No. 18

Memorandum

TO: Mayor, Mayor Pro Tem & City Council

FROM: Grayson Path, City Manager
Gene Anderson, Finance Director
Thomas McMonigle, Fire Chief

SUBJECT: **PARIS FIREFIGHTERS RELIEF AND RETIREMENT FUND**
PURSUE A PENSION BOND
FREEZE FIRE PENSION
TRANSFER EMPLOYEES TO TMRS

DATE: June 13, 2022

BACKGROUND:

The City of Paris provides two separate retirement programs for its employees: 1) Texas Municipal Retirement System (TMRS) for non-fire department personnel, and 2) Paris Firefighters' Relief and Retirement Fund ("Pension") for fire department personnel. The Pension was created circa 1941, is regulated under the Texas Local Fire Fighters Retirement Act (TLFFRA), and is managed by a local Board of Trustees.

In August 2020, it was brought to my attention that an article appeared in a Dallas newspaper discussing the various TLFFRA funds throughout the state and their individual funded status. According to this article, the Paris Pension was the least funded TLFFRA fund in the state of Texas. It stated that we were 30% funded, but many of our sister cities were not much better. The main point of the article was that this is an issue that cities all over the state were facing and very few of those cities had found a way to address the problem. It is a growing problem for both the employees served by the pension as well as the taxpayers responsible for funding it.

Having been spurred by the information in the article, I began investigating our Pension. Through this process, I learned that our Pension would become "fully funded" in approximately 30 years under our current contribution and payout formula. I also learned that this has been the expectation for the previous approximately 40 years. In other words, changes in legislation, the economy, and the benefit payout itself have all acted to make the "fully funded" goal a moving goal post. This situation carries the ever present danger that the fund could eventually run out and/or be so far behind that any hope of catching up would become highly improbable. Each of us have heard of stories from large metropolitan areas that have had to make drastic changes to their benefits due to insurmountable costs to sustain their pension funds. This often has unfortunate consequences for the men and women who worked their entire career for their retirement pension.

In December 2020, we learned that there was legislation being considered to amend the TLFFRA to force cities to dramatically increase their contribution amounts to address this growing issue. Such a change would present challenges because other legislation has placed caps on the city's ability to raise funding each year. To our knowledge, the legislation never went anywhere, but it is reasonable to assume that someday the legislature could actually pass this or something similar which will take effect whether we are prepared for it or not.

In November 2021, we met with the Board of Trustees to get an update on the Pension. The Pension's actuary had just completed a study to incorporate the substantial pay increases that the Fire Department had been given starting in October 2021 to see if this made an impact. While the fund was still at 29% funded, and while we still needed an approximate $16 million to be fully funded with only $5 million in the fund already, the pay increases did shrink the "fully funded" trajectory from 33 years down to 23 years. This is of course a significant improvement. But I was then educated on another key component in this equation. Our trajectory to a fully funded status assumes that the retirement benefit payout itself will not change. In the early 2000s, the Board of Trustees voted to set the benefit payout at $94 multiplied by your number of years of service, per month. Therefore, if you worked 30 years (in any position/s), you will be paid approximately $94 x 30 years of service x 12 months = $33,840.00 each year. If the Department voted to increase this formula, it would increase the unfunded liability and thus push out our fully funded status. This would also require an increase to the annual contribution by both the city and firefighter. Currently the employee puts in 16% of their pay as contribution while the city puts in 14% (total of 30%). This contribution, along with the current balance of approximately $5 million in the fund as an investment, is what is currently keeping the fund afloat. However, I also learned that we are spending more annually on benefits to current retirees than we are bringing in through collection. Therefore, our trajectory will not be accomplished without an increase in the contribution and/or a large deposit of funding in to the Pension fund by the city. In addition, the benefit payout bears no relation to the amount of contribution you place in. Whether you make higher rank pay or lower rank pay, you will still receive the same benefit amount for the same number of years of service.

With the above information in hand, and after discussing this with our team, I reached the following conclusions:

1. Under our current mode of operation, it is unlikely we will ever reach a fully funded status.
2. To simply deposit a large sum of money in to the fund requires a) money the city does not have without issuing long term debt and b) accepting that in a few years, this process might need to be repeated.
3. Reaching a fully funded status hinges on the department not increasing their benefit payout

and therefore accepting that in 30+ years from now, employees will be only making approximately $34k in retirement, which is unlikely to keep pace with the rising cost of living.

