Date: April 5, 2019

To: President Bielinski and Board of Trustees

From: Finance Committee of the Village Board
Trustee Dan Sullivan, Chair
Trustee Senta Plunkett
Trustee George Pearce

Subject: Funding Changes to the Amortization Schedule- Public Safety Pension Plans

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Recommendation

Implement an open 15-year rolling amortization schedule for the public safety pension plans, to be phased in between Fiscal Years 2020 – 2023; utilize General Fund reserves to offset portions of the tax levy increase.

Background

For the past two years, the Finance Committee has been reviewing long term strategies to address the Village's public safety pension funding challenges in a manageable and sustainable way. While the Village has responsibly funded its pension obligations, and routinely makes it actuarially required contributions, the plans' unfunded liabilities continue to grow. The growth in unfunded liabilities is due to enhanced pension benefits afforded by the Illinois General Assembly without funding enhancements as well as a funding method set forth in State law which results in a dramatic increase in the cost of public safety pensions leading up to 2040.

To understand the magnitude of the pension challenges, the table below displays the costs to the Village of public safety pensions since 1999, when the Illinois General Assembly approved benefit enhancements for public safety officers.

	1998	2019
Village Contribution	$596,800	$5,096,000 754% increase
Pensions as a % of Tax Levy	8%	27%
Pensions as a % of General Fund Expense	3%	14%
Total Pension Liabilities	$-2.7 million (over funded)	$56.5 million under funded
Funded Status	Police: 105.67% Fire: 106.90%	Police: 64.60% Fire: 60.80%

The State law, which requires pension funds to be 90% funded by 2040, is considered a closed system. The Village policy is to be 100% funded by 2040. This funding method means that there is an end date at which time the pension funds must pay down most of their unfunded liability. Previous State imposed funding deadlines of 2020 and 2033 have been extended, now to 2040, and a similar extension beyond 2040 is currently contemplated in bills before the Legislature. By deferring the end date in a closed system, current contributions are reduced, but total liabilities grow and lead to greater increases to pension costs in the future. Rather than based on sound financial principles, the State law is an arbitrary date set through a political process designed to defer necessary contributions. The result of a closed system with a moving end date has been a continued build up in unfunded liabilities and ultimately unmanageable escalation in required contributions.

To address the long term fiscal health of the Village, the Finance Committee determined that a structural change to an open funding system is appropriate. While such a change will increase pension contributions in the short term, it is intended to stabilize and reduce future contributions as the Village pays down its unfunded liabilities (assuming all other actuarial assumptions are met). This approach is fiscally sustainable and will leave the Village with manageable pension contribution levels in the future.

Discussion

In working with the Village's Actuary and Staff, the Finance Committee updated the pension plans' actuarial assumptions and determined that an open 15-year rolling amortization schedule was in the best long term interests of the Village and could be phased in over time to limit the immediate cost to taxpayers.

<u>What is an open amortization schedule?</u>

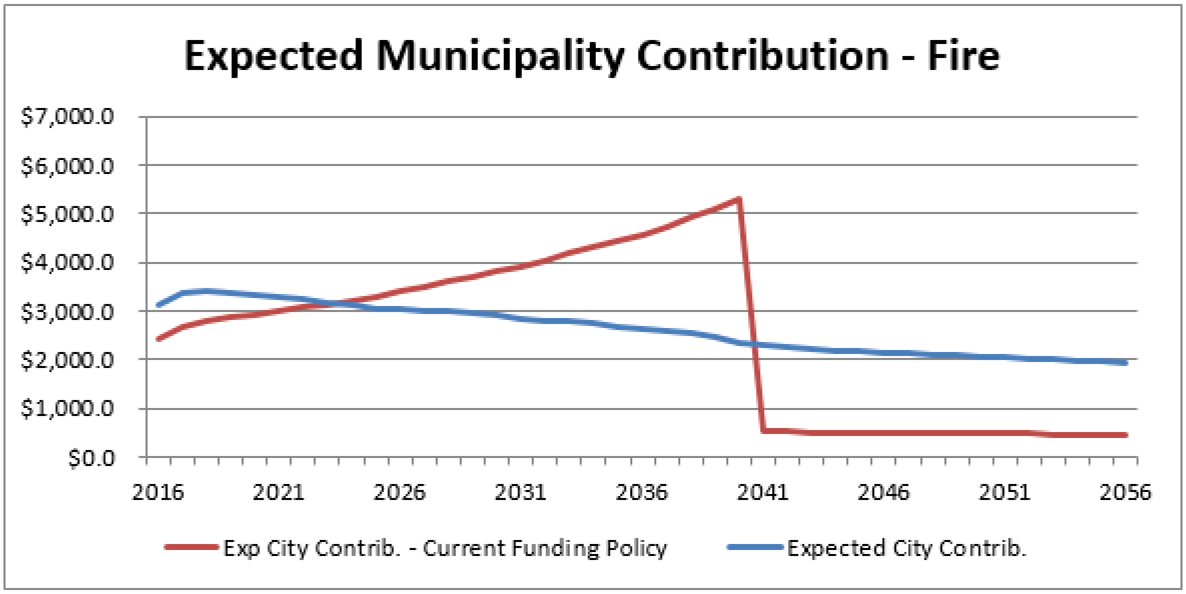
An open schedule means the amortization period would be continuous and reset every year to a rolling 15-year period. While under the recommended open amortization, a pension fund would never reach 100% funding, it would theoretically, over time, reach and maintain an 80% - 90% funding level. Such level of funding is commonly accepted among actuaries to be a healthy level for public sector pension plans.

