Public Safety Pension Funding

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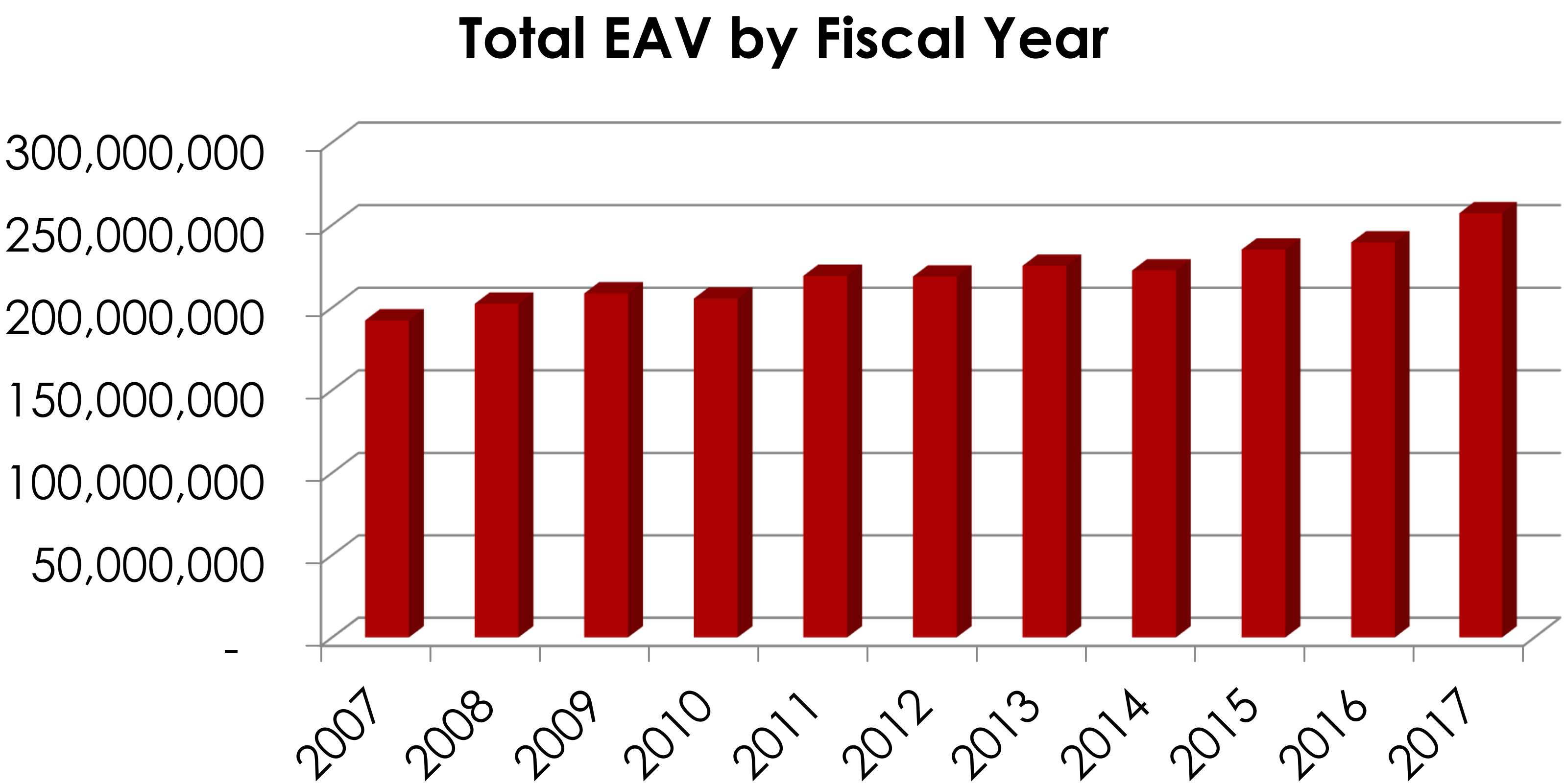
PENSIONS 101: Downstate Police & Fire Pension Fund 40 ILCS 5/3 & 5/4-125

- **State statute-required benefits for eligible municipal public safety employees in municipalities with 5,000 - 500,000 citizens**
- **Firefighter employee contribution = 9.455% of salary**
- **Police employee contribution = 9.91% of salary**
  - **Note: Employee contribution for Social Security & Medicare = 7.65%**
  - **Police and Firefighters don't receive Social Security benefits on their income derived from public safety**
- **All employee benefit levels are set by state statute not at the local level.**
- **Employer contribution based on investment returns, actuarial analysis and changing benefit levels**
- **IL Constitution prohibits diminishing of pension benefits. All benefit levels and employee contribution levels are set by the state of IL.**
- **City levies the property tax and upon receipt the appointed pension board oversees the investment. Per state statute only certain investments are able to be made.**

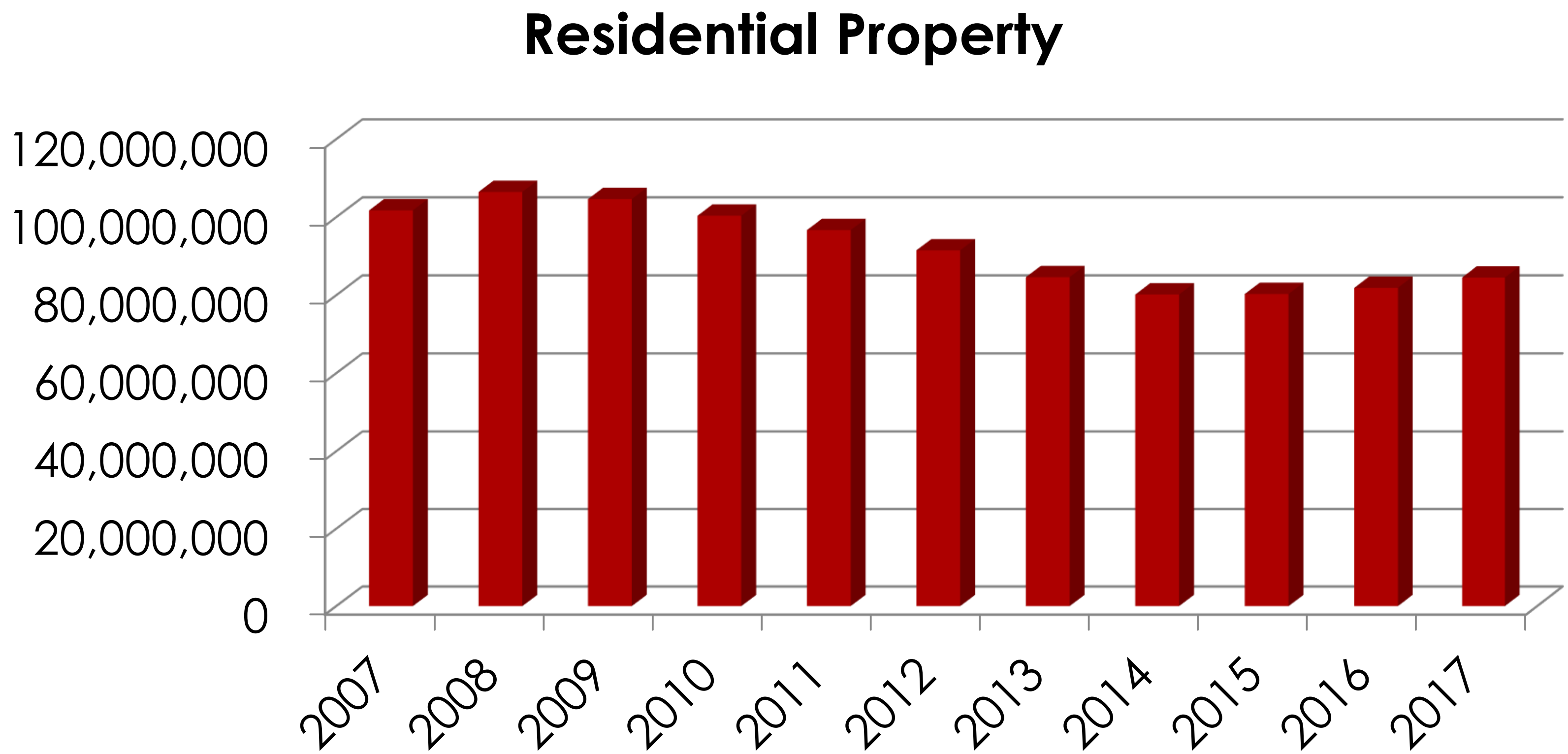
PENSIONS 101: Sources of Funding

