



Response to Council Request: Councilwoman Pastor Regarding Proposition 106

THIS ITEM IS FOR INFORMATION ONLY.

This report provides the City Council with information in response to a request made by Councilwoman Laura Pastor at the July 2, 2019 Policy Session for staff follow up about Proposition 106 that will be considered by Phoenix voters on the Aug. 27, 2019 ballot. Councilwoman Pastor asked about the impact of the initiative on City programs, monetary and long-term effects on the City, as well as an estimate of the City's pension contribution over several years including this year and last year.

The City of Phoenix does not take a position on pending ballot measures. The following information is provided for informational purposes only in response to specific questions from the City Council and is not intended to express either support or opposition to the proposition. This report responds to questions and does not address all potential beneficial or detrimental impacts of the proposition. The projections in this memo are based on the information currently available and do not reflect all possible scenarios and/or outcomes.

Summary of Proposition

- Proposition 106 language as submitted (**Attachment A**) would amend the City Charter to impose new requirements related to the City budget and the funding of public pensions for the City of Phoenix Employees' Retirement System (COPERS), the State of Arizona's Elected Officials' Retirement Plan (EORP), and the State of Arizona's Public Safety Personnel Retirement System (PSPRS). Specifically, the proposition would require the City to conduct an annual assessment of each of the above pension plan's current and future pension debt, apart from and in addition to any other annual actuarial assessment currently performed by the City and/or the State of Arizona's pension plans themselves.
- Under the proposition, in each year, if the City's current and future pension plan liabilities are not at least 90 percent funded, the City must impose a cap on budget growth for all City programs including budgets for parks, municipal courts, libraries,

and information technology but excluding budgets for police, fire, first responders, labor agreements executed before Jan. 1, 2018, enterprise funds, and voter-approved special revenues or revenue funds. All excess funds above the budget cap must be spent solely towards the payment of the City's current and future pension liabilities, beginning with the State of Arizona's Public Safety Personnel Retirement System until all pensions are 90 percent funded.

- Lastly, the proposition, if adopted, would require elected officials to reimburse the City for all prospective pension plan employer contributions made by the City on the elected official's behalf.

Potential Impact on Budget and City Programs

- Under the terms of the proposition, if pensions are not at least 90 percent funded, the City Council cannot increase the budget for General Fund (GF) programs other than to account for population growth and inflation. However, the proposition does not specify whether "population growth, per the U.S. Census" and "rate of inflation for the previous year" (the benchmarks for fixing budget growth), refer to national or local population and inflation rates. It also is not clear how the two factors are used together to fix budget growth, and the language for this calculation is not consistent throughout the proposition.
- The proposition proposes limiting all growth in funding for General Fund programs and services, with some exceptions, until pension liabilities are at least 90 percent paid, beginning with PSPRS. The impact of this budget growth cap would fall upon non-public safety GF departments such as: Parks, Library, Human Services, Neighborhood Services, Street Transportation, Municipal Court, Prosecutor, Public Defender, and internal services like Public Works fleet and buildings, Budget, Finance, Audit, Human Resources and Information Technology. It could also result in a need to reduce non-Police, Fire and First Responder employment and/or compensation.

To illustrate, as requested by Councilwoman Pastor, if the proposition's limit on budget growth had been triggered for the FY 2019-20 budget, the City Council could not have used the \$55 million GF surplus to expand non-public safety services or increase non-Police, Fire and First Responder employee compensation. Therefore, the additions in the FY 2019-20 budget for Youth Services, Homelessness Prevention and Affordable Housing, Neighborhood Preservation and Revitalization, Parks, Infrastructure, and Census 2020 **(Attachment B)** likely would not have been allowed. Instead any funds in excess

of the prior year's budget (FY 2018-19), as adjusted for population growth and inflation, would have to be spent toward paying down pension liabilities, beginning with PSPRS, or to increase police, fire and first responder budget line items, or other exempt line items.