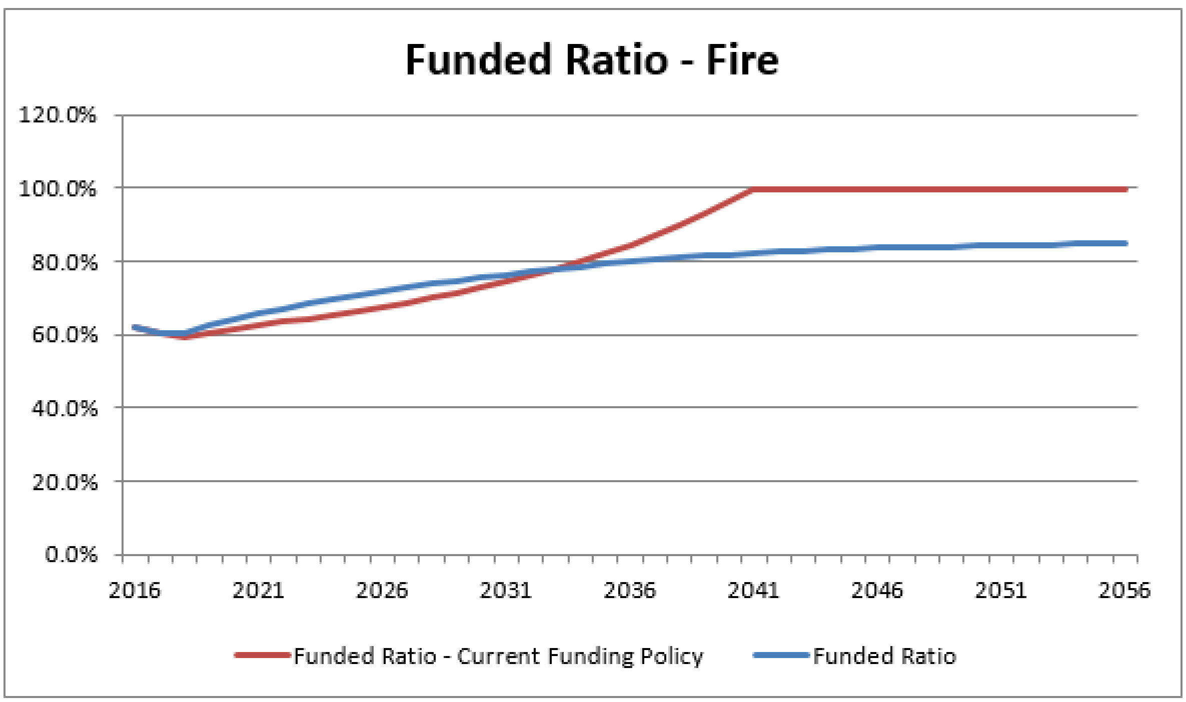
<u>How does an open amortization schedule impact contributions and funding levels?</u>

Under current Village policy (100% funded by 2040), annual public safety pension contributions are expected to increase by an additional 80% to more than $9 million by 2040.

Alternatively, the open 15-year rolling amortization schedule will increase contributions to a high of $6.5 million in 2023, after which they are projected to decline to less than $4 million by 2040.

