Pension Funding Approaches For Evanston Police and Fire Pension Funds

Evanston City Council

October 9, 2017

What do Article 3 and 4 Pension Benefits Include?

- Pension with age and service
- Non-duty disability
- Line of duty or occupational disease disability
- Upon death, pension payments are payable to the widow(er) and/or dependents

- These benefits are the City’s long-term disability insurance for Police and Fire members

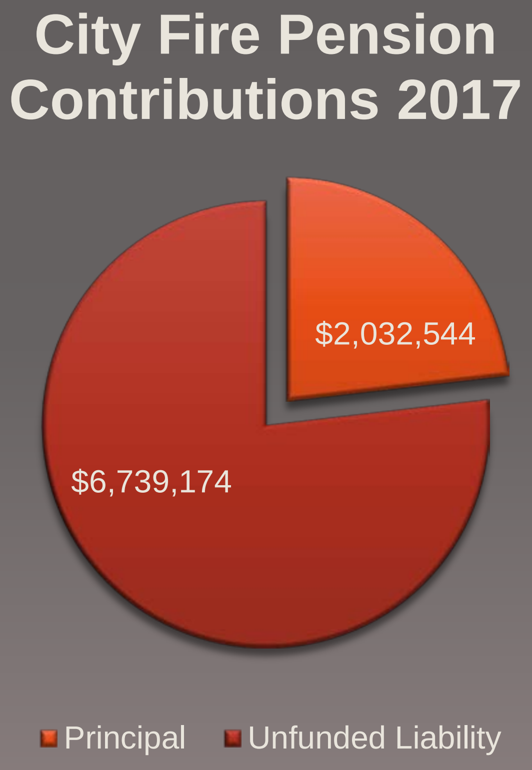
Where are we today?

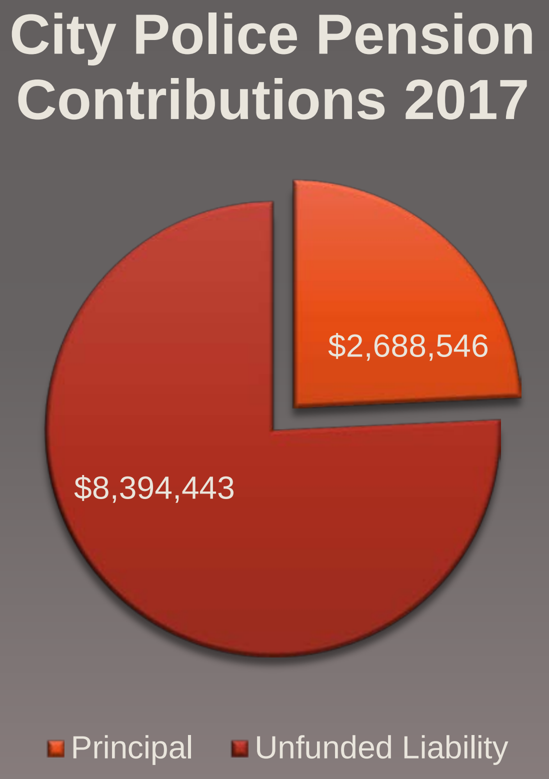
- Current Funding Levels
  - Fire
    - 6.25% assumption - 43.2%
  - Police
    - 6.25% assumption - 46.9%

Why are we at these levels today?

- State requirement to fully fund pensions by 2040
- Interest rates near 30 year historical lows
- Investment type restrictions
- Changes in actuarial funding formulas to better reflect reality
- Aging participants, more retirees
- New accounting standards

Where does the pension levy go?





Three Important Notes

- This unfunded liability is on benefits *already owed* to current employees and retirees. This debt must be reported on the City's financial statements.