4. This will deter young men and women from considering a career as a Paris Firefighter, let alone promoting as there are no retirement incentives to either.
5. The growing unfunded liability will become more challenging for our future taxpayers to take on and address, particularly if an increase in benefits is ever approved, which could one day lead to the city's having to make difficult decisions.
6. If the legislature ever passes legislation like that referred to above, the city could be forced in a direction it is not ready to move in a very short period of time.
7. To ask the fire employees and taxpayers to increase their annual contribution beyond the 16%/14% will continue to become a challenging request, particularly given this only seems to be a costly and perpetual band aid for the situation.
8. And finally, even if annual contributions are increased, the annual benefit is not increased, and the city deposits a large sum of money, what ground has been gained? Eventually the retirement benefit will become undesirable by employees and/or we will need to issue more long term debt to keep the fund afloat for an indefinite period of time. This seems to be the inevitable future for many small scale pension funds.

After considering all of this, we concluded that something needs to change. You don't just keep throwing wood into a fire: eventually you need to take the necessary steps to put the fire out.

STATUS OF ISSUE:

Having learned all of this, we set out to explore an option of moving the Paris Fire Fighters from the Pension over to the city's TMRS. TMRS is a well-established, well run, and well-funded program. The contribution rate is 7% Employee / 14% city matching contributions (it was 6%/12% until it was changed for FY21/22). In reality, the city's required contribution is actuarially determined each year and generally has averaged below 8%. All in all, it is a much more cost friendly program for the employee and the taxpayer. In addition, assuming the same factors at play for pay and years of service, the benefit is believed to be much more advantageous to the employee than the current Pension.

With this in mind, we reached out to TMRS and the Pension actuary to explore the options. While a blending or merger of the assets in the Pension with TMRS is not possible, we are working out a plan where the city would "freeze" the Pension and move all existing and future employees over to TMRS accounts. For existing employees under the Pension, you would be vested for your years of service to date, but it would be frozen as of the date the transition takes place, with all future years counting towards TMRS. The employee and city's annual contribution rate would drop from 16%/14% to 7%/14% respectively (again, the city's actual contribution would be closer to 8%). Doing this, however, would require the city to take out a large bond to fund the unfunded liability of the Pension. If managed correctly, this funding would serve the life of the Pension and, in time, when the last existing beneficiary passes away, the Pension would cease to exist. For existing employees, when they retire, they would have a Pension account and a TMRS account. The two combined should equate to something greater than what the current Pension would pay. In the meantime, the employee will keep more of their paycheck (16% - 7% = 9%), which they could, in turn, invest in a private retirement on the side (the city would not contribute towards that). It must also be noted that the City of Paris maintains a State of Texas Section 218 Agreement (with some amendments) for Social Security payments. This agreement from 1956 (with amendments in 1965 and 1983) brought in all employees in to Social Security, excluding "emergency services", "elective positions", and "fee basis positions". It should be noted that "police" was added in 1965 while other emergency services remained excluded and EMS did not start until later, but they were brought straight in to Social Security. To the point, the Fire Department is currently excluded from Social Security. We are currently seeking legal confirmation, but it is our understanding at this time that whatever is done to the Fire Pension in this process has no bearing on whether or not the City and employee contributes to Social Security, until this agreement is ever amended. At this time, we are not recommending this. If that were to occur, then the employee and City would have to contribute the social security rate.

The Board of Trustees' actuary has opined that an approximate amount of $12 million will be needed in a bond to fund the Pension. He has also determined that the TMRS retirement benefit is more advantageous than the Pension retirement benefit for the employee. Unfortunately, TMRS is not as direct and simple as a $94 multiplied by your number of years of service, per month, calculation, so we cannot predict the final benefit for individual employees. We have, however, created test cases which reasonably show that employees should have a greater return on investment if converted to TMRS.

TMRS has made it plain that they will not touch the Pension itself; the Pension will forever be the responsibility of the city and Board of Trustees. They, however, will onboard all the fire department employees as if they were brand new employees in any other department. They would be starting with a zero balance in their TMRS account, but that would grow with their contributions. Their benefit would also be commensurate to their pay. The more they make, the greater their retirement benefit will be. With the revamped pay schedule and a move to TMRS, the desire to make a career with the City of Paris Fire Department and even to promote to a higher rank should be more financially appealing than it was two years ago.