- **Funded primarily through property taxes (since the great recession property values have not kept up with increasing obligations). The only sources of revenue for funding pensions are employee and employer contributions along with investment earnings.**
- **The City of Rochelle general fund revenues have seen slight increases. While overall EAV has been steadily increasing, residential property values have remained flat.**
- **Based on current rate of return and updated actuarial assumptions, the average annual increase for contributions is 3%-5%. Must be funded 90% by 2040.**
- **IMRF, Police and Fire pensions are listed as a Long-Term Debt on the City's balance sheet. Unfunded portion of $11,068,488 for police and fire as of most recent audit. The unfunded portion does not include the annual cost. This is the cost of an active members participation in the pension fund.** If the fund were 100% funded, we would still have this cost as we progress forward.

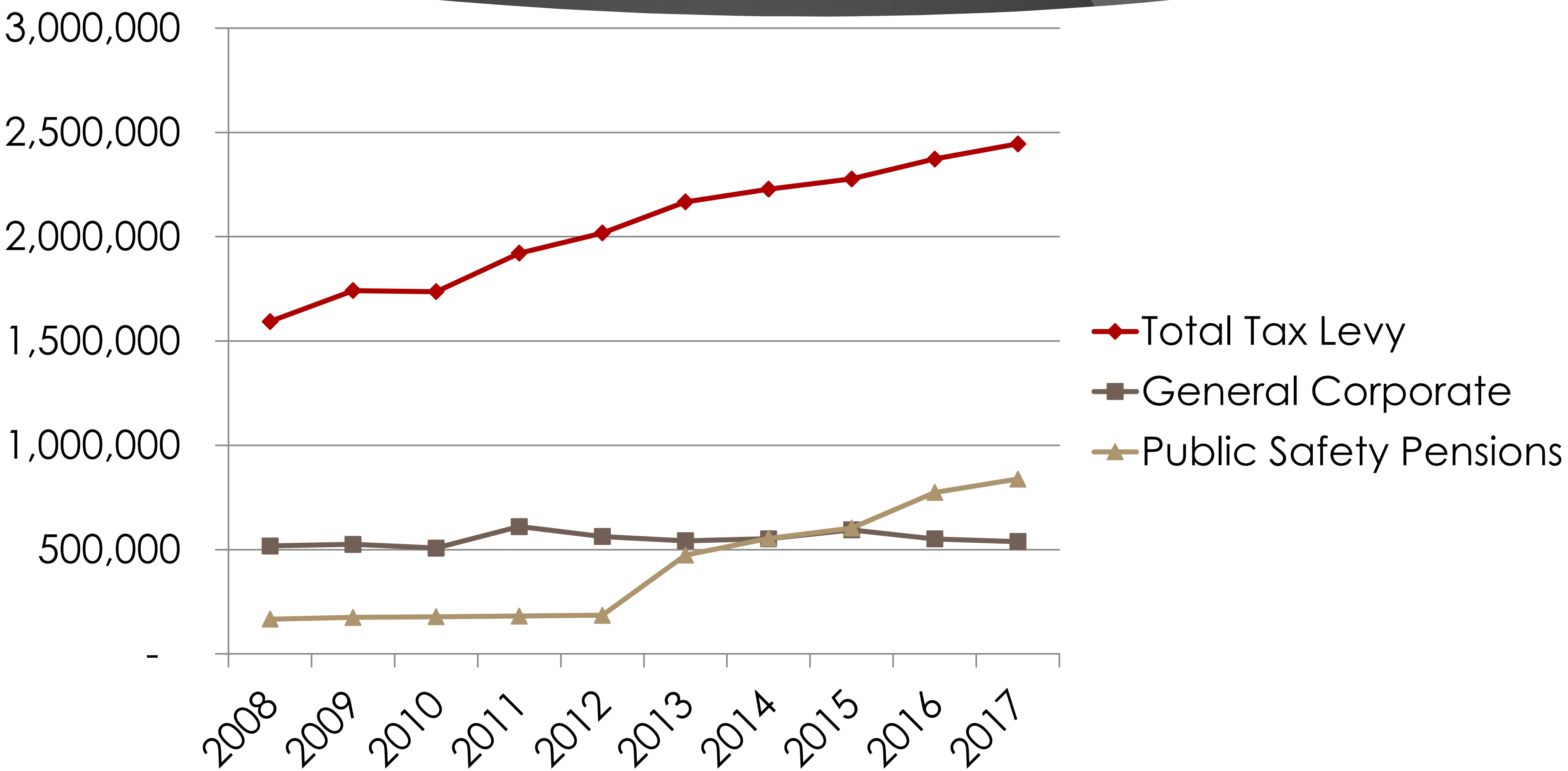
Most Property Types have Increased in Value in Recent Years



