

OVERVIEW

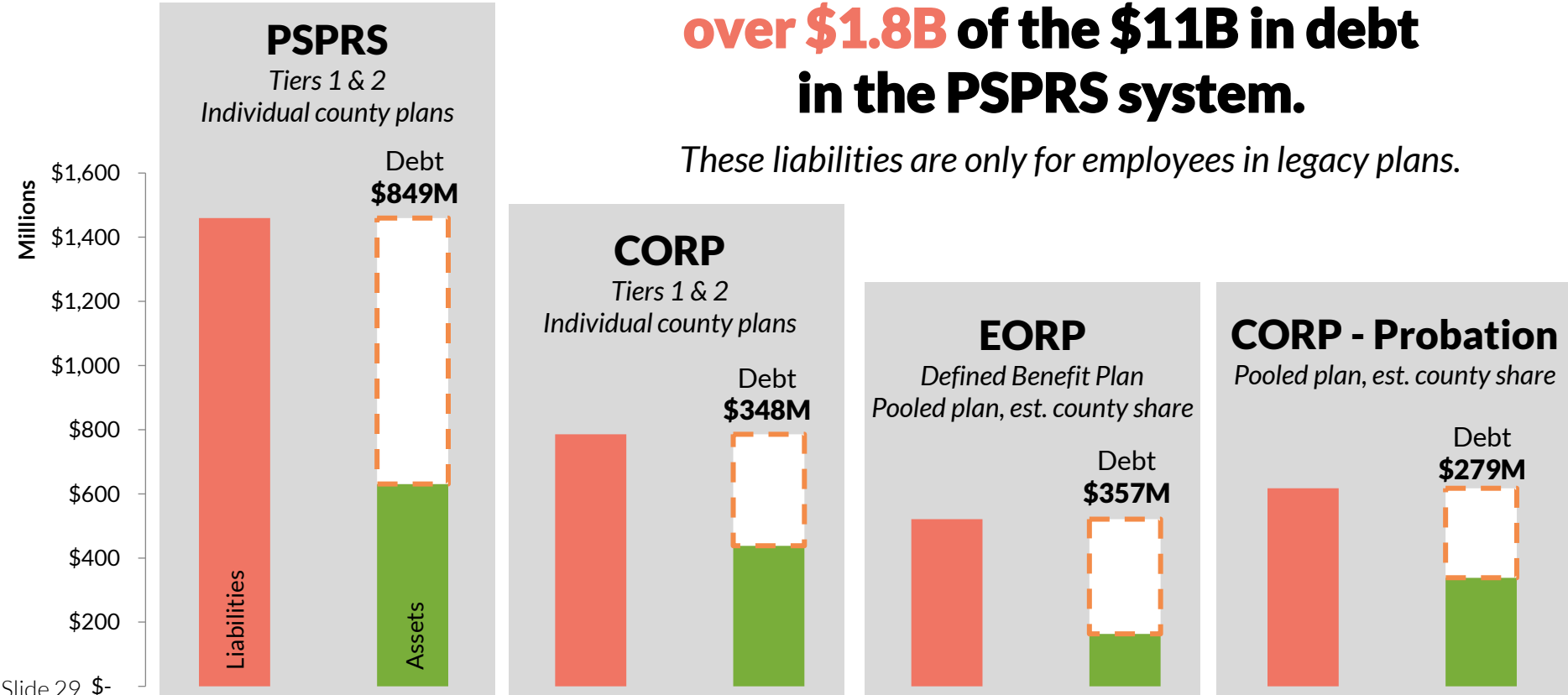
- There is over \$11B in PSPRS system debt, **\$1.8B for county plans.**
- The minimum payments set by the PSPRS board have been too low.
 - That has led to the accumulation of even more debt.
- The **PSPRS board is going to make adjustments** to the plan assumptions to increase payments and prevent further debt accumulation.
 - That will significantly increase employer contributions into the system.
- However, these **changes are necessary** to prevent future growth in the system's debt.





**Currently, county employers hold
over \$1.8B of the \$11B in debt
in the PSPRS system.**

These liabilities are only for employees in legacy plans.



