



## **Budget Foundation – Increase to Additional Discretionary Payment Amount to Address Unfunded Pension Liabilities**

2025-27 Financial Plan

---

### **Summary**

The City of San Luis Obispo, like many other California municipalities, is a participant in the California Public Employees' Retirement System (CalPERS) pension system, which provides retirement benefits to City employees. The City identified addressing unfunded pension liabilities as a priority with the Fiscal Year 2018-19 Supplemental Budget and the Fiscal Health Response Plan recommended Additional Discretionary Payments (ADPs) to reduce the City's unfunded liability. The most recent actuarial evaluation (presented in May 2023) showed that the City's unfunded pension liabilities have continued to grow due to various factors, especially the volatility of investment returns and changing actuarial assumptions.

To address this issue and reduce the long-term financial burden on the City, staff recommends increasing the annual ADP to CalPERS. These payments, if approved, would be in addition to the required contributions to the pension system and would be specifically aimed at reducing the City's unfunded liability more quickly than required.

### **Last Actuarial Review**

In 2023, the City engaged Foster & Foster, an independent national actuarial consulting firm, to perform a review of the City's progress in paying down unfunded pension liabilities. That analysis attributed the City's unfunded liabilities to recent investment losses, CalPERS policies designed to smooth contribution rates, enhanced benefits contained in legacy City pension plans, and a growing share of retired members relative to active members.

Foster & Foster's report showed that the City's largest plan, Miscellaneous, should reach 80% funded status by 2034 and 100% funded by 2044. Despite market volatility since the report was issued, staff believe the recommendations in that report are still valid and that continued ADPs are both necessary and sufficient to reduce the City's unfunded liabilities.

The report from Foster & Foster can be found at the link below:

<https://opengov.slocity.org/WebLink/DocView.aspx?id=176986&dbid=0&repo=CityClerk>

### **Funded Status**

The City's funded status with CalPERS is determined based on the market value of assets relative to the funding target produced by the entry age actuarial cost method and actuarial assumptions adopted by CalPERS. The actuarial cost method allocates the total expected cost of a member's projected benefit to individual years of service. The value of the projected benefit that is not allocated to future service is referred to as the accrued liability and is the plan's funding target on the valuation date. The unfunded liability equals the funding target minus the assets. The unfunded liability is an absolute measure of funded status and can be viewed as employer debt. The funded ratio equals the assets divided by the funding target. The funded ratio is a relative measure of the funded status and allows for comparisons between plans of different sizes.

The table below includes the metrics described above for each of the City's pension plans:

Plan	Assets	Accrued Liability	Unfunded Liability	Funded Ratio
Miscellaneous	\$ 176,888,182	\$ 280,827,234	\$ 103,939,052	63.0%
PEPRA Safety Fire	1,107,320	1,228,175	120,855	90.2%
PEPRA Safety Police	6,335,275	7,125,194	789,919	88.9%
Safety	148,020,550	236,750,071	88,729,521	62.5%
Safety Fire 2nd Tier	4,482,657	5,808,518	1,325,861	77.2%
Safety Police 2nd Tier	2,675,761	3,142,868	467,107	85.1%
<b>Total</b>	<b>\$ 339,509,745</b>	<b>\$ 534,882,060</b>	<b>\$ 195,372,315</b>	<b>63.5%</b>

In addition to the Public Employees' Pension Reform Act (PEPRA) Safety plans, 70% of active members on the Miscellaneous plan, which includes all non-safety employees, will receive benefits limited by PEPRA. These limitations include reduced benefit formulas, increased retirement ages, a cap on pensionable compensation, potentially higher employee contribution rates, and more. All but one City bargaining group also make additional employee contributions to offset City costs. These reductions in benefits were intended to improve funded ratios throughout the CalPERS system, but it may take many years to see improvements to the City's unfunded liabilities as a result of PEPRA alone.

### Investment Returns

CalPERS is one of the largest institutional investors in the world and manages a total portfolio of over \$500 billion on behalf of its members. CalPERS invests these funds to maximize returns without taking on excessive risk to ensure that funds are available when needed to make required payments to retirees.

The portfolio is constructed to meet its target returns, which are also used as the discount rate in actuarial models. As shown in the table below, actual investment returns vary dramatically from year to year and have underperformed the target rate in four of the last six years.

	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22	FY 2022-23	FY 2023-24
Net Investment Return	6.7%	4.7%	21.3%	-6.1%	5.8%	9.3%
Target	7.0%	7.0%	6.8%	6.8%	6.8%	6.8%
Variance	-0.3%	-2.3%	14.5%	-12.9%	-1.0%	2.5%

### **Inflation with Staffing Costs**

Since adoption of the Fiscal Health Response Plan with the FY 2018-19 budget, total wages citywide have increased significantly due to headcount increases and cost of living adjustments in an inflationary era. The table below details the recommended ADP increase in line with wage growth from FY 2018-19 to FY 2023-24.

<b>ADP</b>	<b>Current</b>	<b>Recommended</b>	<b>% increase</b>
General Fund	\$ 2,000,000	\$ 2,660,859	33%
Water Fund	164,840	245,418	49%
Sewer Fund	169,419	250,875	48%
Parking Fund	61,003	97,543	60%
Transit Fund	12,555	15,973	27%
Whale Rock	21,417	27,324	28%
TBID	7,976	10,879	36%
<b>Total</b>	<b>\$ 2,437,210</b>	<b>\$ 3,308,870</b>	<b>36%</b>

### **City Council Guidance**

Staff is seeking guidance from Council on a recommended increase to the annual ADP amount. For the current year, staff recommends that Council direct staff to recommend allocation of FY 2023-24 unassigned fund balance to increase the ADP with the FY 2024-25 Second Quarter Budget Report.