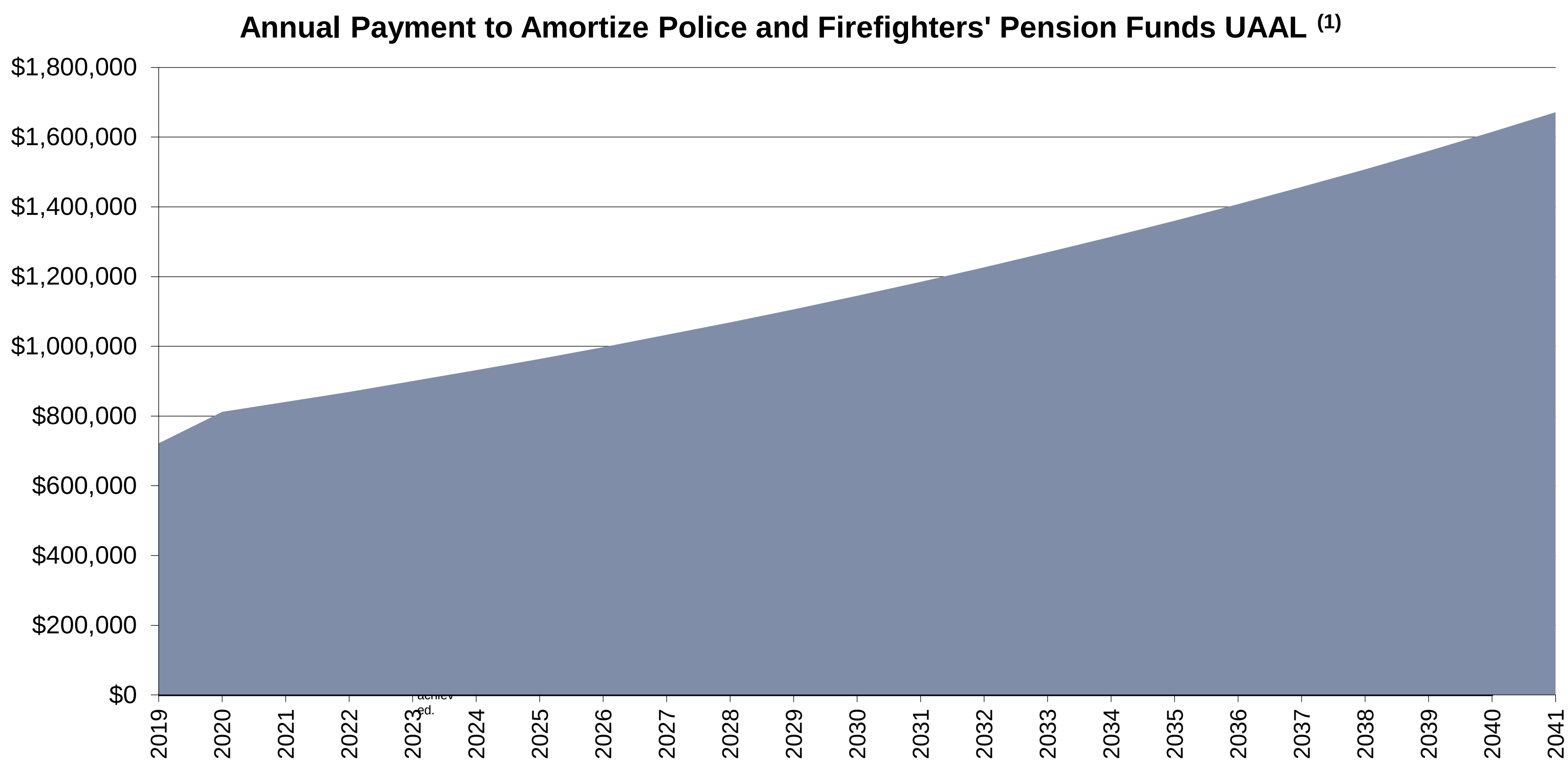
Residential Property Values are Starting to Increase



City of Rochelle Tax Levy Through Fiscal Year 2017



2019-2041 Projected Required Contribution



(1) Assumes actuarially projected results are achieved.

Summary of the City's Police and Firefighters' Pension Plans

The City's Police and Firefighters' Pension Plans had the following characteristics as shown in the City's 12/31/17 Comprehensive Annual Financial Report:

- City of Rochelle has unfunded Police pension liabilities of approximately $5.986 million.
- City of Rochelle has unfunded Firefighters' pension liabilities of approximately $5.082 million.
- Combined funding level of 61%, (statewide average for downstate pension plans is 57.58%)
- Police Pension plan funded at 94.2% on 4/30/09, Fire Pension plan funded at 92.7% on 4/30/07.
- The pension funds assumed rate of return is 6.75%, which is used to calculate annual contributions. Lower ROR means higher annual payments.
- Baird estimates that the City could borrow at about 4.57% in the bond market.
- Should the City apply bond proceeds to retire its Police or Firefighters' pension liabilities there a potential savings could exceed $5 million over a 22 year period.
- Even when funded 100% there is always the normal cost. That is the annual cost of an active members participation in the pension fund. If the fund were 100% funded, we would still have this cost as we progress forward.

City Fiscal Responsibility

- Historically, the City has funded 100% of the city's actuarial recommended levels. The State DOI also provides recommendations, but typically lower.
- Jan 1,2018 actuary report recommended City's portion of the fire pension funding level be $482,180 (This includes the normal contribution and the unfunded liability). This represents a $17,192 increase over the previous year.
- Jan 1, 2018 actuary report recommended City's portion of the police pension funding level be $614,329 (This includes normal contribution and unfunded liability). This represents an increase of $56,455 from the previous year.
  - In the next 5 years, fire pension benefit payments are expected to increase 3%-5% annually **(dependent upon ROR, actuary assumptions and actuarial experience…incidents of disability…PSEBA)**
  - In the next 5 years, police pension benefit payments are expected to increase 3%-5% annually **(dependent on ROR, actuary assumptions and actuarial experience…incidents of disability…PSEBA)**
  - Increased costs are due primarily to updated actuarial numbers & lower than expected rates of return on investments
  - The City's policy is to have both funds 100% funded by 2040 or sooner if funds are available.

Funding Options

- Continue annual contributions as normal, but set a policy dedicating additional funds annually above the actuarial recommended amount. Chris and Jeff to present options during budget discussions.
  - $1,096,509 annual contribution-property tax levy, additional $109,650 (10%) from video gaming towards unfunded liability.
- Consider funding up front entire unfunded liability through the issuance of a Pension Obligation Bond. This should only be considered as a long-term attempt to shore up unfunded liabilities without major budget cuts and/or property tax increases.
- Rochelle is NOT Chicago and is not considering this for short-term budget relief. The City's budget can handle the current liabilities without tax increases due to growth.

