DATE: May 18, 2022

TO: Council Budget & Finance Committee Members

FROM: Director of Finance

SUBJECT: Review and Comment on the Annual City Benefit Liabilities and Funding Plan

## RECOMMENDATION

That the Committee reviews and comments on the status of the City's benefit liabilities and current policies regarding funding the City's benefit liabilities.

## SUMMARY

The City of Hayward actively manages its benefit liabilities and completes actuarial valuations for many of its long-term benefit liabilities. This report provides an overview of the balances and funding status of the City's benefit liabilities.

## BACKGROUND

The City of Hayward, like all cities and municipal agencies, manages unfunded benefit liabilities as part of its financial picture. In 2013, staff began providing the Council Budget & Finance Committee and the City Council with an annual review of the City's benefit liabilities and funding plan for unfunded liabilities.

Unfunded liabilities are defined as identifiable obligations of an organization for which the organization does not have 100 percent of the funding (cash or other assets) set aside to cover the cost should all obligations become immediately and simultaneously due. Generally, an organization operates based on policies that attempt to find a responsible balance between funding the appropriate portion of these obligations, the associated risk that the unfunded portion of the obligations presents to the organization, and responsible and realistic management of the organization's resources.

Achieving this careful balance is considered the practical and responsible approach since payment demands of these obligations rarely, if ever, occur simultaneously. The alternative would be to fully fund the obligations, eliminating the liability for the present time, which can present challenges in meeting current operating expense obligations. In 2020, as recommended by the Committee and the Council, the City established a Section 115 irrevocable trust for the prepayment of retiree medical liabilities. Staff will continue to provide updates on the funding status of the City's unfunded liabilities on an ongoing basis.

**DISCUSSION**

The City actively manages its benefit liabilities and completes actuarial valuations for benefit liabilities except for accrued leave payouts (analysis conducted by staff). These valuations consider the economic, demographic, and historical compositions of the benefit programs and establish amounts that the City should set aside each year to fund its benefit-related financial obligations. It is critical that the City continues to manage and address its benefit liabilities to ensure long-term fiscal stability. Actuarial valuations identify the Annual Required Contribution (ARC) an agency should make toward the funding of the benefit and the liabilities. This is essentially the minimum funding amount that should be responsibly made by any organization. The ARC is generally comprised of two elements: a portion of funding for current costs (sometimes referred to as "pay go") and a portion of funding for future costs (the Unfunded Actuarial Liability or UAL).

As bond rating agencies review the City's debt, they actively consider the level of the City's unfunded benefit liabilities and the economic pressure this places on the City. Failure to meet the minimum recommended funding levels or implement a plan to achieve full funding of the ARC and/or a long-term plan to pay down the future liabilities could have a negative impact on future bond ratings – with a possible resultant increase in the cost of borrowing should the City seek to incur new debt or wish to finance existing debt.

Table 1 provides a summary of the City's benefit liabilities and current levels of funding based on the most recent actuarial valuations. Each of these benefit liabilities is unique in its structure and the degree of funding varies depending on the benefit.

**Table 1: Summary of Benefit Liabilities (in millions)**

| (*in millions*) | Actuarial Valuation Date | Accrued Liability | Value of Assets | Funded Ratio | Unfunded Liability | Unfunded Ratio |
|---|---|---|---|---|---|---|
| CalPERS Police Safety Plan | 6/30/2020 | $ 443.37 | $ 261.53 | 59.0% | $ 181.85 | 41.0% |
| CalPERS Fire Safety Plan | 6/30/2020 | $ 326.37 | $ 197.12 | 60.4% | $ 129.24 | 39.6% |
| CalPERS Miscellaneous Plan | 6/30/2020 | $ 503.64 | $ 323.94 | 64.3% | $ 179.70 | 35.7% |
| **Total Cal PERS** | | **$ 1,273.38** | **$ 782.59** | **61.5%** | **$ 490.79** | **38.5%** |
| OPEB - Retiree Medical Police Officers | 6/30/2020 | $ 38.71 | $ 4.38 | 11.3% | $ 34.33 | 88.7% |
| OPEB - Retiree Medical Firefighters | 6/30/2020 | $ 17.45 | $ 3.08 | 17.7% | $ 14.36 | 82.3% |
| OPEB - Retiree Medical Miscellaneous | 6/30/2020 | $ 24.12 | $ 4.03 | 16.7% | $ 20.08 | 83.3% |
| **Total OPEB-Retiree Medical** | | **$ 80.27** | **$ 11.50** | **14.3%** | **$ 68.77** | **85.7%** |
| Workers' Compensation | 6/30/2021 | $ 13.62 | $ 28.19 | 207.0% | $ (14.57) | -107.0% |
| Accrued Leave Payouts | 6/30/2021 | $ 7.45 | $ - | 0.0% | $ 7.45 | 100% |
| **TOTAL** | | **$ 1,374.73** | **$ 822.28** | **59.8%** | **$ 552.44** | **40.2%** |

As of May 10, 2022, the market value of the assets held in the trust is $19.4 million.

Acceptable or Best Practice levels of funding vary by liability type. In general, funding these liabilities at a level in the 75 – 80 percent range is considered adequate and sustainable.

**California Public Employee Retirement System (CalPERS)**

*Current annual cost: $47.9 million*
*Unfunded Liability: $490.8 million*

Benefit Summary – CalPERS is a defined benefit pension plan funded by a combination of employee and employer contributions. The City's retirement benefit plans represent the largest benefit liability and CalPERS retirement rates continue to be one of the most significant citywide budgetary pressures. This same budgetary stress is felt by the State of California and the over 2,000 public entities statewide that contract with the California Public Employees' Retirement System (CalPERS) for pension benefits. When CalPERS performs its actuarial analysis, it uses data from previous fiscal years; for example, the employer rates for Fiscal Year 2023 are based on data as of June 30, 2021.

The City contributes to three plans: Police Safety Plan; Fire Safety Plan; and Miscellaneous Employee Plan (all non-sworn employees). All full-time and part-time benefited employees are required to participate in CalPERS. The three plans are independent of one another with different contract plan amendments negotiated over the years through the collective bargaining process. Assets and liabilities of each plan are segregated with no cross-subsidization from one plan to another.

CalPERS Retirement Rates – The cost of the retirement plans is broken into Employee Contribution rates (fixed) and Employer Contribution rates (variable). Both rates are a percent of projected payroll. The Employee Contribution is fixed and is based on the pension plan formula (generally 9 percent for public safety plans and 7 percent or 8 percent for miscellaneous plans). The Public Employees' Pension Reform Act of 2013 (PEPRA) introduced new benefit formulas effective January 1, 2013, that affect new employees to the City that have not previously been part of the CalPERS system. While there is little immediate financial benefit to the City with this "two-tiered" system, the long-term benefit of lower retiree costs can be significant.

Many of the City's bargaining groups contribute beyond the CalPERS defined Employee Contribution portion and "pick-up" a portion of the Employer Contribution: 6 percent for sworn police and fire personnel and 3-5 percent for all non-sworn/professional personnel (pursuant to bargaining unit agreements). The Employer rates displayed in Table 1 represent the full employer cost according to and as assessed by CalPERS, this rate does not reflect the negotiated cost-sharing "pick-up" agreements, as these agreements do not affect the overall cost of CalPERS.

Over the last several years, the CalPERS Board of Administration has considered and adopted several rate methodology changes that directly impact the retirement rates that cities pay (employer contribution rates). Each of these changes is effective in different fiscal years, with varying phase-in schedules. While these changes significantly increase our current retirement costs, they are intended to stabilize the long-term sustainability of CalPERS retirement plans, helping cities in the long-run. Many of these changes should have been implemented long ago by CalPERS.

