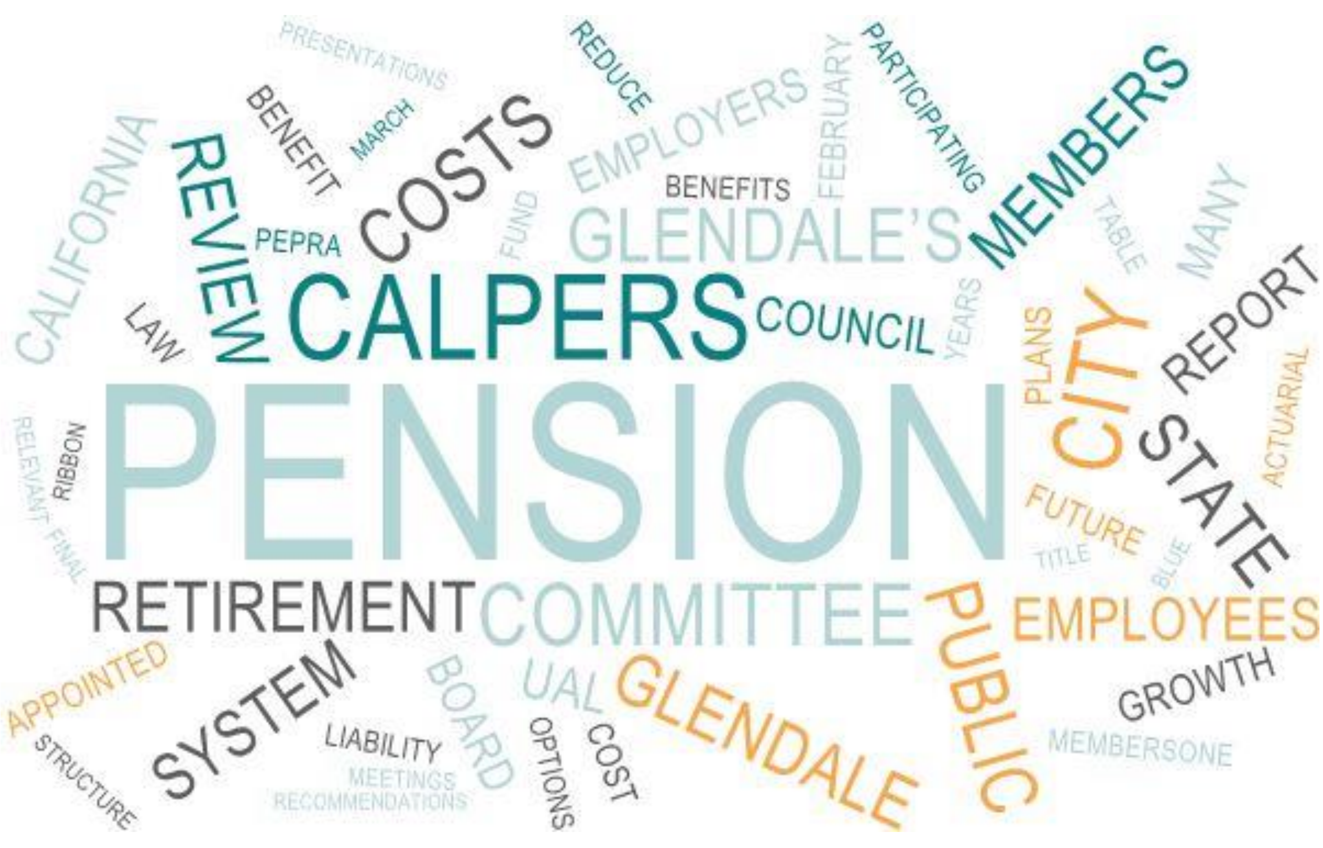
Report of The City of Glendale's

Blue-Ribbon Pension Review Committee

June 2022



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Composition Of The City Of Glendale's Blue-Ribbon Pension Review Committee

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- Mike Bain
- Roland Kedikian
- Alex Knights
- Alan Manning
- David Masias
- Grant Michals
- Herbert Molano
- Laura Nelson
- Susan Wolfson
- Alison Finch
- Michael Wenz
- Joseph Palos
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- Matt Doyle, Director of Human Resources, Retired
- Michele Flynn, Director of Finance, Retired
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- Aymee Martin, Acting Director, Human Resources
- John Takhtalian, Deputy City Manager

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I. *Executive Summary*

On March 31, 2021, the City of Glendale ("City" or "Glendale") formed a Blue-Ribbon Pension Review Committee ("Committee"). The Committee consists of 15 members, representing a diversity of backgrounds and with relevant education and experience in finance, law, and accounting. This report is the result of many meetings, hours of presentations from, and discussions with, pension experts, and a review of hundreds of pages of material. The Committee was tasked with conducting a comprehensive review of Glendale's pension system, structure, and costs and producing a final report with recommendations to the City Council.

Like many California public employers, Glendale contracts with the California Public Employees' Retirement System (CalPERS) to provide retirement benefits to its workforce, both civilian employees (i.e., "Miscellaneous") and police officers and firefighters (i.e., "Safety"). As a participating local employer, Glendale does not directly control many of the aspects of CalPERS administration and operations, such as its investments, actuarial assumptions, benefit levels, or employer contribution rates.

In 2012, an act of the State Legislature, known as the Public Employee Pension Reform Act ("PEPRA"), created a new, lower benefit tier for public employees hired after January 1, 2013. PEPRA was aimed at controlling the *future* growth in pension costs for participating employers but did virtually nothing to immediately reduce the growing employer payments toward Unfunded Accrued Liabilities ("UAL"). While PEPRA has and will continue to have a positive impact on the overall pension costs for participating employers, the savings will take many years to be fully realized. In addition to PEPRA, Glendale, like many CalPERS participating employers, has taken substantial action to help curtail the growth in pension costs, including increasing employee pension cost sharing, enacting multiple benefit tiers for both Miscellaneous and Safety employees, limiting growth in wages (i.e., cost-of-living increases), and creating a Section 115 Trust for pensions, commonly known in Glendale as the Pension Rate Stabilization Fund.

These cost containment actions have not addressed the City's ballooning UAL payments, which have grown at rates that far outpace both the City's growth in General Fund revenues and consumer prices. The growth in Glendale's pension costs puts significant pressure on the City's ability to deliver critical municipal services, while also providing a competitive total compensation package to recruit and retain a high-quality workforce. More needs to be done to accelerate the paydown of the UAL to ensure an affordable, sustainable, equitable, and competitive pension system into the future.

Toward these goals, and against the backdrop of the practical and legal limitations imposed on employers to modify retirement benefits, the Committee makes the following recommendations to City Council, which are discussed in greater detail in ***Section III*** of this report.

a. Create a Policy to Accelerate Pay Down of UAL

b. File a Validation Action For Issuing Pension Obligations Bonds (POBs)

c. Establish Greater Transparency and Focus on Pension Liability in Bargaining

d. Restructure Glendale's Collective Bargaining Program

e. Pursue Increases to Employee Cost Sharing

As detailed in the remainder of this report, despite reasonable actions taken by the City and the State to control pension costs, Glendale's pension costs continue to grow. More needs to be done in Glendale and statewide to proactively address this issue, but California's pension problems are many years in the making and there are no "silver bullets" or quick fixes available. Any viable solution must take a long view that balances the need to reduce pension costs with the need to maintain sufficient service levels and a productive workforce.

Considered against the backdrop of increased demand for City services from residents, the pension funding challenge becomes clear. The question is, how does Glendale, or any California city for that matter, contribute a greater share of its resources toward pensions without diminishing existing municipal services, while simultaneously investing more in infrastructure and traditionally underfunded governmental services such as parks, libraries, homelessness services, and affordable housing?

In that spirit, this report provides the City Council with a framework to proactively reduce Glendale's UAL while continuing to provide retirement benefits that are affordable, sustainable, equitable and competitive in the long and short-term.

II. *Background*

a. *The Blue-Ribbon Pension Review Committee*

On March 30, 2021, the Glendale City Council formed a Blue-Ribbon Pension Review Committee ("Committee"). The Committee consists of 15 members, 10 appointed by the City Council and 5 appointed by the City Manager. Given the complexity of the subject matter, members were selected who possessed relevant education and experience in such fields as finance, law, or accounting. The Council originally provided that five of the members of the Committee would be designated by labor, however, one of these slots was never filled. Hence, in reality, the Committee operated with 14 members.

The Committee was tasked with developing an understanding of the overall pension system structure, researching future anticipated costs, and ultimately advising the City Council on options and priorities for addressing pension costs and reducing Glendale's unfunded actuarial liability ("UAL"). Specifically, the Committee had the following tasks:

- Comprehensive review of Glendale's pension system, structure, and costs;
- Review and critique Glendale's pension reform efforts to date;
- Recommend options for reducing or eliminating Glendale's UAL;
- Review alternative financing methods for Glendale's UAL;
- Evaluate the feasibility of alternative retirement solutions; and,
- Produce a final report and recommendations to the City Council.

This report is the result of many meetings, hours of presentations from, and discussions with, pension experts, and a review of hundreds of pages of material. ***Table 1*** lists the presentations received by the Committee and underscores the range and depth of topics analyzed by the Committee.

Table 1. Pension Committee Meetings and Presentations

Meeting Date	Name of Presenter	Title/Subject of Presentation
October 4, 2021	John Takhtalian, Michelle Flynn et al	Background on Glendale's Pension Obligations
October 18, 2021	Linda M. Ross, Esq.	Vesting Rights for Public Employees
November 1, 2021	Mary Beth Redding (Bartel)	CalPERS Actuarial Issues Part I
November 1, 2021	Michael Garcia	Brown Act presentation
November 15, 2021	Mary Beth Redding (Bartel)	CalPERS Actuarial Issues Part II
December 6, 2021	Michael Cohen (CFO, CalPERS)	Review of ALM Decisions and the Path Forward
January 3, 2022	Committee Member Bain	Actuarial Concepts
January 3, 2022	Committee Member Kedikian	Options Available and Parameters to Consider
January 3, 2022	Committee Member Molano	Glendale's Public Pension
January 17, 2022	Isabel Safie	Legal Consideration in Terminating CalPERS Pension Contract
January 17, 2022	Jason Bradford	Pension Obligation Bonds Debt Service for Hypothetical Termination Liability
February 7, 2022	Mitch Barker, Jennifer Meza & Keith Stribling (PARS)	PARS 115 Trust – Pension Rate Stabilization Program Review
February 22, 2022	Ted Siedle	Forensic Audits of Pension Fund
February 22, 2022	Marcia Fritz	Strategies to Reduce Pension Costs
February 22, 2022	Suzanne Harrell (Harrell & Company Advisors, LLC)	Pension Funding Strategies
March 7, 2022	Rick Cole, Former City Manager, City of Santa Monica	General discussion of his experiences as an elected official and in City management over the past 40 years

Concern with pension expenses and pension reform is not new. Reasonable actions have been taken by Glendale and others to address these concerns, even if incremental in nature, but pension liabilities continue to grow in Glendale and across the state. This report addresses the growth in Glendale's UAL and recommends options for proactively managing and reducing the liability. The Committee recommends these options to preserve Glendale's financial stability and to ensure it meets current and future obligations to residents, City stakeholders, employees, and retirees in the future.

b. *The California Public Employees' Retirement System*

Glendale contracts with The California Public Employees' Retirement System ("CalPERS") for the administration of its employees' pension plans. Established in 1932, CalPERS is a public retirement system that administers pension plans on behalf of almost 3,000 public school, local agencies, and State employers in California. CalPERS is the largest pension fund in the United States with $474 billion in assets and over 2 million members as of February 2022.[1]

As a state-wide public retirement system, CalPERS operates under the authority of California State law.[2] CalPERS is governed by a 13-member Board of Directors, who, per the California Constitution, "have plenary authority and fiduciary responsibility for investment of moneys and administration of the system."[3] With this authority, the Board sets the policies followed by CalPERS staff for determining required contributions and investing pension funds. In accordance with State law and Board policies, CalPERS calculates member retirement benefits, pays retirees, tracks relevant data, and collects contributions from employees and employers.

The composition of CalPERS 13-member Board is mandated by law and cannot be changed unless approved by a majority of California's registered voters. A description of the CalPERS Board is shown in ***Table 2***.

Table 2. Composition of the CalPERS Board of Directors

Six (6) Elected Members	**Three (3) Appointed Members**	**Four (4) Ex-Officio Members**
▪ **Two** by and from all CalPERS members ▪ **One** by and from all active State members ▪ **One** by and from all active school members ▪ **One** by and from all active public agency members ▪ **One** by and from retired members of CalPERS.	▪ Appointed by the Governor: ○ **One** elected official of a local government ○ **One** official of a life insurer ▪ **One** public representative appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.	▪ The State Treasurer ▪ The State Controller ▪ The Director of the California Department of Human Resources ▪ A designee of the State Personnel Board

[1] Bartel Associates March 22, 2022, update to *CalPERS Actuarial Analysis – 6/30/20 Valuation Preliminary Results* for City of Glendale Miscellaneous and Safety Plans.
[2] California Government Code, Title 2, Division 5, Parts 3-8 (Sections 20000-22970.89). Among others, Part 3 covers the administration of the retirement system including membership, contributions, and benefits.
[3] California Constitution, Article XVI, Section 17, as amended by Proposition 162.

Pension plans – also known as “defined benefit” plans – are distinguished from other kinds of retirement plans because they promise members a specified monthly annuity for life upon retirement. For CalPERS’ members, that annuity is determined according to the member’s (i) final average pay, (ii) years of service, (iii) age at retirement and (iv) “benefit factor.” The specific formula is determined by the member’s type of employer (State, school, or local public agency); the member’s occupation (e.g., Miscellaneous or Safety); and the specific provisions in the contract between CalPERS and the member’s employer. For example, in Glendale the retirement benefits for Miscellaneous employees (i.e., non-sworn personnel) hired after January 1, 2013, are determined by a “2.0% @ 62” formula. This formula indicates the employees’ benefit factor (2.0%) and the age at which they can retire and collect their pension (62 years) without a benefit reduction. This means that at 62 years of age an individual can retire and receive a monthly annuity according to the following formula:

Years of Service x 2.0% x Final Average Pay

The monthly payments for CalPERS annuitants can be adjusted for cost-of-living by 2.0% annually to help maintain spending power while in retirement. Importantly, Glendale employees ***do not*** participate in Social Security while employed by Glendale and do not receive Social Security benefits upon retirement unless they have worked and qualified for Social Security benefits in other non-City employment.

