CITY OF WHEATON Illinois

**CITY MANAGER'S OFFICE**
303 W WESLEY STREET, WHEATON, IL, 60187
630.260.2012 | www.wheaton.il.us

# MEMORANDUM

**TO:** The Honorable Mayor and City Council

**FROM:** Michael G. Dzugan, City Manager

**DATE:** September 2, 2021

**SUBJECT:** **Resolution/Pension Obligation Bond Review**

In anticipation of the City Council's consideration of the Pension Obligation Bond Parameters Ordinance, New Business #2, the attached Resolution sets forth a history and key points of the City Council's process and deliberations for identifying expenditure reduction opportunities by analyzing funding options addressing the City's Police and Firefighters unfunded pension liabilities.

The Resolution concludes acknowledging certain statements drawn from the 6 meetings, and multiple documents and reports.

Attachment

**RESOLUTION R-2021-**
**A RESOLUTION SETTING FORTH THE REVIEW OF PENSION OBLIGATION BONDS TO FUND POLICE AND FIREFIGHTERS PENSION UNFUNDED LIABILITIES**

**WHEREAS**, the City of Wheaton ("City") established a strategic priority of Financial Stability with a goal to identify expenditure reduction opportunities including a specific initiative to analyze the unfunded liabilities of the City's police and firefighters pension plans; and

**WHEREAS**, Illinois Compiled Statutes require the City's police and firefighters pension plans to be 90% funded by 2041; and

**WHEREAS**, the City's annual funding contributions for the police and firefighters pension plans are targeted at 100% funding by 2041; and

**WHEREAS**, the City's total police and firefighters pension contributions have increased from $3MM in FY 2016 to $5.7MM in CY 2021, a 90.5% increase and estimated to continue to increase placing significant pressure on revenues to fund operating and capital expenses; and

**WHEREAS**, unpredictable pension contributions make annual budgeting decisions difficult, the establishment of a viable and reasonable financial strategy that achieves predictable annual pension payments, reduces long term costs and achieves statutory required funding will be a key variable to completing long range financial planning and budgeting as the City looks to continue to provide efficient and effective services to residents; and

**WHEREAS**, the complexity of developing a financial strategy with achievable funding options addressing the City's unfunded pension liabilities demanded consultation with expertise in the areas of actuarial, investment, bond and disclosure counsel, and public finance; and

**WHEREAS**, to assist the City with developing achievable funding options, the City engaged four consultants with expertise in the fields of actuarial (Foster & Foster), investment (Marquette Associates), bond and disclosure counsel (Chapman and Cutler, LLP), and public finance (Robert W. Baird & Co.); and

**WHEREAS**, the City Council, in a deliberate and methodical manner, held six public meetings considering pension funding options on the following dates: September 21, 2020, November 23, 2020, January 25, 2021, March 8, 2021, April 26, 2021, and May 24, 2021; and

**WHEREAS**, during these meetings, the City Council considered the benefits and risks of the following financial strategy funding options:

- Continue current funding approach, "status quo", per actuarial recommendation to achieve 100% funding by 2041.

- Make a one-time $6MM contribution to the pension funds, with $6MM coming from the excess reserves of the General Fund, while continuing to maintain the 40% General Fund fund balance policy.
- Make $6MM in contribution payments to the pension funds spread over 5 years, addressing dollar cost averaging concerns, with $6MM coming from the excess reserves of the General Fund, while continuing to maintain the 40% General Fund fund balance policy.
- Issue $10MM non-taxable General Obligation Bonds with a 15-year level debt service structure for capital projects and make a $10MM one-time contribution to pension plans with $6MM coming from the excess reserves of the General Fund, while continuing to maintain the 40% fund balance policy, and $4MM from the Capital Projects Fund.
- Issue $52MM in taxable Pension Obligation Bonds to fund its unfunded liabilities (bring funded ratio to 100%) with a 20-year level debt service structure and an assumed bond rate of 2.46% vs. the plans' 6.75% investment return target.
- With all options, evaluate the impact of a 15-year open amortization period, lower payroll growth assumption, and dollar cost averaging of investments.

