



**Lake Havasu City Police Facility
2360 McCulloch Boulevard North
Lake Havasu City, Arizona 86403
Work Session
Minutes – Final**

Tuesday , October 11, 2016

5:00 PM

CALL TO ORDER

Mayor Nexsen called the meeting to order at 5:00 p.m.

PLEDGE OF ALLEGIANCE

The Mayor led in the Pledge of Allegiance.

ROLL CALL

PRESENT: Councilmembers Mark Nexsen, Dean Barlow, Don Callahan, Donna Brister-McCoy, Jeni Coke, and Cal Sheehy

ABSENT: Councilmember Michele Lin

CALL TO PUBLIC

There were no requests to address the Council.

PUBLIC HEARING

5.1 Public Safety Pension Retirement System (PSPRS) Financial Outlook

Administrative Services Director Tabatha Miller addressed the Council and stated that pension liability and the increasing cost is not unique to Arizona but in the fiscal year 2015 changes in government accounting required that all governments add to their financial statements their unfunded pension liability. She said what that means for Lake Havasu City is that staff added approximately \$75 million in liability to the City's books. Ms. Miller stated that \$50.5 million or over two-thirds of that amount is related to the Public Safety Retirement System (PSPRS) and the remaining one-third is related to the Arizona State Retirement System (ASRS), making one-third of the employees responsible for two-thirds of the unfunded liability. Ms. Miller said what that means going forward is that it is going to impact contribution rates and how the City funds that. She stated that Proposition 124 that passed last year will make some changes and certainly changes going forward for new members to help alleviate some of that stress.

Senior Budget Analyst Cassandra Clow reviewed the following for Council:

- Types of Retirement Plans
- PSPRS Overview
- Member Benefits
- Employee/Employer Costs
- Actuarial Projections
- Proposition 124 (SB 1428)
- Expenditure Limitation



Retirement Plans


- ☐ **Defined Contribution Plan**
Each participant has a separate retirement account, such as a 401k, and the participant directs how contributions are invested. Retirement income is based solely on the amount contributed and is dependent on investment.
- ☐ **Defined Benefit Plan**
Provides a lifetime retirement benefit calculated using a fixed formula that typically factors in highest salary and years of service. The plan directs how contributions are invested.




Defined Benefit Plan Types


- ☐ **Agent multiple-employer plans**
Separate accounts for each employer's assets and liabilities. Pooled investments and split of administrative costs. Separate actuarial reports and customized contribution rates.
- ☐ **Cost-sharing multiple-employer plan**
All assets and liabilities are pooled into one account. One actuarial report completed for all employers. All employers pay the same contribution rate.





PSPRS Overview


- ❑ Established in 1968 in accordance to A.R.S. §38-841
 - ❑ System manages three different retirement plans:
 - 1.) Public Safety Personnel Retirement System (PSPRS) Plan
 - 2.) Corrections Officer Retirement Plan (CORP)
 - 3.) Elected Officials' Retirement Plan (EORP)
 - ❑ Criteria to participate in PSPRS Plan:
 - 1.) Must be employed by a participating employer
 - 2.) Must be a paid police officer or a paid firefighter
 - 3.) Must be under the age of 65
 - 4.) Must work at least 40 hours each week for more than 6 months of each year
- 



Weakened PSPRS Factors

- Permanent Benefit Increase (PBI) mechanism
- Underperforming investment returns

These factors are causing a very low available funding of liability percentage averaging 49%. Public pension plans are ideally expected to maintain a minimum funding level of 80%.



Permanent Benefit Increase

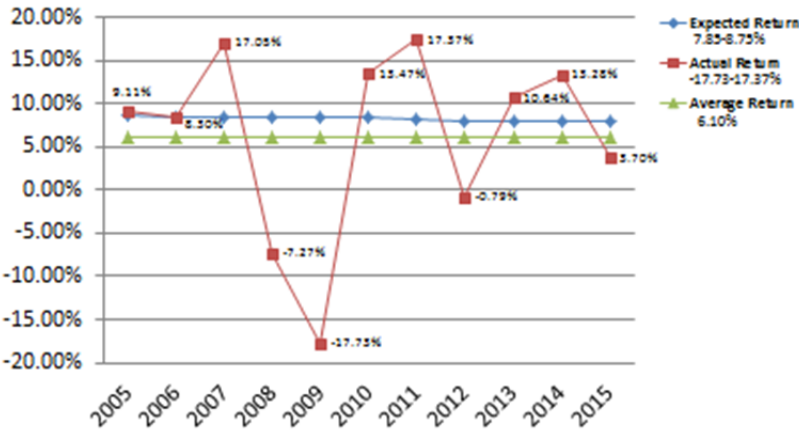
- 50% of Investment Earnings above 9% annual return rate are reserved for future benefit increases

