CITY OF MURRIETA
PENSION FUNDING POLICY

I - INTRODUCTION

The City of Murrieta (City) provides its permanent employees with a defined benefit pension through the California Public Employees' Retirement System (CalPERS). Recent changes at CalPERS have increased the City's required payments to the pension plan and decreased the plan's funded status. The City is anticipating that CalPERS will continue to enact changes to increase the financial stability of its pension program, and that those changes will result in higher City contributions. The City has assessed options to help address the increased pension costs and their volatility and has determined that it would be beneficial to join a trust in which to set aside City funds for future pension payments.

II – PURPOSE

The purpose of this Pension Funding Policy (Policy) is to establish a plan, methodology and a process for funding current and future costs associated with the City's contractual obligations to provide pension benefits as set forth in the City's labor agreements.

III – OBJECTIVE

The City shall seek to reach and maintain its pension funding level at 90% funded for each of its plans.

IV - POLICY

It is the policy of the City to fulfill its obligation to maintain fiscally responsible management practices and to ensure that promised pension benefits are funded. To that end, the City will meet its pension funding obligations as follows:

1. **Actuarially Determined Contributions**: Each fiscal year, the City will contribute to CalPERS the amount determined by CalPERS actuaries to be the minimum required employer contribution for that year. The minimum employer contribution consists of two components, normal cost and unfunded accrued liability ("UAL"). The normal cost is expressed as a rate that is applied to pensionable payroll costs and reflects the cost of pension benefits earned by employees in the current fiscal year. The UAL payment is a flat dollar amount that represents a portion of the cost of past benefits earned by employees, but for which, because of deviations in actual experience and changes in assumptions about investment performance, the normal cost rates established for those prior years have been determined to be insufficient to provide the promised retirement benefit. The CalPERS actuaries recalculate the total UAL each year and an updated multi-year amortization schedule is provided to show

the projected annual minimum required employer payments.

2. **Annual UAL Payment**: CalPERS offers the option to make monthly payments on the UAL or prepay the entire annual UAL amount at a discounted level by the end of July. Assuming the City's current reserves meet their respective reserve policies, the City will prepay its annual UAL payment each July to achieve budgetary savings.

3. **Section 115 Pension Trust**: The City will establish and maintain a pension stabilization fund in the form of a Section 115 Pension Trust (Trust). Assets in the Trust may be used only for pension related costs and at the direction of the City Council. The City's objective with the Trust is to accumulate assets to fund its CalPERS pension costs and future obligations, as well as mitigate the budget impact of costs associated with future UAL. The City will strive to meet the following guidelines:

   - *Initial Deposit*: To begin the funding of the Trust, the City will make a one-time contribution of $3.0 million to the Trust utilizing previously set aside reserve funds allocated for a pension trust by City Council.

   - *Ongoing Deposits*: The City will consider making additional contributions to the Trust on an annual basis at a minimum every year. City staff may bring forward an additional contribution to the Trust Plan based on the General Fund surplus beginning from FY 2022/23, measured as of June 30 each year to the City Council during the year end and submittal of the financial statements. The amount will be based on unassigned General Fund Balance when revenues exceed expenditures in the audited financial statements. The recommended contribution amount will be approved by the City Council via Resolution.

   - *Investment Portfolio Selection*: City staff will work with the Trust's investment advisor, to select investment portfolios based on the City's risk tolerance and projected withdrawal schedule from the Trust.

   - *Use of Trust Funds*: Funds as allowed by the Trust may be used for any of the following purposes: (1) City's annual UAL payment to CalPERS, (2) City's annual normal cost payment to CalPERS, (3) reimbursement to the City for CalPERS pension costs, and (4) Additional Discretionary Payments to CalPERS. Withdrawals will be recommended by the City Manager or designee during the budget process or as a separate City Council Agenda Item for approval.

   - *Funding Goals*: As stated above, the City is targeting a funded ratio of 90% for each of its pension plans. When measuring its funded ratio, the City should incorporate assets in the Trust, in addition to the assets under management by CalPERS. The City may consider foregoing contributions to the Trust if its funded ratio exceeds the target 90% funded status, or if the current assets on deposit in the Trust are projected to be sufficient to cover budgetary fluctuations in the future.

4. **Additional Discretionary Payments:** CalPERS allows member agencies to make Additional Discretionary Payments (ADPs) at any time and in any amount, which would serve to reduce the City's UAL and future required contributions. Once the City's Trust is established, the City has the option to make ADPs to CalPERS using the assets held in the Trust, if desired. The City will consider ADPs within the context of its annual evaluation of reserve levels, budgetary requirements, funded ratio, and other timing considerations unique to CalPERS' investment performance. ADPs may prove to be advantageous in the future once Trust levels are funded to sufficient thresholds to stabilize budgetary volatility.

5. **Pension Obligation Bonds:** Pension Obligation Bonds (POBs) are a tool that can be used to provide an ADP to CalPERS upon the determination that the cost to borrow the funds for the payment is less than continuing to make the projected prescribed UAL payments at the current discount rate. If the City considers issuing POBs, the following guidelines will apply:

    - Expert advice and analysis by actuaries and Financial advisors will be utilized to quantify the risk of CalPERS investment underperformance (including discount rate reductions, stock market crashes, or sustained investment underperformance) and the threshold at which the City would be worse off issuing POBs versus not.

    - Significant education and evaluation will occur at the City staff and Council level given the complexity of POBs.

    - The interest rate on the POBs shall be at least 2.5% less than the current CalPERS discount rate.

    - The final maturity date on the POBs will be no greater than the final projected payment date of the UAL at the time the POBs are issued.

    - The POBs structure will contain an early call provision.

    - The POBs shall not finance normal cost and shall only be used to refinance UAL.

    - The POBs should provide significant demonstrated cash flow savings.

    - The City shall budget and transfer a portion of projected cash flow savings to the Trust to mitigate against future increases in the UAL that are likely to occur. Any cash flow savings not transferred to the Trust shall be transferred to the City's other reserves.

V - DELEGATION OF AUTHORITY

The management oversight responsibility for the City's pension program is delegated by the City Council to the Treasurer. The City Manager serves as the Treasurer. The Treasurer has delegated the authority to conduct transactions and to manage the operation of the Section 115 Trust to the Finance Director. These officers shall meet regularly to discuss retirement costs and to review CalPERS actuarial report and the City's normal cost and UAL. Contributions and withdrawals must meet the City's fiscal objectives. No person may engage in additional pension transactions except as expressly provided under the terms of this Policy.

VI - REPORTING

Addressing retirement costs is a dynamic process. CalPERS makes adjustments annually to a City's normal Cost and Unfunded Accrued Liability (UAL). These changes require multi-year financial planning and for the City to make corresponding budgetary adjustments. The City shall therefore evaluate its pension liabilities each year.

After the release of the most current CalPERS actuarial report, staff shall present a summary of each plan's funding status. New amortization levels shall be specifically addressed. This information shall be presented during a public City Council meeting, which shall include a summary of funding status, funding progress compared to prior years, as well as any recommended actions and/or budget adjustments to address areas of concern.

VII - POLICY REVIEW

The City will review this policy periodically to determine if changes to this policy are necessary to ensure progress is being made towards funding the City's CalPERS pension costs and mitigating the impact of the costs associated with future UAL.