In contrast to 401(k) style *defined contribution* plans, CalPERS members cannot withdraw funds at their discretion, and the monthly benefit they receive upon retirement does not depend on the amount they contributed to the pension fund or the fund’s investment returns. If poor investment returns or faulty assumptions lead to a funding shortfall, contracting employers, like Glendale, are required to make up the difference, even though they do not have authority over the day-to-day operation of the fund’s investments or operations. Contracting agencies do not have a hand in the planning and investment of their employees’ pension funds, the determination of required contributions, or calculation of retirement benefits. In short, Glendale is financially liable for planning and investment decisions over which it has no control. Moreover, although CalPERS has a fiduciary duty to its members, it does *not* have a fiduciary duty to its contracting agencies.

c. *Historical Context*

In 1999, the California State Legislature passed SB 400, enhancing the retirement formulas for State employees and paving the way for public Safety employees to retire at the age of 50 with 3.0% of their highest annual salary ("3.0% @ 50") per year of service. SB 400 allowed employees to retroactively switch into "First Tier benefits" defined by the enhanced retirement formulas, which lowered the retirement age for all State workers. This means that all service by an employee before the passage of SB 400 was recalculated based upon the higher benefit rate even though employers' contributions up to that time were based upon a lower benefit formula.

SB 400 placed pressure on local agencies to provide the same enhanced benefits to their employees. Amid the "dot-com bubble" and historically high rates of return on its investments, CalPERS assured local public employers that they would not be required to pay higher contributions for the benefit improvements. Inasmuch as agencies' plans were "super-funded" – requiring no annual employer pension contribution – agencies negotiated changes to their labor contracts to remain competitive in the labor market. Glendale was one of those agencies.

Evidence presented to the Committee suggests that Glendale, like many other jurisdictions that adopted the enhanced benefit formulae, did not conduct much, if any, independent analysis of the cost of the retroactive benefit enhancements, and that public discussion of these changes was minimal. Certainly, there were many reasons by the time Glendale enacted the enhanced benefits in 2001 to suspect that the enhanced benefits would come with substantial costs. However, recognizing that, "what's done is done," and that Glendale was one of hundreds of jurisdictions that adopted the retroactive enhanced benefit formulae, a majority of the Committee (over the objection of some) chose not to focus extensively on a deeper analysis of the City's decision-making process at the time. Also, critically, as discussed later in this report, PEPRA now prohibits retroactive benefit increases and addresses other failings that led to the unsustainable benefits that were enacted in 2001.

During the economic downturn that followed the dot-com bubble, CalPERS increased employer contribution rates to recoup their investment losses. Unfortunately, however, an even more severe economic downturn was on the horizon. During and following the period known as the "Great Recession," which officially began in December 2007 and lasted through June 2009,[4] pension systems experienced massive investment losses resulting in further increases to employer pension costs. In many cases, the increases to employer pension contributions significantly affected local budgets, resulting in broad service reductions (e.g., layoffs and furloughs), various active employee compensation reductions and cost containment actions (e.g., increased benefit cost sharing), or new taxes.

In response, State and local agencies, including Glendale, took a variety of steps to mitigate increases in pension costs. In January 2013, the State Legislature implemented the Public Employee Pension Reform Act (PEPRA), the most comprehensive reform of California's public pension systems since the benefit enhancements of the early 2000's.

PEPRA aimed to reduce long-term pension costs and liabilities by instituting reduced benefit formulas for employees hired *after* January 1, 2013, as defined in the statute (i.e., "new" employees). In comparison to benefit formulas for employees hired *prior* to January 1, 2013 – also known as "Classic" employees – PEPRA formulas have lower benefit factors and higher retirement ages. PEPRA requires new employees to pay at least half (50%) of the "normal cost" of their benefit – the annual cost of service accrued during the fiscal year for active employees – and prohibits employers from paying this contribution on their employees' behalf.[5]

Although PEPRA did little to lower employer pension costs for *current* employees (i.e., "Classic" employees), it eliminated the following pension "spiking" practices for the calculation of compensable earnings in Gov. Code § 31461(b):

- **Termination pay:** one-time cash payments of unused leave time, paid upon retirement, beyond amounts that would otherwise be earned and payable in the final compensation period;

[4] National Bureau of Economic Research (www.nber.org)
[5] Employers may bargain to have employees pay a greater portion of the normal cost; however, employers were prohibited from using impasse procedures to impose a contribution higher than 50% of the normal cost until January 1, 2018.

- **Cash outs of vacation or sick pay** beyond the amounts earned and payable in the final compensation period;
- **On call pay**: pay for additional services performed outside normal working hours; and,
- **Pension enhancements**: pay made to enhance a member's retirement benefit, such as cash paid in lieu of an in-kind benefit, one time or ad hoc payments, and payments paid solely due to termination of employment.

PEPRA also allowed employers to impose up to a 12% employee contribution for Classic Safety employees and 8% for Classic Miscellaneous employees. PEPRA further prohibits employers from granting retroactive pension enhancements that would apply to service prior to the date of the enhancement. This effectively prohibits a repeat of the early 2000's retroactive benefit enhancements widely enacted throughout California. This provision applies to both classic and new members and essentially constrains employees to more reasonable plans on a go-forward basis.

As shown in ***Table 3***, PEPRA substantially lowered the normal cost of pension benefits for both Miscellaneous and Safety employees. However, the savings produced by implementing lower cost pension tiers under PEPRA have largely been overshadowed by growing UAL payments. Importantly, in the absence of PEPRA, participating CalPERS agencies would have experienced even more severe growth in their pension costs. In FY 2010-11, a few years prior to the implementation of PEPRA, Glendale enacted reduced pension benefits for new hires ("Classic Tier 2") in order to help control the growth in pension costs. This is the retirement tier available to new hires in Glendale who have qualifying CalPERS service with a different agency (i.e., "laterals").

Table 3. Miscellaneous & Safety Pension Tiers, Active Employee Count, and Normal Cost

Group	Tier	Formula	Number of Actives	Total Normal Cost FY22-23
Miscellaneous	Classic Tier 1	2.5% @ 55	710	18.88%
	Classic Tier 2 ("Lateral Tier")	2.0% @ 55	78	17.46%
	PEPRA	2.0% @ 62	617	13.93%
Miscellaneous Sub-Total	--		***1,405***	***17.36%***
Police	Classic Tier 1	3.0% @ 50	144	32.82%
	Classic Tier 2 ("Lateral Tier")	3.0% @ 55	23	30.96%
	PEPRA	2.7% @ 57	58	25.48%
Fire	Classic Tier 1	3.0% @ 50	106	30.13%
	Classic Tier 2 ("Lateral Tier")	3.0% @ 55	13	30.79%
	PEPRA	2.7% @ 57	38	22.86%
Safety Sub-Total	--		***382***	***30.12%***

As ***Table 3*** indicates, the majority of Glendale's employees are Classic members. Glendale should see greater savings from PEPRA in the long run as Glendale's ratio of PEPRA to Classic employees increases overtime. But currently, pension expenses continue to strain the financial health of public agencies across California, and Glendale's growing UAL payments remain a cause for concern. Importantly, lower future benefits do nothing to reduce the current UAL. It is simply the difference between promised benefits and funding, an amount owed, similar to a bond or other debt, though somewhat more volatile because it is increased or decreased based upon CalPERS' market returns. And, like any debt, the UAL has a "carrying cost," and interest rate equal to CalPERS' discount rate – currently 6.8% per annum.

This report focuses heavily on the UAL and the ongoing cost of funding the UAL, and recommends options to City Council so that Glendale can more effectively control its pension costs and reduce its UAL.

d. *General Constraints on Controlling Pension Costs*

To properly frame the options reviewed and recommended by the Committee, it should be noted that any approach available to the City for managing its pension obligations will be subject to the following constraints: 1) vested rights; and 2) competitiveness.

Vested Rights

What are vested rights? In general, having a vested right to an asset means the asset cannot be taken by a third party. Whether the vestee yet possesses the asset does not matter; once the asset is vested, the vestee has a right to present or future possession of that asset.

For the most part, pension benefits of current retirees are assumed to be vested. Thus, the focus of pension reform efforts is generally on new employees and the *prospective service* of current employees. The question is, can the pensions of active employees be changed prospectively for service not yet provided?

The importance of the prospective benefit issue cannot be overstated. Liability for current employees generally is 40% or more of the total CalPERS liability for most jurisdictions (typically higher for Safety). Importantly, many believe we are close to the top of the market, so there is a significant risk that, if a recession occurs, CalPERS funded ratio will drop significantly as it did in 2009. **The only lever that could reasonably be expected to reduce accrued pension liability derives from changes to *prospective* benefits.**

In California, pension benefits become vested when an employee begins service for an employer (*Kern* – 1947). When positive changes are made to a pension system during employment, such changes become vested as well (*Bett*s – 1978). Once vested, pension benefits can be changed under limited circumstances, however, the changes must:

- Be reasonable (*Allen I* – 1955);
- Relate to the theory of a pension system and its successful operation (Id.); and,
- Should or must be accompanied by comparable new advantages (*Allen II* – 1983).

This constellation of rulings is often referred to as the "California Rule." The third bullet is particularly significant. Insofar as the goal is *cost-reduction*, the California Rule appears to undermine the whole point of reducing prospective pension benefits. If reductions *must* be accompanied by comparable new benefits, it is hard to see how changing prospective pension benefits could possibly alleviate the financial strain caused by the cost of those benefits.

On a positive note, in *Alameda Deputy Sheriffs' Assn., et al. v. Alameda County Employees' Retirement Assn, et al.* (2018) 19 Cal.App.5th (*Alameda*), the California Supreme Court rejected the argument that the California Rule always requires a "comparable new advantage." *Alameda* revolves around whether PEPRA's provisions against pension "spiking" violate vested pension rights. The Court held that the California Rule requires only that "the level of pension benefits to be preserved if it is feasible to do so without undermining the Legislature's permissible purpose in enacting the pension modification." Because the purpose of the PEPRA provisions was to ban "spiking," adding a comparable advantage was not required. This arguably creates a back door in the California Rule by permitting modifications without including comparable benefits, when doing so would frustrate the permissible modifications.

The Court also noted that a truly "prospective" modification would be one "that applies only to pension rights accrued after its effective date while preserving unchanged the law applicable to pension rights accrued prior to that date." Although that statement is dicta (and therefore not binding on a future court), tailoring a modification so it applies in this manner is a potential avenue around the California Rule altogether.

Whether prospective modifications to core pension elements would be legally permissible as a cost-saving measure is an open question, although the Supreme Court has already cast considerable doubt on this proposition. However, even if the law were settled, changes to CalPERS would require legislative approval. At this time, this is unlikely to happen given the makeup of the State Legislature. That means any change to prospective pension benefits will most likely come from a state-wide initiative or changes to an independent pension plan. As a participating CalPERS agency, the latter is not an option for Glendale. In Section IV, the report evaluates in greater detail the option of participating in an initiative to lobby the Legislature. However, the fact that there continues to be a legal cloud over the possibility of reducing prospective benefits, makes the likelihood of a legislative solution even more remote at this time. Moreover, it is unlikely that a legislative solution could be timely enough to correct the City's current fiscal circumstance.

Competitiveness

As with any element of total compensation, the value of an employer's retirement package relative to its competitors is relevant to prospective and current employees. Whether employees can get better retirement benefits in the same position at a different agency likely makes a difference to recruitment and retention outcomes. There are many reasons why it is important for public agencies to maintain a high-quality, high-performing workforce. Some of those reasons are financial in nature, and some of those reasons are specifically related to pension costs. For example, the employer pension costs associated with a given employee do not go away if that employee transfers to another agency, and, unless that employee's former position goes unfilled, the original employer will incur new pension costs when a replacement is hired.

More generally, Glendale, like all cities in California, relies on its employees to provide the very services that are being threatened by increasing pension costs. A central motivation for pension reform is to free up funds so that public services can be adequately maintained and enhanced. Reducing pension costs with strategies that drive current and prospective employees away from Glendale could be counter-productive to the core goal of improving municipal services. Any action to contain pension costs, must put competitiveness into the proper context.

The Committee did not review Glendale's market competitiveness based upon salary or other benefits, concluding that is a matter better left to those involved in the labor relations process. However, it remains a factor the City must consider as it seeks to address its pension costs.

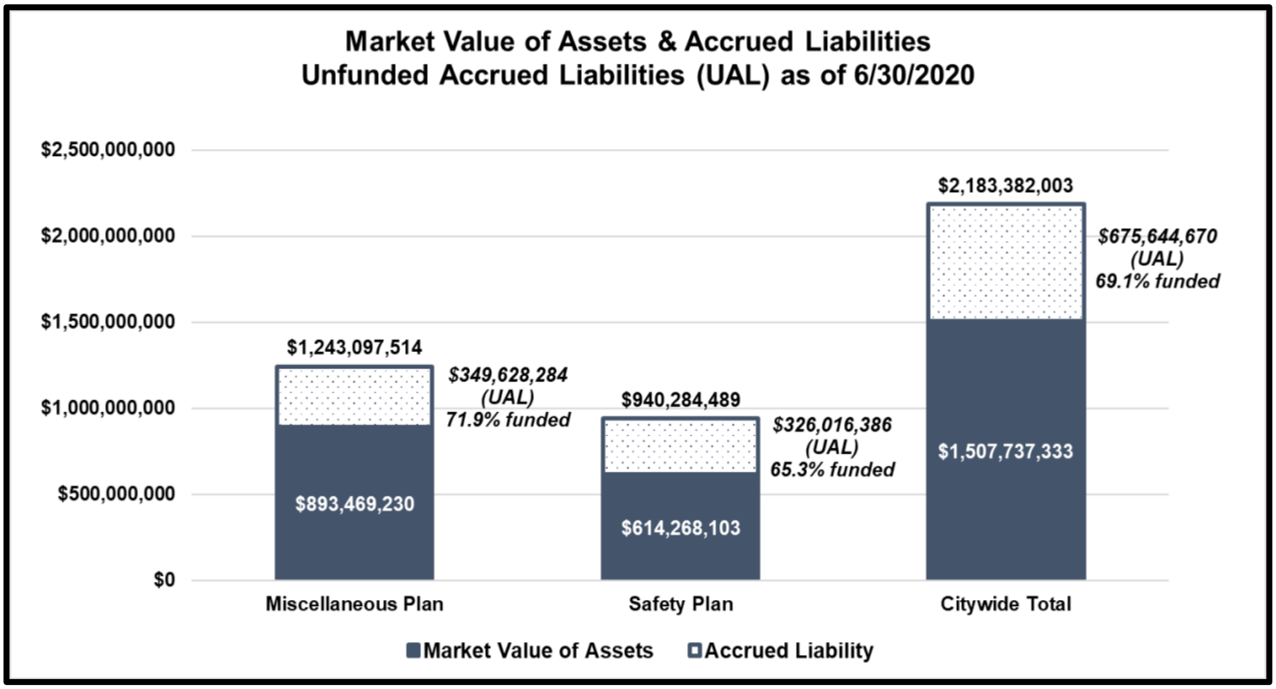
e. ***Glendale's Pension Plan Funding Levels***

A pension plan's funding ratio or funding level is a point-in-time measure of its assets relative to its obligations and is a common benchmark for assessing the relative health of a plan or system. It is calculated by dividing total assets of a pension plan (i.e., resources available to pay for pension benefits) by the total accrued liabilities (i.e., the present value of current and accrued future benefits), typically expressed as a percentage. The difference between a plan's liabilities and assets is known as the Unfunded Accrued Liability (UAL). This is the amount that is owed to the plan and is amortized over a reasonable period, with the goal of achieving full funding over time.