Average Pension Benefit	\$	53,000
PBI (4%)	\$	2,120

	Retiree 1	Retiree 2
Pension before PBI	\$ 30,000	\$ 80,000
Annual PBI	2,120	2,120
Pension after PBI	\$ 32,120	\$ 82,120
Benefit Increase %	7.1%	2.7%

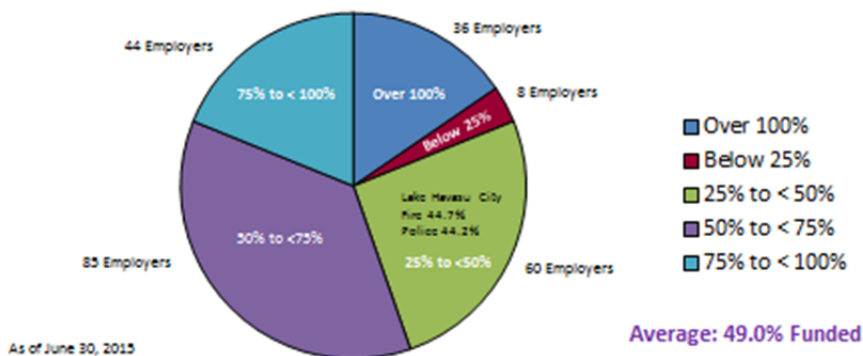
Rates of Investment Return

As of June 30, 2005 through June 30, 2015 (Unaudited)



PSPRS Funded Status Comparison

233 Participating Employer Accounts



Unfunded Liability Comparison

	Total Liability	Total Assets	Unfunded Liability	Funded %	ER Cost %
Prescott Police Dept.	\$47,748,181	\$11,866,879	\$35,881,302	24.90%	63.63%
Prescott Fire Dept.	\$55,985,310	\$17,579,338	\$38,405,972	31.40%	69.82%
Flagstaff Police Dept.	\$62,484,536	\$23,502,335	\$38,982,201	37.60%	41.23%
Flagstaff Fire Dept.	\$69,729,278	\$26,439,852	\$43,289,426	37.90%	62.37%
Lake Havasu Police Dept.	\$45,097,182	\$19,912,752	\$25,184,430	44.20%	41.28%
Lake Havasu Fire Dept.	\$45,392,323	\$20,275,582	\$25,116,741	44.70%	38.91%
Kingman Police Dept.	\$23,291,145	\$12,086,531	\$11,204,614	51.90%	35.61%
Bullhead Police Dept.	\$38,562,732	\$20,721,960	\$17,840,772	53.70%	33.03%
Kingman Fire Dept.	\$25,483,711	\$14,633,047	\$10,850,664	57.40%	33.62%
Bullhead Fire Dept.	\$41,065,718	\$28,074,172	\$12,991,546	68.40%	26.20%

Based on June 30, 2015 AZ PSPRS Consolidated Report

PSPRS Plan Benefits

- Monthly lifelong pension
- Disability benefit
- Survivor benefit
- Retiree health insurance premium subsidy
- DROP Program- Members enrolled before 1/1/12
(Deferred Retirement Option Plan)

PSPRS Benefits Provided

Benefit eligibility criteria and formulas based on initial membership date:

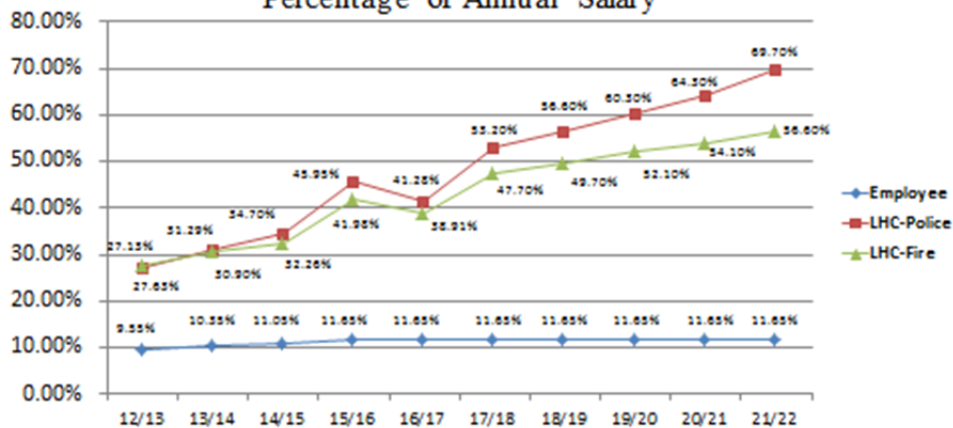
	Before 1/1/12	After 1/1/12
Years of Service/Age required for benefits	20 years of service at any age or 15 years of service at age 62	25 years of service and age 52.5
Benefit monthly dollar amount is based on	3 consecutive years of last 20 years with highest average compensation	5 consecutive years of last 20 years with highest average compensation
Benefit percentage	50% less 4% for each year under 20 years or plus 2-2.5% per year for more than 20 years; 80% max	62.5% less 4% for each year under 25 years or plus 2.5% per year for more than 25 years; 80% max

Lake Havasu City Covered Employees

Police Department PSPRS	No.	Averages		
		Age	Service	Annual Pay or Retirement Allowance
Actives	69	37.4	9.5	\$70,667
Retirees & Beneficiaries	47			47,386
DROP	6			47,526
Terminated	12			
Total	134			