Why is the funding goal 100%?



100%

Liabilities

Future benefits already earned by current employees or retirees.

Assets

Employer contributions, employee contributions and investment earnings.

100% funded means: *enough assets to invest to cover benefit payments already earned by employees and retirees.*

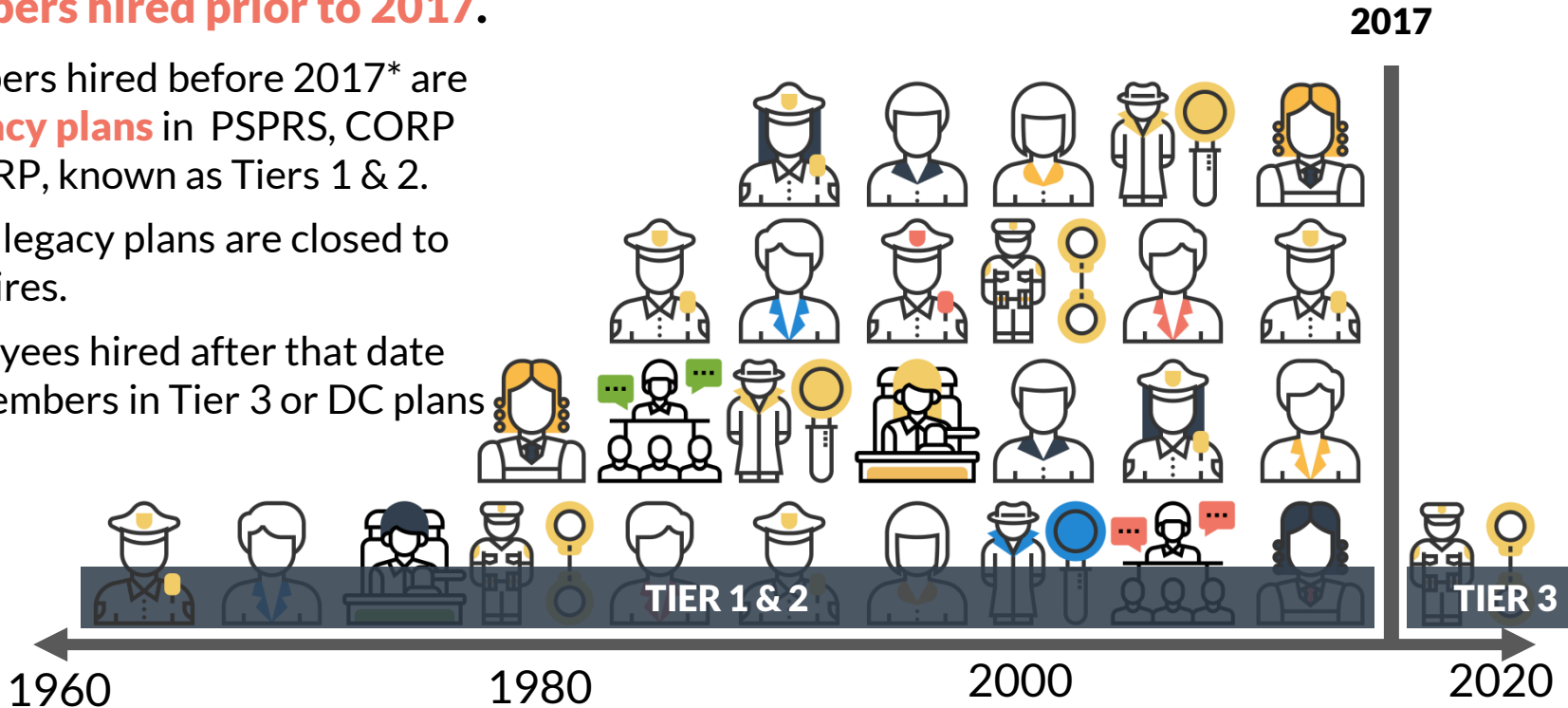
- PSPRS Liabilities are benefits current employees and retirees have already accumulated.
- A funded status under 100% means employers have to pay more in contributions to make up for the lost investment earnings.