**WHEREAS**, upon deliberation, focus was directed to the issuance of $52MM in taxable Pension Obligation Bonds with an assumed bond interest rate of 2.46% with further sensitivity analysis on different average investment returns of 6.75%, 4%, and 2.5% over the current 20-year remaining closed amortization period and how the Pension Obligation Bond approach compared to the current status quo approach; and

**WHEREAS**, a summary of the results of the sensitivity analysis using different average investment return assumptions is shown below:

**6.75% Average Investment Return over 20 Years**

| | **Total Cost** | **Gross Increase/(Savings)** | **Present Value Increase/(Savings)** |
|---|---|---|---|
| **Status Quo** | $97MM | | |
| **POB, 20 Years at 2.46%** | $70MM | ($27MM) | ($11MM) |

**4% Average Investment Return over 20 Years**

| | **Total Cost** | **Gross Increase/(Savings)** | **Present Value Increase/(Savings)** |
|---|---|---|---|
| **Status Quo** | $198MM | | |
| **POB, 20 Years at 2.46%** | $195MM | ($3MM) | ($1MM) |

**2.5% Average Investment Return over 20 Years**

| | **Total Cost** | **Gross Increase/(Savings)** | **Present Value Increase/(Savings)** |
|---|---|---|---|
| **Status Quo** | $242MM | | |
| **POB, 20 Years at 2.46%** | $249MM | $7MM | $3MM |

**WHEREAS**, the City Council reviewed on August 9, 2021 and approved on August 16, 2021 an updated debt management policy that includes goals, processes, debt limitations, and the review of certain benchmarks when considering new debt; and

**WHEREAS**, the City Council will consider a future pension funding policy to guide the manner in which the City funds its long-term cost of benefits that will look at annual required contributions by assessing the use of the entry age normal level percentage of payroll actuarial cost method, an investment return assumption no greater than 6.75% per year, a payroll growth assumption no greater than 4%, actuarial value of assets amortized over an open 15-year period, and non-economic assumptions such as rates of separation, disability, retirement, and mortality.

**NOW, THEREFORE, BE IT RESOLVED** by the Mayor and the City Council of the City of Wheaton, DuPage County, Illinois, that:

**Section 1**: The City's debt burden will rise with the issuance of Pension Obligation Bonds though the total long-term obligations of the City will be unchanged as the bonds will be used to replace the unfunded police and firefighters pension plans' liabilities.

**Section 2**: Upon issuance of the Pension Obligation Bonds, the City will replace an unfunded liability that was amortized with escalating annual contributions payments with a level-dollar debt repayment.

**Section 3:** It is reasonable to assume, given over the last 10 years the rate of return on the police and firefighters pension funds have averaged 7.2%, that the 6.75% actuarial rate of return is achievable over the life of the Pension Obligation Bonds which is above the assumed bond rate of 2.46% which should generate expected savings for residents estimated at $11MM present value savings over the next 20 years.

**Section 4:** The issuance of the Pension Obligation Bonds will essentially fully fund the City's police and firefighters pension plans thereby reducing the amount and volatility of future pension contribution payments relative to the status quo option.

**Section 5:** Pension Obligation Bond proceeds will not be used to fund normal costs.

**Section 6:** The City will continue to make ongoing pension contributions, including normal costs consistent with actuarial requirements, while developing a pension funding policy that will include an investigation of new unfunded actuarial accrued liabilities amortized over an open 15-year amortization period, a payroll growth assumption less than 4%, an investment rate of return assumption less than 6.75% per year, and annual review of non-economic assumptions such as rates of separation, disability, retirement, mortality, etc. as reflective of actual experience.

**Section 7**: The principal risk is understood as the potential for market volatility related to the invested bond proceeds and the prospect that lower-than-projected investment returns could introduce the need for the City to use other sources beyond the bond proceeds to make its unfunded pension liability payments over the 20-year term of the bonds.

**Section 8:** The City will create a Budget Stabilization Fund that may be utilized to offset short-term smoothed losses due to any annual investment performance below the actuarial rate of 6.75% and implement a dollar-cost averaging investment strategy for the bond proceeds.

ADOPTED this 7th day of September, 2021.

________________________________________
Mayor

ATTEST:

___________________________________
City Clerk

Roll Call Vote:
Ayes:
Nays:
Absent: