City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 3, 2013

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: RASHAD M. YOUNG, CITY MANAGER RMY

SUBJECT: BUDGET MEMO # 13: POLICE – FIRE PENSION REFINANCING

This memorandum is in response to the following question requested by Councilman Wilson: "What would be the estimated fiscal impact of "refinancing" the start-up costs currently being paid down within the Public Safety Defined Benefit Pension Plan?"

Current accounting rules allow for changes in the amortization period to "refinance" the unfunded liability; however, the City's current funding status, the recommendations from the Ad Hoc Benefit Advisory Committee, and upcoming changes to financial reporting for pensions suggest that continuing to extend our "mortgage" will not address the long term stability issues with our pension plans. The Ad Hoc Benefit Advisory Group's report can be found at http://alexandriava.gov/Retirement.

The expenditure impact of refinancing the liability is about a $100,000 cost savings for each year extended, but the impact on financial soundness of the overall pension plan may be more significant.

The amount of the City's annual contribution to the plan has several elements that can increase (or decrease) the cost of the plan. When the plan was started in 2004, a very long amortization (or mortgage) period was chosen, in part to decrease the cost to the plan for participants. A decision to extend the mortgage should be made in conjunction with considering the potential for increases in the future. First, there are changes in the plan demographics that are increasing the cost of the plan. Current mortality estimates (how long people are expected to live) indicate public safety plan participants are living longer than they used to have contributed to the costs of the plan. This is good news from a wellness perspective but does represent a real cost to the plan. Second, the plan has almost recovered from the investment losses in 2008-2010, but the overall funding percentage of the plan from investment returns and contributions remains below its pre-recession levels.

If we extend the mortgage this year, we will have to make up the difference in the future unless we make significant changes to plan benefits. Changing the amortization period is a fiscal policy that should be considered in context with other cost issues related to the pension plan. Even if the plan funding had recovered to its pre-recession level, proposed accounting and rating agency changes to the way pension plans are presented in the City's financial reports will impact how we display and record the cost of the plan. For instance, rating agencies will no longer focus entirely on whether we made our current year "mortgage" payment. They will also consider our progress in paying down the mortgage.

Also, new accounting rules lowering investment return assumptions may increase the cost of the pension. Refinancing the costs now could leave the City with fewer options in addressing those changes at a future date.

The Ad Hoc Advisory Committee recognized the need to have an adjustment mechanism that shares the cost of the increases between the City and plan participants. Refinancing the mortgage does not provide ways to share the cost and provide a long-term solution; rather, it delays the cost onto future participants and taxpayers.

When the Ad Hoc Advisory Committee recommended an adjustment mechanism, one of the stated goals was to maintain the long term integrity of the plan in the future. Changing the amortization period moves the cost to a future year with a hope that the future cost will be lower. The Committee recommended putting a mechanism in place that shares the increased costs instead of hoping for something better. Employee work groups are developing several options for addressing the long term stability that would allow the plan to continue to make funding progress without pushing out the costs to the future.