1. *March 2012 Change (effective FY 2014, two-year phase-in through FY 2015):* In March 2012, the CalPERS Board acted to reduce the assumed rate of investment return from

7.75 percent to 7.5 percent. The employer rate impact from this action was effective FY 2014, with a two-year phase-in, and a full rate impact by FY 2015. The actual rate impact resulting from this change ranged from 3 – 5 percent of payroll depending on the plan type.

2. *April 2013 Change (effective FY 2016, five-year phase-in through FY 2020):* On April 17, 2013, the CalPERS Board adopted significant rate methodology changes that directly impacted employer rates starting in FY 2016, phased in over five years, with the full impact being felt in FY 2020. The anticipated rate impact resulting from this change was approximately 2–5 percent of payroll beginning FY 2020. These actuarial changes were designed to boost funding levels and make employer rates more predictable in the long run:

   ✓ Shorter smoothing period[1] and shorter amortization period for gains/losses
   ✓ Closed instead of rolling thirty-year amortization
   ✓ Use market value of assets to determine rates[2]

3. *February 2014 Change (effective FY 2017, five-year phase-in through FY 2021):* On February 18, 2014, the CalPERS Board adopted additional rate methodology changes. While the Board voted to retain its current long-term assumed rate of return at 7.5 percent, they did adopt actuarial changes to assumed mortality rates. The new mortality assumptions were expected to increase costs to local agencies by an average of 6–9 percent of payroll for safety classifications and 3–5 percent of payroll for miscellaneous employees by the end of their five-year phase-in in FY2021. Some municipal officials believe these estimates may be low because of the continued decline in the local government workforce in many cities, reducing the number of active employees contributing to CalPERS.

4. *November 2015 Funding Risk Mitigation Policy:* On November 15, 2015, the CalPERS Board recently adopted a funding risk mitigation policy designed to incrementally lower the discount rate in years of good investment returns, help pay down the pension fund's unfunded liability, and provide greater predictability and less volatility in contribution rates for employers. Under the policy established a mechanism to reduce the discount rate - or assumed rate of return - by a minimum of 0.05 percentage points

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[1] "Smoothing" and "Closed vs. Rolling Amortization" go hand in hand. Smoothing refers to the method by CalPERS plans to address the unpredictability of investment income and the impact that unpredictability has on employer rates. The revised "smoothing" plan determines the rate increase needed to reach a funding level of 100 percent in 30 years, phase in the rate increase over five years, and then to maintain those rates as steadily as possible or even lower them. In the past, CalPERS employed an amortization and smoothing policy that spread investment returns over a 15-year period with the actual gains and losses experienced by the investment pool paid for over a rolling 30-year period. With the current change, CalPERS will employ an amortization and smoothing policy that will pay for all gains and losses over a fixed 30-year period with the increases or decreases in the rate spread directly a five-year period.

[2] CalPERS has traditionally used the actuarial value of their investments in their financial calculations and rate projections (i.e., the investment assets fluctuate in value from one day to the next, so the administrators calculate an average value for the assets, over a given period of time, or the "actuarial value"). In accordance with new FY 2015 GASB provisions, CalPERS will only use "market value," which is using the actual value of the investment assets as determined by the market and adjusting the value up or down accordingly.

to a maximum of 0.25 percentage points in years when investment returns outperform the existing discount rate, currently 7.5 percent, by at least four percentage points. The four-percentage point threshold is intended to offset increases to employer contribution rates that would otherwise increase when the discount rate is lowered, and help pay down CalPERS' unfunded liability.

CalPERS staff modeling anticipates the policy will result in a lowering of the expected portfolio volatility to 8 percent in about 21 years, improve funding levels gradually over time, and cut risk in the system by lowering the volatility of investment returns. While rates are expected to increase for CalPERS employers in the future, the policy is designed to minimize any increases above projected rates.