Who is this debt owed to?

The \$11B in system wide debt (\$1.8B in county plan debt) is owed to **members hired prior to 2017**.

- Members hired before 2017* are in **legacy plans** in PSPRS, CORP or EORP, known as Tiers 1 & 2.
- These legacy plans are closed to new hires.
- Employees hired after that date are members in Tier 3 or DC plans



* Legacy plan in PSPRS is for members hired after July 1, 2017
Legacy plan in EORP is for members hired after January 1, 2012,
Legacy plan in CORP is for members hired before July 1, 2018.

Dates of service



Total Liability - County Sheriff PSPRS Plans

34%

from benefits
already earned
by current
employees

58%

from future
benefits for
currently retired
members.

More than half of the current liabilities are owed to already retired members.

- Several plans currently have more retirement benefits paid out annually than are made in employer contributions.
- Courts have ruled that these **benefits are guaranteed** by the AZ Constitution.

How did this debt accumulate?



Contributing Factors

Plan design was flawed

- Permanent Benefit Increase (PBI) structure was unpredictable and gave benefit increases even when plans were massively underfunded.



Resolution

Prop. 124 in 2016, Prop. 125 in 2018 traded PBI for more sustainable COLA.

New hires put in more sustainable system.

Legislative changes, including:

- Modifications to existing member benefits that were subsequently overturned.
- Capping employer contribution rates.



Litigated, previous structure restored.

Benefit changes only for new hires.

Capped contributions rates removed.

Poor investment performance during the Great Recession



Board of Trustees restructured to improve governance (include investment experts, employer representatives).

Board recognizes need for more “recession-proof” portfolio mix.

Payroll-based payments have made employer contributions insufficient

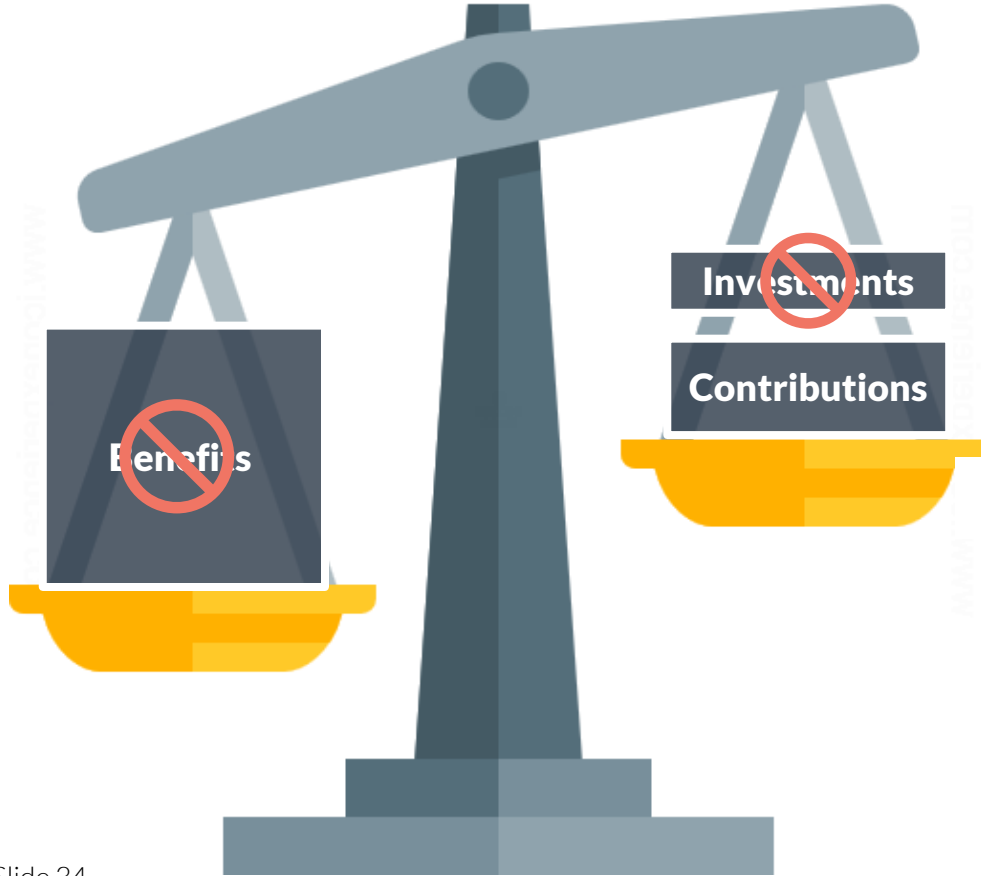


Hired new actuarial firm.

Replaced system administrator.

LEFT UNRESOLVED: Making adjustments to historically erroneous assumptions.

Why are increased contributions necessary?

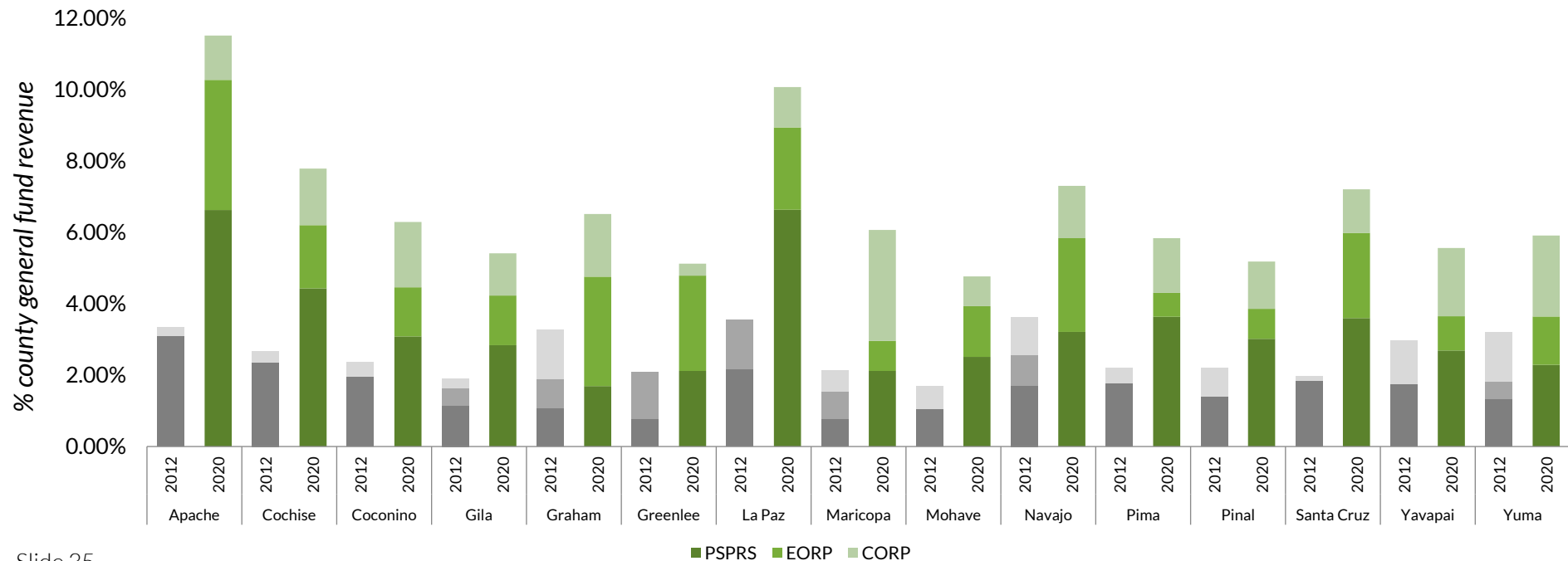


- Benefits can grow, however courts have ruled that pension benefits are protected by the AZ Constitution, and **can't be diminished**.
- Target investment returns are already high at 7.3%. Seeking higher investment returns **would require riskier investments**, making it more likely that the fund will lose assets.
- Contributions are the only thing that can be toggled to properly fund the system.

