City Council of Philadelphia

Finance and Budget Team:

City of Philadelphia FY2019 Pension Fund *Preliminary* Actuarial Valuation Update

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Executive Summary: On 2/27/2020, the City of Philadelphia Municipal Retirement System released a PowerPoint titled *Preliminary Actuarial Valuation Results as of July 1, 2019*. This release highlights the Pension Fund's fiscal position at the beginning of FY20, and recent historical structural changes to the Pension Fund. **This preliminary information – provided by the actuarial consulting firm *Cheiron* — will be followed by a full valuation report, which will be released in April.**

The report highlights several important data points:

- The Pension Fund's funded ratio has **increased from 46.85% to 49.67%.**
- The Fund experienced a **positive net cash flow** for the second year in a row.
- Recent changes, including the *Revenue Recognition Policy*, changes in investment strategy, and introduction of Plan 16, resulted in a further 2.24% reduction in the *Unfunded Actuarial Liability* (UAL). *Figure 1* highlights the reversal in UAL growth trends since 2014.

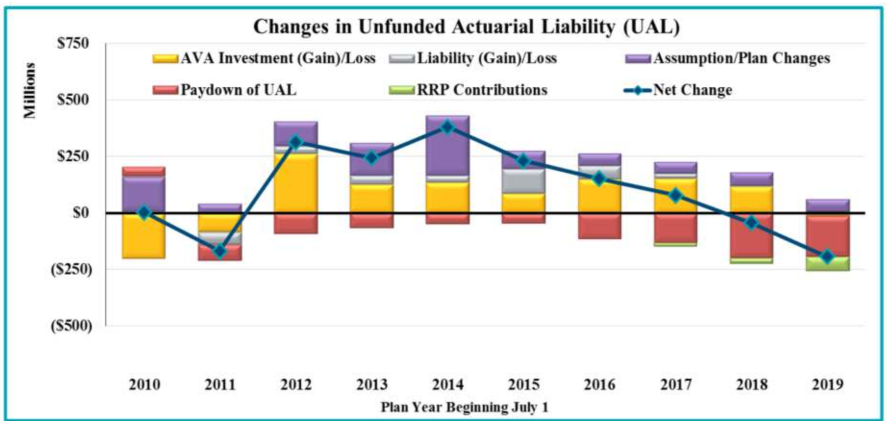

Figure 1

Key Figures: The *Q2 Quarterly City Manager Report* updated the City's pension cost projections for FY20. The City, which spent $752.5 million in the General Fund on pension related costs, **is projected to spend $749.1 million in FY20, which represents 14.6% of projected FY20 expenditures. The currently adopted FY20-24 Five-Year Plan projects stable pension related costs in the near-term.**

	General Fund Expenditures	
	FY19 Actual	FY20 Q2 Projection
Pension (MMO)	$ 590,415,269	$ 580,863,172
Pension Obligation Bonds (Debt Service)	$ 109,793,658	$ 109,794,742
Local Sales Tax	$ 52,099,331	$ 58,113,611
Plan 10	$ 239,048	$ 300,000
Total	**$ 752,547,306**	**$ 749,071,525**

Figure 2[1]

[1] Pension Obligation Bonds (POBs) are projected to cost the City $109.8 million in debt service payments in FY20. Philadelphia's POBs were issued in 1999 by Mayor Ed Rendell and expire in 2029. With a POB, a municipality issues taxable debt and invests the proceeds in the market. If the investment returns are higher than the borrowing costs, the City benefits by growing its assets faster than it would have without the debt. However, given the risk associated with this type of debt instrument, the *Government Finance Officers Association* recommends against governments from issuing POBs, while credit rating agencies view them as a credit negative.

Philadelphia's local sales tax revenues are projected to raise $58.1 million in FY20. During the recession, the City was granted authority by the State of Pennsylvania to implement an additional 1% sales tax to cover expenses in the short-term. This agreement was extended in 2014, with the understanding that the first $120 million is to go to the School District, while any "extra" revenues above $120 million go directly to the Pension Fund.

The City had two consecutive years of cash-flow positive balance sheets. This very good news is a reflection of structural changes in investment strategy, the implementation of a *Revenue Recognition Policy*, discretionary General Fund contributions, and the introduction of a "stacked-hybrid" plan for new employees. When a fund is cash-flow positive, it means that more revenue is being deposited into the fund than is being withdrawn (excluding investment earnings). This allows the fund's investments to grow independent of fund withdrawals. This insulates the fund from the volatility (ups-and-downs) of the market and is key to the fund's long-term solvency. As shown in *Figure 3*, for the Pension Fund to experience a cash-flow positive year is a huge accomplishment – one that the overwhelming majority of plans have not achieved.