The CalPERS Board implemented the first revision to the Funding Risk Mitigation Policy on February 14, 2017, lowering the first threshold for triggering a discount rate reduction from a 4.0% difference between actual investment return and discount rate to a 2.0% difference. This policy was implemented effective FY 2021.

5. *December 2016 Lowering of Discount Rate (effective FY 2018, three-year phase-in through FY 2020):* On December 21, 2016, the CalPERS Board voted to lower the discount rate from 7.5% to 7.0%. Lowering the discount rate, also known as the assumed rate of return, resulted in employers that contract with CalPERS to administer their pension plans experiencing increases on top of their normal costs and unfunded actuarial liabilities. Active members hired after January 1, 2013, under the Public Employees' Pension Reform Act will also see their contribution rates rise.

   The actuarial valuations provided to the City of Hayward by CalPERS immediately prior to this decision in August 2016 included the then-final rates for FY 2018; however, these rates did not incorporate the change to discount rates, which resulted in FY 2018 rates increasing over FY 2017 rates by 1.0– 8 percent of payroll. The rate change to assumed discount rates significantly impacted the City's required contributions in the years since. The City's revised rates (combined average for all groups) increased from 37.1% in FY 2018 to 56.2% in FY 2023 based on the latest CalPERS actuarial valuation from July 2021.

6. *February 2018 Change to Amortization Period for New Members:* The CalPERS Board recently voted to shorten the period over which actuarial gains and losses are amortized from 30 years to 20 years for all new members. The change in the amortization period will speed up the rate of debt payments to CalPERS, and likely increase cities' annual pension costs. The new policy was effective as of the June 30, 2019, actuarial valuations, and payments under this new policy began in FY 2021.

7. *November 2021 Lowering of Discount Rate (effective FY 2024, no phase-in)*: On July 12, 2021, CalPERS reported a 21.3% net return on investments for the year ending on June 30, 2021. The higher-than-expected investment return triggered the Fund Risk Mitigation Policy first adopted in 2015 and resulted in a reduction of the discount rate from 7.0% to 6.8%. Triggering of the policy also began a process of revising assumptions and portfolios, culminating in the approval of the new discount rate on November 17, 2021. Contributions under the new discount will be effective in FY 2024. CalPERS agency valuation reports reflecting the new employer rates, normal costs, and

unfunded accrued liability will be available beginning in the summer of 2022.

*Estimated Rate Impacts and Projected Normal Cost Increases:*
The most recent valuations, as of July 2021, reflect rate projections that include all of the rate actions taken by the CalPERS Board prior to the triggering of the Fund Risk Mitigation Policy and approval of the new 6.8% discount rate in November 2021. Table 2 provides a detailed summary of the City's projected CalPERS employer rates and normal costs (employer contribution) based on the then-current discount rate of 7.0%. Under the CalPERS rate projections shown in Table 2, by FY 2028, rates for Miscellaneous Plans are estimated to be 38.6% of payroll, rates for Police Safety Plans are projected to be 76.7% of payroll, and Fire Safety Plans are projected to be 67.1% of payroll. During the five-year period from FY 2023 through FY 2027, the City will see its contributions for the Miscellaneous plan increase by $3.3 million, by $3.1 million for the Police plan, and by $2.4 million for the Fire plan.