How has this already impacted counties?



Just 8 years ago, 3% of county general fund resources on average were dedicated to PSPRS payments, in 2020 it will be almost 7%.

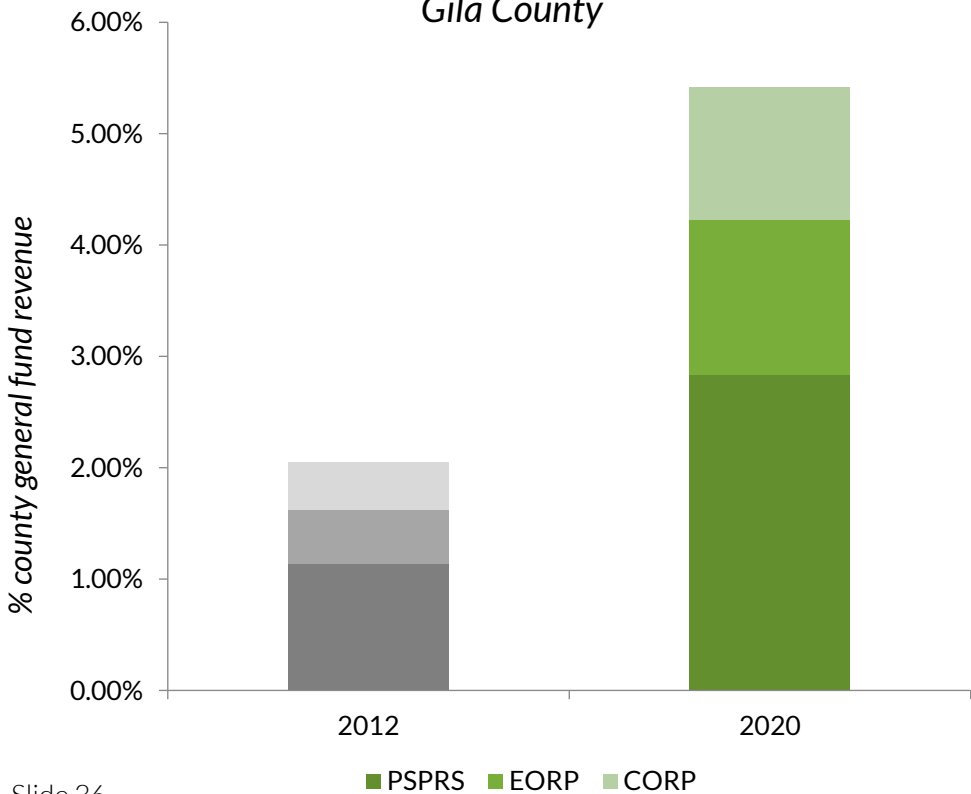


How has this already impacted counties?



