EL DORADO LAFCO

LOCAL AGENCY FORMATION COMMISSION

AGENDA OF MARCH 25, 2015

REGULAR MEETING

TO:	**Ken Humphreys, Chair, and Members of the El Dorado County Local Agency Formation Commission**
FROM:	**José C. Henríquez, Executive Officer**
AGENDA ITEM #8:	**CONSIDER AND ADOPT POLICY CHANGES RELATED TO PAYING DOWN THE LAFCO UNFUNDED LIABILITY FOR PENSIONS**

RECOMMENDATION

Staff recommends that the Commission consider and adopt the draft policy changes to ensure a process is in place for paying down the unfunded liability for pension in the coming years.

REASON FOR RECOMMENDED ACTION

The Commission directed staff to return with a policy to achieve that objective during the budget discussions.

BACKGROUND

Last year, the Commission adopted Policy 2.10 to establish an “Emergency Expense” fund. This fund acts as a reserve to assist LAFCO with funding catastrophic and unexpected non-budgeted items that may imperil operations. The funding mechanism for this reserve is the difference between the actual carryover amount from the previous fiscal year and the budgeted carryover amount when the former is larger than the latter. The size of the reserve is set at 5% of the LAFCO budget.

In October 2014, CalPERS released its actuarial valuation report on LAFCO. It contains information on what this agency needs to pay into the system for the next two years as well as other useful information. The valuation report indicated that the agency is 91.6% funded on its pension obligations. The unfunded accrued liability amount (UAL, which is the difference between LAFCO’s current market value of assets and normal accrued liability to meet the future pension of staff) will be 36,536 by the end of the current fiscal year.

The payment into the CalPERS system includes two parts. The first is the payment for "normal costs." This is the building of assets to meet pension obligations as they accrue. The second part is to pay down the UAL. In prior years, the UAL used to be factored into the employer rate. Starting in FY2015-16, CalPERS will separate the UAL out of the employer rate so that the latter is almost exclusively composed of "normal costs." The UAL would then be a lump sum that can be paid in full at the beginning of the fiscal year or in monthly increments throughout the fiscal year.

Assuming the rate of growth of the UAL and the UAL payment amounts stay the same, staff estimated that funded ratio will not reach 100% until the end of Fiscal Year 2041-2042. But this assumes that all things remain the same. The CalPERS system as a whole is about 76% funded. The CalPERS Board of Directors has set a goal to be at least 80% funded within 15 years. The employer rate was increased for the State of California in April 2014, to take effect immediately. The rate was also increased for school districts and local governments, to take effect in 2016. It is conceivable that as long as a plan remains not fully funded there will be sharp increases in the employer rate.

During the budget discussion, staff and the Budget Ad Hoc Committee recommended that the Commission consider paying down the entirety of the UAL as early as possible. This would be akin to paying down the principal on a home loan early. By being fully funded, LAFCO can lower its employee costs by having a lower employer rate and by no longer having to pay the UAL lump sum and any associated interest on the UAL. Lower budgets, in turn, help the funding agencies. The recommendation included that the funding mechanism be excess carryover funds beyond those budgeted once the reserve is fully funded. The Commission agreed with the recommendation and directed staff to return with a policy.

Adding a policy on the payment of the unfunded liability to Policies & Guidelines Section 2.10 is not appropriate because this section is specific to fund balances. A policy on paying down the unfunded liability fits better in Section 2.7 (Financial Policies). However, this new policy needs to be tied to the "Emergency Expense" subsection because the funding mechanisms are the same. These two sections would need to establish priorities and timing. As a result, staff recommends amending subsection 2.10.5(c) to the following:

2.10.5(c) Assigned: An "Emergency Expense" fund set at a maximum of 5% of the LAFCO budget for the purposes of funding non-budgeted legal expenses that may occur from time-to-time; unexpected catastrophic expenses; or an unexpected drop in revenues. Expenditure of "Emergency Expense" funds must receive prior approval of the Commission. An emergency expense can be authorized from the "Emergency Expense" with approval of the Executive Officer and either Commission Chair or Vice Chair for an amount totaling less than $10,000.00 during a monthly period. Assignments into this classification will not be allocated in the budget. Instead, assignments into this fund will come from any carryover monies that are in excess of the estimated carryover amount specified in the final budget.

Upon the time the "Emergency Expense" fund is fully funded in accordance with this policy, the application of any excess carryover monies will be applied per Policies & Guidelines Section 2.7.5

Staff also recommends the adoption of a new Policies & Guidelines Section 2.7.5:

2.7.5 To the extent that LAFCO's Plan with the California Public Employees' Retirement System has a funded ratio of less than 100%, and provided that the "Emergency Expense" fund is fully funded in accordance with Policies & Guidelines Section 2.10.5(c), it is the intent of this Commission to allocate any carryover monies that are in excess of the estimated carryover amount specified in the final budget towards paying down the unfunded accrued liability until the funded ratio reaches 100%. This allocation will continue until LAFCO's Plan's funded ratio is 100% or unless the "Emergency Expense" fund is not fully funded per Policies & Guidelines Section 2.10.5(c).