Along with the city's financial advisor and bond counsel, we are working out the needed steps to issue a 20 year pension bond under state law. As a disclaimer, we can find no other precedent of other communities having 1) taken out a pension bond, while simultaneously: 2) freezing their fire pension, and 3) moving their employees to TMRS, so we have reached out to the Attorney General to see if there are any additional steps they are going to ask of us. Our legal counsel feels quite confident we have a way forward, but until that is ironed out, nothing is a guarantee. In addition, we are working with the Board of Trustee legal counsel regarding pension-specific statutory requirements and areas that need to be ironed out in an agreement between the City of Paris and Board of Trustees.

Please see the Budget section below for additional commentary.

Next Steps

Assuming the City Council is favorable to addressing this issue, we are still working with the Attorney General, Bond Legal Counsel, Pension Legal Counsel, Actuary, Financial Advisor, Third Party Legal Counsel regarding Social Security, and the Fire Pension Board to address several final details. But, the next step is to determine whether the City Council is willing to entertain this project. If so, then we intend to bring back to you a Pension Bond as well as an agreement with the Pension Board by the July 25, 2022 City Council meeting (or thereabouts).

I feel very good that we have found a solution that will work long term for the Fire Department, City of Paris, and Paris taxpayers; one that our descendants will look back and be grateful for.

We will happily do our best to answer questions. There is a large team of individuals working together on this, so I feel confident we can find an answer when a question arises.

BUDGET:

Assuming it moves along as planned, the city happens to have an existing bond retiring in FY21/22, which means in FY22/23 there will be available property tax rate that could be moved to this bond. The goal is to find a way to minimize the impact to the taxpayers while increasing retirement benefits for fire department personnel. Given the taxpayers are already acclimated to the existing property tax rate, instead of dropping the rate and asking that it be raised again later, my recommendation to the City Council will be to keep the rate and replace the retiring bond with the new bond. In conjunction with that recommendation, I will ask that the City Council consider adding an additional 1 cent in property tax. According to our calculations, assuming the numbers we have to date, this should save the taxpayers an additional $3 – 5 million over the life of the bond. This is a significant financial investment that the city and taxpayers would be taking on to solve this problem, but I believe it is mutually beneficial to all parties.

With a drop from 14% contribution to approximately 8% with TMRS, and assuming the City does not have to enter the employees in to Social Security, the City will realize a significant increase in available funds within the General Fund. It is recommended that this be repurposed to help offset other costs the City has and/or must take on.

Along with this, we have been working with our financial advisor to address our property tax caps under state law. We have developed a means, under state law, to issue this pension bond without impacting our Senate Bill 2 property tax caps from 2020. If the City Council agrees to pursue this, more will be explained at a later date.

For the employees, they will go from 16% annual contribution to the existing pension to 7% annual contribution to the new TMRS account like all other employees. This will be a significant benefit to these employees.

All in all, there appear to be significant wins for the employees, taxpayers, and municipal operations if this works out. And finally, assuming the market and return on investment holds favorably, the large deposit could see the fund through final life of the program, the taxpayer's expense for pension should end when the final payment for debt is completed (20 years), and the pension itself will terminate upon the passing of the final beneficiary with all future beneficiaries within the department coming under the TMRS.

Disclaimer – It must be stated that this all assumes a favorable market and return on investments. It is not impossible that at some future point, the City might have to deposit additional funds (possibly even another smaller bond) to fund the Pension. We are working off of best estimates assuming future variables, all produced by an actuary. However, having frozen the fund with no new employees entering in to it, the City will have hedged its risk and eventually will bring it to a conclusion.

OPTIONS:

1. Authorize the City Manager to continue pursuing this project and bring back at a future date a Pension Bond and an agreement with the Pension Board.
2. Request additional information to be brought back.
3. Reject the proposal and keep the Pension as is.
4. Recommend other solutions for funding the pension and/or giving employees a better retirement benefit.

RECOMMENDATION:

1. Authorize the City Manager to continue pursuing this project and bring back at a future date a Pension Bond and an agreement with the Pension Board.