, and Fund Surpluses*.** Reserves (often invested in LAIF) regularly do not earn returns that can offset the interest rate that CalPERS charges on the outstanding UAL balance. Supplemental contributions into the Pension Plans and/or the 115 Trust Pension Reserve Fund (see Section 4C below entitled "Establishment and Operation of a 115 Trust Pension Reserve Fund") from available reserves, one-time revenues, and fund surpluses can generate substantial long-term net savings. Each supplemental contribution, referred to by CalPERS as an Additional Discretionary Payment (ADP), reduces the UAL balance, the Annual Required Contributions (ARC) for future years, and the total interest costs associated with the UAL. CalPERS does not apply any prepayment penalties to ADPs. Therefore, during each budget cycle, the City staff shall review all available reserves, one-time revenues, and fund surpluses to determine whether any such funds could be used to make an ADP to pay down the UAL, keeping in mind operational and capital budgetary constraints while maintaining adequate reserves and balancing the fiscal soundness of eliminating the high-interest UAL debt. Every effort should be made to make an ADP during years with added bases to avoid ramp-up periods and the associated costs. ADPs should not adversely affect the City's general operations and fiscal soundness.

3. **Annual Review of the CalPERS Actuarial Valuation Reports.** The City staff shall review or cause to be reviewed the annual CalPERS actuarial valuation reports once they are made public by CalPERS. The review should focus on identifying the annual UAL changes to each Pension Plan and quantifying the associated cost implications and the corresponding impact on the Funded Ratio.

B. City Contributions.

1. ***Annual Contribution Relative to Payroll*.** Recognizing the benefit of long-term returns and the need to proactively manage the high long-term costs associated with

carrying UAL, the City will proactively contribute funds to the CalPERS Pension Plans and/or the 115 Trust Pension Reserve Fund based on a percentage of each Fiscal Year's forecasted payroll.

In each Fiscal Year where the Pension Plans total Market Value of Assets combined with the 115 Trust Pension Reserve Fund balance is less than 120% of the Entry Age Normal Accrued Liability (which summation is hereafter referred to as the "115 Trust Pension Reserve Fund Ceiling"), during the City's normal budget adoption process (beginning with the 2024-25 Fiscal Year budget), the City will contribute to the 115 Trust Pension Reserve Fund in amounts that are between 5% and 10% of the forecasted payroll for that Fiscal Year (the "Annual Contribution") as recommended by the City Finance Director and approved by the City Council as part of the final Adopted Budget.

2. ***Other Contributions*.** If the funded ratio falls below 95%, any discretionary contributions from the City will be allocated to CalPERS Pension Plans as an ADP. However, if the funded ratio surpasses 95% but remains below the 115 Trust Pension Reserve Fund Ceiling, the Annual Contributions will be directed to the 115 Trust Pension Reserve Fund.

C. Establishment and Operation of a 115 Trust Pension Reserve Fund.

1. ***Establishment of a 115 Trust Pension Reserve Fund*.** The City has established a 115 Trust Pension Reserve Fund managed by a third-party investment manager (the "Investment Manager"). The 115 Trust Pension Reserve Fund may receive funds deposited into it at the discretion of the City Council, based on recommendations made by the City staff during the annual budget process. Funds in the 115 Trust Pension Reserve Fund shall only be used for the City's pension benefits costs (i.e., UAL and Normal Costs) associated with the City's Pension Plans in accordance with the goals and objectives set forth in this Policy.

2. ***Operation of the 115 Trust Pension Reserve Fund*.** Amounts contributed by the City shall be deposited in the 115 Trust Pension Reserve Fund and used solely for the purpose of making ADP's and Normal Cost payments, as described below.

   To achieve and maintain the Funding Level Objective, each year during the budget cycle, City staff shall calculate, or cause to be calculated, the upcoming Fiscal Year's estimated Funded Ratio by taking into account the most recent Valuation Report's statement of Funded Ratio and adjusting for the estimated UAL amortization base that will be either added or subtracted due to the prior Fiscal Year's investment result of either exceeding or falling short of the then current Discount Rate for that Fiscal Year (the "Estimated Funded Ratio"). If the Estimated Funded Ratio is estimated to be less than the Funding Level Objective, to the extent funds are available in the 115 Trust

Pension Reserve Fund, the appropriate member of staff shall either make or shall direct the Investment Manager to make an ADP to CalPERS in the amount necessary to bring the Funded Ratio back up to the Funding Level Objective.

Except in the cases of Fiscal Hardships (defined below), money in the 115 Trust Pension Reserve Fund shall not be used for normal costs until such time as the amount therein, when combined with the Market Value of Assets (as set forth in the most recently published Valuation Report) exceeds the 115 Trust Pension Reserve Fund Ceiling. To the extent monies in the 115 Trust Pension Reserve Fund on June 30th exceed the 115 Trust Pension Reserve Fund Ceiling (after consideration has been given to the amounts therein required to be paid to CalPERS for the ensuing Fiscal Year to maintain the Estimated Funded Ratio at or above the Funding Level Objective), any such surplus may be used to offset the City's Normal Cost payment made to CalPERS in such Fiscal Year.

4. ***Fiscal Hardship*.** In the event of a Fiscal Hardship (as defined below), the 115 Trust Pension Reserve Fund may be utilized for either normal or UAL costs until the Fiscal Hardship is no longer in effect.

   "Fiscal Hardship" means an economic hardship, or other unanticipated fiscal emergency, that has been declared by resolution of the City Council.

D. Transparency and Reporting. The Pension Plans' funding should be transparent to all stakeholders, including plan participants, annuitants, the City Council, and City residents. To achieve this Policy objective, copies of the annual actuarial valuation reports for each Pension Plan shall be made available to the City Council and posted on the City's website. The City's audited financial statements shall also be posted on the City's website because they include, among other things, information on the City's current and future annual Pension Plan contributions as well as the funded status of each Pension Plan.

E. Annual Budget to Contain Policy Directed Information. The City's annual operating budget shall consider the items specified in this Policy for inclusion in each such annual budget.

F. Review of Policy. Funding a defined benefit pension plan requires a long-term horizon planning approach. This Policy is intended to provide general objectives and guidelines, which will require periodic review to consider changes in the City's financial position and Pension Plan funded status over time. As such, City staff will review the policy for implementation of new best practices and will provide to City Council for adoption on an as needed basis, not to exceed five years.