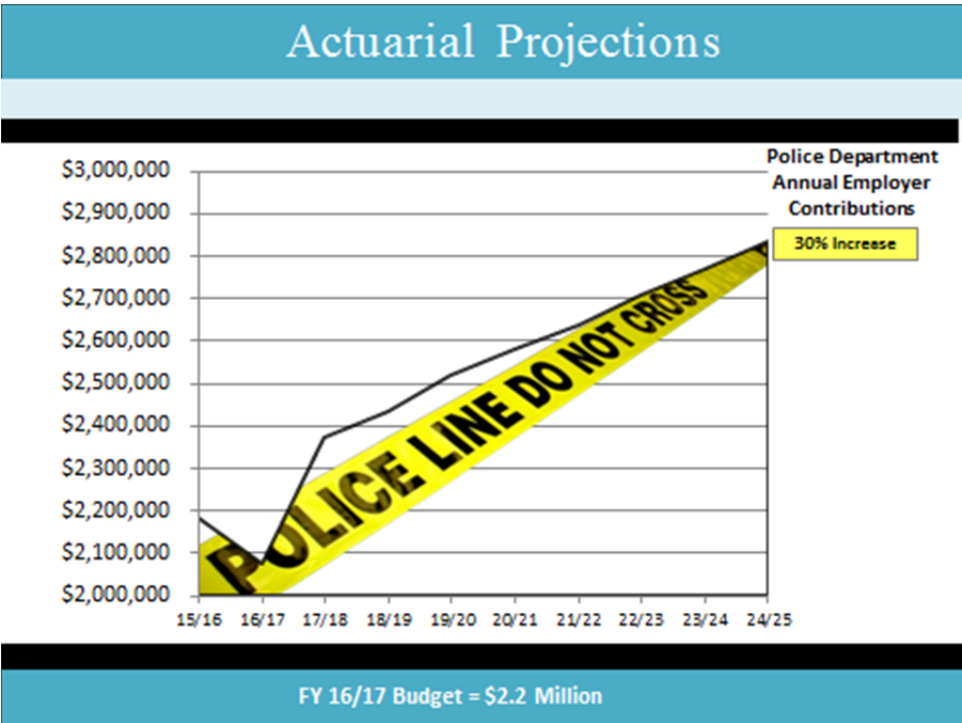
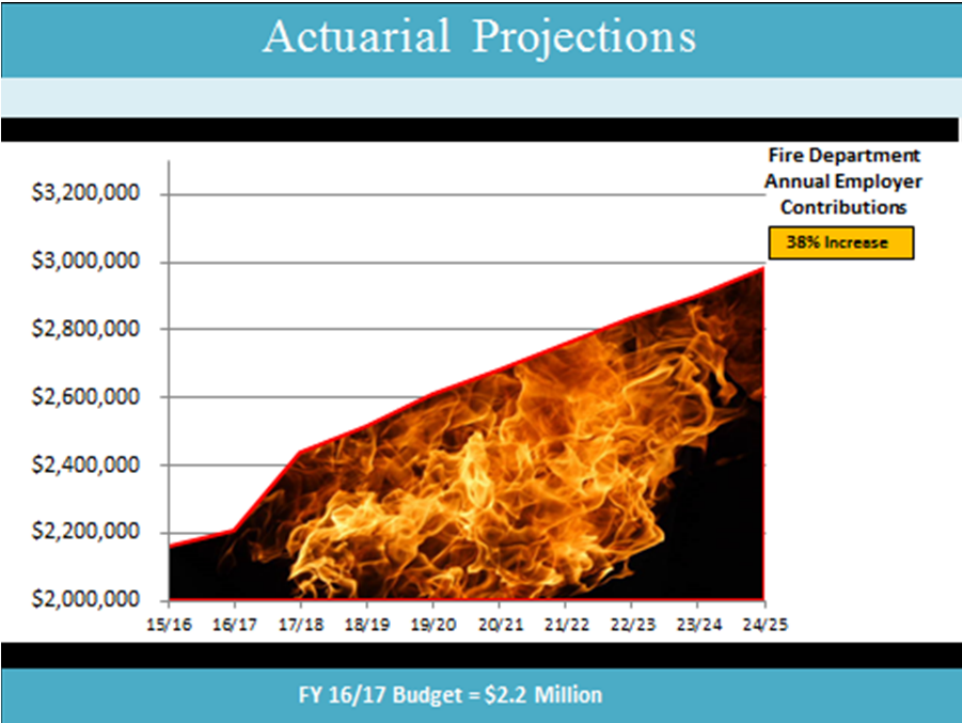
As of June 30, 2015 Actuarial Report