PSPRS, CORP & EORP Payments % GF Revenue

Gila County



**Rapidly increasing pension payments
consume a larger share of county
resources.**

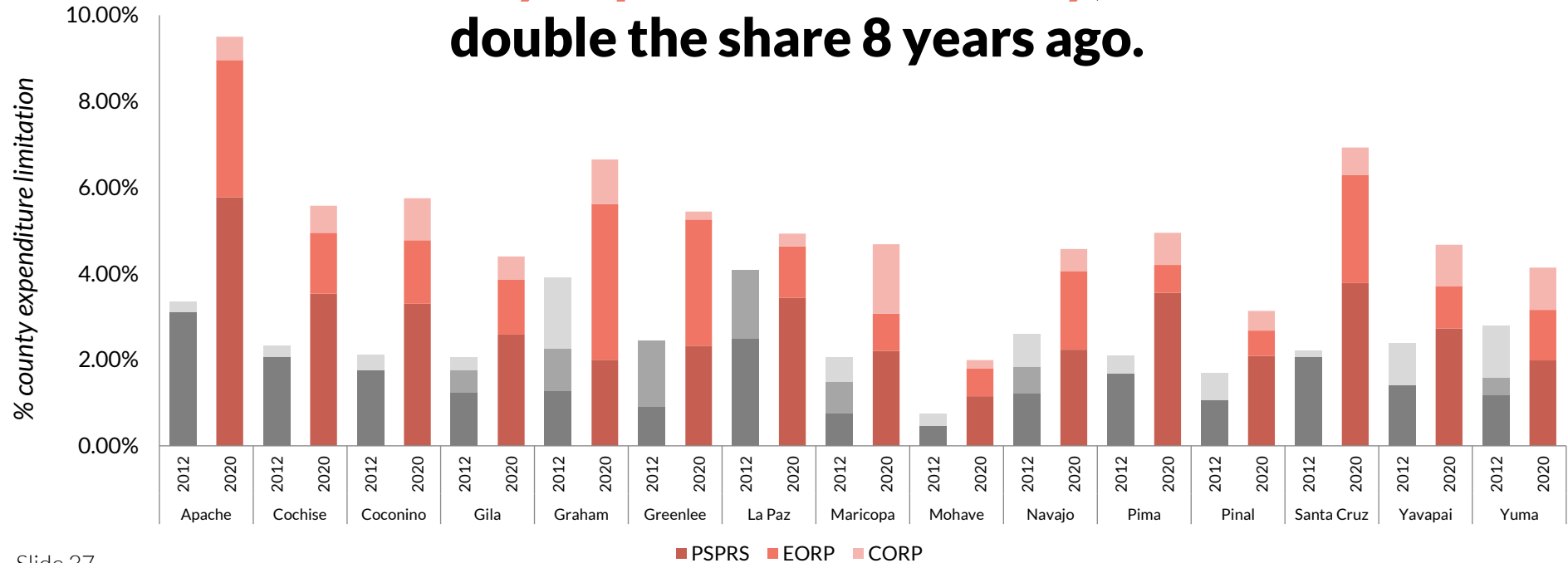


*Primary property tax rate required
to fund pension payments*

How has this already impacted counties?



Growth in pension costs has outpaced formulaic expenditure limit growth, now taking up almost 6% of county expenditure authority, more than double the share 8 years ago.



How has this already impacted counties?



Growth in pension costs have dramatically outpaced growth in county expenditure authority.