The charts the follow illustrate how the Village's current closed funding policy (red line in each chart) compares to an open system (blue line in each chart) for the fire pension fund. Note that the trend is similar for the police pension fund.





As the tables that follow demonstrate, the recommended open funding policy is less costly to the Village over time as compared to the existing closed system:

Total Village Contributions from now to 2040	
	Public Safety Contributions ($)
Current Closed Funding Policy*	147,000,000
Proposed Open Funding Policy	109,000,000
Difference in Village Contributions	**38,000,000**

If the State of Illinois were to extend the funding deadline as anticipated to 2050, and the Village sought to be 90% by that time, the impact would be as follows:

Total Village Contributions from now to 2050	
	Public Safety Contributions ($)
Closed Funding System	224,000,000
Proposed Open Funding Policy	146,000,000
Difference in Village Contributions	**78,000,000**

Financing the Rolling 15-Year Amortization Schedule & Impact to Wilmette Residents

Public safety pension contributions are paid directly through a dedicated portion of the Village's property tax levy. While alternative revenue sources to fund enhanced public safety pension contributions were considered, none would bring in enough proceeds to meet the funding need nor would any be stable enough to ensure the Village could meet its obligations. As such, any increases to pension funding will most likely need to come from property tax increases.

Contribution Method	**2019 ($)**	**2020 ($)**	**2021 ($)**	**2022 ($)**	**2023 ($)**
Current/Baseline	5,096,000	5,296,000	5,737,000	5,826,000	5,936,000
Transition to 15-Year Amortization from 2020 - 2023	N/A	5,436,000	6,081,000	6,419,000	6,550,000
Incremental Increase in Contributions	N/A	340,000	645,000	338,000	131,000

The Committee reviewed a number of financing strategies and determined that utilizing a projected $1.25 million of General Fund reserves from Fiscal Year 2020 – 2023 to limit the rate of property tax increases was the least impactful option for Wilmette taxpayers. The impact to the Village's portion of the property tax levy (operations, pensions, debt service) and the average Wilmette property tax bill[1] for each amortization option would be as follows:

	Total Property Tax Levy Increase				Total Increase in Property Tax Payments to Village from Current Proj.
	2020	**2021**	**2022**	**2023**	
Current Projection	3.78%	3.10%	3.34%	3.61%	
Recommendation	3.85%	4.21%	4.32%	5.64%	+150
Projected Reserve Drawdown	$200,000	$500,000	$500,000	$50,000	

<u>How might Moody's react to the funding change?</u>
The Finance Committee's recommendation to pursue an open system is preferred by bond rating agencies over the existing policy for the simple reason that it makes future pension contributions more manageable (see the blue vs red line in the first chart on page three) while paying down the unfunded liability at a rate that is comparable to the existing policy.

Documents Attached
The following attachments demonstrate the required pension contributions through fiscal year 2030 for each of the financing options discussed above:

Attachment #1- Baseline Public Safety Pension Contributions through 2030

Attachment #2- Public Safety Pension Contributions through 2030 w/ a Phased-In Open 15-Year Rolling Amortization

[1] The approximate average property tax bill is $15,000 and the Village's share of the tax bill is 12%

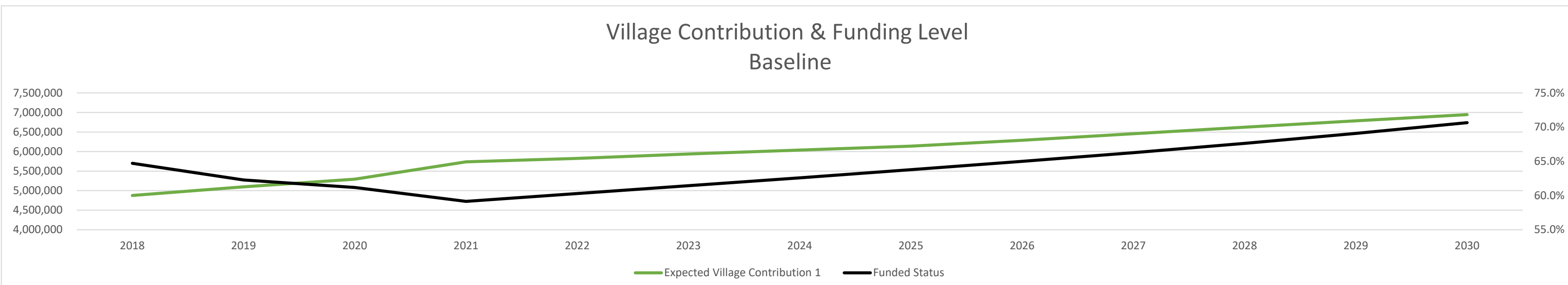
Projected Contributions
Wilmette 1. Baseline/Current