Contribution Costs Percentage of Annual Salary

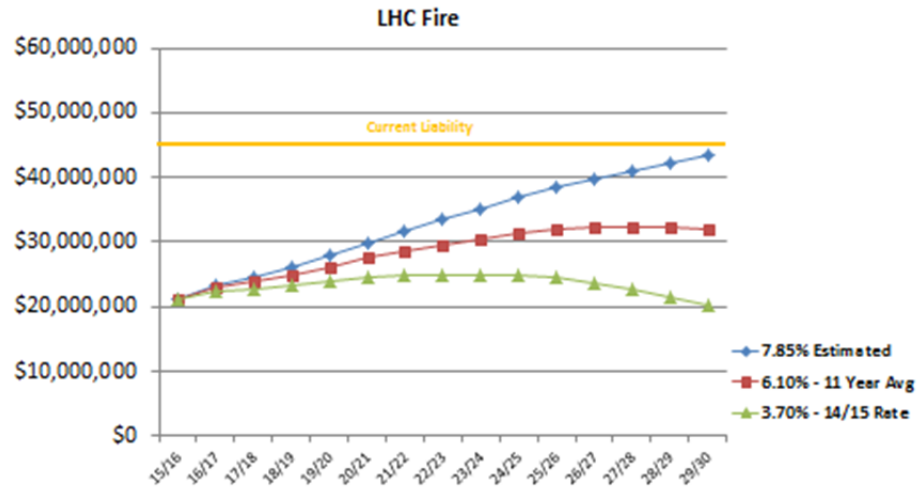


FY 16/17 Average Employer Contribution Rate = 42.61%

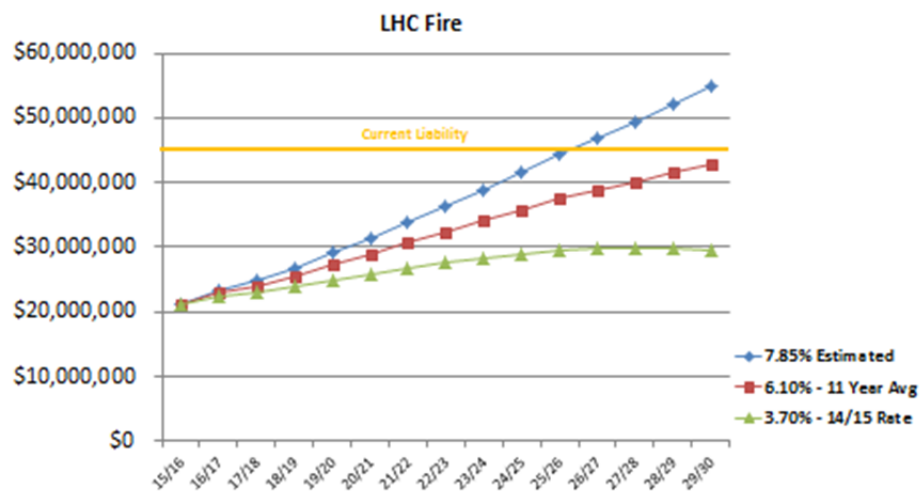
Mayor Nexsen stated for clarification, this is not the contribution rate it is the percentage of annual salary. He added if somebody is making \$50,000, at 60 percent the City is paying an additional \$30,000 for retirement benefits, to which Ms. Clow stated that was correct.