- Many terms in the proposition are not defined and thus there is some uncertainty regarding the meaning, intent and potential impact of the measure. For example, regarding the required annual assessment of pension debt and pension solvency, the terms "pension debt" and "pension solvency" are not defined. Similarly, related to the budget growth cap, the terms "90% funded" and "First Responders" are not defined.
- The City would still be required to make the legally mandated annual payments to the PSPRS, COPERS, and EORP pension plans. (The proposition would not end elected officials' pensions, but rather requires current elected officials to reimburse the City for future contributions to the pension on their behalf, so the City would continue to pay on its EORP liability). Annual pension contributions for all systems have been historically increasing and are forecasted to continue to rise. If triggered in a given year, the Proposition's cap on budget growth could impair the City's ability to increase budgets to meet the required contribution obligations. If that were to occur, the City would likely have to reduce funding for other GF programs to cover the required pension contributions.
- The proposed cap on budget growth also could limit the City's ability to borrow additional funds necessary to maintain aging infrastructure. Limiting the City's ability to finance could affect the City's bond ratings and increase capital costs.

Potential Monetary and Long Term Impacts

- The annual assessment method in the proposition requires calculation of pension liabilities using an estimated rate of return based on the most recent 10-year historical experience of the pension plan. This rate would be adjusted every year. Below is a table showing the annual changes to the 10-year historical rate of return for PSPRS.

Fiscal Year	Ten-Year Average Rate of Return
2008-09	1.1%
2009-10	1.2
2010-11	4.6
2011-12	6.0

2012-13	6.5
2013-14	6.3
2014-15	5.8
2015-16	5.0
2016-17	4.6
2017-18	6.0
2018-19	9.15

Note: This information is from City of Phoenix Comprehensive Annual Financial Reports.

- Yearly fluctuations in an individual plan's rate of return could result in an inaccurate forecast if used annually to assess whether pensions are at least 90% funded. The Finance Department has estimated that every one percent change in the return on the investment could result in a \$500 million to \$700 million change in the net pension liability leading to an under- or over-valuing of the plan's liabilities each year. (This estimate is unaudited and is derived from the Finance Department modeling of actuarial studies for planning and analytical purposes.)
- The annual assessment required by the proposition also includes a proposed basis for determining the liability using a historical 10-year average life expectancy of plan members. Industry standards for developing life expectancy rates used to determine future pension plan liabilities are based on a significant population to accurately produce a valid forecast. According to actuarial standards, the member populations in the City's plans are not large enough to provide an accurate forecast of life expectancy rates.
- The Pension Clause of the State Constitution requires retirement plans to be funded using actuarial standards. Pension plan funding levels according to the proposition's accounting assessment may differ from the funding levels reflected in the plans' Annual Actuarial Valuations and the Comprehensive Annual Financial Statements relied upon by rating agencies, external auditors and investors.
- The City's actuarially determined annual required contributions (ARC) for pensions will not change whether or not Proposition 106 passes.

City Pension Contributions

- Pension contributions for PSPRS over the past five years are as follows:

<u>Fiscal Year</u>	<u>Annual PSPRS Contribution 1/</u>
2015-16	\$142,230,000
2016-17	\$170,316,000
2017-18	\$197,906,000
2018-19	\$247,016,000
2019-20	\$271,180,000 (Estimate)

1/Amounts for FY 2015-16 and 2016-17 are from the FY 2017-18 Comprehensive Annual Financial Report, Required Supplementary Information, page 117. Amount for FY 2017-18 is from the unaudited FY 2018-19 Comprehensive Annual Financial Report. Amounts for FY 2018-19 and 2019-20 are from the approved budget.

At this time we are not able to forecast the impact of the proposition on future contributions due to the unknown nature of future population, inflation and economic growth.

Responsible Department

This item is submitted by City Manager Ed Zuercher and the Budget and Research, Law and Finance departments.

PROPOSITION NUMBER 106

Descriptive Title

Proposed amendment to the Charter of the City of Phoenix to: (1) require the City to conduct an additional annual assessment of all of its pension liabilities; (2) impose a cap on budget growth for City programs including budgets for parks, libraries, and information technology but excluding budgets for police, fire, first responders, labor contracts executed before January 1, 2018, enterprise funds and voter-approved special revenues or revenue funds, if pensions are not at least 90% funded, and mandate that all funds above the budget cap be spent solely toward pension liabilities; and (3) require elected officials reimburse the City for all future pension contributions made by the City on the elected officials' behalf.

Text

Chapter XXIV, Article V of the Charter of the City of Phoenix will be added as follows:

WITHIN THIRTY DAYS AFTER THE EFFECTIVE DATE OF THIS ACT, THE CITY COUNCIL SHALL ADOPT AMENDMENTS IMPLEMENTING THE FOLLOWING PROVISIONS OF THIS ACT, INCLUDING STRIKING ANY CURRENTLY-EXISTING PROVISIONS OF THE CITY CHARTER INCONSISTENT WITH THE TERMS OF THIS ACT. CHAPTER XXIV SHALL BE AMENDED BY ADDING PART V, TO PROVIDE FOR THE FOLLOWING:

1. **DEFINITIONS**

1.1 "ACT" MEANS RESPONSIBLE BUDGET ACT.