**Table 2: CalPERS Rate Comparison & Growth**

| *(in the $1,000s)* | FY 2022 | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 | FY 2028 |
|---|---|---|---|---|---|---|---|
| **Miscellaneous** | | | | | | | |
| Employer Contribution ($) | $ 18,316 | $ 19,434 | $ 20,419 | $ 21,462 | $ 22,094 | $ 22,756 | $ 23,296 |
| **Change over Prior Year** | **$ 1,493** | **$ 1,118** | **$ 985** | **$ 1,042** | **$ 633** | **$ 662** | **$ 540** |
| Employer Contribution Rate (%) | 35.9% | 36.9% | 37.8% | 38.6% | 38.7% | 38.8% | 38.6% |
| **Change over Prior Year** | **2.2%** | **1.0%** | **0.9%** | **0.8%** | **0.1%** | **0.1%** | **-0.2%** |
| **Police** | | | | | | | |
| Employer Contribution ($) | $ 18,084 | $ 19,616 | $ 20,521 | $ 21,468 | $ 22,093 | $ 22,668 | $ 23,095 |
| **Change over Prior Year** | **$ 1,267** | **$ 1,532** | **$ 905** | **$ 947** | **$ 624** | **$ 575** | **$ 428** |
| Employer Contribution Rate (%) | 66.8% | 74.6% | 76.0% | 77.4% | 77.4% | 77.4% | 76.7% |
| **Change over Prior Year** | **1.2%** | **7.8%** | **1.4%** | **1.4%** | **0.0%** | **0.0%** | **-0.7%** |
| **Fire** | | | | | | | |
| Employer Contribution ($) | $ 13,110 | $ 13,738 | $ 14,420 | $ 15,096 | $ 15,570 | $ 16,004 | $ 16,327 |
| **Change over Prior Year** | **$ 1,321** | **$ 627** | **$ 683** | **$ 675** | **$ 474** | **$ 434** | **$ 322** |
| Employer Contribution Rate (%) | 61.0% | 64.6% | 66.0% | 67.2% | 67.5% | 67.5% | 67.1% |
| **Change over Prior Year** | **3.1%** | **3.6%** | **1.4%** | **1.2%** | **0.3%** | **0.0%** | **-0.4%** |

*Funding Status & Plan*

The City is fully meeting its annual required contribution (ARC) amounts based on the CalPERS premium rates. Given the new CalPERS "smoothing" methodology, the long-term intent is to fund the City's liability over the 30-year amortization period.

## Retiree Medical (OPEB)

*Annual Required Contribution (ARC): $7.2 million*
*Unfunded Liability: $68.8 million*

Components of OPEB $7.2 million ARC:
$3.6 million: Current Retirees ("pay as you go")
$3.6 million: Unfunded Actuarial Liability

The retiree medical benefit represents the second-largest benefit liability and is the most significantly underfunded of the City's benefit liabilities. By City Council resolution – and as agreed to with some bargaining groups – the City provides certain health care benefits for employees who retire directly from the City with at least five years of City service (most bargaining groups require ten years of service) and who are vested in the California Public Employees Retirement System (CalPERS). The City participates in the CalPERS health care plan, which is governed under the California Public Employees Health and Medical Care Act (PEMCHA).

The City contributes a fixed dollar amount for retiree medical benefits for all employees, except sworn police employees hired before June 12, 2012 (rate tied to Kaiser plan rates), with amounts varying by employee bargaining group and coverage level as governed by PEMCHA. Benefits continue for surviving spouses in amounts as required by PEMCHA. As of June 30, 2021, approximately 624 retirees were eligible and were receiving retiree health care benefits from the City at an annual cost of about $3.6 million, which is the "pay as you go" amount the City currently pays.

There are approximately 821 active employees that may be eligible to receive health care benefits upon retirement. This group of employees represents the number of eligible, current employees and it is the City's current maximum exposure; it does not necessarily mean all of these employees will either retire with the City or ultimately meet the requirements for receiving this benefit. Similar to the CalPERS retirement plan, the increased life longevity of retirees places stress on the benefit. The updated actuarial valuation of our Local Plan will consider these impacts within its analysis.

*Funding Status & Plan*

The current ARC was determined as part of a March 2021 actuarially determined contribution by MacLeod Watts, the City's OPEB Actuary. The valuation analysis was calculated based on the results of the June 30, 2019, valuation and the trust asset values as of June 30, 2020. The analysis considered benefits that are expected to be earned in the future as well as those already accrued, and is required by the Governmental Accounting Standards Board (GASB) to be completed every two years; the most recent actuarial report was completed in July 2021.

