



City of Virginia Beach

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September 8, 2017

The Honorable William D. Sessoms, Jr., Mayor
Members of City Council

Subject: VRS Unfunded Pension Liability

Dear Mayor and Council Members:

As a follow up to the City Council briefing on the City's Debt Management, we received a request for information regarding the increase in the GASB 68 unfunded liability for the City and School Board of \$147.2 million from the last fiscal year.

The following information is provided regarding this increase:

- VRS commissions the preparation of two reports of all pension plans which provide different methods and results:
 - The **actuarial valuation** report which has always been used by VRS and is the basis for rate setting. FY 2017 pension liability using this method is \$383.7 million for the City and \$676.7 for the Schools.
 - The **accounting regulations (GASB 68)** report that was effective beginning in fiscal year 2015. The FY 2017 pension liability using this method is \$411.1 million for the City and \$740.8 million for the Schools. Both of these amounts are increases totaling \$147.2 million from the prior year.
- A detailed spreadsheet and graphs are attached which shows the history of the unfunded liabilities using both methods, the rates paid, the amount of the amortization of the liability as well as other relevant information for both the City and Schools.
- The **actuarial valuation** is performed every two years. This valuation provides a summary of the funded status of the plans and is used to determine the employer contribution rates needed to fund the pension plans (funding approach). The actuarial valuation method uses a 5-year smoothing of actual returns so that spikes in rates and liabilities is avoided, which is very useful for rate setting purposes. As noted on the attached worksheet, the unfunded liability in 2013 (highest actuarial calculation of \$521.4 million) to the most recent actuarial calculation of \$383.7 million shows a reduction in the unfunded liability of \$137.7 million for the City. The School's highest actuarial liability was in FY 2012 of \$805.2 million and it is \$676.7 in FY 2017, a reduction of \$128.5 million.

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- The **accounting, or GASB 68**, report provides the unfunded (net) pension liability that is reported in the CAFR. This method uses much of the information from the actuarial valuation method as the basis for its calculations; however, the accounting approach uses the market value of assets (rather than the smoothed value of assets used in the funding approach) to determine the unfunded pension liability. Using the market value of assets has made the unfunded pension liability more volatile. The rise in the unfunded pension liability is directly related to the 1.9% VRS investment return during fiscal year 2016. The investment return for fiscal year 2017 was 12.1%; therefore VRS indicates that the City of Virginia Beach would see a reduction in unfunded pension liability in the following year (August 2018).
- GASB requires the use of the long-term expected return on investments to the extent the plan has sufficient projected assets to pay future benefits. If the locality does not have sufficient projected assets a portion of the discount rate would need to reflect the rate on tax-exempt municipal bonds. VRS has reported that for the City of Virginia Beach plan assets will be sufficient to pay for future obligations; therefore, the use of a 7% assumed rate of return for both the funding and accounting calculations of the unfunded pension liability is appropriate.

In short, **the calculations are correct** and there are no other calculations of which City Council has not been made aware.

The methodology used in the GASB 68 calculation reflects the actual results for the most recent year (FY 2016 in this case), and thus the GASB 68 (accounting) unfunded pension liability will exhibit some volatility from year to year. Although it is reasonable to expect this volatility, it is important to remember that our unfunded pension liability is being amortized over a closed period with 26 years remaining at June 30, 2017, which is included with our employer paid pension cost each year, these amounts represents nearly 50 percent of our payments.

The City's long history of funding our actuarially determined contribution rates and the General Assembly's commitment to now also fund the required contribution rate (teachers) should result in the elimination of our legacy unfunded liability in 26 years.