As shown in ***Table 4***, as of June 30, 2020 (the most recent CalPERS actuarial report), Glendale had approximately \$2.2 billion in accrued pension liabilities compared to assets of \$1.5 billion (market value of assets), resulting in a net UAL of \$675.6 million for its Miscellaneous and Safety Pension Plans combined ("citywide"). The cumulative funding citywide was approximately

69.1%. Separately, Glendale's Miscellaneous and Safety Plans (which includes both sworn Police and Fire) were funded as follows: the Miscellaneous Plan was 71.9% funded with a $349.6 million UAL and the Safety Plan was 65.3% funded with a $326.0 million UAL.[6]

Table 4. Market Value of Assets & Accrued Liabilities[7]



The most recent CalPERS actuarial valuations were published in July 2021. At the time the actuarial valuation was prepared, the FY 2020-21 investment return rate was not known. Accordingly, CalPERS assumed a 7.0% rate of return net of expenses to develop funding ratios, liabilities, and contribution levels. The actual gross rate of return for FY 2020-21 was 21.3%, which is more than three times higher than the estimates used in the actuarial valuations. This means that the City's true funding level has improved relative to the figures presented in the July 2021 valuations, even though Glendale's actual contributions through FY 2022-23 remain unchanged. The exact amount of that improvement will not be known until new valuations are

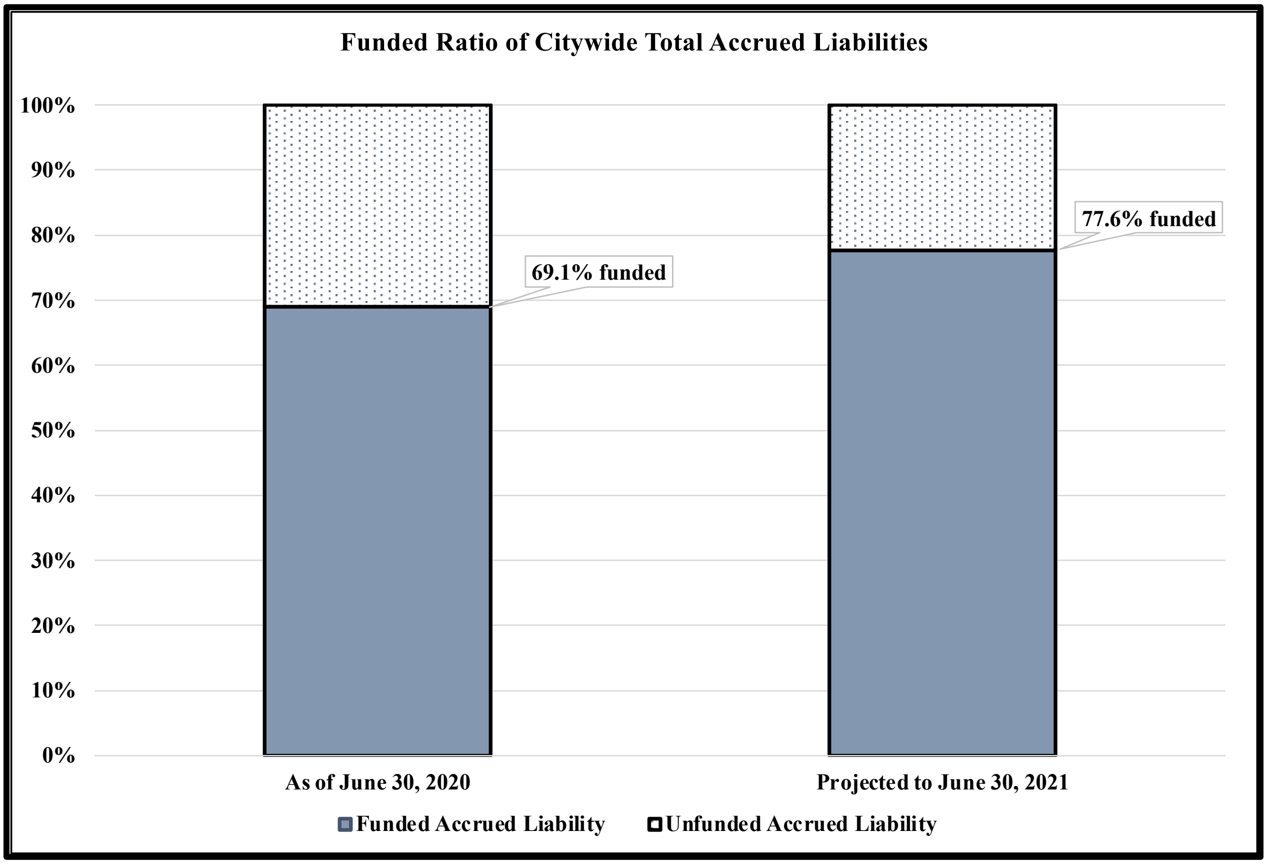
[6] See CalPERS, *Miscellaneous Plan of the City of Glendale, Annual Valuation Report as of June 30, 2020*, July 2021; and, CalPERS, *Safety Plan of the City of Glendale, Annual Valuation Report as of June 30, 2020*, July 2021.
[7] Note, the City's GASB 68 valuation reflected in its June 30, 2021, financial statement reflect slightly different figures due to differences in actuarial assumptions.

released in July 2022, at which time the full impact of the 21.3% return will be captured and offset by implementation of CalPERS' risk mitigation policy.

In 2015, CalPERS adopted a new Funding Risk Mitigation Policy to help balance pension plan risks, funding, and costs. The primary purpose of the policy was to reduce risk in the CalPERS investment portfolio. De-risking under the policy is achieved by lowering the discount rate when actual investment returns exceed the expected rate of return by certain thresholds, but at least by 2.0%. The discount rate reductions range from 5 to 25 basis points (0.05% to 0.25%) on a sliding scale depending on the actual returns experienced. Reducing risk in the investment portfolio lessens the likelihood of future volatility in employer UAL payments since an investment portfolio with less risk is less likely to experience losses during future market downturns. Importantly, the lowering of the discount rate has the effect of increasing the City's total pension liabilities and the resulting UAL payment. In the context of the risk mitigation policy, the new UAL produced by lowering the discount rate is offset by excess gains, effectively smoothing the impact on employer costs.

Based on actuarial analysis provided to the Committee by Bartel Associates, a leading actuarial firm in California, the impact of the 21.3% return is substantial. ***Table 5*** compares the citywide funded ratio as of June 30, 2020, with Bartel's projected funded ratio to June 30, 2021, factoring in the full 2021 investment return of 21.3%, offset by the risk mitigation policy. As shown in ***Table 5***, the funded level of the plan is anticipated to improve from **69.1%** funded to **77.6%** as a result of the investment return. The remainder of this report uses the CalPERS actuarial valuations as of June 2020 (published July 2021) because they are publicly available and determine the City's annual pension contributions.

Table 5. Bartel's Estimated Effect of 21.3% Return on Citywide Funded Ratio



Unfunded liabilities increase when actual results (economic, demographic, or investment) differ unfavorably from the actuarial assumptions used in projecting a plan's cost. For example, if investment earnings fall below the assumed rate of return, unfunded liabilities increase. If people live longer than forecasted, unfunded liabilities increase. Similarly, general wage enhancements (i.e., across-the-board increases) add to total pension liabilities, and will result in unfunded liabilities if the wage increase granted exceeds the actuarially assumed wage growth (per the July 2021 actuarial valuations, wages are assumed to increase 2.75% annually). Managing the rate at which wages grow is particularly important for controlling pension costs because it is one of the few levers that participating employers have some control over even if that control is limited by the collective bargaining process.

While Glendale's UAL represents a substantial and growing liability relative to available resources, it is important to understand that even if its Miscellaneous and Safety Plans were 100%

funded, there will still be circumstances that cause UAL to develop in the future. **UAL is a regular part of forecasting over long periods of time; pension plan funding requires a long-term perspective.**

The UAL in Glendale and other CalPERS participating agencies has increased for several reasons, including:

- Changes in actuarial assumptions and methodologies such as the rate of return (discount rate), projected life expectancy (mortality rates), asset smoothing techniques, and the UAL amortization period enacted by CalPERS in recent years;
- Changes in benefit levels in the early 2000's (i.e., pension formula enhancements); and,
- Investment losses and gains that are less than the assumed rate of return.

When evaluating the funding level of a pension plan and its relative health, it is important to consider the business cycle, which in macro-economic terms, is a series of economic expansions and contractions. A hypothetical plan that has an 80% funded level at the peak of a business cycle is generally not as healthy as a plan that is 80% funded at the lowest point, or trough, of an economic contraction, all else being equal. Given the considerable economic uncertainties permeating the national economy today – such as the lingering impacts of the COVID-19 pandemic, supply-chain issues, record high inflation, and ongoing geopolitical uncertainties – it is important to assess pension plan funding levels relative to the overall direction of the economy and markets.[8]

Some experts have used an 80% funding level as a general benchmark to determine whether a pension plan is financially healthy. However, according to the American Academy of Actuaries, there is no single funding level that adequately distinguishes a healthy plan from an unhealthy one. Multiple factors should be considered when evaluating funding levels, including the underlying financial strength of the employer, funding policies, and investment strategies.

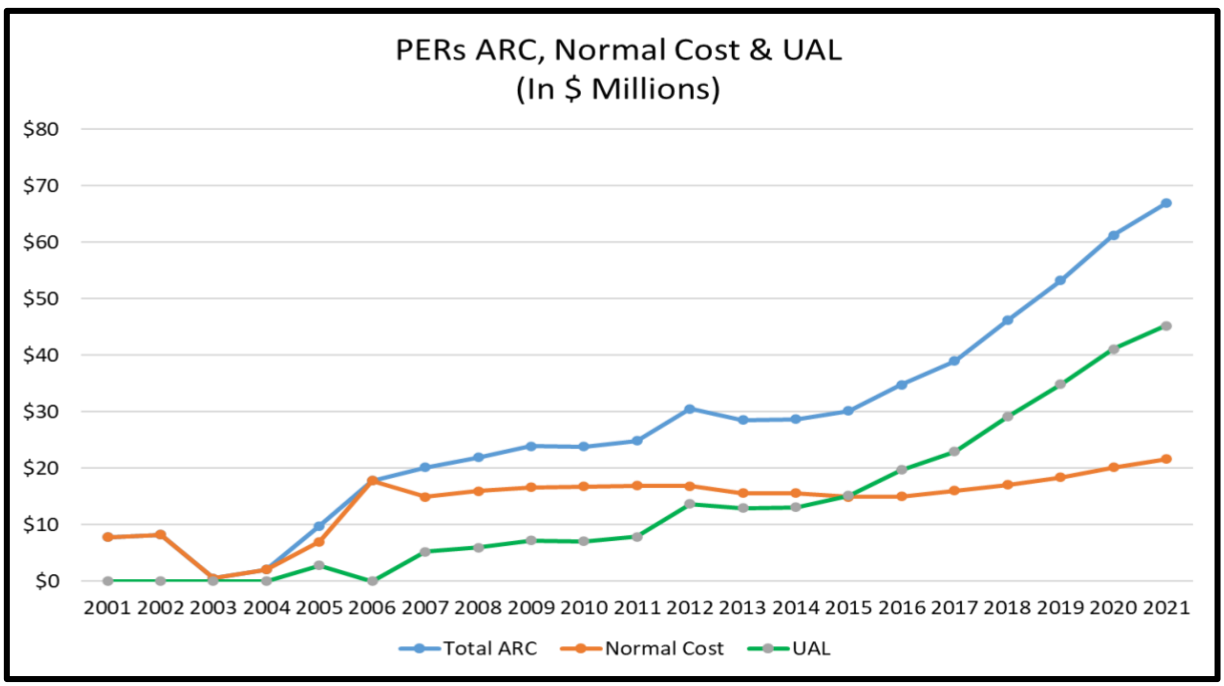
[8] This is another reason why this report does not focus on Bartel's actuarial analysis that factors in the full 2021 investment return of 21.3%, offset by the risk mitigation policy. Given the current economic and geopolitical climate, the Committee is not confident that the market won't take back most, if not all, the gains reflected in Bartel's estimate.

Ultimately, pension plan sponsors should have a goal of accumulating assets equal to 100% of pension obligations.[9]

f. *Glendale's Pension Costs & Budget Implications*

Employer contributions toward pension costs consist of two key components: the normal cost and UAL payment. The normal cost is the annual cost of the benefit accrued during the fiscal year for active employees. The normal cost reflects the value of the benefits earned by active participants in any given year and the amount necessary to fully fund the benefits earned by active workers that year assuming all actuarial assumptions are realized. In contrast, the UAL payment is the amortized dollar amount over assets needed to fund past service credit earned (or accrued) for members who are currently receiving benefits (i.e., retirees), active members, and for members entitled to deferred benefits. ***Table 6*** shows the rapid increase in Glendale's annual required contribution (ARC) over a 20-year period, which is driven chiefly by growth in the City's annual UAL payment.

Table 6. Glendale's Contributions to CalPERS[10]



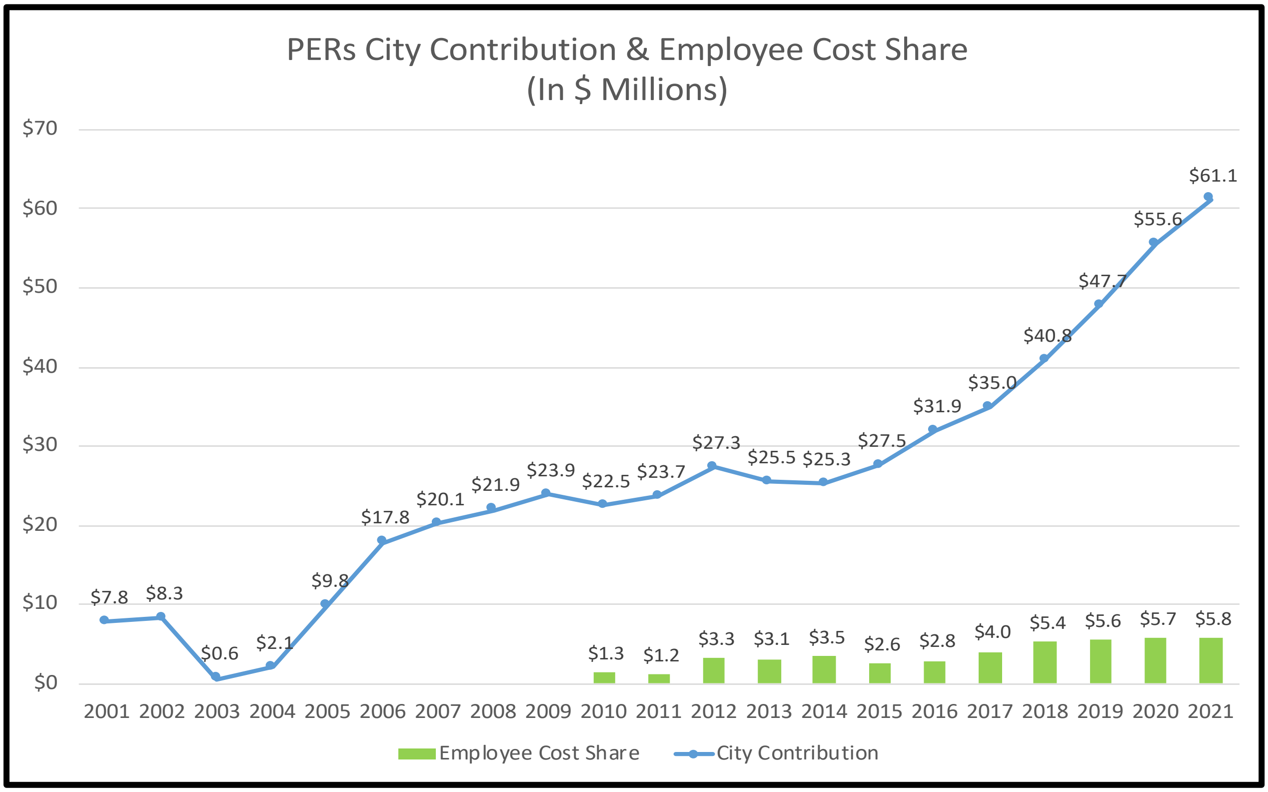
[9] American Academy of Actuaries, "*The 80% Pension Funding Myth," April 2014.*
[10] *City of Glendale, Finance Department*

As mentioned previously, Glendale has a UAL of $675.6 million as of June 30, 2020. For Fiscal Year (FY) 2022-23 Glendale is required to make a UAL payment of approximately **$57.2 million** to pay down the citywide UAL. Beginning in FY 2017-18, CalPERS required employers to make UAL payments as a fixed dollar amount, a change from the previous methodology of expressing the employer UAL payment as a percentage of payroll. This change was made to help ensure UALs were fully amortized and insulated from changes in the size of agency payrolls resulting from actions such as furloughs, layoffs, and vacancies.

Importantly, Glendale's $57.2 million UAL payment for FY 2022-23 is in addition to normal cost employer contributions that are expressed as a percentage of payroll. According to the City's most recent actuarial reports, the FY 2022-23 employer normal cost for the Miscellaneous Plan is 9.86% of pensionable pay (excluding any employee cost sharing) and 20.62% of pensionable pay for the Safety Plan (excluding any employee cost sharing). This is the "blended" employer normal cost rate for both pre- and post-PEPRA hires as reflected in the CalPERS actuarial report.

Table 7 shows the growth in employer contributions to CalPERS and the share of employer costs paid by employees (excluding the regular required employee contributions) over a 20-year period. As reflected in ***Table 7***, Glendale negotiated employee cost sharing prior to the implementation of PEPRA in 2013, and since FY 2014-15, both employer contributions and the amount of employer costs shared by employees have increased. However, the majority of the increasing employer contributions have fallen to the City. This is a problem because Glendale's revenues have not increased at nearly the same pace.

Table 7. Glendale's Contributions to CalPERS and Employee Cost Share[11]



As reflected in ***Table 8***, Glendale's required amortization payment of the UAL has grown substantially in recent years. As mentioned previously, the growing UAL is in part due to reductions in the assumed rate of return, which results in higher total pension liabilities and increased UAL payments. From FY 2017-18 to FY 2022-23, the City's total fixed UAL payment will almost double, increasing from approximately $30.2 million in FY 2017-18 to nearly $57.2 million in FY 2022-23 across its Miscellaneous and Safety Plans combined. This equates to an average annual growth rate of 13.6% over this six-year period, which is nearly four times the average annual rate of inflation. Measured from February 2017 to February 2022 (most recently published index as of the date of this report) the Consumer Price Index for All Urban Consumers (CPI-U) for the West region experienced an average annual growth rate of 3.6%, much of which was driven by significant inflationary pressures in early 2022.[12]

[11] *City of Glendale, Finance Department*
[12] US Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers (CPI-U), West region 2017-2022

Table 8. Glendale's Unfunded Accrued Liability Payments[13]

	Miscellaneous UAL Payment	Safety UAL Payment	Total Citywide UAL Payment	Year-over-Year % Increase
FY 2017-18	$16,759,848	$13,416,099	$30,175,947	0.0%
FY 2018-19	$20,295,669	$15,860,473	$36,156,142	19.8%
FY 2019-20	$24,048,223	$18,514,935	$42,563,158	17.7%
FY 2020-21	$26,465,007	$20,364,925	$46,829,932	10.0%
FY 2021-22	$30,049,099	$23,272,769	$53,321,868	13.9%
FY 2022-23	$32,317,385	$24,834,069	$57,151,454	7.2%
Avg Annual Increase	**14.0%**	**13.1%**	**13.6%**	**--**

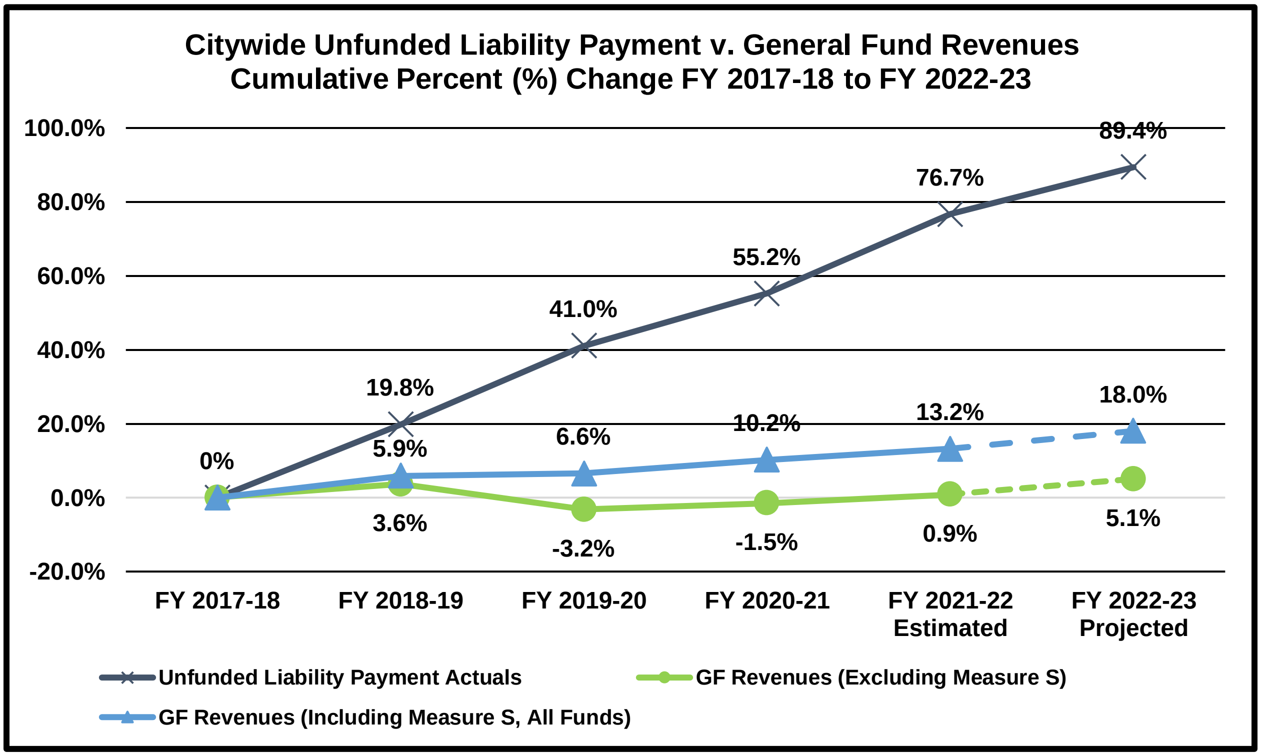
Growth in the City's UAL payments puts significant pressure on the City's budget, particularly in the General Fund which is the major fund used to cover public Safety costs, including both Police and Fire. For context, Glendale's $57.2 million UAL payment for FY 2022-23 is significantly more than the City spent from its General Fund on libraries ($10.5 million), parks ($15.2 million), and community development ($18.9 million) combined in FY 2020-21.[14]

The growth in the City's total UAL payment has significantly outpaced growth in the City's General Fund revenues. ***Table 9*** captures the cumulative percent change in the City's UAL payments relative to the cumulative percent change in General Fund revenues, both including and excluding Measure S, from FY 2017-18 through FY 2022-23 (projected).[15]

As demonstrated in ***Table 9***, while UAL payments increased 89.4%, General Fund revenues, excluding Measure S, are projected to increase by just 5.1% through Fiscal Year 2022-23. When Measure S revenues are included, the City's General Fund revenues increased cumulatively by 18.0%, still significantly less than the cumulative growth in UAL payments.

[13] These figures do not reflect the City's pre-payment of the UAL. The City has historically pre-paid its UAL. In FY 22-23 for example, this resulted in a ~$2.0M savings.
[14] City of Glendale, CA, Annual Comprehensive Financial Report, June 30, 2021.
[15] The FY 2022-23 budget is currently under development. For purposes of this table, the FY 2022-23 General Fund revenues both with and without Measure S revenues are preliminary and subject to change.

Table 9. Citywide Unfunded Liability Payment v. General Fund Revenues[16]



Measure S – which was approved by voters in November 2018 – is a 0.75% general sales tax. The revenues generated by this tax are not restricted by ballot and can be used for any general governmental service. As shown in ***Table 10***, the first full year of Measure S revenue collection occurred in FY 2019-20. For FY 2022-23, the City is projecting approximately $30 million in annual Measure S revenues.

Table 10. City of Glendale Measure S Revenues

($ in Millions)	Measure S Revenues (All Funds, including General Fund)
FY 2017-18	$0.0
FY 2018-19	$5.2
FY 2019-20	$22.7
FY 2020-21	$27.4
FY 2021-22 Estimated	$29.4
FY 2022-23 Projected	$30.2

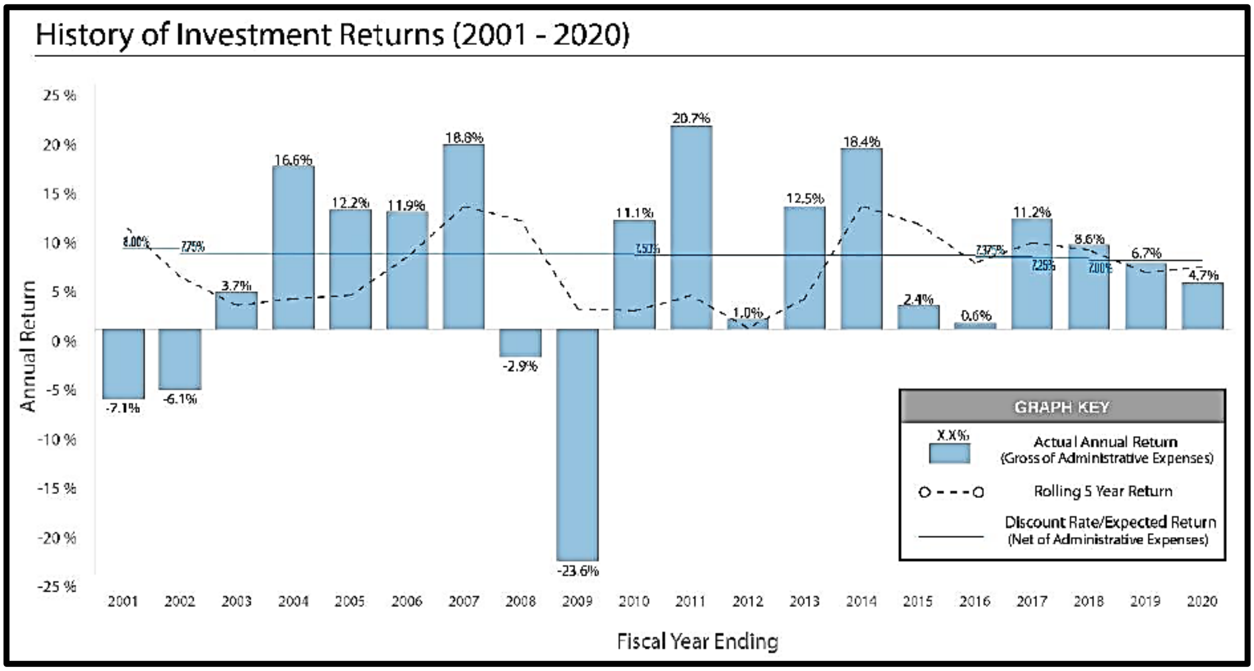
[16] It should be noted that approximately two thirds of the UAL payments are paid by the General Fund. The point of ***Table 9*** however is simply that the rate of increase in the UAL payments far outstrips the rate of increase in General Fund revenue.

In short, Glendale's UAL payment is taking up a larger share of available resources. Glendale's UAL payment across all revenue sources made up **20.4%** of total General Fund revenues, excluding Measure S, in FY 2020-21 (most recent actuals), up from **13.0%** of General Fund revenues, excluding Measure S, in FY 2017-18. For FY 2022-23, Glendale's citywide UAL payment of $57.2 million is approximately **23.3%** of projected FY 2022-23 General Fund revenues, excluding Measure S. Whenever a fixed expenditure grows at a faster rate than revenues, it squeezes existing services, potentially resulting in personnel expense cost containment (e.g., lower or no general wage increases for active workers, increased benefit cost sharing, etc.) and/or reductions to services through furloughs or layoffs.

g. *Historical CalPERS Investment Returns & Future Pension Cost Considerations*

Table 11 shows a 20-year history of CalPERS' actual investment returns and the expected rate of return (discount rate). As shown in the table, the annual rate of return has been less than the assumed discount rate in 10 years out of the last 20 years (2001, 2002, 2003, 2008, 2009, 2012, 2015, 2016, 2019, and 2020), while actual investment losses have occurred in four 4 years. Not surprisingly, the largest investment loss occurred in 2009, when the CalPERS system posted a 23.6% loss, at the height of the market downturn during the Great Recession.