- These benefits are guaranteed by the Illinois State Constitution

- Because all funding is based on models, the unfunded liability will continue to fluctuate based on real world conditions

Solutions

- Stay the Course
- Raise Revenue
- Issue Pension Obligation Bonds(POBs)

Stay the Course

- Tier 1 is the legacy system for employees hired before Jan 1, 2011
- Tier 2 benefits will have a dramatic impact on future cost rate – all employees will be Tier 2 by 2045

Stay the Course

- Employer costs decrease ~75% once Tier 2 members completely replace Tier 1 members
  - Savings is gradual
  - The Tier 2 pension system is cheaper *to the employer* than Social Security and a 401(k) style match

- This strategy will take 20+ years to arrive at our goal and will require ongoing increases in the pension levy

Slide adapted from Foster and Foster

Raise Revenue - Ongoing

- Continue to increase property taxes

Raise Revenue - One Time Addition Methods

- Sale of City physical assets
  - Ex: Maple St. Parking Garage
    - Hypothetical value: $40m
    - Cash from sale divided between pension funds roughly 60/40 police/fire.
- Cash infusion
  - Ex: Today’s proposal for an additional $400k

Fire Impact Fee Proposal

- Fifty cent ($0.50) per square foot on all new construction over 10,000 ft^2
- Only new construction with previous property tear down; fee reduced by square footage of original structure
- Excludes single family and build outs of existing structures
- Estimated at $500,000 per year

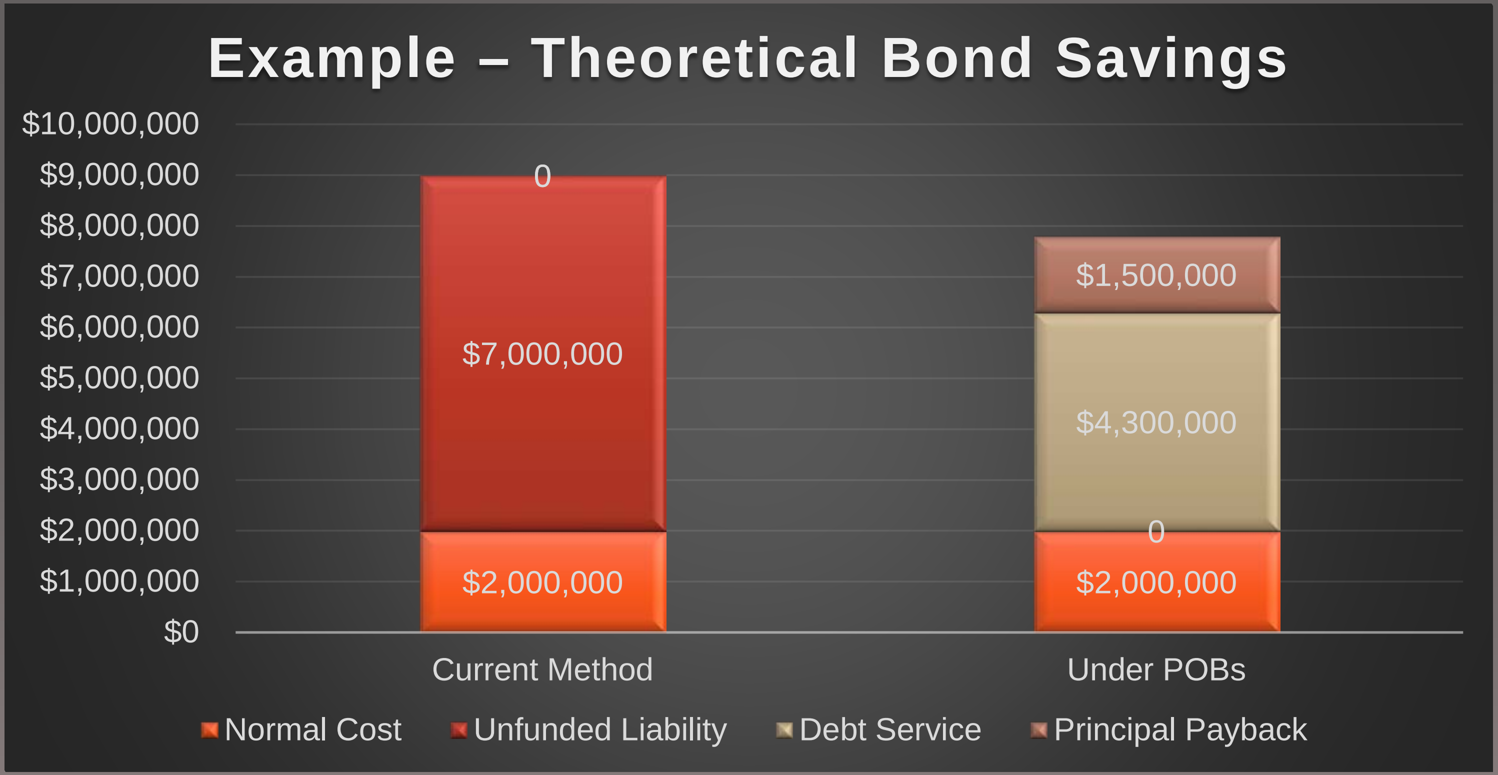
Why the Fire Impact Fee?