Respectfully,



David L. Hansen
City Manager

Attachment

cc. Patricia A. Phillips
David Bradley

Attachment #1

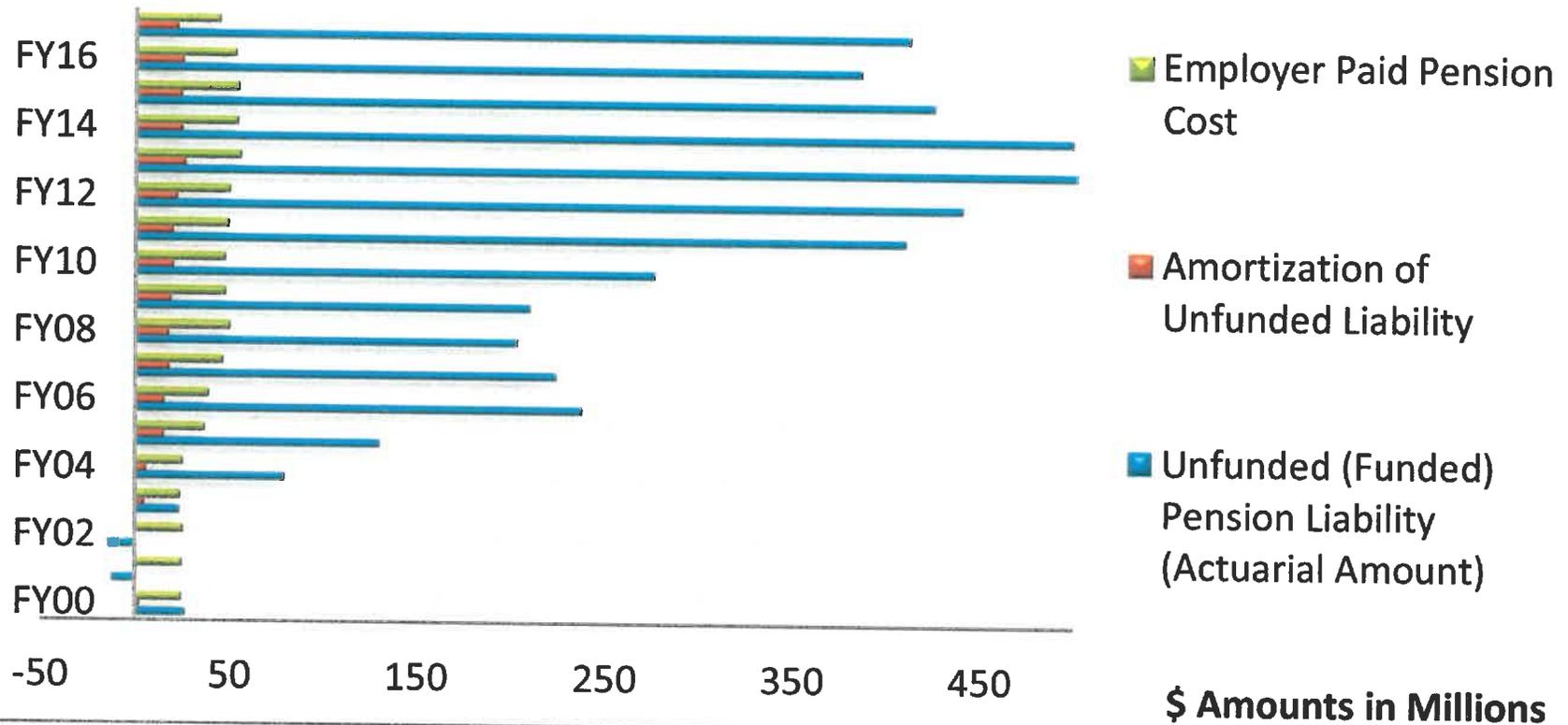
**CITY OF VIRGINIA BEACH
PENSION COST and UNFUNDED (FUNDED) PENSION LIABILITY**

<u>CITY</u>	<u>FY00</u>	<u>FY01</u>	<u>FY02</u>	<u>FY03</u>	<u>FY04</u>	<u>FY05</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>	<u>FY11</u>	<u>FY12</u>	<u>FY13</u>	<u>FY14</u>	<u>FY15</u>	<u>FY16</u>	<u>FY17</u>
Employer Paid Pension Cost	24,070,526	24,275,750	24,809,687	23,270,746	24,489,406	36,042,451	38,095,906	45,676,301	49,270,686	47,155,843	46,752,410	48,314,954	49,174,585	54,955,790	53,239,952	53,444,533	52,111,492	43,919,386
Unfunded (Funded) Pension Liability:																		
Actuarial Valuation ²	26,170,074	(12,270,103)	(13,781,862)	22,998,154	78,057,019	129,088,587	236,799,342	223,008,182	202,128,956	209,220,951	275,115,137	409,266,217	439,493,622	521,436,188	498,340,359	424,386,003	384,821,254	383,729,377
GASB 68	N/A	333,771,570	337,372,334	411,098,059														
Amortization of Unfunded Liability ³	1,785,175	-	-	4,309,474	5,295,649	14,519,241	14,737,110	17,354,584	17,011,723	18,330,599	19,468,446	19,271,198	21,283,117	25,682,380	24,049,601	23,569,602	24,339,216	21,738,197
Employer Contribution Rate	8.59%	8.01%	7.50%	6.00%	6.00%	10.25%	10.32%	12.28%	12.72%	11.48%	11.48%	12.58%	12.58%	15.68%	15.68%	16.35%	16.35%	13.88%
Member Contribution Rate paid by City ¹	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	4.00%	3.00%	2.00%	1.00%	0.00%
Total Percent Paid	13.59%	13.01%	12.50%	11.00%	11.00%	15.25%	15.32%	17.28%	17.72%	16.48%	16.48%	17.58%	17.58%	19.68%	18.68%	18.35%	17.35%	13.88%
<u>SCHOOLS</u>	<u>FY00</u>	<u>FY01</u>	<u>FY02</u>	<u>FY03</u>	<u>FY04</u>	<u>FY05</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>	<u>FY11</u>	<u>FY12</u>	<u>FY13</u>	<u>FY14</u>	<u>FY15</u>	<u>FY16</u>	<u>FY17</u>
Employer Paid Pension Cost	39,243,334	38,130,469	26,504,093	29,600,649	31,435,862	41,528,747	45,818,846	59,259,462	64,819,165	59,971,025	48,834,904	38,851,684	47,372,479	64,684,867	60,157,821	68,115,013	62,618,103	58,330,813
Unfunded (Funded) Pension Liability:																		
Actuarial Valuation ²	(18,831,324)	(50,888,102)	(8,069,124)	61,125,675	152,069,894	319,050,257	394,454,530	383,211,291	375,678,610	458,255,053	638,972,598	726,364,143	805,165,621	766,803,503	761,069,991	762,057,038	701,177,742	676,716,565