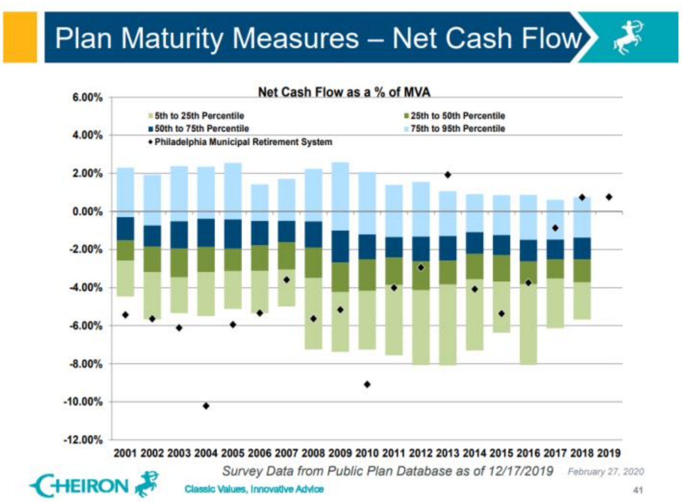

Figure 3

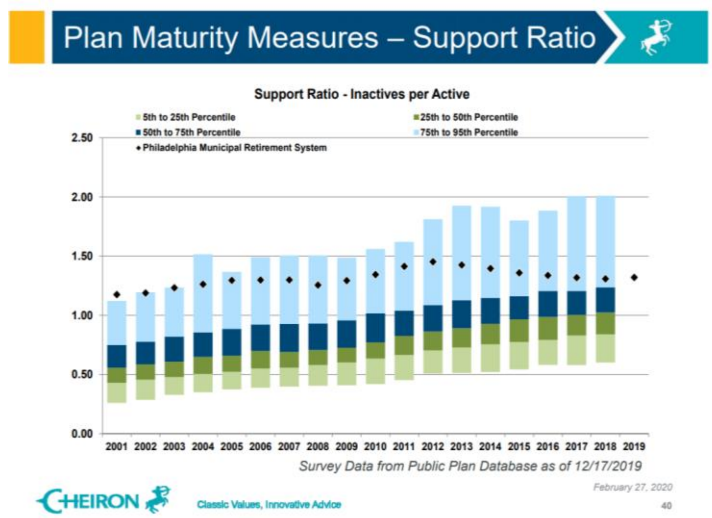

Figure 4

The Pension Fund's "Support Ratio" (The Ratio of Inactive Employees to Active Employees) continues to stabilize. During the Great Recession, the City of Philadelphia implemented "hiring freezes" to reduce costs. By not hiring additional employees during the hiring freeze, the Support Ratio increased dramatically from 2008 to 2012. Philadelphia's Support Ratio has historically been one of the highest in the nation (the lower the ratio, the better). As shown in *Figure 4*, Philadelphia is now moving towards the middle of the pack as other plans increase the number of retirees (or, as other plans become more "mature").

Summary of Participation - As of 7/1/2019	
Description	**# of Participants**
Actives	28,596
Retirees	22,241
Survivors	8,574
Disabled	3,883
Terminated Vested	965
DROP	2,069
Total	**66,328**

The City Pension Fund continues to lower the assumed rate of return. The current assumed rate of return is 7.55%, significantly lower than the high of 9% at the beginning of the decade. The Pension Board has continued to incrementally lower the assumed rate by 5 basis points (0.05%) every year, and plans to do so for the foreseeable future, for the purpose of improving the risk profile of the Fund. However, please bear in mind that **since the assumed rate of return is the assumed growth rate of the Fund's assets, lowering the rate increases the amount of money the City is required to deposit annually**. A continual, gradual 5 basis point reduction allows the City to make structural changes not only to funding streams, but investment strategy, and move towards long-term sustainability and solvency. **In FY19, the Fund returned 5.6%, with a 3-year Average Market Value Return of 9.21%.**

__**Conclusion:**__ The health, stability and long-term solvency of the City's Pension Fund is of utmost importance for maintaining the City's current positive financial trajectory. The *Finance and Budget Team* will continue to monitor, analyze, and report on the continuing progress made by the Pension Fund going forward.