What are Pension Obligation Bonds?

- Pension Obligation Bonds (POBs) are generally taxable municipal bonds issued for the express purpose of funding retirement benefits.
- Issuing debt to help fund a pension fund
  - POBs reduce but do not eliminate the annual contribution to the pension plan.
  - POBs are typically issued to fund the unfunded actuarial liability of the pension plan.

Potential Benefits to the City from POBs

- Could generate significant expected total gross savings, assuming the System's investments realize the assumed 6.75% rate of return.
- Provides the City with flexibility to structure repayments to best meet its needs.
- Replaces one existing legal obligation with another, less costly liability.
  - No material net increase in the City's obligations.
  - Rating agency treatment is expected to be neutral overall.
  - The City's rating analysis would treat the POBs as bonds instead of pension liabilities.
- Lowers the "hurdle rate" on investments from the historical average investment rate (6.75%) to the POB cost of funds (estimated to be 4.57% in today's market). More money in the market earning a return.

Alternative Funding Method for the City's UAAL With Level Debt Service Structure

Alternative Funding Method Level Debt Service Illustration [1]

Interest on Bond Years		Tax Collection Year Ending December 31	Year of UAAL Payment	Annual Payment to Amortize UAAL [2]	Principal	Interest	Net Total Debt Service	Assumed Savings [3]	UAAL Balance [2]	POB Balance
	*					Avg= 4.57%				
	*									$12,690,000
3,851	*	2019	2020	$722,133	$100,000	$616,569	$716,569	$5,564	$12,326,001	$12,590,000
18,823	*	2020	2021	$811,771	$250,000	$558,427	$808,427	$3,345	$12,346,235	$12,340,000
32,131	*	2021	2022	$840,184	$285,000	$549,452	$834,452	$5,733	$12,339,423	$12,055,000
49,402	*	2022	2023	$869,589	$325,000	$539,078	$864,078	$5,512	$12,302,744	$11,730,000
71,856	*	2023	2024	$900,025	$370,000	$527,020	$897,020	$3,005	$12,233,154	$11,360,000
99,443	*	2024	2025	$931,526	$415,000	$512,923	$927,923	$3,603	$12,127,366	$10,945,000
127,278	*	2025	2026	$964,129	$445,000	$496,614	$941,614	$22,516	$11,981,834	$10,500,000
155,127	*	2026	2027	$997,874	$465,000	$478,680	$943,680	$54,194	$11,792,733	$10,035,000
184,273	*	2027	2028	$1,032,799	$480,000	$459,522	$939,522	$93,277	$11,555,944	$9,555,000
217,731	*	2028	2029	$1,068,948	$505,000	$439,266	$944,266	$124,682	$11,267,022	$9,050,000
251,685	*	2029	2030	$1,106,360	$525,000	$417,703	$942,703	$163,658	$10,921,186	$8,525,000
290,757	*	2030	2031	$1,145,083	$550,000	$395,023	$945,023	$200,061	$10,513,282	$7,975,000
332,866	*	2031	2032	$1,185,161	$575,000	$370,988	$945,988	$239,174	$10,037,767	$7,400,000
378,088	*	2032	2033	$1,226,642	$600,000	$345,573	$945,573	$281,070	$9,488,675	$6,800,000
426,497	*	2033	2034	$1,269,574	$625,000	$318,753	$943,753	$325,822	$8,859,587	$6,175,000
480,792	*	2034	2035	$1,314,009	$655,000	$290,503	$945,503	$368,507	$8,143,599	$5,520,000
539,905	*	2035	2036	$1,359,999	$685,000	$260,635	$945,635	$414,365	$7,333,292	$4,835,000
602,981	*	2036	2037	$1,407,599	$715,000	$229,056	$944,056	$463,543	$6,420,690	$4,120,000
674,609	*	2037	2038	$1,456,866	$750,000	$195,737	$945,737	$511,129	$5,397,220	$3,370,000
750,953	*	2038	2039	$1,507,856	$785,000	$160,412	$945,412	$562,444	$4,253,677	$2,585,000
828,488	*	2039	2040	$1,560,631	$825,000	$123,046	$948,046	$612,585	$2,980,169	$1,760,000
904,572	*	2040	2041	$1,615,253	$860,000	$83,776	$943,776	$671,477	$1,566,076	$900,000
989,485	*	2041	2042	$1,671,787	$900,000	$42,840	$942,840	$728,947	$0	$0
$8,411,591				$26,965,798	$12,690,000	$8,411,591	$21,101,591	$5,864,207		
$8,411,591										
4.57%										