- Rational Relationship
- Over the past 20 years 70 new buildings added millions of square feet to protect
- Volume of calls up: Over 10,000 calls in 2016
- Workforce injury rate: 20.8 injuries per 1000 fires, .48 injuries per 1000 non-fire emergencies

Pension Obligation Bonds(POB's)

- Create a fixed repayment schedule for addressing the unfunded liability
- Reduce payments on the unfunded liability if investment earnings are greater than the interest rate on the pension bonds
- Current cost to borrow: 4.5% (for 20 year bonds)
- Recommended ROI Assumption: 6.25%
- **This is not the creation of new debt**
  - Savings based on difference between interest rate of bonds and assumed ROI

Pension Obligation Bonds



Potential Advantages of POBs

- Advantages:
  - Fixed debt interest is at historical lows
  - Puts the City on the footing for a long term solution
  - Reduces the risk future budgets will reduce payments on the unfunded liability
  - May reduce payments on the liability if interest rate on borrowing is lower than the future investment returns

Potential Disadvantages of POBs

- Money borrowed is above “risk-free rate” so there is a risk of negative returns
- Money borrowed is “locked in”
- Bond Rating agencies are neutral to negative to this approach – may be different for Illinois
- May increase the liability if future investment returns are lower than the cost to borrow
- A “big-bet” has more risk and more return than “bond issue averaging”

Action Item

- We are requesting that the Council direct city staff to work with the pension boards to start a formal inquiry into the funding methods presented tonight to address the unfunded liabilities of the police and firefighter’s pension funds.

- In short, let’s start the process and be back in six weeks with a formal proposal and recommended actions.

Thank you

- Mary Tomanek and Graystone Consulting
- Tim Schoolmaster, EPPF

Appendix

Tier I Benefits

- REGULAR RETIREMENT-Age 50 with 20 or more years of service
- 50% salary on last day of service first 20 yrs.
- Year 20-30 increase by 2.5% per full year
- Maximum benefit 75% salary (30 years)
- 3% COLA increase after age 55-compounded
- Disability Line of Duty 65% of salary
- Disability Non-duty 50% of salary
- Death of Retired Member 100% of benefit to eligible survivor, no annual increases
- Refund of contributions-up to 20 years service

Tier 2 Benefits

- REGULAR RETIREMENT-Age 55 with 10 or more years of service   Maximum 75% of salary
- 2.5% of final avg. salary for each year (FAS is highest salary based on highest consecutive 96 months of the final 120 months of service)
- Early retirement at age 50 with 10+ yrs. but penalty of <u>½% for each month prior to age 55</u>
-   (that is: 6% per year PENALTY prior to age 55)
- Annual salary cap $111,571.63 indexed for inflation(lesser of 3% or ½ CPI Increase)
- Death of Retired Member-66 2/3% benefit-CPI increases after age 60

Stay the Course Details

- Tier 2 benefits will have a dramatic impact on future cost rates
  - Tier 1 benefits
    - Total normal cost is around 30% of pay
      - Actual rate varies based on actuarial assumptions and methods
    - Member contributions are either 9.455% or 9.91%
    - Employer normal cost is around 20% of pay
  - Tier 2 benefits
    - Total normal cost is around 15% of pay
      - Reflects smaller COLA, later retirement, 8-year final average pay
    - Member contributions remain at either 9.455% or 9.91%
    - Employer normal cost is around 5% of pay

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