Table 11. History of CalPERS Investment Returns[17]

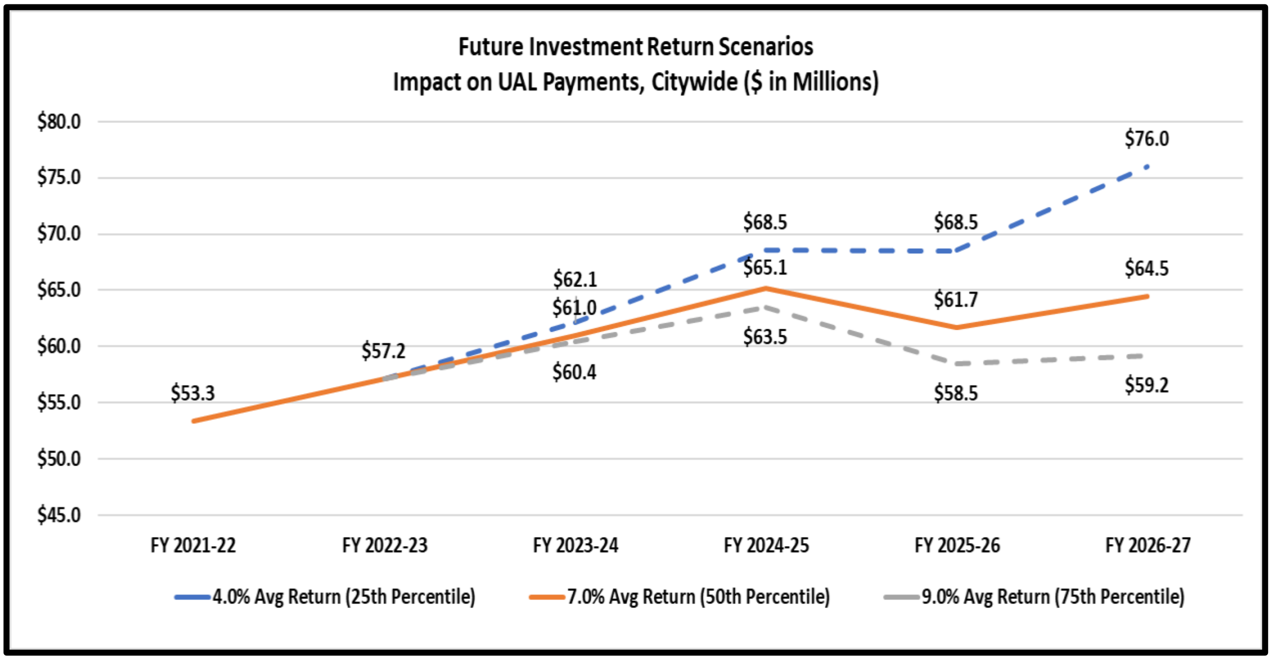


The significant growth in pension expenditures for the City is expected to continue in the near-term even under optimistic future return scenarios according to CalPERS statistical modeling. ***Table 12*** shows Glendale's UAL payment assuming a 4%, 7%, and 9% average rate of return, which reflects the 25th, 50th, and 75th percentile of return scenarios, respectively.[18] Half of the observations generated by CalPERS' stochastic model had four-year average returns within these bands. Generally, these ranges of outcomes represent the upper- and lower-bound impact of likely future return scenarios on the City's UAL payments, though returns outside of these scenarios are also possible, though less likely. As shown in ***Table 12***, Glendale's UAL payment is forecast to increase through FY 2024-25, even if CalPERS achieves an average rate of return of 9.0% over the next four years.

[17] CalPERS, *Miscellaneous & Safety Plan of the City of Glendale, Annual Valuation Report as of June 30, 2020*, July 2021.

[18] According to CalPERS, "The projections provide a range of results based on […] investment return scenarios assumed to occur during the next four fiscal years (2020-21, 2021-22, 2022-23 and 2023-24). The projections […] assume that all other actuarial assumptions will be realized and that no further changes […] will occur." CalPERS, *Miscellaneous & Safety Plan of the City of Glendale, Annual Valuation Report as of June 30, 2020,* July 2021.

Table 12. Investment Return Scenarios



On a positive note, the 21.3% investment return for FY 2020-21 that is not fully recognized in CalPERS' actuarial valuations will help to alleviate some of the growth in the City's UAL payments reflected in Table 6. As mentioned previously, however, the savings will be offset by costs due to triggering a reduction in the future assumed rate of return under the risk mitigation policy.

Table 13 shows Bartel's long run projections as of March 2022 for the City's contributions to CalPERS for its Safety plan under different investment return scenarios, and ***Table 14*** shows the same but for the City's Miscellaneous plan. Both tables represent the City's contributions as a percent of payroll and factor in employee cost sharing.

Table 13. Bartel's Contribution Projections for Glendale's Safety Plan[19]

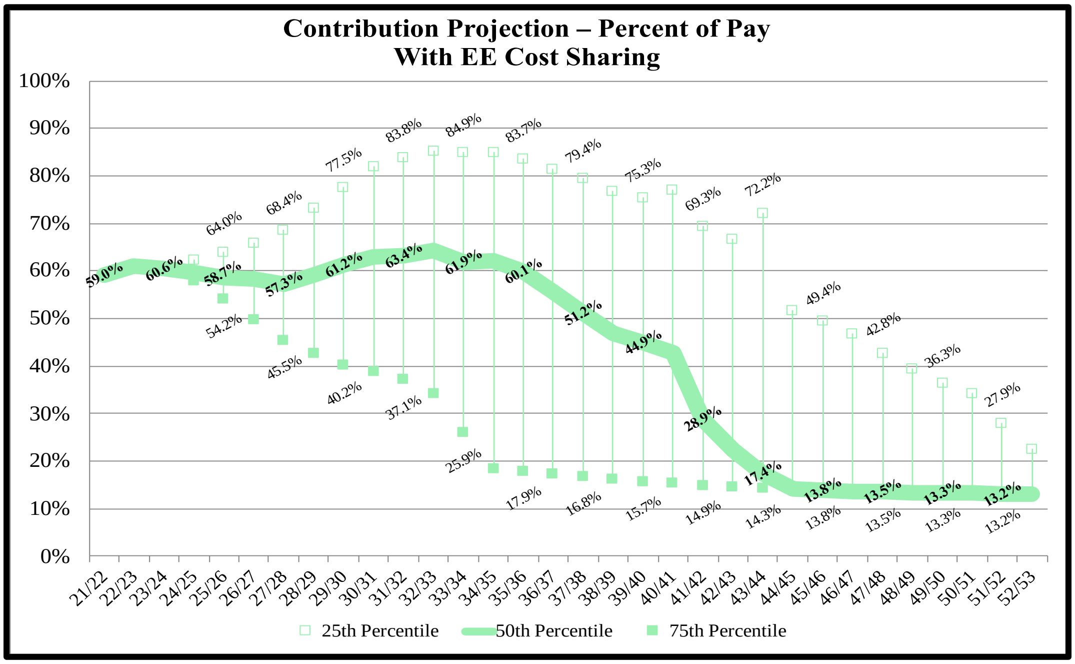
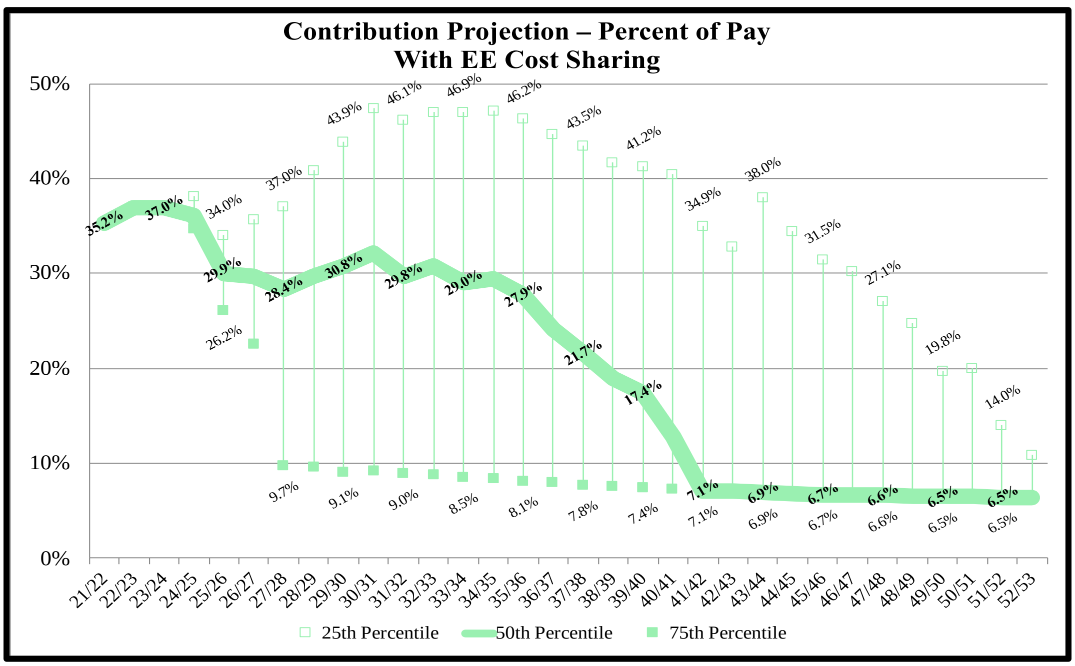


Table 14. Bartel's Contribution Projections for Glendale's Miscellaneous Plan[20]



[19] Bartel Associates March 22, 2022, update to *CalPERS Actuarial Analysis – 6/30/20 Valuation Preliminary Results* for City of Glendale Miscellaneous and Safety Plans.
[20] *ibid*

Both tables display a significant drop in the City's contributions around the year 2040 *if* CalPERS' investment returns align with the 50th percentile of return scenarios. This drop reflects the projected cost savings from a growing complement of PEPRA members – who have less costly benefits – and the phasing out of active and retired Classic members from Glendale's pension plans. However, it is important to emphasize some of the other key assumptions on which both tables rely. Namely, the tables assume that (i) investment returns will generally be lower over the next 10 years and higher beyond that, (ii) the discount rate will ultimately reach 6.0%, and (iii) there will be *no other changes to CalPERS investment methods or assumptions, no other benefit improvements, and no other gains or losses in CalPERS' portfolio*. As with any long run projections, the predictive utility of the projections decreases the further out they reach in time. Moreover, ***Tables 13 & 14*** show that even if all the model's actuarial assumptions were consistently satisfied and the long run projections were perfectly predictive, the City's contribution levels would still be highly dependent on fluctuations in CalPERS' rate of return. Even in the best return scenarios, Glendale still has many years to go before it starts experiencing significant relief in contribution levels.

Given the economic uncertainty of the present moment, and the uncertainty of markets in general, the long run projections in ***Tables 13 & 14*** must be viewed in the appropriate context. Importantly, these projections should not lead the City to believe that its pension issues will be solved simply by the passage of time. Glendale's pension issues are putting significant strain on the City's fiscal health *right now*, and proactive steps need to be taken to alleviate that strain as quickly as possible; the City cannot wait for a long run possibility that may never materialize.

Considered against the backdrop of increased demand for City services from residents, the pension funding challenge becomes clear. The question is, how does Glendale, or any California city for that matter, contribute a greater share of its resources toward pensions without diminishing existing municipal services, while simultaneously investing more in infrastructure and traditionally underfunded governmental services such as parks, libraries, homelessness services, and affordable housing?

h. *Glendale's Internal Revenue Code Section 115 Trust for Pensions*

In July 2017, the Glendale City Council approved and adopted the funding of a Pension Rate Stabilization Fund under Internal Revenue Code (IRC) Section 115, commonly known as a Section 115 Trust. The City's initial contribution to its Section 115 Trust was $26.5 million. The Glendale City Council authorized an additional contribution of $5.5 million to the Trust in December 2019. Trust assets, both contributions and investment earnings, once deposited, are irrevocable and can only be used to pay for pensions. Accordingly, local governments should consider the limited eligible use when depositing General Fund resources into a Trust. That said, Section 115 Trusts provide municipal employers with several key advantages.

First, a Section 115 Trust allows a municipality to invest in financial instruments otherwise unavailable to them, potentially increasing long-term yield. California Local Government Code Sections 53600-53608 limits the types of investments and maturities to which a local government can invest public funds, including its pooled cash and other reserves accounts, with Safety and liquidity being the primary objective. The additional yield that can be generated by a Section 115 Trust relative to the return on pooled cash, can be significant and provide a meaningful financial benefit over a long-term period.

Second, a Section 115 Trust allows the local government employer to maintain control over its investment strategy, unlike contributions that are made to CalPERS. Glendale, for example, has chosen to invest 5% of its portfolio to cash, 50% to equities, and 45% to fixed income, which is a more conservative, risk-averse allocation compared to CalPERS, with a target investment return rate of 5.0%.[21]

Lastly, assets in a Section 115 Trust can be used as a vehicle to maximize employer flexibility by providing a reserve (stability) and investment returns (yield). For example, assets in a Section 115 Trust can be used to smooth employer pension expenditures in any given year in response to market losses, actuarial assumption changes, or even "black swan" events such as the COVID-19 pandemic that severely and suddenly impact General Fund revenues. It can also be used to strategically accelerate paydown of UAL and thereby generate long-term cost-savings.

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[21] City of Glendale, CA, Annual Comprehensive Financial Report, June 30, 2021.

Despite these advantages, there are some downsides to Section 115 Trusts. Sections 115 Trusts can be structured to have a more conservative target rate of return, meaning that investment earnings might lag those produced by CalPERS over a longer-term horizon. It could be argued that a participating employer would, over a long-term period, have performed better if they had just deposited the funds directly into CalPERS rather than invested them in a Section 115 Trust. Some sponsors of Section 115 Trusts do this by design, balancing a lower expected long-term yield relative to CalPERS with improved stability (less volatility), potentially fewer investment losses, and more flexibility in how those assets can be used.

As shown in ***Table 15***, as of June 30, 2021 (the most recent audit), Glendale had $39.8 million in the Section 115 Trust, of which approximately $32 million was direct employer contributions to the Trust and $7.8 million, approximately 19.6% of the balance, was achieved through investment earnings.[22] As of March 31, 2022, the City's Section 115 Trust had a market value of approximately $38.4 million.[23]

Table 15. Section 115 Trust Employer Contribution & Investment Return

($ in Millions)	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	Total
City Contributions	$26.5	-	$5.5	-	$32.0
Investment Earnings	$1.1	$1.9	$0.2	$4.7	$7.8
Total Assets	**$27.6**	**$29.5**	**$35.1**	**$39.8**	**$39.8**
Investment Return %	***4.0%***	***6.3%***	***0.5%***	***11.7%***	

The City does not have a formal policy concerning its Section 115 Trust. Currently, the City funds the Section 115 Trust on an ad hoc basis when resources can be made available. The City also does not have a formally adopted policy that sets forth a target balance in the Section 115 Trust nor does it have a policy that governs how the assets will be used and under what circumstances. As the balance in the Section 115 Trust grows, it will be helpful to adopt a formal policy to enhance transparency and establish overall guidance for current and future policymakers.

