- Board of Directors
  Finance and Insurance Committee

9/10/2019 Board Meeting

9-3

Subject

Prefunding PERS and OPEB

Executive Summary

The Finance and Insurance (F&I) Committee has been exploring options for managing Metropolitan Water District of Southern California's (Metropolitan) pension plan and Other Post-Employment Benefits plan (OPEB), which provides retiree medical benefits. Metropolitan participates in the CalPERS retirement system for pension benefits and has a §115 trust fund managed by the California Employers' Retiree Benefit Trust to provide retiree medical benefits. Staff has conducted a multi-part presentation series to the F&I Committee covering key pension and OPEB plan assumptions and potential prefunding alternatives, assuming such supplemental funding was available.

As of June 30, 2018, Metropolitan's pension funded ratio was 75.5 percent, and the OPEB funded ratio was 51.3 percent as reported in Metropolitan's financial statements.

Details

Background

Metropolitan funds employer pension contributions to CalPERS[1] on an annual basis. Included in this contribution is an amount to reduce Metropolitan's unfunded actuarial liability (UAL). Beginning in Fiscal Year (FY) 2018, CalPERS began collecting the UAL in dollar amounts rather than monthly as a percentage of the contribution amount. CalPERS has made a number of changes to its actuarial assumptions that are increasing public agency employer contributions. For example, CalPERS has lowered its discount rate, changed its contribution policy, and changed assumptions about mortality of retirees. These changes will be phased in, resulting in increases in both normal costs (the costs incurred annually for active members) and the UAL, and therefore will require higher contributions from Metropolitan. In addition, active members hired after January 1, 2013, under the California Public Employees' Pension Reform Act (PEPRA) will also see their contribution rates rise in FY 2020/21.

In FY 2014, Metropolitan began funding its OPEB trust fund. Metropolitan currently contributes the full OPEB Actuarially Determined Contribution (ADC) annually. The ADC for any fiscal year is determined by Metropolitan's actuary, Bartel Associates, LLC (Bartel), based on an analysis prepared every two years.

Summary of Presentation Series

In November 2018, updates on Metropolitan's unrestricted reserves, pension funding and OPEB funding were provided to the F&I Committee. As of June 30, 2018, Metropolitan's pension funding ratio was 75.5 percent, down from 92.4 at June 30, 2009; the OPEB funding ratio was 51.3 percent and is expected to improve significantly during the next ten years as Metropolitan contributes its full ADC. Unrestricted modified accrual reserves were $474 million at June 30, 2018, $153 million below the target.

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[1] For active members hired prior to January 1, 2013 ("Classic member"), Metropolitan also funds member contributions.

Metropolitan's reserve policy is established in Administrative Code §5202, Fund Parameters. If reserves are over target and Metropolitan's fixed charge coverage ratio is at or above 1.2 times, amounts over target may be expended for any lawful purpose of the District, as determined by the Board of Directors. Previously, Metropolitan's Board used reserves over target to fund OPEB, capital expenditures, and water management actions. As reserves at June 30, 2018, were under target, there were no reserves available in FY 2018/19 to make additional contributions to the pension or OPEB plans.

In April 2019, Bartel provided a presentation to the F&I Committee that covered background information on the CalPERS pension plan, an estimate of Metropolitan's future contribution requirements as a percent of pay and dollars, and future funded status. Based on Bartel's forecast of amortizing the UAL, Metropolitan's pension plan would not be 100 percent funded until FY 2039. Bartel also provided background information on the OPEB trust fund which, based upon current forecasts, will be 100 percent funded by June 30, 2037.

In July 2019, Bartel provided a second presentation to the F&I Committee that reviewed Metropolitan's contribution projections, the makeup of the UAL, and scenarios to pay down the UAL more quickly than CalPERS amortization schedule. Paying down the UAL more quickly results in less interest paid to CalPERS and lower payments over the long-run. The examples provided assumed $100 million was available to pay down the UAL.