Assumed Unfunded Actuarial Accrued Liability Funded by POBs	***$12,326,001***
Assumed Present Value Savings @ Bond Rate...……	***$2,780,358***
Assumed PV Savings @ Bond Rate / UAAL...................…............................	***22.56%***

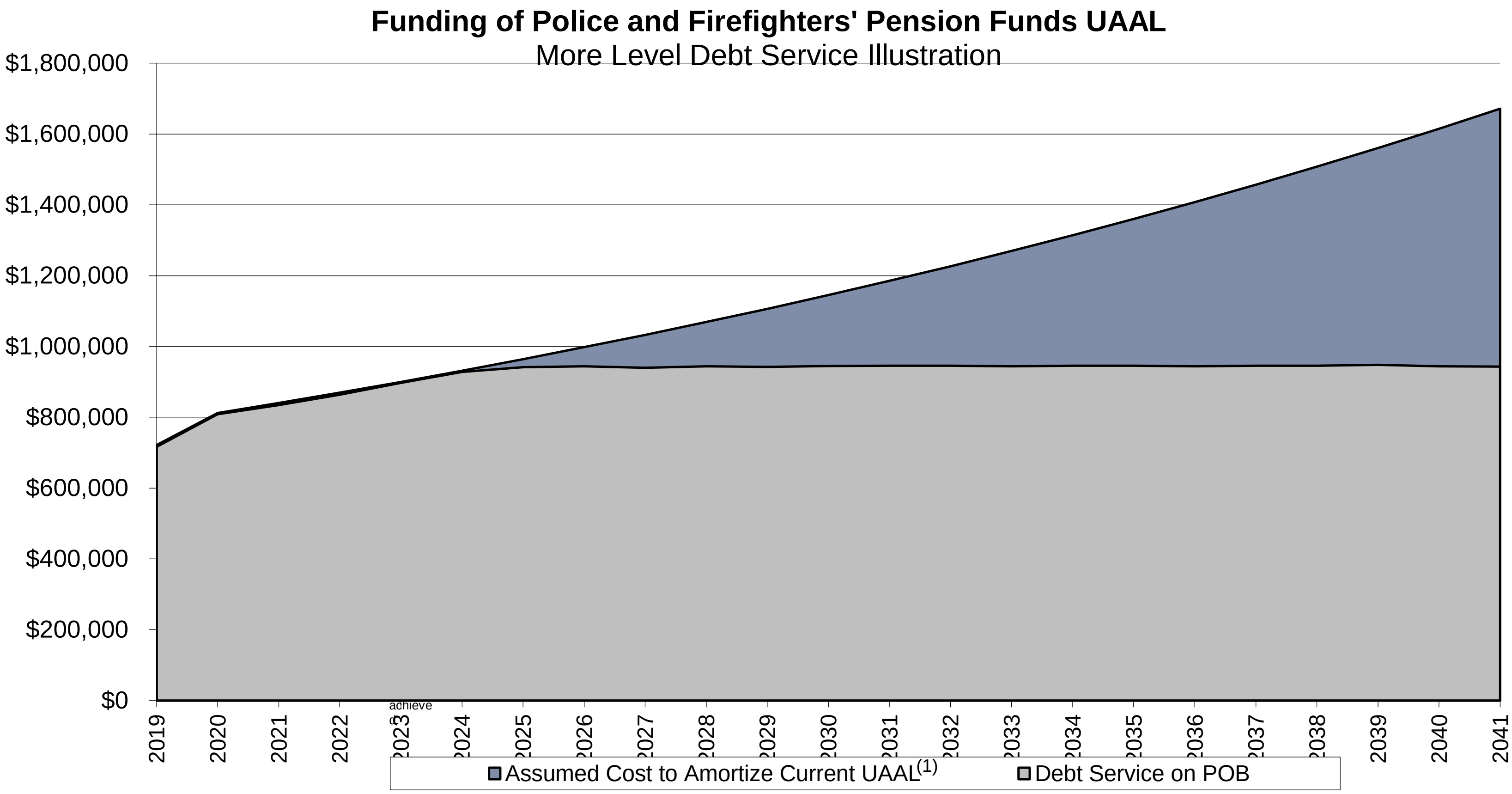
Interest Rate Sensitivity Analysis	***+10 basis points***	***-10 basis points***
Potential Gross Savings	*$5,614,550*	*$6,109,670*
Potential Present Value Savings	*$2,606,476*	*$2,957,225*
Hypothetical Refunding Bond Yield (Discount Rate)	*4.731%*	*4.524%*
Potential Percent Present Value Savings	*21.146%*	*23.992%*