Total Assets – No Contribution Changes

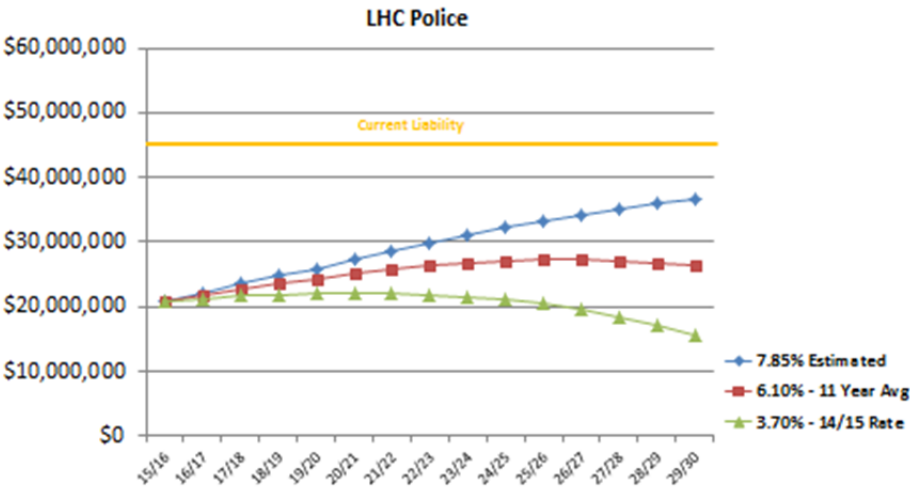


Total Assets – With Contribution Increases

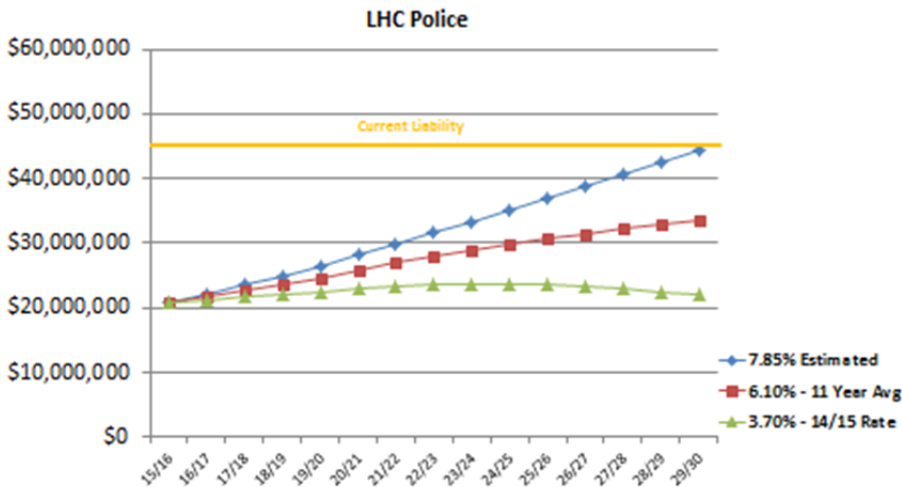


Based on June 30, 2016 AZ PSPRS GASB 68 Report

Total Assets – No Contribution Changes



Total Assets – With Contribution Increases



Based on June 30, 2016 AZ PSPRS GASB 68 Report

Proposition 124 (SB 1428)

Three Major Changes to PSPRS:

1. Exchanges the current Permanent Benefit Increase structure for a Cost of Living Adjustment based on inflation using CPI, capped at 2 percent
2. Establishes a voluntary "catch-up" Defined Contribution provision for non-social security participants hired from 1/1/12 to 6/30/17
3. Allows the Arizona Legislature the ability to modify public retirement benefits for future or prospective employees

Proposition 124 (SB 1428)

Changes for Employees hired before 1/1/12:

Exchanges the current Permanent Benefit Increase structure for a Cost of Living Adjustment

Permanent Benefit Increase (Old Structure)	50% of Investment Earnings above 9% annual return rate are reserved for future benefit increase. If enough reserves are available, all retirees receive same annual increase; 4% of average pension benefit.
Cost of Living Adjustment (New Structure)	Benefit increase based on inflation using CPI, capped at 2 percent.

Proposition 124 (SB 1428)

Changes for Employees hired from 1/1/12 to 6/30/17:

- ☐ Exchanges the current Permanent Benefit Increase structure for a Cost of Living Adjustment based on inflation using CPI, capped at 2 percent
- ☐ Establishes a voluntary “catch-up” Defined Contribution provision for non-social security participants

	% of Gross Pensionable Compensation
Employee Cost	3%
Employer Cost	4% for FY 17/18 and 3% each FY thereafter

Proposition 124 (SB 1428)

Changes for Employees hired on or after 7/1/17:

- Restriction or elimination of cost of living adjustments when plan falls below 90% funded

Funding Ratio	Cost of Living Adjustment
90% or more	Up to 2% based on inflation using CPI
Between 80% and 90%	Up to 1 ½ % based on inflation using CPI
Between 70% and 80%	Up to 1% based on inflation using CPI
Less than 70%	No Cost of Living Adjustment

Proposition 124 (SB 1428)

Changes for Employees hired on or after 7/1/17 (Continued):

- Employee may make irrevocable election of Defined Contribution Plan or a Defined Hybrid Benefit Plan. If no election after 90th day of employment, then employee is automatically enrolled in Defined Hybrid Benefit Plan for the remainder of employment with any employer under the system.




Plan Choices	Minimum Contribution Rates
Defined Contribution Plan	Employee = 9% ; Employer = 9%
Defined Hybrid Benefit Plan (Includes enrollment in new PSPRS plan and the Defined Contribution Plan for non-social security participants)	PSPRS Plan: Percentage based on actuarial report's unfunded liability; Split 50% Employee and 50% Employer Defined Contribution Plan: Employee = 3%; Employer = 3%

Proposition 124 (SB 1428)

Changes for Employees hired on or after 7/1/17 (Continued):

- Benefit multiplier changed from flat 2.5% to range of 1.5% to 2.5%



Credited Service	Benefit Multiplier Per Year (Maximum 80%)
Between 15 and 17 Years	1.50 %
Between 17 and 19 Years	1.75%
Between 19 and 22 Years	2.00%
Between 22 and 25 Years	2.25%
25 Plus Years	2.50%



Proposition 124 (SB 1428)

Changes for Employees hired on or after 7/1/17 (Continued):



- Capping of pension benefits based on maximum salary of \$110,000
- Requires employees to work until age 55 before retiring (up from 52.5 years)



Expenditure Limitation

HB2512 stated that a municipality's payment to PSPRS unfunded liability is excluded from their expenditure limitation.