The City's OPEB unfunded actuarial accrued liability is amortized as a level percentage of projected payroll using a closed thirty-year amortization period that has twenty years remaining as of the latest valuation date. The minimum funding target is the ARC, currently estimated at $7.2 million annually. Pursuant to City Council direction, the City began contributing toward the cost of the UAL both through direct City contributions, as well as employee contributions pursuant to some bargaining unit agreements. Payments for both components of the ARC are built into payroll to spread the cost appropriately across all City funding sources. Additional voluntary contributions towards the ARC were made in FY 2014 of $1 million and FY 2015 of $2 million; however, in an effort to reduce the use of reserves in FY 2016 and FY 2017, additional voluntary contributions were not made. In FY 2018, the City reinstated its practice of contributions toward the ARC, in the amount of $1 million, with additional voluntary contributions in the amount of $2 million for FY 2019, and $2.5 million in FY 2020. The City had anticipated making a significant voluntary contribution of $4.0 million in FY 2021; however, due to fiscal uncertainties brought on by the COVID-19 pandemic, Council recommended a reduced contribution of $1 million during budget adoption. During the FY 2021 Mid-Year Review, Council recommended an additional $1.0 million contribution, for a total voluntary contribution of $2.0 million in FY 2021. In FY 2022, the City met Council's commitment to fully fund retiree medical benefits by making its first full ARC payment. The City continues to meet its commitments by fully funding its ARC payment for FY 2023.

During labor negotiations in 2017, two employee groups agreed to contribute funding to an irrevocable trust to fund unfunded retiree medical obligations. IAFF Local 1909 recognized the continued need to fund retiree medical and agreed that employees represented by Local 1909 would continue to contribute one percent (1%) of base salary (excluding all special pays, allowances, and overtime), to an irrevocable trust to fund the unfunded retiree medical obligations. The contribution made by employees to the trust fund shall be exclusively allocated for the expense of retiree healthcare of its members. Hayward Police Officers Association (HPOA) agreed that employees represented by HPOA would begin contributing one percent (1%) of base salary (excluding all special pays, allowances, and overtime) effective July 1, 2018, to an irrevocable trust to fund the unfunded retiree medical obligations for their members.

Additionally, in 2020, the City established a Section 115 Irrevocable Trust with CalPERS – a California Employers' Retiree Benefit Trust (CERBT) as recommended by both the Committee and the full Council. The trust was established as a means to deposit additional funds as they become available to the City. The funds are then placed in the trust to offset expenses related to future payments and to reduce future liabilities.

**Workers' Compensation**

*Current annual cost: $10.9 million*
*Unfunded Liability: -($14.6) million*

The City is self-funded for Workers' Compensation and began its program on July 1, 1975. Payments are made to the Workers' Compensation Self-Insurance Fund by transfers from all City funds through established rates assessed against payroll pursuant to classification type. These accruals represent estimates of amounts to ultimately be paid for reported claims, past experience, recent claim settlement trends, and other information. Funds are available to pay claims and administrative costs of the program on a pay-as-you-go basis.

It is important to understand that payments on indemnity claims may be made over a very long period of years. Indemnity claims are those in which future medical care is projected to be needed for the injured worker and the cost is largely dependent on the type and severity of the injury, as well as whether or not the claimant is a sworn employee.

*Funding Status & Plan*

Pursuant to the latest actuarial valuation presented to the City in November of 2021, a funding status of 70–85 percent is recommended. Table 1 shows that the City is currently well overfunded. Several years ago, the Workers' Compensation Fund was severely underfunded. In an effort to improve funding levels, an additional percentage was applied on top of the standard rate. As a result of this methodology, the Workers' Compensation Fund is overfunded by 200%.