1.2 "ANNUAL ASSESSMENT" MEANS A YEARLY RECORD OF THE CITY OF PHOENIX EMPLOYEES' RETIREMENT SYSTEMS FINANCIAL CONDITION.

1.3 "CITY OFFICIAL" MEANS THE MAYOR AND MEMBERS OF THE COUNCIL OF THE CITY OF PHOENIX, WHETHER SERVING BY ELECTION OR APPOINTMENT.

1.4 "FUNDED" MEANS THE AMOUNT PROJECTED TO BE REQUIRED TO BE OWNED IN A PENSION SYSTEM, BY TAKING INTO ACCOUNT CAPITAL CONTRIBUTIONS AND RETURN ON INVESTMENTS, IN ORDER TO SATISFY ALL OBLIGATIONS TO PAY RETIREMENT

BENEFITS.

1.5 "GAAP" MEANS GENERALLY ACCEPTED ACCOUNTING PRINCIPLES WHICH ARE THE ACCOUNTING STANDARDS ADOPTED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION.

1.6 "GASB" MEANS THE GOVERNMENTAL ACCOUNTING STANDARDS BOARD WHICH IS THE SOURCE OF GAAP PRINCIPLES FOR STATE AND MUNICIPAL GOVERNMENTS.

1.7 "PENSION FUNDING" MEANS REQUIRED EMPLOYER CONTRIBUTION RATES ARE DETERMINED ACTUARIALLY TO FUND FULL BENEFITS FOR ACTIVE MEMBERS AND TO AMORTIZE ANY UNFUNDED ACTUARIAL LIABILITY AS A LEVEL PERCENT OF PROJECTED MEMBER PAYROLL OVER THE AMORTIZATION PERIOD.

1.8 "SEAT" MEANS THE OFFICE OF AN ELECTED OR APPOINTED MEMBER OF THE CITY COUNCIL WHICH CONSISTS OF A MAYOR AND EIGHT (8) OTHER MEMBERS.

1.9 "TEN YEAR RATE OF RETURN" MEANS THE RETURN AN INVESTMENT PROVIDES OVER A PERIOD OF TIME, CALCULATED AS A TIME-WEIGHTED INVESTMENT. THE ANNUAL RETURN RATE IS MEASURED FROM THE INITIAL AMOUNT OF THE INVESTMENT.

2. ANNUAL ASSESSMENT

a) THE PHOENIX CITY COUNCIL SHALL PRODUCE AND PUBLISH, ON AN ANNUAL BASIS, AN ASSESSMENT REPORT THAT PROVIDES AN ASSESSMENT OF THE CITY OF PHOENIX'S PENSION DEBT AND THIS ANNUAL REPORT SHALL EMPLOY GAAP PRINCIPLES IN ACCORDANCE WITH OVERSIGHT AND PRINCIPLES PROMULGATED BY THE GASB.

b) IN ASSESSING THE PENSION DEBT, THE REPORT SHALL ONLY UTILIZE THE HISTORICAL ANNUAL AVERAGE RETURN ON INVESTMENT OF THE PREVIOUS 10 YEARS, AND SHALL ONLY UTILIZE THE

HISTORICAL LIFE EXPECTANCY OF PENSION PARTICIPANTS OF ALL CITY OF PHOENIX PENSION SYSTEMS OF THE PREVIOUS 10 YEARS, TO DETERMINE PENSION SOLVENCY AND DEBT AMOUNT.

1. THE ANNUAL ASSESSMENT SHALL NOT UTILIZE ANY ASSUMPTIONS OR ESTIMATES FOR POTENTIAL RETURNS.

3. FULLY FUNDED PENSIONS

a) THE CITY COUNCIL IS REQUIRED BY CHARTER XVIII SECTION 6(B)(3) TO ADOPT A YEARLY BUDGET. IF THE ANNUAL ASSESSMENT OF THE CITY OF ALL PHOENIX EMPLOYEES' RETIREMENT SYSTEMS DEMONSTRATE THAT THE RETIREMENT SYSTEMS ARE NOT AT LEAST 90% FUNDED, THEN THE CITY COUNCIL'S BUDGET GROWTH IS FIXED AT AN AMOUNT NO GREATER THAN POPULATION GROWTH, PER THE U.S. CENSUS, AT THE RATE OF INFLATION FOR THE PREVIOUS YEAR, EXCEPT FOR BUDGETARY LINE ITEMS FOR POLICE OFFICERS, FIREFIGHTERS AND FIRST RESPONDER PROTECTIONS.

