

LAKE ARROWHEAD COMMUNITY SERVICES DISTRICT

MEMORANDUM

DATE: September 28, 2021

TO: **BOARD OF DIRECTORS**
Lake Arrowhead Community Services District

FROM: **JOHN O'BRIEN, Finance Manager**
CATHERINE CERRI, General Manager

SUBJECT: **CONSIDER APPROVING CALPERS PENSION UNFUNDED ACCRUED LIABILITY FUNDING OPTION**

A. RECOMMENDATION

It is recommended that the Board of Directors approve a single lump sum payment of \$1,700,000 towards the District's CalPERS Pension Unfunded Accrued Liability (UAL) to be disbursed as soon as administratively possible.

B. REASON FOR RECOMMENDATION

The District would like to satisfy the District's current UAL by making 5 annual payments of \$1,700,000. This would save the District approximately \$13,680,000 in interest over the projected 25-year life of the UAL. This payment would represent the third of these five payments.

C. BACKGROUND INFORMATION

The District is a member of the California Public Employee Retirement System (CalPERS) which is the nation's largest public pension fund with investments of \$485 billion in both domestic and international markets and is one of the largest private equity investors in the world.

District CalPERS Pension Plan Overview

Since 2003, the District has participated in the CalPERS Miscellaneous Risk Pool defined benefit plan. The District has three distinct plans within the Miscellaneous Risk Pool detailed as follows:

- Tier 1 Plan (2.5% @ 55) – closed plan and includes employees who were employed with the District prior to October 2011.

- Tier 2 Plan (2% @ 55) – plan open only to new employees who are current CalPERS members or members of reciprocal agencies prior to January 2013.
- PEPRA Plan (2% @ 62) – all new employees who are not members of CalPERS before January 2013.

District Participation Data - Active Employees	
	Fiscal Year 2021-22
Tier 1	24
Tier 2	3
PEPRA	28
Total	55

CalPERS Pension Plan Changes

CalPERS has implemented several pension plan changes over the past few years to ensure its sustainability, including the following:

- Public Employee’s Pension Reform Act (PEPRA) (effective 2012-13)
- Assumption Changes in mortality rate (effective 2016-17)
- Investment/Discount Rate Changes (effective 2017-18)
- Amortization Policy (effective 2018-19)

Of the plan changes above, assumption changes, investment/discount rate changes and the amortization policy all directly impact the District’s annual pension expense.

District CalPERS Pension Plan Components and Costs

The District’s total pension liability is actuarially determined based upon participant history and various assumptions including retirement age, life expectancy, and inflation. All of these assumptions are periodically reviewed by CalPERS and adjusted based upon experience.

Funding for the pension liability consists of investment income and employee and employer contributions. Employer contributions have two major cost components which are the Employer Normal Cost contributions and the Unfunded Accrued Liability (UAL) contributions. Employer Normal Cost contributions are based upon a percentage of payroll. UAL is based on the difference between the projected or anticipated return of investment and the actual return on investments.

2021-22 Contribution Rates – Normal Cost Portion			
Plan	Employer	Employee	Total
Tier 1	11.59%	7.96%	19.55%
Tier 2	10.34%	6.91%	17.25%
PEPRA	7.59%	6.75%	14.34%

The District's estimated required contributions are as follows:

District Annual Pension Employer Contributions (Estimated)		
Plan	2021-22	2022-23
Tier 1	293,354	306,430
Tier 2	22,838	24,515
PEPRA	132,520	145,517
UAL	644,213	598,784
Total	1,092,925	1,075,246

District Projected CalPERS Pension Plan Unfunded Accrued Liability

The District's total pension liability is \$37.4 million, which is 76.75% funded, resulting in an estimated \$8.5 million unfunded accrued liability.

District Plan Funded Status and UAL - June 30, 2020 Valuation Date				
	Accrued Total Liability	Market Value of Assets	Unfunded Accrued Liability (UAL)	Funded Ratio
Tier 1	35,701,344	27,309,640	8,391,704	76.50%
Tier 2	274,188	255,235	18,953	93.10%
PEPRA	1,408,169	1,273,275	134,894	90.40%
District Total	37,383,701	28,838,150	8,545,551	76.75%

While the above UAL total of \$8.5 million is the latest figure provided by CalPERS in their most recent valuation report, a clarification with regards to the timing of the District's past additional payments may be helpful. CalPERS has a reporting lag time of two years. Therefore, the \$1.7 million additional payment made during the 2020-21 fiscal year will be reflected in next year's June 30, 2021 report which will be issued in August of 2022. The CalPERS projected report based on the payments made by the District to date, including last year's \$1.7 million, estimates the current UAL at \$6.75 million.

District CalPERS UAL Funding Options

The District has been proactively paying down the District's UAL over the past two years. As a reminder, the District paid an additional \$300,000 in the 2018-19 fiscal year and \$1,700,000 in both the 2019-20 and 2020-21 fiscal years.

The Board of Directors has repeatedly expressed interest in continuing to make additional payments toward the District's UAL in order to save on the associated interest costs. With interest rates at historic lows and the UAL carrying a 7% discount rate, there is very little opportunity cost associated with continuing this plan.

In September of 2019, the Board of Directors reviewed and considered several options for paying down the UAL. The Board settled on the option of making 5

annual discretionary payments of \$1,700,000. This would save the District approximately \$13,680,000 in interest over the projected 25 year life of the UAL, as well as provide the District with the flexibility of deciding each year whether or not to make the payment. This payment currently being proposed would represent the third of these five payments.

Staff would like to point out several broader economic matters that appeared since the last UAL payment. It appears that the majority of the economic consequences related to the responses to the Covid-19 virus are in the past. As highlighted before, the District has been incredibly fortunate to have only seen a slight uptick in payment delinquencies that has been offset by an increase in consumption. Unfortunately, the District has experienced a wide range of rising costs that will surely affect operating costs as well as capital improvement projects in the future. Lastly, because CalPERS had investment returns for the 2020-21 fiscal year in excess of its stated discount rate of 7%, the discount rate applied to future calculations will be reduced by .20%. This means that the District can expect to be required to fund a slightly higher contribution rate in the 2022-23 fiscal year. As of the time of this report, estimated numbers have not been released for individual agencies, but staff will continue to monitor this development. While no future scenarios can be guaranteed, staff feels confident making this payment will benefit the District and not cause the District to have to alter any of its short to medium term plans of providing quality service to its ratepayers and/or improving the District's systems through its capital improvement plans.

Lastly, it is important to understand that while the District can pay off the current UAL, the District is still subject to future trends that can either increase or decrease future liabilities. These trends include changes to the CalPERS discount rate, investment returns, salary changes, workforce fluctuations and mortality rates

D. FISCAL IMPACT

The funds will be provided by the Water Operations Fund (100), the Wastewater Operations Fund (200), the Deer Lodge Park Operations Fund (300) and the Rimforest Operations Fund (400).

E. ENVIRONMENTAL IMPACT

None.

F. ATTACHMENTS

None.