Assumptions

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Actual Return on Assets	-7.50%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%
Inflation	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Val Interest Rate	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%
Payroll Growth Rate	3.70%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
Amort - 1. Baseline	23	22	21	20	19	18	17	16	15	14	13	12	11

Valuation Year		**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Combined	Actuarial Accrued Liability	142,277,000	151,561,000	156,345,000	160,995,000	165,471,000	169,695,000	173,728,000	177,538,000	181,057,000	184,480,000	187,798,000	190,961,000	193,937,000
Combined	AVA	92,055,000	94,403,000	95,649,000	95,227,000	99,783,000	104,269,000	108,752,000	113,234,000	117,671,000	122,259,000	127,023,000	131,942,000	137,018,000
Combined	Unfunded Actuarial Accrued Liability	50,222,000	57,158,000	60,696,000	65,768,000	65,688,000	65,426,000	64,976,000	64,304,000	63,386,000	62,221,000	60,775,000	59,019,000	56,919,000
Combined	Funded Status	64.7%	62.3%	61.2%	59.1%	60.3%	61.4%	62.6%	63.8%	65.0%	66.3%	67.6%	69.1%	70.7%
Combined	Expected Village Contribution 1	4,877,000	5,096,000	5,296,000	5,737,000	5,826,000	5,936,000	6,037,000	6,137,000	6,291,000	6,456,000	6,624,000	6,785,000	6,945,000
Combined	*Annual Increase*		*219,000*	*200,000*	*441,000*	*89,000*	*110,000*	*101,000*	*100,000*	*154,000*	*165,000*	*168,000*	*161,000*	*160,000*

[1] The 2018 amount shown is the actual contribution made during the calendar year and the 2019 amount is the budget amount.



Attachment #2- Contribtution Projections for Recommended Transition to Open 15-Year Rolling Amortization

Projected Contributions

Wilmette - Recommended- Transition to 15 Year Rolling Amortization

Assumptions

Actual Return on Assets	-7.50%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%
Inflation	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Val Interest Rate	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%
Payroll Growth Rate	3.70%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
Employee Contribution Rate	9.455%	9.455%	9.455%	9.455%	9.455%	9.455%	9.455%	9.455%	9.455%	9.455%	9.455%	9.455%	9.455%
Amort - 2a. Transition to 15 Year Rolling Amortization	23	22	20	18	16	15	15	15	15	15	15	15	15

Valuation Year		2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Combined	Actuarial Accrued Liability	142,277,000	151,561,000	156,345,000	160,995,000	165,471,000	169,695,000	173,728,000	177,538,000	181,057,000	184,480,000	187,798,000	190,961,000	193,937,000
Combined	AVA	92,055,000	94,403,000	95,649,000	95,372,000	100,296,000	105,433,000	110,636,000	115,606,000	120,274,000	124,817,000	129,232,000	133,470,000	137,507,000
Combined	Unfunded Actuarial Accrued Liability	50,222,000	57,158,000	60,696,000	65,623,000	65,175,000	64,262,000	63,092,000	61,932,000	60,783,000	59,663,000	58,566,000	57,491,000	56,430,000
Combined	Funded Status	64.7%	62.3%	61.2%	59.2%	60.6%	62.1%	63.7%	65.1%	66.4%	67.7%	68.8%	69.9%	70.9%
Combined	Expected Village Contribution 15 yr amort.	4,877,000	5,096,000	5,436,000	6,081,000	6,419,000	6,550,000	6,374,000	6,194,000	6,064,000	5,940,000	5,814,000	5,674,000	5,530,000
Combined	*Annual Increase*		*219,000*	*340,000*	*645,000*	*338,000*	*131,000*	*(176,000)*	*(180,000)*	*(130,000)*	*(124,000)*	*(126,000)*	*(140,000)*	*(144,000)*

[1] The 2018 amount shown is the actual contribution made during the calendar year and the 2019 amount is the budget amount.