(1) This illustration represents a mathematical calculation of potential interest cost savings, assuming hypothetical rates based on current rates for taxable general obligation bonds rated A+ with AA rated bond insurance as of September 20, 2018. Actual rates may vary. If actual rates are higher than those assumed, the interest cost savings would be lower. This illustration provides information and is not intended to be a recommendation, proposal or suggestion for a refinancing or otherwise be considered as advice. Assumes the bonds are dated as of November 26, 2018 with principal due January 1 and a first interest payment on July 1, 2019. Preliminary, subject to change.

(2) Total UAAL, annual payment and interest are based on estimated actuarial schedules provided by Lauterbach & Amen, LLP as of December 31, 2018. Figures above do not include contribution for normal cost. Unfunded liability payoff does not include any potential new unfunded liability that could occur subsequent to the estimate date.

(3) Assumes actuarially projected results are achieved and bonds are issued as described.

Alternative Funding Method for the City's UAAL With Level Debt Service Structure (Cont.)



(1) Assumes actuarially projected results are achieved.

POB Risks

- Especially in this low interest rate market environment, the principal risk is that earnings on POB proceeds will be less than the assumed 6.75% rate. The following shows the result of the various earnings scenarios:

Actual Earnings Achieved	Result
Above Actuarial Rate	Savings Greater Than Expected
Actuarial Rate	Expected Savings Received
Below Actuarial Rate, but Above POB Rate	Savings Less Than Expected
POB Rate	No Savings
Below POB Rate	Loss

- Investing a large dollar amount all at once could result in adverse market timing.
  - Can be addressed through agreement with the pension plan.
- The POBs are "hard" liabilities. Pension payments can sometimes be considered "soft" liabilities. **NEVER UNDERFUND (local vs. state actuarial reports)**
- Additional changes may arise as a result of such things as mortality tables, payroll changes, asset valuation method, benefit levels, etc. (This risk will be present whether the POBs are issued or not.)

POB Considerations

- In order to be most effective, POBs must be part of a long-term comprehensive strategy to fully fund the pension plan's unfunded liability.
- To provide the best chance for success, the issuer should evaluate the economic drivers of the POBs at the time of a contemplated issuance. Think long-term, not short-term budget impacts.
- Future underfunding of the annual determined contribution payment will diminish the impact of the POB. If the City moves forward the Council should pass a policy to always fund the annual contribution. No Pension holidays.
- The use of the POBs should be considered on an individual basis with the issuer's specific pension system characteristics, risk profile and overall debt and financial position. If the City decides not to move forward, the City Manager and Finance team will develop a long-term strategy to pay down the unfunded liability with additional annual payments.
- Neither the GFOA nor the ILGFOA endorses the use of POBs. They in fact recommend that they not be used.

City of Rochelle

- Rochelle’s Standard & Poor’s bond rating is AA
- Received Certificate of Achievement for Excellence in Financial Reporting since 2015

- Contact Jeff Fiegenschuh with any additional questions at 815-561-2000