CITY OF NAPERVILLE
MEMORANDUM

DATE: November 21, 2017

TO: Mayor and City Council

FROM: Doug Krieger, City Manger
Erik Hallgren, Financial Services Supervisor

SUBJECT: CY2018 Proposed Budget Workshop #3 - Public Safety Pension Funds

PURPOSE

The purpose of this memorandum is to provide City Council with an overview of the City's pension contributions and future impacts as well as recommendations by the City's actuarial consultant.

DISCUSSION

Financial Impact

Since FY07, the City has experienced a 144% increase in required pension payments. Additionally, the City is projecting a 16% increase from CY17 to CY18, placing significant pressure on the City's annual budget. The recent increases have been caused by several factors that included, but are not limited to, changes in the mortality tables and fluctuations in the market returns on pension investments. Furthermore, the City's current pension funding methodology requires 100% funding by 2033, compared to the state's minimum requirement of 90% funding by 2040. Overall, the City's pension funding practices have led the City to have the highest funding percentage level of comparable public safety pensions, with a combined funding ration of 72.3%, which is the actuarial value of assets versus actuarial accrued liabilities.

	FY07	FY11	CY17	FY07 to CY17 Increase	CY18 Projection	Annual Increase
Police Pension	2,762,370	4,708,411	6,538,474	137%	7,129,194	9%
Fire Pension	2,883,432	4,569,167	7,237,440	151%	8,896,264	23%
Public Safety Total	**5,645,802**	**9,277,578**	**13,775,914**	**144%**	**16,025,458**	**16%**

City Assumptions

Currently, the City utilizes a RP2000 mortality assumption with a 7% assumed interest rate for both the Police Pension Fund and Fire Pension Fund.

The City's current assumptions utilize Entry Age Normal (EAN) cost method. The City amortizes 100% of the EAN unfunded liability and reflects a closed amortization period ending in 2032. Under the EAN method, the cost of each retiree's benefit is based on a level percent of payroll between the time employment started (entry age) and the assumed retirement date. The goal is smooth cost over time to provide a constant funding percentage annually by amortizing the payment of actuarial accrued liabilities over a period of time. The ideal scenario for EAN is that the Year 1 percent of pay contributed will be the same as the Year 20 percent of pay contributed; a more stable contribution.

Conversely, the Illinois Pension Code allows the use of the Projected Unit Credit (PUC) cost method. Under the PUC method, the cost of each retiree's benefits is based on each period of service separately to accumulate the final obligation. The goal is to contribute funding commensurate with the value of benefits earned in the current year.

Credit Rating Impact
Pension contributions also impact the City's credit rating score. The City's credit rating agencies factor in the City's pension burden as well as other criteria when rating the City's credit. They consider debt adjustments, budgetary performance and management score (methodology in pension funding). Not following the actuarial determined value in pension funding would potentially negatively impact the City's rating score. Additionally, lowering pension contribution amounts, or changing the methodology to balance the budget, could also negatively impact the City's credit rating.

Funding Approach
The City consulted with Foster & Foster Actuaries regarding the City's funding approach. According to Foster & Foster, they do not recommend the City adopt the statutory minimum approach to funding. The statutory approach produces a back-loaded payment stream that dramatically increases the City's contributions over the long-term. Using the statutory minimum funding approach versus the City's current approach delays the pay-down of the current unfunded liability and increases interest costs to the plans.

Foster & Foster also recommends an open methodology funding approach where the City amortizes its unfunded liability over a consistent 15-year period. 15 years is the maximum period to use since the payments are large enough to pay down the City's unfunded liability. By adopting an open amortization approach, the amortization period always remains the same. A period longer than 15 years could produce insufficient payments that allow the unfunded liability to grow. The IMRF pension fund has adopted the 15-year open amortization approach, so there is some movement towards this approach in Illinois.

<u>CONCLUSION:</u>
Staff is recommending the City adhere to Foster & Foster's recommendations as well as adopt an open amortization approach.

<u>RECOMMENDATION</u>
Include this memo as part of the CY2018 Budget Workshop agenda packet.