GASB 68	N/A	634,759,878	667,262,915	740,779,053														
Amortization of Unfunded Liability ³	-	-	-	14,801,083	17,230,791	24,156,628	26,169,933	33,578,643	36,164,166	34,325,471	28,369,591	22,378,856	27,703,105	38,623,668	34,876,003	38,795,060	33,976,289	33,705,665
Teachers:																		
Employer Contribution Rate	9.04%	7.54%	4.24%	3.77%	3.77%	6.03%	6.62%	9.20%	10.30%	8.81%	8.81% ⁴	3.93%	6.33%	11.66%	11.66%	14.50%	14.06%	14.66%
Member Contribution Rate paid by City	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	4.00%	3.00%	2.00%	1.00%	0.00%
Total Percent Paid	14.04%	12.54%	9.24%	8.77%	8.77%	11.03%	11.62%	14.20%	15.30%	13.81%	13.81%	8.93%	11.33%	15.66%	14.66%	16.50%	15.06%	14.66%
Non Professional:																		
Employer Contribution Rate	5.90%	5.25%	5.00%	3.00%	3.00%	4.00%	4.00%	12.52%	7.52%	6.64%	6.64%	6.26%	6.26%	9.11%	9.11%	9.11%	9.11%	7.02%
Member Contribution Rate paid by City ¹	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	4.00%	3.00%	2.00%	1.00%	0.00%
Total Percent Paid	10.90%	10.25%	10.00%	8.00%	8.00%	9.00%	9.00%	17.52%	12.52%	11.64%	11.64%	11.26%	11.26%	13.11%	12.11%	11.11%	10.11%	7.02%
Actuarial Assumed Investment Rate	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	7.50%	7.50%	7.50%	7.50%	7.50%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
Achieved Net Return on Investments	N/A	-7.40%	-7.30%	2.50%	17.90%	12.00%	12.40%	20.40%	-4.40%	-21.10%	14.10%	19.10%	1.40%	11.80%	15.70%	4.70%	1.90%	12.00%

Notes:

1. Employees are required to contribute 5% towards their retirement, prior to July 1, 2012 this was assumed by the employer. Beginning July 1, 2012 required to pay the 5% and it was phased in over a period of 5 years.
2. Actuarial Valuation is determined as of June 30 of the prior year.
3. The unfunded liability is amortized and is included in the annual employer paid pension cost. Prior to FY13 the amortization period was open, however beginning in FY13 it is now a closed period with 26 years remaining.
4. The General Assembly changed the contribution rate from 13.81% to 0% for the last quarter of FY10.

City Pension Liability and Cost by FY



School Pension Liability and Cost by FY