Finally, in August 2019, a second staff presentation was provided to the F&I Committee that compared Bartel's forecast of total contributions for pensions through FY 2027/28 to Metropolitan's forecast for the same period, discussed the challenges of addressing the UAL, presented a goal-based matrix of prefunding options, and provided an additional funding scenario.

Options to Address UAL

Both Bartel and staff presented a menu of options to prefund Metropolitan's CalPERS UAL, summarized in Table 1 below.

TABLE 1: Options to Prefund UAL

Objective	**Solution**
Pay down UAL faster/save interest	CalPERS Fresh Start or "Soft" Fresh Start
Reduce contributions in peak years	§115 Supplemental Pension Trust
Provide contribution flexibility, if needed	CalPERS "Soft" Fresh Start, §115 Supplemental Trust
Stabilize contribution rates	§115 Supplemental Pension Trust
Combination	CalPERS "Soft" Fresh Start, §115 Supplemental Pension Trust

Payments directly made to CalPERS are likely to provide the best long-term investment return, but are irrevocable and do not count towards future obligations. Metropolitan has no control over how these additional payments are invested. In addition, PEPRA prevents contributions from dropping below normal cost. Direct payments to CalPERS can be made under a "Fresh Start," under which Metropolitan would request a shorter amortization period, or a "Soft Fresh Start," under which Metropolitan would make additional payments without requesting a formal shorter amortization period. Under the "Fresh Start" option, once CalPERS establishes a shorter amortization period, Metropolitan would be obligated to make the established higher payments annually.

Metropolitan could also establish a §115 Supplemental Pension Trust. Funds contributed to a pension trust are also irrevocable and can only be used to reimburse Metropolitan for contributions to CalPERS. Metropolitan could have more control over how the funds are invested to mitigate investment risk and volatility. Funds in a §115 Supplemental Pension Trust do not count as pension obligations under Governmental Accounting Standards Board accounting principles.

Bartel provided three scenarios to demonstrate how using $100 million to prefund the UAL could provide long-term benefits. Under all three scenarios, Metropolitan would realize reduced pension funding costs, both in nominal terms as shown as dollars saved and on a present value basis. These outcomes are summarized in Table 2 below.

Table 2: Benefits of Prefunding UAL

Option	**$ Savings**	**Present Value of Savings @ 3%**
Short Base (2003, 2009, & 2011)	$43.5 M	$21.8 M
Long Base (2016)	$153.8 M	$63.8 M
Combination, Short Base (2003 & 2009) and §115 Supplemental Trust	$47.7M	$18.7 M

The mid-cycle biennial budget review highlights the financial challenges Metropolitan is facing for FY 2019/20. Lower revenues and additional expenditures result in an anticipated draw on reserves. As explained above, Metropolitan's reserve policy provides that if reserves are over target and Metropolitan's fixed charge coverage ratio is at or above 1.2 times, amounts over target may be expended for any lawful purpose of the District, as determined by the Board of Directors. As reserves at June 30, 2019, are projected to remain under target, there would be no reserves available in FY 2019/20 to make additional contributions to the pension or OPEB plans, absent an action by the Board to waive or revise this policy.

Looking forward, Metropolitan could include additional amounts in its biennial budget and ten-year forecast to prefund additional contributions towards the UAL. Bartel has determined that if Metropolitan annually funded an additional $15 million towards its pension obligations, Metropolitan's pension funded ratio could reach the 80 percent funded threshold by June 30, 2028, and 86 percent funded by June 30, 2030.

With regard to OPEB, based on current projections, Metropolitan is on track to reach the 80 percent funded threshold by June 30, 2029.

Policy

Metropolitan Administrative Code Section 5107: Biennial Budget Process

Metropolitan Administrative Code Section 5108: Appropriations

Metropolitan Administrative Code Section 5200: Funds Established

Metropolitan Administrative Code Section 5202: Fund Parameters

Fiscal Impact

None

8/22/2019

June M. Skillman
Interim Assistant General Manager/Chief Financial Officer
Date

8/26/2019

Jeffrey Kightlinger
General Manager
Date

Ref# cfo12669385