HB2512 Final Disposition: Held in Senate



Ms. Miller stated that staff used the lower PSPRS contribution rate in this current fiscal year due to the Expenditure Limitation (EL) because staff was concerned that it would count as an expenditure. She said when Proposition 124 was written it was actually written to exclude PSPRS contributions especially above and beyond the minimum required from the EL but that language was taken out of Proposition 124 because some municipalities thought that it was debt of the municipality and therefore when it is paid, it would be treated like a debt payment and would be exempt from the EL. Ms. Miller stated that staff contacted the State Auditor's Office who deals with the EL and enforces any violations, and they said it is an expenditure and will be treated like an expenditure whether you make minimum or additional contributions. She added that staff does acknowledge the \$50 million liability and added that the City could make payments against it but are not sure how to get around the EL. She said the City could accrue the money and set it aside but cannot fund PSPRS directly. Mayor Nexsen stated that it was his understanding that the League of Arizona Cities and Towns (League) was pushing very hard for this to not count against the cities on the EL but Maricopa County attorneys fully believed and convinced everybody that it would not impact the cities, so the League did not push the issue. Mayor Nexsen stated unfortunately the Maricopa County attorneys were wrong.

Mayor Nexsen stated it is a good thing that the Permanent Benefit Increase (PBI) changed because that was a death sentence for any of the retirees over time because you cannot increase the benefit 4 percent on an annual basis then have losses of 17 percent and still receive the 4 percent. Mayor Nexsen stated to get around the EL the City could have earnings on more of our assets. He said if we borrowed and funded the actuarial present value of what it would take based on certain earnings, the City would be able to contribute less over time if there were more assets in the account today, especially with today's interest rates. Ms. Miller stated not necessarily locally in Arizona but she has heard of municipalities in other states, because the interest rates are so low, borrow money to fund their unfunded pension liability. She said it is a possibility but expressed concern with the negative dips in interest rates. Mayor Nexsen stated that as long as your earnings exceed your interest rate you can calculate whether or not you are better off funding that liability and how much quicker you can catch up to fully funded. He added that he thought there was a mathematical equation to see if it does make sense based on the interest rates. Mayor Nexsen said he assumed that the City would not be able to manage our own fund and would have to have a fund manager which has not shown to be a stellar performance in the past. He added that even though each one of the PSPRS funds are separate funds, they are pooled for the purpose of a fund manager and are broken out separately so the City does not have any control how they are investing. Councilmember Sheehy asked who manages the PSPRS fund, to which Ms. Miller stated that she does not know who manages the PRPRS but added they do contract the fund management. Councilmember Sheehy asked, as contributors, if the City has any say or a seat on the PSPRS board. Ms. Miller explained that the City has no say on that board only the local PSPRS that manages our local eligibility and decisions for employees.

Mayor Nexsen stated that nine or ten years ago the PSPRS was not allowed to invest in emerging markets because of their investment policy. He added that changed but unfortunately that was when the emerging markets started going in the other direction. He said the PSPRS wants to remain conservative but you have to make sure if you are going to remain conservative you have to earn enough to actually fund the liability. Councilmember Sheehy asked if that was controlled by the Legislature. Ms. Miller explained that the Arizona Revised Statutes control what they are allowed to invest in and added that the ASRS and PSPRS have different investment outlines and that ASRS has consistently out-performed PSPRS.

Councilmember Sheehy asked if the Governor appointed the PSPRS Board. Ms. Miller stated that Proposition 124 changed the makeup of the Board because one of the problems was that they did not have sufficient representation from fund managers, accountants, and financial people and the people that were doing the investing did not have the background that they felt was needed. Mayor Nexsen stated that they can pool the assets for investment but they cannot pool the liability so each city and town is completely separate.

Vice Mayor Callahan asked if there was a limit to how much of the unfunded liability the City can pay. Ms. Miller stated there is nothing to stop us other than the EL. Mayor Nexsen said the other thing that PSPRS was trying to encourage cities to do, instead of paying it piecemeal over 24 or 26 periods, pay it all up front and that way if they are earning 8 percent you get to earn it on that lump sum right from the beginning as opposed to over time. He added the opposite works if they have a really bad year.

