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PHASE II: SECTION 3

PASADENA FIRE AND POLICE RETIREMENT SYSTEM

SUMMARY

The Pasadena Fire and Police Retirement System (FPRS) administers the pension system for certain retired Safety employees of the City of Pasadena. FPRS is a closed plan and does not accept newly hired employees. There are no active employees who are members of the plan. Nonetheless, certain plan attributes, primarily the cost of living adjustment (COLA), make the plan benefits for retirees costly. As a result, the City has chosen to borrow funds by issuing Pension Obligation Bonds (POB) amounting to over \$156 million for both principal and interest as of June 30, 2010 to fund the plan.

All Safety employees hired after 1977 participate in a CalPERS Safety Plan, and all non-Safety employees participate in a CalPERS Miscellaneous Plan. The City also offers retiree health benefits to the employees and retirees of these plans which have an unfunded actuarial accrued liability (UAAL) of nearly \$31 million as of June 30, 2010.

Pasadena's pension obligations, especially those of the FPRS, present a substantial financial challenge for the City. The existing funding source for the debt payments on the bonds that fund FPRS will expire in 2014, leaving the City without a dedicated source to pay the debt service. Without identifying an alternative source of funds, the City will be required to further subsidize the plan from discretionary General Fund resources which will have a direct impact on the City's ability to maintain services to the taxpayers.

As part of its effort to establish long-term funding strategies to address the impending expiration of dedicated funding, in March 2011 the City Council authorized staff to initiate the preparation for the issuance of a third set of POBs in an amount up to \$65 million. In addition, the City should explore opportunities to reduce other pension obligations for its active CalPERS and OPEB plans.

PURPOSE

The City of Pasadena and its Fire and Police Retirement System (FPRS) were chosen by the Civil Grand Jury (CGJ) for in-depth review based on the FPRS' extraordinarily low funded ratio and closed status and the City's substantial POB debt and retiree health benefit unfunded liability.

BACKGROUND

The City of Pasadena offers pension benefits to its current employees through the CalPERS Miscellaneous and Safety plans and to certain former Safety employees through the Pasadena Fire and Police Retirement System (FPRS). Although FPRS was closed to new members in 1977, its obligation to provide retirement benefits for retirees represents a significant liability, the long-term funding for which is undetermined as of the writing of this Report. The City of Pasadena also offers a retiree health benefits program with a liability of \$30.8 million, which is completely unfunded, and has outstanding POB debt totaling approximately \$156 million. The

CGJ chose the City of Pasadena for this review, primarily because of the financial challenges being posed to the City by FPRS. Exhibit 29 shows key attributes of FPRS and other pension obligations for Pasadena excluding the CalPERS plans.

GOVERNANCE

The Pasadena Fire and Police Retirement System (FPRS) was established by Article XV of the Pasadena City Charter. FPRS is governed by a 5 member retirement board of trustees representing the City Council, City residents and FPRS members. Its operations are reported as a Pension Trust Fund in the City's financial statements. The system's asset allocation and investments are reviewed by the Board and by an independent investment consultant, and contract actuaries. The FRPS is staffed by two part-time employees who administer the Plan.

FPRS HISTORY AND FUNDING STRUCTURE

1. Effect of Unlimited COLA

According to City documents, FPRS has had a challenging financial history since around 1960. In that year, City Charter amendments provided an unlimited COLA for the members that was fully adjustable based on changes in the Consumer Price Index (CPI). With inflation in the broader economy during the subsequent years, the plan saw dramatic increases in the COLA and, therefore, in its expenses. In 1977, the system was closed to new members and modified to increase contribution rates for the City and for active members. Additionally, active members were given the option of transferring to the CalPERS plan. However, as one City document stated, "few existing participants elected to join CalPERS and the modifications proved inadequate to address the continuing rise in the COLA benefit."⁴³

The City attempted to roll back the COLA benefit and successfully obtained voter approval in 1981 for a Charter amendment that limited the COLA to 2%. However, the Pasadena Police Officers Association sued successfully, claiming that the amendments impaired the vested rights of its members. An appellate court upheld the ruling and the uncapped COLA was reinstated, paving the way for the system's funding challenges that persist today.

⁴³ "Fire and Police Retirement System Task Force Report," presented to City Manager, Michael J. Beck. April 2010.

