



DATE: August 17, 2016
TO: Leonard Martin, City Manager
FROM: Bob Scott, Assistant City Manager
SUBJECT: Pension Funding Policy

BACKGROUND

At the August 16, 2016 budget work session, City Council requested that staff recommend a policy for funding the City's pension obligations above and beyond the actuarially determined contribution (ADC). This request came about because Council in previous years' budgets had made the decision to continue paying the TMRS calculated ADC at the FY 2012 rate of 13.95%. Since that time, the TMRS ADC has decreased in four of the five years and will be 12.44% for FY 2016 (see attached spreadsheet). While City Council wants to be conservative in meeting its TMRS obligations, it also does not want to unnecessarily tie up resources that can be used for other purposes. In plain English, the policy question is:

"Should we contribute more than the TMRS required amount, and if yes, how much is enough?"

STAFF ANALYSIS

Given that the question is how much more than the ADC should be contributed, any policy that is ultimately adopted will be both a positive and subjective judgment -there is no right answer. However, several items should be considered in making this subjective determination:

Passing it Forward can be Offset by Paying it Forward. Unlike the City's bonded debt used to acquire assets that will serve our citizens for many years into the future, the unfunded actuarial accrued liability represents an obligation for past services only. In this respect, past operating costs will be paid for by future taxpayers (passing it forward). It is also true, however, that the City routinely finances assets with 30-year lives over 15 to 20 years resulting in a benefit to future taxpayers (paying it forward).

Crystal Balls are Often Cloudy. Actuarial valuations attempt to quantify and predict many years into the future. Historically, these projections have often been wildly optimistic resulting in the nationwide phenomenon of governments that always paid their ADC still having huge unfunded liabilities. In recent

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years, TMRS has demonstrated strong governance resulting in conservative assumptions that have managed this risk and helped most of its cities to maintain or improve their funded status. However, pension risk can never be completely eliminated and the City's policy of contributing more than the ADC is similar to creating a contingency line item in a construction budget to hedge against any unanticipated expenses that could occur.

Over-Contributing Improves Funded Status and Reduces Future Rates. In the past five years, the City has contributed approximately \$2.2 million more than its ADC resulting in a lower unfunded liability, significant interest cost avoidance and an overall rate that is lower than it would have been if the additional contributions had not been made.

Carrollton's Pension Obligations Compare Favorably Nationwide. Nationwide, state and local governments in 2013 (most recent data available) were 71.8% funded with most experts agreeing that this level is far below desired levels and many have claimed that public pensions are in crisis. Comparatively Carrollton's 93.4% funded status puts it among some of the best funded plans in the country. Aggressive action in reducing benefit levels combined with always contributing its ADC and in some years contributing more than its ADC have placed the City in its current position.

STAFF RECOMMENDATION

Taking these factors into consideration, staff recommends the following policy

- 1) Carrollton will always contribute its actuarially determined contribution as an absolute minimum.
- 2) Recognizing the inherent uncertainties surrounding public sector pensions, the city council desires to manage and smooth the volatility of its required ADC by:
 - a. In years that the ADC rate drops, City Council should consider maintaining the previous year's rate. This excess contribution should be evaluated annually and generally should be kept within a range of 0 to 1 percentage points above the upcoming year's ADC.
 - b. When the contribution exceeds the ADC by the amount specified in a. it will automatically be reduced to the top of the range.
 - c. City Council as part of their annual budget deliberations will determine where in the range contributions will be made taking into consideration overall funded status, recent trends in both the ADC and funded status and other budgetary needs.

Attachment: TMRS Analysis of Funding Progress and Contribution Rates

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