Typically, Workers' Compensation rates charged against live payroll include a component of the cost toward unfunded liability. Since the City has achieved a funding level above the recommended 85 percent, analysis of methodology will be compared with the funding strategies outline in the actuary. It is anticipated that staff will be reducing the Worker's Compensation rates, which will result in a significant reduction in contributions from all City operating funds to adjust to a more appropriate funding balance level.

**Accrued Leave Payouts (Compensated Absences)**

*Current annual cost: varies*
*Unfunded Liability: $7.5 million*

It is the City's policy to permit employees to accumulate earned but unused vacation and sick leave benefits. The City records the cost of vacation and sick leave as "earned." Earned vacation and sick leave that is taken during the year is payable from the fund(s) to which the employee's salary or wage is charged. When an employee retires or otherwise separates from the City, vacation balances are paid out to the employee, and in some cases, some of the accumulated sick leave is also paid out (pursuant to bargaining unit agreements). These payouts are paid through a department's budget from vacancy salary savings – and are not specifically budgeted for as a separate line item.

*Funding Status & Plan*

For several years, the City had lowered this liability over its all-time high in FY 2012. Beginning in 2016, the City began to realize increases in the accrued leave liability year over year. The steady change was attributed to an increase in the number of employees who had been employed with the City of Hayward for five or more years, accruing more leave and increasing the City's liability. However, accrued leave liability was significantly reduced in FY 2021. The total liability as of FY 2021 is $7.5 million, a decrease of $2.0 million compared to the prior fiscal year. Table 3 provides a historical overview of the City's accrued leave liability.

**Table 3: Accrued Leave Liability History**

| | Unfunded Liability | Change from Prior Year |
|---|---|---|
| FY 2010 | $9,250,970 | $1,773,756 |
| FY 2011 | $10,497,994 | $1,247,024 |
| FY 2012 | $10,701,569 | $203,575 |
| FY 2013 | $8,589,354 | ($2,112,215) |
| FY 2014 | $7,230,041 | ($1,359,313) |
| FY 2015 | $7,104,541 | ($125,500) |
| FY 2016 | $7,660,340 | $555,799 |
| FY 2017 | $7,894,439 | $234,099 |
| FY 2018 | $7,913,945 | $19,506 |
| FY 2019 | $8,347,418 | $433,473 |
| FY 2020 | $9,511,174 | $1,163,756 |
| FY 2021 | $7,452,742 | ($2,058,432) |

A reduction of $2.0 million in accrued leave liability from FY 2020 and FY 2021 is attributed to several key factors. During local and state restrictions, travel was also restricted, resulting in less travel and an increase in vacation/leave balances. Additionally, several bargaining unit agreements included the temporary lifting of vacation/leave caps, resulting in increased accrued leave balances in FY 2020. In FY 2021, as both local and state restrictions lifted from pent-up demand, the City began to see an increase in the use of vacation/leave balances. The use of these vacation/leave balances resulted in a reduction in the accrued leave liability in FY 2021. It is anticipated that the City will continue to experience a reduction in its accrued leave liability as several vacation/leave caps have been restored, and the continued drawdown of vacation/leave balances.

Accrued Leave payouts are currently absorbed within each department's budget appropriation. In practice, the salary savings achieved through normal attrition and the vacancy created by the exiting employee cover the cost of these payouts. In general, departments have had enough salary savings to accommodate this cost.

A possibility to further fund this liability is to build a funding mechanism into payroll as a component of the fringe benefit rate (e.g., 1% of payroll for non-sworn and 2% of payroll for sworn positions). While this might provide a segregated funding source that would prevent spikes to department payroll budgets for large payouts, it does increase the overall City payroll budget. Given the City's fiscal challenges, it does not seem a prudent use of City resources at this time to add this cost. Staff recommends continuing to actively manage employee leave balances in order to lower the overall long-term liability.

**NEXT STEPS**

Staff will continue to actively manage benefit liabilities and report annually to the Committee and the Council on the funding status of these benefit liabilities, including a review of existing Council policies regarding funding.

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Approved by:

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