b) ANY EXCESS CITY BUDGET FUNDS GREATER THAN INCREASES FOR POPULATION GROWTH AND THE RATE OF INFLATION FOR THE PREVIOUS YEAR, EXCEPT FOR BUDGETARY LINE ITEMS OF FOR POLICE OFFICERS, FIREFIGHTERS AND FIRST RESPONDER PROTECTIONS SHALL BE SPENT SOLELY TOWARD PENSION DEBT.

c) ANY EXCESS BUDGET FUNDS SHALL FIRST BE SPENT TOWARDS COMPLETELY SATISFYING OUTSTANDING DEBTS TO THE PENSION SYSTEMS FOR POLICE OFFICERS, FIREFIGHTERS AND FIRST RESPONDERS. ONCE THESE FUNDS ARE DEEMED 90% FUNDED CAN EXCESS FUNDS BE USED TO SATISFY THE OUTSTANDING DEBTS TO THE OTHER CITY OF PHOENIX EMPLOYEES' RETIREMENT SYSTEMS.

d) THE PASSAGE AND OPERATION OF THIS ACT SHALL NOT INTERFERE WITH, IMPACT, ABROGATE, NULLIFY, NOR INVALIDATE ANY CONTRACTUAL AGREEMENTS, BETWEEN THE CITY OF PHOENIX AND ANY LABOR UNIONS, THAT WERE EXECUTED PRIOR

TO JANUARY 1, 2018.

e) THE PASSAGE AND OPERATION OF THIS ACT SHALL NOT INTERFERE WITH, IMPACT, ABROGATE, NULLIFY, NOR INVALIDATE ANY CITY ENTERPRISE FUNDS OR VOTER APPROVED SPECIAL REVENUES OR REVENUE FUNDS.

4. ELECTED CITY OFFICIALS

a) ALL ELECTED OR APPOINTED CITY OFFICIALS WHO PARTICIPATE IN OR QUALIFY FOR ANY PENSION OR RETIREMENT SYSTEM, SHALL BE REQUIRED TO REIMBURSE THE CITY FOR ALL EMPLOYER CONTRIBUTIONS EQUAL TO THE FURTHERANCE OF THEIR PENSION OR RETIREMENT SYSTEM BENEFITS EARNED OR ACCRUED AFTER THE ENACTMENT OF THIS ACT.

b) THIS ACT SHALL NOT IMPACT ANY PENSION OR RETIREMENT BENEFITS EARNED BY CITY OFFICIALS PRIOR TO THE EFFECTIVE DATE OF THIS ACT.

5. DECLARATION OF EMERGENCY

a) THE PROVISIONS OF THIS ACT MAY BE WAIVED, EXCEPT FOR SECTIONS 1 (8) AND (9), IF THERE IS A SPECIFIC FORMAL DECLARATION OF EMERGENCY BY THE MAYOR. THE DECLARATION MUST THEN BE APPROVED BY A VOTE OF 8 OF THE 9 MEMBERS OF THE CITY COUNCIL. SUCH DECLARATION CANNOT EXTEND BEYOND ONE BUDGETARY YEAR.

Question

Shall Chapter XXIV, Article V be added to the Charter of the City of Phoenix to require the City to conduct an additional annual assessment of all of its pension liabilities; to impose a cap on budget growth for City programs including budgets for parks, libraries, and information technology but excluding budgets for police, fire, first responders, labor contracts executed before January 1, 2018, enterprise funds and voter-approved special revenues or revenue funds, if pensions are not at least 90% funded, and mandate that all funds above the budget cap be spent solely toward pension liabilities; and to require elected officials to reimburse the City for all future pension contributions made by the City on the elected officials' behalf as described above?

YES

NO

PASSED by the Council of the City of Phoenix this 1st day of May, 2019.


MAYOR

ATTEST:

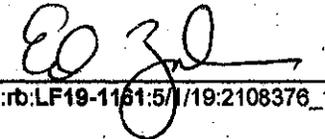

City Clerk



APPROVED AS TO FORM:


Acting City Attorney

REVIEWED BY:


City Manager

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