[22] *Ibid.*
[23] City of Glendale, Finance Department, PARS Section 115 Trust Balance as of March 31, 2022.

i. *Additional Actions Taken by Glendale to Contain Pension Costs*

In addition to establishing a 115 Trust, Glendale has taken several steps to manage its pension obligations and reduce costs, some of which this report has already mentioned. Such steps include:

- Requiring employees to pay the full "employee" share of pension costs (since the 1980s);
- Requiring employees to pay a portion of the "employer" share of pension costs (since the adoption of the enhanced retirement plans in the early 2000s);
- Adopting "2nd tier" retirement formulas in 2010/2011 (before PEPRA was implemented in 2013);
- Eliminating the retiree medical insurance implied subsidy in 2015, which separated active employees from retirees, and erased a $250 million liability from Glendale's balance sheet;
- Negotiating concessions and wage freezes with employee groups from roughly 2009 through 2015; and,
- Multiple rounds of layoffs that reduced the salaried employee headcount by approximately 400 positions between 2009 and today.

III. *Committee Recommendations*

Given the various limitations discussed throughout this report, it is important to remember that adequately addressing Glendale's pension funding challenges will require additional financial resources. Challenges that are decades in the making cannot be solved overnight and there are no "silver bullets" in pension reform. In this vein, the recommendations below are presented as a means for ensuring Glendale can provide retirement benefits that are:

- **Affordable** in the near-term, without crowding out the City's capacity to provide quality services to the public and reasonable salary increases to active employees;

- **Sustainable** over the long-term, ensuring that benefits will be secure and reliable for career employees and their beneficiaries throughout retirement;
- **Equitable,** so that benefit costs are distributed fairly across generations; and,
- **Competitive**, to support effective recruitment and retention of a strong municipal workforce

As Glendale continues to manage its pension obligations and prevent unnecessary increases in pension costs, the Committee asks that the City keep the following maxims in mind:

- Actively scrutinize disability retirement claims and discourage use of consultants and medical professionals who have created a cottage industry;
- Hire Safety experts to minimize risky environments, especially among public Safety workers assigned to "desk jobs" which comprise the bulk of claims;
- Inventory Safety positions to determine if use of force is a significant, occasional, or very rare part of the job and fill as many positions with Miscellaneous workers as possible; and,
- Maintain competitive compensation packages to retain employees as employer pension costs do not go away when workers transfer to other agencies.

a. ***Recommendation to Create a Policy to Accelerate Pay Down of UAL***

As required by law and CalPERS contractual agreements, the Committee recommends that Glendale continuing making the full normal cost and UAL payments to CalPERS pursuant to its annual actuarial valuation reports. In addition to the minimum required contributions, the Committee recommends that the City create a policy to accelerate pay down of the UAL.

Accelerated pay down of the UAL (i.e., making annual UAL payments in addition to the minimum set by CalPERS) can generate long-term savings, increase intergenerational taxpayer equity in the distribution of pension costs, and help stabilize the City's finances in the event of economic downturn. As with other forms of debt, unfunded liabilities accrue interest costs; funding the UAL more quickly will reduce the City's expected cumulative interest payments to

CalPERS by shortening the amortization period. Larger, upfront UAL amortization payments generally lead to larger reductions in interest costs over time. In addition, the market rate of return will apply to a larger pool of assets leading to higher level of funding (assuming market gains). Paying more of the UAL now also helps to ensure that future generations are not disproportionately paying for services that they did not receive, enhancing intergenerational taxpayer equity. Moreover, the higher the funding level, the more quickly the fund will recover in the event of a market downturn. However, it is also true that the higher the funding level, the more dollars there are that could be lost in a market downturn, which highlights the importance of de-risking the investment portfolio to remove volatility from expected returns as much as is practical.

Based on a cumulative assessment of Glendale's current pension challenge, the Committee recommends the City Council adopt the following policy framework to accelerate pay down of Glendale's UAL. In general, any relevant policy should:

- Establish an ongoing annual obligation to fund the City's UAL through additional contributions to CalPERS and/or the City's Section 115 Trust;
- Formalize the process for making additional contributions;
- Designate funding source(s) for additional contributions;
- Designate whether funds are directed to the section 115 Trust or CalPERS; and,
- Recognize an ongoing commitment to prioritize paying down the UAL over other discretionary expenditures.

It is worth noting that any time an additional payment is made to CalPERS, future required payments will be lower than they would have been otherwise. The City could do its own calculation of the payments that would otherwise have been required and budget for that as its required contribution in order to further accelerate paydown of the UAL. Administratively, this would require additional actuarial work, but it could be done.

Two specific policy options are discussed in more detail below. Although both options ultimately recommend additional contributions to CalPERS above the required annual amortization payments, Glendale's 115 Trust is an essential component of the first option, but not the second. A strategy built around the second option *could* be integrated with the first option and thereby use the 115 Trust, but as indicated below, the second option could also be taken up independently of the 115 Trust.

i. Additional Contributions to the 115 Trust

The City does not currently have a Council approved policy concerning its Section 115 Trust. As a result, the City currently lacks clear goals and procedures for: 1) funding the Trust with regular contributions; 2) achieving some rational target balance in the Trust; and, 3) providing guidance to policymakers for how the Trust assets should be used and under what conditions. Having a formally approved Council policy governing pension funding and the Section 115 Trust will make it possible to measure the City's progress against stated benchmarks and help ensure that both current, *and future,* employees, policymakers, and residents understand the long-term intent of the City's funding of this Trust.

As stated earlier, Glendale has approximately $38.4 million in the Section 115 Trust as of February 2022. Unless otherwise indicated, the following recommendations are meant to be complementary components of one overarching policy option. Glendale should target achieving and maintaining a balance in the Pension Rate Stabilization Fund (Section 115 Trust) equal to **$65 million**. This is approximately equal to 1 years' worth of the City's current required contributions to CalPERS. Glendale should annually contribute at least **$5 million** from the City's General Fund into the Section 115 Trust Fund until such time that the target balance is achieved.

A fixed dollar amount is not the only method available for setting the Section 115 Trust target balance. Alternatively, Glendale could set a target balance equal to a percentage (e.g., 25%) of General Fund revenues or equal to Glendale's annual citywide UAL payment. Another option is to contribute to the 115 Trust on the assumption that CalPERS's discount rate will eventually fall to 6.2%, for example, and therefore demand higher annual amortization payments. So long as the actual discount rate (currently 6.8%) is higher than the assumed rate (e.g., 6.2%), the 115 Trust balance would hold additional funds that could be used to accelerate paydown of the UAL. However, the downside of linking the Section 115 Trust target balance to a variable number rather than a fixed dollar amount is that it may set the target unrealistically high in some years and unhelpfully low in other years.

Once the target balance is achieved, Glendale should contribute 115 Trust investment earnings in excess of the target balance toward accelerating paydown of the UAL. Assuming a $65 million Section 115 Trust balance and a 5% annual return, the total contribution amount would be approximately **$3.3 million** annually. It is recommended that the City further prioritize one-time resources during budget deliberations to further expedite paydown of the CalPERS UAL to the extent that they are available.

Glendale should annually review its asset allocation and investment strategy in the Section 115 Trust. It is recommended that Glendale continue to target a return rate that prioritizes Safety and liquidity and maintain a more risk-averse portfolio relative to CalPERS overall.

A detailed example of how this policy could be written is attached as ***Exhibit A***.

ii. Expedited Payment Schedule for UAL

Either as an alternative to, or in tandem with, the first option above, Glendale could accelerate the pay down of its UAL by adopting an expedited payment schedule based on a reduced amortization period for its UAL. As noted earlier, during its annual valuation process CalPERS attributes plan investment gains and losses to the year of the valuation as a separate debt or "base." Each base is then amortized over a maximum of 30 years to determine the required UAL payment for that year. However, CalPERS also provides contracting agencies the option to consolidate multiple amortization bases into a single refinanced debt to be paid off over a shorter period – also known as a "Fresh Start." Formal Fresh Start agreements with CalPERS should be avoided as they irrevocably bind contracting agencies to higher annual payments. Instead, following the City of Santa Monica, Glendale could adopt its own *informal* Fresh Start payment schedule without an official agreement with CalPERS.[24]

The City of Santa Monica adopted an expedited payment schedule based on a 13-year amortization period for its $467 million UAL. At the time of adoption, Santa Monica estimated that the expedited payment schedule would require additional annual contributions of $4 - $11 million over the first 10 years, but ultimately result in approximately $106 million in savings over 30 years.

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[24] CalPERS actually encourages agencies to adopt informal Fresh Start schedules.

By reducing the time-horizon for the accrual of interest costs, shorter amortization periods generally reduce expected cumulative contributions. On the other hand, annual contributions will generally be greater as a result. In short, money for additional annual contributions must come from somewhere. For example, the City of Santa Monica funded its expedited paydown schedule through a combination of one-time savings, budget reductions and reallocations. The potential for long-term interest savings must, of course, be weighed against the risk of shortfalls and reductions in service in the short-term.

As noted earlier, Glendale could adopt an expedited payment schedule based on a reduced amortization period in conjunction with the 115 Trust policy outlined above. An actuary could analyze the additional annual payment requirements and estimated long-term savings associated with different reduced amortization periods. These estimates could be used to adjust the policy's 115 Trust target balance and/or annual contributions from the General Fund to the Trust.

b. *Recommendation to File a Validation Action For Issuing POBs*

Public employers, to varying degrees, have used Pension Obligation Bonds (POBs) to address long-term unfunded pension liabilities. At a high-level, a POB is a debt instrument, issued on a taxable basis, by a public employer that has a primary goal of achieving positive cash flows. A positive cash flow on a POB occurs when the interest rate paid by the employer for servicing the debt is less than the rate of return on the bond proceeds after being deposited and invested in a pension system.

The use of POBs rests on this assumption: that the yield generated by investing the bond proceeds will be greater than the interest rate paid overall for debt service.

Market conditions favorable for POBs appear to have materialized in the first half of 2020 at the onset of the COVID-19 pandemic when interest rates were low and the market had declined significantly. This was evidenced by an uptick in the volume of POB issuances.[25]

The Government Finance Officers Association (GFOA) recommends that state and local governments do not issue POBs. The GFOA guidance against POBs was reaffirmed in February

[25] S&P Global Ratings, *Pension Obligation Bond Issuances Continue to Increase in 2021*, October 14, 2021

2021.[26] POBs can be complex and carry considerable risk. As the "spread" increases, it signals increasing market volatility risk. Employers should exercise caution and consider their unique circumstances when evaluating the pros and cons of issuing POBs. Failing to achieve the targeted rate of return can cause the issuer to be straddled with both fixed debt service payments on the POBs and additional UAL payments, which can exacerbate long-term funding challenges.

Again, the success of POBs is highly dependent on market timing. Some jurisdictions have handed CalPERS very significant sums, and then suffered large market losses. ***Table 16*** illustrates the negative relationship between increases to bond interest rates and budget savings.

Table 16. Savings Sensitivity to Bond Interest Rates[27]

	AA+ Rated February 2022 Rates	February 2022 Rates + 0.25%	February 2022 Rates + 1.00%
Budget Savings	$154.4M	$141.5M	$103.9M
Effective Rate (Including Costs of Issuance)	3.07%	3.32%	4.07%
Change from February 2022	--	($12.9M)	($50.5M)
% Reduction In UAL Payments (6.8% ROR)	19.3%	17.7%	13.0%

At the moment, interest rates are going up and the discount rate is going down. It would therefore appear that the window to issue a POB is narrowing. For these reasons, the Committee recommends that the City Council only authorize the filing of validation action, which has an estimated cost of approximately $25,000. Once the validation study is complete, the City can revisit the issue of whether to actually issue POBs based on market conditions.

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[26] Government Finance Officers Association, Pension Obligation Bond Advisory, January 1, 2015, Re-affirmed February 2021

[27] Suzanne Harrell (Harrell & Company Advisors, LLC,), *Pension Obligation Bonds Presentation to Glendale Pension Committee*, February 22, 2022.

In order to issue POBs in California and render a final legal opinion regarding the validity of the bonds, a judicial validation process must be undertaken and completed in Superior Court. POBs fall under an exception to the constitutional debt limit. Importantly, validation does not obligate the City to issue POBs or even to have agreed on a specific plan of finance. The first step in the validation process is the preparation of bond documents, including authorization by the City Council to seek the validation. The bond documents can be written with flexible terms to position Glendale to move quickly if it decides to issue POBs at a future date. The validation process can take several months to complete.

If the Council is interested in using POBs on the basis of the validation action, the Committee recommends using them only as one tool among others for accelerating the paydown of the City's UAL and consider the risks outlined above carefully.

c. *Recommendation to Establish Greater Transparency on Pensions in Bargaining*

To ensure that Glendale's pension costs are kept in check during MOU negotiations, the Committee recommends adopting measures to bring greater focus to pensions in labor negotiations. The Committee's recommendations are intended to be implemented in a manner consistent with the City's obligation to engage in collective bargaining under MMBA.

CalPERS assumes a rate of annual salary growth when developing its annual contribution levels. CalPERS' most recent valuations for Glendale set this rate at 2.75%. Whenever the City gives COLAs above that rate, it runs the risk of adding to its UAL. Thus, when the City negotiates its labor contracts, it should consider the fiscal impact of the addition to the UAL that could arise out of one or multi-year COLAs that exceed CalPERS assumed rate of salary growth. The City should enact a policy to notify the public if, and when, a negotiated labor contract involves COLAs beyond that rate.

The City should also enact a policy requiring it to include estimated increases to pension costs in costing for contract negotiations. The policy should require the City to publicize this costing on the City's website and review it with Council in open session. All costings in labor negotiations should include additional pension contributions projected by CalPERS due to the increased cost of amortizing the unfunded liability. That is, all costings should include "the cost of doing nothing" – the increases to Glendale's pension contributions that will occur even in the absence of wage increases. For example, as was shown previously (see ***Table 8***), Glendale's citywide UAL payment will increase by approximately $3.8 million in FY 2022-23 relative to the contribution in FY 2021-22. In comparison, a 1.0% salary increase for all Miscellaneous and Safety employees is approximately equal to $1.6 million.[28] This means that the $3.8 million increase in Glendale's UAL payment is approximately equivalent to a 2.4% salary increase for all City employees.

Without this information the public cannot assess the true increases in the City's employment costs in a particular year.

d. *Recommendation to Restructure City's Collective Bargaining Program*

The Committee recommends that the Council restructure its collective bargaining practices to increase transparency and accountability to the public. In contrast to the recommendations in the previous section, this section recommends establishing greater transparency in bargaining in general, not only greater transparency in bargaining about pension costs. This is because the cost of pension benefits is driven in significant part by increases in compensation. The Committee discussed the two options below, but there may be other options worth exploring.

i. Civic Openness In Negotiations ("COIN")

Following other jurisdictions in California (e.g., Costa Mesa, Beverly Hills, Orange County, Rancho Palos Verdes, Fountain Valley, Fullerton, etc.), the City could adopt a labor relations program similar to Civic Openness In Negotiations ("COIN"). Practices associated with COIN include:

- Contracting with independent negotiators to replace City management in negotiations with bargaining units;
- Using an independent auditor to analyze costing of proposals;
- Disclosing all proposals and counterproposals to the public within 24 hours of submission;

[28] This is based on a projected citywide payroll of $163,613,682 for FY 22-23, with the Safety payroll at $56,385,841 and Miscellaneous payroll at $107,227,552. See CalPERS, *Miscellaneous & Safety Plan of the City of Glendale, Annual Valuation Report as of June 30, 2020*, July 2021.