Exhibit 29. FPRS and Other Pasadena Pension Benefit Attributes, Excluding CalPERS

MEMBERSHIP		PLAN BENEFITS AND OPTIONS	
Active Members	-	Normal Retirement Age	50
Retired Members	223	Benefit Formula	2% x Sal
Disabled/Retired Members	131	Lump-Sum Death Benefit	60%
Retired Survivors	52	Survivor Benefit	60%
Inactive Members	275	Retiree Health	Defined Benefit
Total Annuitants	275	Deferred Compensation	Yes
ACTUARIAL		FINANCIAL	
<i>Investment/Discount Rate</i>		<i>Pension Fund</i>	
Assumed Actuarial Rate	8.00%	Actuarial Accrued Liability	\$ 166,096,000
One Year Actual Return (FY 2010)	17.90%	Unfunded Actuarial Accrued Liability	\$ 56,356,000
		Funded Status	66.1%
<i>Methods</i>		<i>Retiree Health Fund</i>	
Investment Smoothing	5 Years	Actuarial Accrued Liability	\$ 30,819,908
Investment Corridor	None	Unfunded Actuarial Accrued Liability	\$ 30,819,156
Amortization of Unfunded Liability	28 Years	Funded Status	0.0%
<i>Contributions</i>		<i>Pension Obligation Bonds</i>	
Employer Contribution	N/A	Principal Balance	\$ 111,525,000
Employee Contribution Pick-Up	N/A	Projected Interest Expense	\$ 44,655,524
Total Contribution	N/A	Total Indebtedness	\$ 156,180,524

Sources: City of Pasadena Comprehensive Annual Financial Report Year Ended June 30, 2010; Pasadena Fire and Police Retirement System Report and Audited Financial Statements for the Years Ended June 30, 2010 and 2009; Pasadena Fire and Police Retirement System Actuarial Valuation as of June 30, 2010.

2. "Contribution Agreement" and POBs

In 1999, after the FPRS funded status dropped to approximately 30%, the City and the FPRS negotiated a "Contribution Agreement" whereby the City agreed to issue \$100 million in POBs and transfer proceeds to the FPRS in order to increase the actuarial funding level to 70%. Additionally, the City agreed to make supplemental contributions to the FPRS to ensure that the funding level increased by 1/2% each year for 20 years, in order to reach a funding level of 80% by 2020. Later in this Section, The CGJ examines the magnitude of the supplemental payments and the City's progress toward achieving the annual 1/2% improvement in funding level.

Another \$40 million in POBs was issued by the City in 2004 in order to maintain the contribution levels agreed upon in the 1999 Contribution Agreement. This occurred after a protracted dispute between the City and the FPRS regarding the accounting methodology for treating the investment losses of the early 2000s. The FPRS agreed to allow the actuarial valuation to be conducted without the requirement that the actuarial

value of assets remain within a 20% “corridor” around the actual market value of assets, in exchange for the City providing additional funds through the issuance of the POBs.

As of June 30, 2010, the total outstanding principal on the POBs was \$111.5 million. Combined with the interest payments, the total outstanding POBs debt is \$156.2 million. The final maturity date of the bonds is May 15, 2022.

3. SB 481 and Redevelopment Agency Funding Relationship

In 1987, the City sponsored and secured the passage of special legislation, Senate Bill 481 that established a funding mechanism for the FPRS. SB 481 authorized the City’s Redevelopment Agency to repay prior General Fund advances to the Downtown Project Area for the purpose of funding the FPRS. According to the City, this funding structure has been effective. The revenue from the Redevelopment Agency has been more than sufficient to cover the debt service on the POBs, provide funds for the City to make its supplemental payment required under the Contribution Agreement, and generate a reserve fund to be used for future obligations of the FPRS.

While the repayment of General Fund contributions by the Redevelopment Agency has been effective thus far, the provisions of SB 481 that allowed the funding relationship to exist will expire on December 31, 2014. At that time, unless the City identifies a new funding mechanism, the City will be without a dedicated funding source to cover its debt service on the POBs and make the required supplemental payments to the FPRS.

MEMBERSHIP AND ACTUARIAL VALUATION

As of June, 30, 2010, the date of FPRS’s most recent actuarial valuation, there were a total of 275 members in the system, 223 of whom were retirees and 52 whom were survivors. There are no active members of the system. The last FPRS employee retired in 2009.

The average annual income for the entire set of 272⁴⁴ FPRS retirees as of February 2011 was \$52,761. However, the distribution of annual incomes for all FPRS retirees is represented in Exhibit 30 showing that individual retirements can be much higher.

1. Declining Liabilities, Funded Ratio

As of June 30, 2010, the date of its most recent actuarial valuation, the FPRS’s actuarial accrued liability (AAL) was approximately \$166.1 million; and its Actuarial Value of Assets (AVA) was approximately \$109.7 million, resulting in an UAAL of approximately \$56.4 million and a funded status of 66.1%. As shown in Exhibit 31, over the past 6 fiscal years the total AAL and the funded ratio have declined.

The pattern of declining funded ratio is driven in part by the market losses of recent years and FPRS’s choice to smooth or account for its losses over a relatively short 5 year period. As discussed in Phase I of this report, the implementation of a smoothing period and the length of such a smoothing period may have a significant impact on a plan’s funded status and required contribution rate.

⁴⁴ Three retirees died after the June 30, 2010 actuarial valuation, bringing the total number of retirees, including survivors, to 272 as of February 2011.