City Manager Charlie Cassens asked if the City were to establish an account and put money into that every year and not call it a retirement fund but call it an account where there is a hedge against the City's unfunded liability if the City could do that. He asked secondly, if staff would have an expectation that the City would be able to realize a better return on managing that account as opposed to PSPRS. Ms. Miller stated the problem is that both the statute and the City's own investment policy are limited as far as riskier investments. She added the City's issue is getting past those EL's on what we can invest. She stated that the City is also limited to a maturity of less than five years and is limited in the ability to invest in high return equities so the City does not have the ability to take that money and put it into a separate account. Ms. Miller stated that it could be put in the City's account but the return on investment is 1.5 percent to 2 percent.

Councilmember Sheehy stated that the presentation showed the unfunded liability as a flat line, and wondered if that would continue to grow or remain flat. Ms. Miller stated that it is based on a certain point in time and an estimate of the current makeup or actuarial. She added the difference is there will be a split on July 1, 2017 when the new plan begins. She said what staff is being told by PSPRS is that the plan will stand on their own as a separate fund. Ms. Miller stated while that line may not stay flat, staff does not necessarily know how it will be impacted based on the decisions and changes that will happen over time.

Councilmember Sheehy stated if he recalled correctly, last budget year or the year before that the City did fund some additional monies towards PSPRS. Ms. Miller stated that was correct but when the EL came earlier than expected staff did not want to run into that issue.

Mayor Nexsen stated as a general rule for both fire and police, if we earned approximately 8 percent going forward the unfunded liability would shrink over time. He added the problem is if it is only earning 6 percent or 3 percent. He said at 6 percent it looked like it was kind of shrinking but at 3 percent the unfunded liability was getting worse. Ms. Miller stated historically 6 percent will help going forward but that 6 percent over the past ten or eleven years that it averaged did not go towards the unfunded liability because the PBI impacted that.

Mayor Nexsen asked if staff's graphs and the expected unfunded liability take into account Proposition 124. Ms. Miller stated they were based on the current system and current retirees. She added that Ms. Clow contacted PSPRS but they did not have an idea how they were going to manage the fund. Mayor Nexsen asked staff to look at scenarios to get around the EL and reduce the unfunded liability.

Councilmember Barlow stated in going through the slides he got the very distinct impression that the City has very little control over the pension system and wondered if the retirement age could be increased by one or two years. Ms. Miller stated that the City could not do that but said in doing research staff did find out that Phoenix and Tucson have their own pension systems for their typical pool such as the ASRS but not for the PSPRS. She added that once you are enrolled going backward is almost impossible.

Mayor Nexsen opened the public hearing.

Mr. Matt Maloney, Lake Havasu Professional Firefighters President, addressed the Council and stated that he appreciated the hard work everyone has put into revamping the PSPRS system and they have made a lot of good changes. He said back in 2004 there were new guidelines put in place because the fund had been mismanaged. He added everything with regard to the fund is reviewed annually so they are not making any long term decisions

because they are not sure what is up and coming with the fund. Mr. Maloney stated in December some members from the PSPRS will be coming to Lake Havasu City and invited everyone to attend the meeting to learn more about the PSPRS.

There being no further comments, Mayor Nexsen closed the public hearing.

Mayor Nexsen stated that Mr. Maloney's point is well taken because when some of the newer firefighters go to the Defined Contribution Plan, they will not be contributing to the old plan so there will be an impact there as well. Mr. Cassens stated another consequence of the program is younger recruits are expected to make a much higher contribution going forward than they have in the past and that could potentially affect the City's ability to recruit because their pension liability is going to be a pretty good chunk of their paycheck. Mayor Nexsen stated long term; he thought it would be better because at least they are going to have assurances that their retirement plan is going to be funded.

ADJOURN

Upon motion by Vice Mayor Callahan, and seconded, the meeting adjourned at 5:51p.m.

CERTIFICATION

I hereby certify that the foregoing is a full and true copy of the Work Session meeting minutes of the Lake Havasu City Council held on the 11th day of October, 2016. I further certify that the meeting was duly called and posted, and that a quorum was present.

Kelly Williams, City Clerk/CMC

Prepared by:

Sacia Graber, City Clerk Assistant/CMC