- Requiring Council members to disclose all communications with official representatives of employee organizations; and

- Posting tentative labor agreements to City's website 30 days prior to Council's ratification to allow for public scrutiny.

These practices can be codified in different ways, but they are typically codified together as components of one larger program. Nevertheless, in principle each practice above is independent from the others. Adopting any one of them would not commit the City to adopting any of the others.

There *are* aspects of COIN that may place undue reliance on the use of outside financial experts – which inappropriately suggests that internal cost assessments may be inaccurate or biased. There is no evidence of any such deficiencies in the City's current financial team. The Committee also recognizes that COIN has been controversial with labor groups. Indeed, all four of the labor representatives on the Committee voted against this proposal and the "Public Bargaining" proposal discussed below. Moreover, in reaction to COIN, the state legislature passed Civic Reporting Openness in Negotiations Efficiency Act ("CRONEY") in 2015, which applies specifically to jurisdictions that have COIN and essentially requires *all* city contracts – not only labor contracts – worth $250,000 or more to have an independent auditor review and report on their costs.

Importantly, CRONEY led Costa Mesa, one of the original proponents of COIN, to repeal its 2012 COIN ordinance in favor of a Transparency in Labor Negotiations policy with similar but not identical provisions. The new policy retains the COIN requirements that proposals and offers be posted online during negotiations and that city council members disclose communications with official representatives of employee associations. However, it abandons the requirement that an independent auditor prepare an economic analysis on the fiscal impacts of each proposal – allowing the analysis to be prepared by the Finance Director and verified by an independent auditor instead. It also abandons the requirement that outside counsel serve as the city's chief contract negotiator – allowing executive staff to fill that role instead. Moreover, it allows the council to adopt a memorandum of understanding with a bargaining group after one public meeting rather than two.[29]

For these reasons, the Committee does not necessarily endorse all aspects of COIN and urges the Council to consider its recommendation in that light. The Committee believes that the primary value of COIN is that it gives the public sufficient time to assess the costs of labor agreements and allows the public to have greater insight into the bargaining process.

ii. Public Bargaining

The Committee also recommended the Council consider requiring that labor negotiations be open to the public – sometimes referred to as "Public Bargaining." Traditionally, labor negotiations have been considered confidential – at least to the point of impasse. Many labor professionals on both union and management sides often express concern that public labor negotiations will lead to increased "grandstanding" and make it more difficult to reach agreements due to increased formality. On the other hand, there have been increasing calls for open labor negotiations in the public Safety realm, and at least one jurisdiction, Oakland, conducts public negotiations with its largest municipal union.

From the standpoint of the Committee, the concern is that labor negotiations often obscure pensionable costs. Importantly, pensions, and hence pension costs, are not just based upon salaries, but upon "Special Compensation" for specialized work, longevity pays, educational incentives, and many other elements of pay that are not readily accessible to the public. CalPERS currently recognizes over 100 varieties of Special Compensation that employers must report,[30] but the public often does not see how changes to Special Compensation are negotiated or economic analyses of their fiscal impact.

e. *Recommendation to Pursue Increases to Employee Cost Sharing*

Currently, CalPERS' "normal" employee contribution for Classic Safety employees is 9% of pensionable wage. CalPERS' normal employee contribution for Classic Miscellaneous

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[29] For reference, Costa Mesa's 2019 Transparency In Labor Negotiations policy is attached as ***Exhibit B***.

[30] *For CalPERS running list of Special Compensation categories and reporting requirements see: https://www.calpers.ca.gov/page/employers/mycalpers-technical-requirements/special-compensation-reportability-table*

employees is 8%. Both before and after PEPRA, employers were permitted to negotiate employee contributions to the employer's payments to CalPERS. Glendale was early in doing so – currently, Glendale's Classic Miscellaneous employees contribute 3.0 – 4.0% of pay to the employer share (for a total employee contribution of 11.0 – 12.0%) and Classic Safety employees contribute 3.5 – 4.5% of pay to the employer share (for a total employee contribution of 12.5 – 13.5%). While it is commendable that Glendale reached these agreements before most other employers, the amount of the cost share has dramatically lagged the increasing employer costs.

Currently, Classic Tier 1 Miscellaneous employees pay up to approximately 63.0% of their total normal cost (up to 12.0% of 18.8%). In contrast, Classic Tier 1 Police employees pay up to approximately 41.0% of their total normal cost (up to 13.5% of 32.8%), and Classic Tier 1 Fire employees pay up to approximately 44.8% of their total normal cost (up to 13.5% of 30.1%). The City should propose to increase the employee cost share for Classic Safety employees to match the pro rata amount for Classic Miscellaneous employees. Recognizing the amounts will be different for Tier 2 employees, this equates to an increase of approximately 7.2% for Classic Tier 1 Police (for a total of 20.7% of pay) and 5.5% for Classic Tier 1 Fire (for a total of 19.0% of pay). Of course, any change in employee cost sharing is subject to labor negotiations with the City's bargaining groups.

The Committee does not recommend cost sharing for PEPRA employees because their plans are significantly less expensive. Indeed, there is anecdotal evidence that the PEPRA plans, if costed separately, have not contributed to the City's unfunded liability to date.[31] PEPRA employees currently contribute 50% of the normal cost of the plans. In the absence of evidence that PEPRA plans are creating new unfunded liability, and to maintain competitiveness in the labor market, increased employee contributions do not appear warranted at this time.

The desirability of making any new proposal for additional cost sharing should be considered in the context of all other proposals on the table at the time of bargaining, Glendale's overall compensation comparability, as well as recruitment and retention considerations. As noted earlier, whether prospective and current employees can get better retirement benefits in the same

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[31] Of course, if CalPERS' assumptions prove incorrect it remains possible that PEPRA employees will add to UAL in the future.

position at a different agency may make a difference to recruitment and retention outcomes, and pension costs do not go away when employees transfer to other agencies. Moreover, Glendale, like all cities in California, relies on its employees to provide the very services that are being threatened by increasing pension costs. The cost saving benefits of increasing employee contributions should be weighed against the risk of driving current and prospective employees away from Glendale.

IV. *Additional Items Evaluated by the Committee, But Not Recommended At This Time*

The Committee explored and evaluated several options to help achieve long-term financial sustainability and affordability of Glendale's retirement benefits. This section discusses the options considered, but not recommended by the Committee. They are included with considerations for and against each option so that the City Council can evaluate for itself all options seriously proposed or explored by members of the Committee.

a. *Withdrawal from CalPERS*

Under California's Public Employee Retirement Law ("PERL"), all employees of the City must be enrolled in CalPERS unless excluded by contract or statute (*see* §20281 and §§ 20300-20305). As a result, Glendale may not provide a defined contribution or deferred compensation plan to employees *in lieu* of a CalPERS defined benefit plan *unless* Glendale elects to withdraw from CalPERS and terminate its contract.

CalPERS discourages termination by imposing a hefty charge backed by a statutory lien (§ 20574). If an agency terminates its contract, CalPERS merges the agency's pension assets into a single termination pool which is invested more conservatively than it was pre-termination – the assumed rate of return is reduced to a variable rate generally based on the yield on 30-year treasury obligations (currently less than 3.0%). This results in underfunding even if the terminating agency's plan was fully funded at the time of termination. The terminating agency must then fully fund the plan on an accelerated basis. The lump sum dollar amount necessary to do this is known as the "termination liability." A statutory lien, applicable to *all assets* except a prior lien or wages, enforces the termination liability.

At this time, if Glendale withdraws from CalPERS, it will incur an estimated termination liability of $2.8 billion to $3.6 billion (depending on the assumed rate of return for the termination pool). Unless CalPERS accepts installments (on which interest would be charged), Glendale would be required to pay down the liability on a lump sum basis. For context, this lump sum is approximately 12 to 15 times greater than the City's total General Fund revenue projection for FY 21-22 ($235,035,000). It is hard to see how the City could acquire the funds necessary to pay down the termination liability.[32]

Moreover, CalPERS has the authority to reduce accrued benefits to a level consistent with the funded status of a terminated plan, and failure or refusal to pay the termination liability would also authorize CalPERS to pursue the City's assets. CalPERS does not bear financial risk from reductions by the City in its funding payments because state law requires CalPERS to pass along the reductions to retirees in the form of reduced pensions.

In addition to the prohibitive magnitude of the termination liability and the risks posed to the City's assets and retired employees, withdrawing from CalPERS would not release the City from its legal obligation to provide future retirement benefits to employees or its contractual obligations to provide a pension or defined benefit plan for *current* employees. Thus, the costs associated with withdrawal go beyond the termination liability; the estimated costs associated with providing retirement benefits post-withdrawal must be added to the termination liability to properly compare withdrawing from CalPERS and the other options explored by the Committee.

In comparison with paying off the City's current UAL (~$675M), withdrawal would protect the City from any losses sustained by CalPERS in the future. However, it seems very unlikely the City would incur an additional ~$2.1B – $2.9B liability in the future after paying down its existing UAL. The City could ask an actuary to calculate the likelihood of this occurring. But whatever the likelihood is, withdrawing from PERS would not release the City from the costs associated with providing new retirement benefits for its employees.

Granted, these retirement benefits need not be structured as a pension plan for *new* employees, but, due to vesting rights, the City likely would need to create new pension plans for its *current* employees. Like the assets in CalPERS' pension fund, the assets in the City's new pension fund would need to be invested, which poses an equivalent risk of creating a new liability.

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[32] Even if the City could acquire the necessary funds, it is not obvious that withdrawing from PERS and paying the termination liability would be a particularly good use of those funds.

Presumably, the kind of events that could cause the City to incur \$2.1B - \$2.9B of new liability from a fully funded CalPERS plan are the kind of events that would affect the entire economy and create new liabilities for any pension fund.

In summary, at this time withdrawing from CalPERS appears prohibitively expensive and would not relieve the City of its obligation to provide a substitute plan for current employees. The Committee is aware, however, that circumstances could change – including changes to the termination pool interest rate and the law of vesting. For those reasons, the Committee recognizes this option could become a "closer call" at another time.[33]

b. *Lobbying & Initiatives*

Although it supports the spirit of the initiatives outlined below, the Committee does not believe it is able to recommend them as practical options to City Council. Lobbying the Legislature and/or CalPERS is not something the City can do by itself with any reasonable hope of success. To make progress here, the City would need to partner with other likeminded public agencies. The Committee was not engaged to organize political initiatives or evaluate the political viability of lobbying efforts. Nevertheless, the initiatives discussed by the Committee are included here for Council's consideration.

i. Different Retirement Plans for New Employees

In partnership with other public agencies, Glendale could lobby the Legislature to permit CalPERS to allow public agencies to adopt different retirement plans (e.g., a defined contribution plan) for new employees.

This idea is essentially a matter of principle: public agencies should be able to determine for themselves the kind of retirement plan they provide new employees. Most private employers have long since moved from defined benefit to defined contribution plans. The advantage of these

[33] It is worth noting that the testimony before the Committee did not establish whether it is possible to issue a termination liability in a Pension Obligation Bond ("POB"). This could be further researched. However, there are other risks associated with POBs that the report considered above. And again, paying off the termination liability with a POB would not absolve the City from its obligation to provide new pensions for current employees and retirement benefits for new employees.

plans, or so-call "hybrid" plans, is that the employer does not bear 100% of the responsibility for market losses, as it does in a defined benefit plan.

However, given that PEPRA is already a fairly modest plan and does not currently appear to be driving the growth in Glendale's UAL, it is not clear how much economic benefit could be gained by going beyond it. It bears repeating that Glendale does not contribute to social security for its employees – that alone would be an annual contribution equivalent to 6.2% of wages.

ii. Freezing Underfunded Plans

In partnership with other public agencies, Glendale could encourage CalPERS to allow contracting agencies to "freeze" underfunded plans. Common in the private sector, when a pension plan is frozen, the plan is closed to new entrants and current plan participants stop accruing benefits. By freezing underfunded plans, Glendale could pay out existing accrued retirement benefits therein and fund any shortfall as needed. Moreover, CalPERS would not be required to guarantee the benefits from the frozen plan and hence would have no need to charge a hefty termination penalty if Glendale decided to withdraw from that plan.

Although frozen plans are common in the private sector, there is a significant argument that they would be impermissible in the public sector under the vested rights doctrine unless provision for freezing benefits was made solely for new employees.

The lack of a provision to address severe underfunding of plans in the public sector is symptomatic of a larger problem; while private plans are subject to federal legislation such as The Employee Retirement Income Security Act (ERISA), there is no overarching framework regulating public pension plans. For example, ERISA has specific provisions governing actions than must be taken to address plan underfunding (including reducing or freezing benefits). There are no similar provisions in the public sector. As a result of ERISA, private sector plans also have much lower earnings expectations. By contrast, one of the central reasons that the City's unfunded liability continues to grow is that CalPERS' earnings expectations have been too high. As it reduces those expectations, the size of the unfunded liability appears to grow because the assets in the fund are predicted to grow at a slower rate.

iii. Duties to Contracting Agencies

In partnership with other public agencies, Glendale could lobby the legislature to establish a set of legal obligations of CalPERS to contracting agencies.

Under current State law, CalPERS only has a fiduciary duty to plan members. That obligation is enshrined in the California Constitution as a result of Proposition 162 in 1992. As a practical matter, CalPERS also has an obligation to the State, as the main plan sponsor. In comparison, contracting California cities and counties have almost no voice at CalPERS, and CalPERS has no real legal obligations to them. CalPERS' contracts with these agencies are essentially contracts of adhesion; CalPERS membership has often been described as like Hotel California: an agency can check out, but it can never leave. As a result, for example, CalPERS had no clearly expressed legal duty when it advised cities in the early 2000s to move into 3% at 50 plans on a retroactive basis and told them that the move would result in no additional costs.

It is often difficult to get timely or reliable responses from CalPERS, and CalPERS has recently taken on the role of attempting to regulate local agencies rather than assist them. This has particularly been the case as CalPERS has aggressively interfered with the ability of local agencies to contract for services. CalPERS also supported recent legislation that renders local agencies responsible for overpayments to employees found in CalPERS audits, often years after errors were made that CalPERS failed to catch at the time.

iv. Greater Transparency from CalPERS

The Global Pension Transparency Benchmark[34] (GPTB) ranks 15 countries on "public disclosure of key value generation elements for the five largest pension fund organizations within each country" and measures the quality of public disclosures relating to "the completeness, clarity, information value and comparability of disclosures."[35] According to the GPTB, CalPERS recently received an overall transparency score of 72 out of 100, the highest score among the surveyed plans from the United States – which average an overall score of only

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[34] GPTB is a joint project of CEM Benchmarking and Top1000funds.com. CEM Benchmarking is "an independent provider of cost and performance benchmarking information for pension funds and other institutional asset owners worldwide." Top1000funds.com is a leading news and analysis site for international institutional investors.

[35] For more information see: https://global-pension-transparency-benchmark.top1000funds.com/

54. The five largest pension fund organizations in the United States are all public, but GPTB's global survey includes public *and private* pension plans, and CalPERS' score is well below the *global* benchmark for pension transparency. This is important because CalPERS is a public plan, and therefore should be expected to be highly transparent.

In reality, CalPERS has a long way to go on transparency issues – especially issues pertaining to its portfolio, charges for consultants and fund managers, and even basic information and policies. The CalPERS website is jumbled and difficult to navigate. Most contracts are "public" in the sense that they are approved in public meetings, but it is almost impossible to locate them as they are not accessible in a single location on the web site. There does not appear to be a listing of fund managers, individual reporting of fees paid to managers, or returns from specific investments. The "Transparency and Accountability" page of the web site is focused almost entirely on compliance issues pertaining to CalPERS Board members.

The GPTB site divides transparency into four categories: Performance, Governance, Cost and Responsible Investing. Glendale, and any other cities similarly situated, could press CalPERS through legislation and changes in its own policies, to focus on transparency in each of these areas.

c. *Litigation Regarding Retroactive Benefit Enhancements*

The Committee discussed the proposal of some Committee members that the City Attorney should explore suing CalPERS for misrepresentations made in and around 2001. Such a lawsuit would seek to recover pension liability due to the enhancements made as a result of these alleged misrepresentations.

The majority of the Committee does not believe that suing CalPERS is a viable strategy and the history of other litigation over retroactive benefit enhancements does not inspire confidence in this approach. For example, courts ruled against Orange County in a lawsuit alleging that retroactive benefit increases granted to Safety workers violated the California Constitution by creating a liability without a vote of taxpayers. The court in that case ruled that a retroactive benefit award did not violate the municipal debt limit, nor did it constitute a prohibited gift of extra compensation. The California Supreme Court denied the County's petition for review in 2011.

The Committee recognized that the *Orange County* suit is distinguishable because it was not based upon a fraud theory. However, especially given the passage of time, and the fact that CalPERS' assets are primarily held in trust for the participant agencies, the Committee was not persuaded that such a lawsuit would be likely to yield positive results.

V. *Conclusion*

As discussed in this report, despite reasonable actions taken by the City and the State Legislature to control pension costs, Glendale's pension costs continue to grow due primarily to substantial growth in the UAL. The amortized payments on the growing UAL far outstrip the City's increases in revenue and are significantly eroding the City's ability to provide other services. Although pension costs are projected to level off in the next five to seven years, there is no guarantee this will happen, and there is significant risk that those costs will swallow an ever-greater percentage of the City's revenues.

The Committee's recommendations fall into a few main categories. The first is to create a more structured policy to pay down the unfunded liability over a shorter time horizon. The lower the UAL, the lower the risk to the City of unaffordable cost spikes. In addition, of course, paying the liability off more quickly should result in considerable interest savings. It does, however, mean paying higher pension costs in the short run, which will require fiscal discipline. As a potential tool in this strategy, we recommend the City explore POBs, but recognize that the timing must be right for POBs to be a viable part of this strategy.

The second major set of recommendations relate to transparency. The creation of this Committee was an excellent first step toward educating the public about the causes, depth and extent of the pension problem in Glendale. However, bargaining and analyzing the City's fiscal position must be imbued with the thought of how the City can remain competitive while recognizing the pension costs in all compensation matters. For example, a 3.0% salary increase does not mean that compensation costs in a given year will increase by only 3.0% -- at the rate UAL payments are increasing, the City is paying the equivalent of nearly a 2.4% salary increase just to fund its unfunded pension liabilities.

These increases are likely to continue as projections suggest CalPERS is likely to lower its discount rate from the current 6.8% (down from 7.0% last year) eventually to something closer to

6.2%. A lower discount rate means a larger UAL and further increases in amortization payments. These increases will be compounded if poor market performance prevents CalPERS from meeting that lower discount rate. Ensuring an awareness of the threat posed by the increasing cost of unfunded pension liability in all expenditure decisions, but especially compensation decisions, will be critical.

Finally, we do recommend an increase in employee cost sharing for classic CalPERS employees but recognize such an increase will need to be negotiated with Glendale's bargaining groups and balanced with the importance of maintaining Glendale's competitiveness in the labor market.

There are no "silver bullets" or quick fixes to Glendale's pension problems. Legal and structural roadblocks further complicate and hamper Glendale's ability to effectively enact meaningful pension reform. Any viable approach must take a long view that balances the need to reduce pension costs with the need to maintain sufficient service levels and a productive workforce. In that spirit, this report provides the City Council with a framework to proactively reduce Glendale's UAL while continuing to provide retirement benefits that are affordable, sustainable, equitable and competitive in the long and short-term.

In closing, we would like to thank the Glendale City Council for creating this Committee, and the Glendale City staff and Committee members who dedicated so much time and effort to address these pressing issues.

Glossary of Actuarial Terms[36]

Accrued Liability: (also called Actuarial Accrued Liability or Entry Age Actuarial Accrued Liability) The total dollars needed as of the valuation date to fund all benefits earned in the past for current members.

Actuarial Assumptions: Assumptions made about certain events that will affect pension costs. Assumptions generally can be broken down into two categories: demographic and economic. Demographic assumptions include such things as mortality, disability and retirement rates. Economic assumptions include discount rate, salary growth and inflation.

Actuarial Methods: Procedures employed by actuaries to achieve certain funding goals of a pension plan. Actuarial methods include funding method, setting the length of time to fund the Accrued Liability and determining the Value of Assets.

Actuarial Valuation: The determination as of a valuation date of the Normal Cost, Accrued Liability, and related actuarial present values for a pension plan. These valuations are performed annually or when an employer is contemplating a change to their plan provisions.

Amortization Bases: Separate payment schedules for different portions of the Unfunded Liability. The total Unfunded Liability of a Risk Pool or non-pooled plan can be segregated by cause, creating "bases," and each such base will be separately amortized and paid for over a specific period of time. However, all bases are amortized using investment and payroll assumptions from the current valuation. This can be likened to a home having a first mortgage of 24 years remaining payments and a second mortgage that has 10 years remaining payments. Each base or each mortgage note has its own terms (payment period, principal, etc.). Generally, in an actuarial valuation, the separate bases consist of changes in unfunded liability due to contract amendments, actuarial assumption changes, method changes, and/or gains and losses.

Amortization Period: The number of years required to pay off an Amortization Base.

Classic Member (under PEPRA): A classic member is a member who joined CalPERS prior to January 1, 2013, and who is not defined as a new member under PEPRA. (See definition of New Member below.)

Discount Rate: The assumed long-term rate of return on plan assets. This is the rate at which projected cash flows are discounted to the valuation date to determine Accrued Liability. This assumption is called "investment return" in earlier CalPERS reports and "actuarial interest rate" in Section 20014 of the California Public Employees' Retirement Law (PERL).

Entry Age: The earliest age at which a plan member begins to accrue benefits under a defined benefit pension plan. In most cases, this is the age of the member on their date of hire.

Entry Age Actuarial Cost Method: An actuarial cost method designed to fund a member's total plan benefit over the course of his or her career. This method is designed to yield a rate expressed

[36] Source: CalPERS, *Miscellaneous Plan of the City of Glendale, Annual Valuation Report as of June 30, 2020*, July 2021.

as a level percentage of payroll. (The assumed retirement age less the entry age is the amount of time required to fund a member's total benefit. Generally, the older a member on the date of hire, the greater the entry age normal cost. This is mainly because there is less time to earn investment income to fund the future benefits.)

Exhibit A

City of Glendale, California

Pension Funding Policy (Sample Draft – Subject to Change)

1. <u>Policy</u>

This policy details the City of Glendale's funding approach for pension benefits. The purpose of the funding policy is to set forth the City's overall pension funding goals, benchmarks that will be used to measure progress, and the methods that will be used to develop and maintain these benchmarks.

2. <u>Objectives</u>

The primary objectives of the City's overall pension funding goals are to provide benefits that are:

- **Affordable** in the near-term, without crowding out the City's capacity to deliver quality services to the public or to provide reasonable salary increases to active employees;
- **Sustainable** over the long-term, ensuring that benefits will be secure and reliable for career employees and their beneficiaries throughout retirement;
- **Equitable,** so that benefit costs are distributed fairly across generations; and,
- **Competitive**, to support effective recruitment and retention of a strong municipal workforce.

3. <u>Pension Funding Goals</u>

Toward these objectives, the City establishes the following pension funding goals:

- Maintain a stable or increasing ratio of pension assets relative to accrued liabilities, with the goal of reaching a 100% funded ratio (full funding) in both its CalPERS Miscellaneous and Safety Pension Plans. For these purposes, the funded ratio is defined as the actuarial value of assets divided by the actuarial accrued liabilities as published in the annual CalPERS actuarial valuation reports for the City's Miscellaneous and Safety Plans. The funded ratio will exclude any City designated reserves or separately managed investments (e.g., Section 115 Trust) from the actuarial value of assets.
- Develop a pattern of stable and regular contributions to CalPERS and accelerate and prioritize paydown of any accumulated UAL by making additional UAL payments in excess of the amounts required by CalPERS.
- To help achieve this goal, the City will maintain and regularly fund a Section 115 Trust for pensions to take advantage of investment returns, strategically paydown the UAL, and provide a reliable source of funding to help alleviate pension funding challenges in any given year due to unanticipated growth in pension expenditures or revenue declines.

- Manage the cost of benefits through labor-management partnership and collective bargaining to reach and maintain an affordable and sustainable pension, including negotiated items that address pension affordability, such as employee pension cost sharing and compensation enhancements, including wage increases and pensionable premium pays.

4. Funding Policy

Minimum Employer Contribution. The City will annually contribute the minimum required employer contribution to its Miscellaneous and Safety Pension Plans as published by CalPERS in the annual valuation reports, which consists of both an employer normal cost expressed as a percentage of payroll (including employee cost sharing) and the employer amortization of the unfunded accrued liability (UAL).

Section 115 Trust for Pensions. In addition to the Minimum Employer Contribution discussed above, the City will use its Section 115 Trust for pensions to gradually accelerate the paydown of the accumulated UAL. This approach balances the need to maintain healthy pension reserves to preserve the stability of municipal services with the long-term savings that can be generated by paying down the UAL on a faster timeline.

- The City will target a balance of **$65 million** in the Section 115 Trust for pensions, funded through a combination of one-time (ad hoc) and regular contributions from the General Fund during budget deliberation, and investment earnings.

    - During budget deliberations, the City will prioritize contributing available one-time General Fund resources to the Section 115 Trust to achieve the minimum target balance (“ad hoc” contributions).

    - Until the target balance is achieved, the City will annually allocate and transfer $5 million from the City’s General Fund into the Section 115 Trust (“regular” contributions).

    - In addition to ad hoc and regular contributions from the General Fund, investment earnings will also help to achieve and maintain the target balance in the Section 115 Trust. The City should target reaching a $65 million balance within three (3) to five (5) years from the adoption of this policy.

- Once the Section 115 Trust has a balance of **$65 million**:

    - During budget deliberations, the City will continue to prioritize contributing available one-time General Fund resources directly to CalPERS to accelerate paydown of the UAL. This approach will help to build pension funding more rapidly, thereby improving plan stability and reducing future contribution requirements. The additional UAL payments can be made directly to the City’s Miscellaneous or Safety Plan or a combination of the two, at the City’s discretion.

    - The City will contribute investment earnings in the Section 115 Trust above the target balance of $65 million directly to CalPERS to accelerate paydown of the

UAL. This transfer will be made until the UAL is fully amortized and Glendale's CalPERS plans are 100% funded. The additional UAL payments can be made directly to the City's Miscellaneous or Safety Plan or a combination of the two, at the City's discretion.

  - Based on the Section 115 Trust current asset allocation and target return rate of 5%, this would generate approximately $3.3 million annually to accelerate paydown of the UAL.

- Once the CalPERS system is 100% funded:

  - The City will annually evaluate the minimum target balance in the Section 115 Trust and make adjustments to the target balance in keeping with the goals and objectives of this policy.

  - It is recognized that the target minimum balance will need to be adjusted in the future to capture changes to overall pension costs, market performance, and the City's underlying financial condition.

  - Section 115 Trust assets may be strategically used to payoff unfunded liabilities as they are accrued in the future resulting in interest cost savings.

5. Emergency Use Provision

In the event of a severe economic downturn the City will seek to continue the payment structure outlined in Section 4 in full, but, if authorized via Council Resolution, may temporarily reduce or defer its supplemental payments from any source to the Section 115 Trust or CalPERS until the City's revenues have recovered.

The City Council may authorize use of the assets, via Council Resolution, in the Section 115 Trust in order to preserve vital city services during severe economic downturns or when pension costs increase significantly. The Resolution must outline the steps the City will take to restore the Section 115 Trust to the target balance over a reasonable time period.

For the purpose of this provision a severe downturn shall be defined as a fiscal year in which aggregate General Fund revenues are projected to be negative and/or less than the forecast growth in the Consumer Price Index for the ensuring fiscal year.

6. Section 115 Trust Investment Policy

The City shall periodically review the rate of return on assets in the Section 115 Trust. In close consultation with its investment manager(s), the City shall make periodic adjustments to asset allocations and target rates of return consistent with the goals and objectives of this policy and to ensure Safety, liquidity, and yield of the portfolio.

7. Transparency and Reporting

Funding of the City's pension program should be transparent to all stakeholders, including City employees, retirees, employee organizations, elected officials, and Glendale residents and taxpayers. In support of this transparency, the following information shall be available:

- *Report to City Council.* When each actuarial valuation for the City's pension plan is completed annually, a copy shall be transmitted to City Council along with a Finance Department report regarding progress toward full funding of the plan and employer contribution, and overall advancement of this policy's goals of affordability, sustainability, and competitiveness. This report should also include relevant information concerning the City's Section 115 Trust.

- *Website Publication.* These actuarial valuations and the City's Annual Comprehensive Financial Report (ACFR) shall be published on the City's website. The ACFR includes information regarding the City's pension plan, contributions to the Section 115 Trust, and the funded status of the plan.

- *Budget Transparency.* The City's annual operating budget shall include clear and specific appropriations for contributions to CalPERS, including minimum employer contributions, ad hoc contributions, and contributions to the Section 115 Trust.

8. Review of Pension Funding Policy

Sustainable pension funding requires a long-term commitment. To ensure that adequate resources are being accumulated to meet the City's pension funding goals, the City will review this policy periodically in conjunction with its actuarial valuation reports and make adjustments accordingly to ensure that the policy's goals and objectives are achieved.

Exhibit B

City of Costa Mesa, Transparency in Labor Negotiations Policy