Expenditure Limit

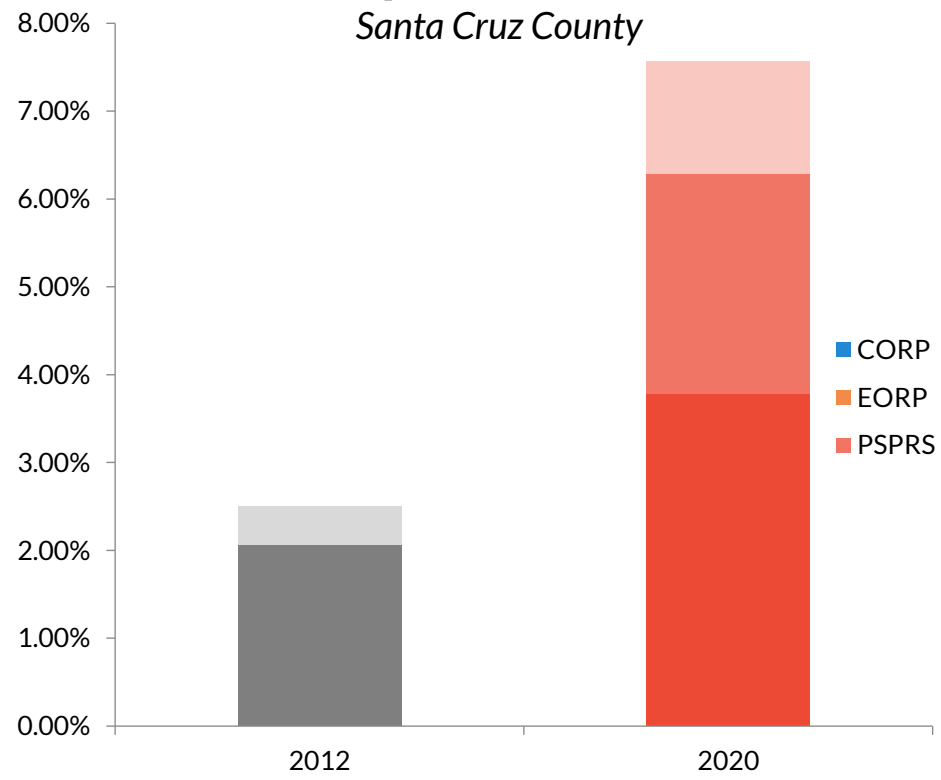
22%

Pension Payments

267%

Growth since 2012

PSPRS, CORP & EORP Payments
% Expenditure Limit
Santa Cruz County



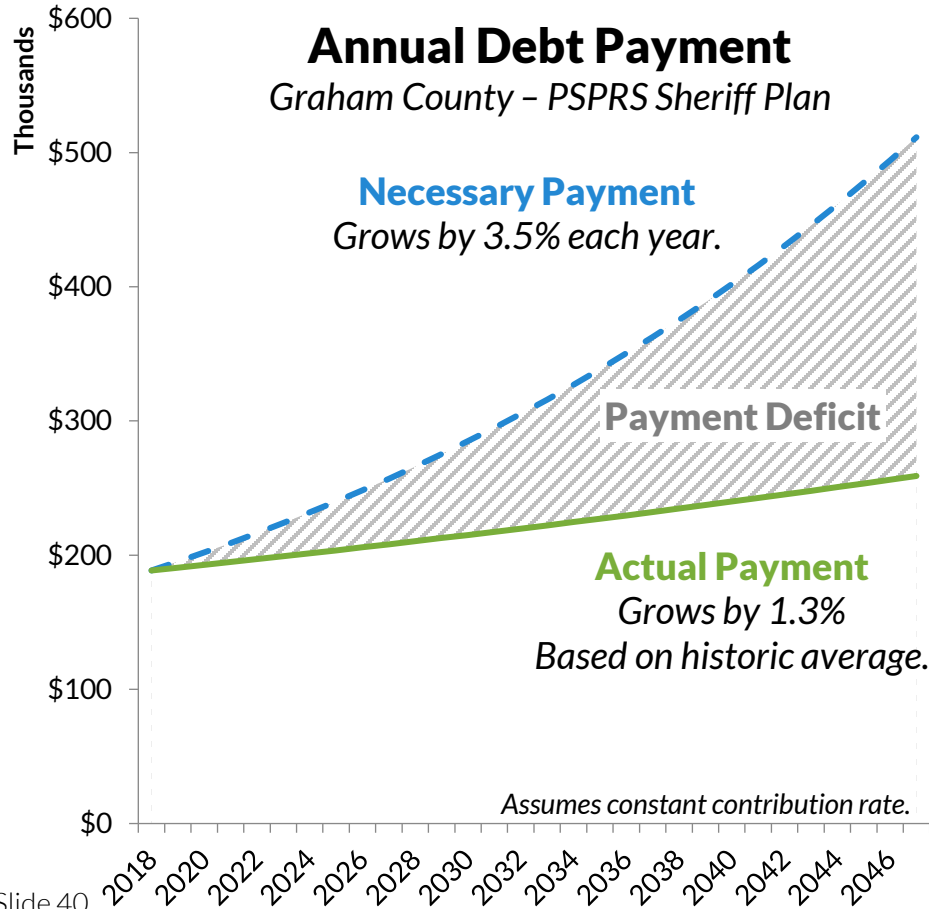
What is the current plan for repaying the debt?



The current debt repayment plan includes inherent risk and requires debt payments to double in future years.

- All debt would be repaid over next 18 or 28 years.
- Make annual payments as a percent of the total payroll in each plan.
- Assumes that your **payroll will grow each year by 3.5%**.
 - Which means payments grow at the same rate, and contribution rates stay the same.
 - For sufficient payments to be made, **payroll has to hit the assumed growth.**
- Any new debt that accumulates is added to the existing repayment schedule.

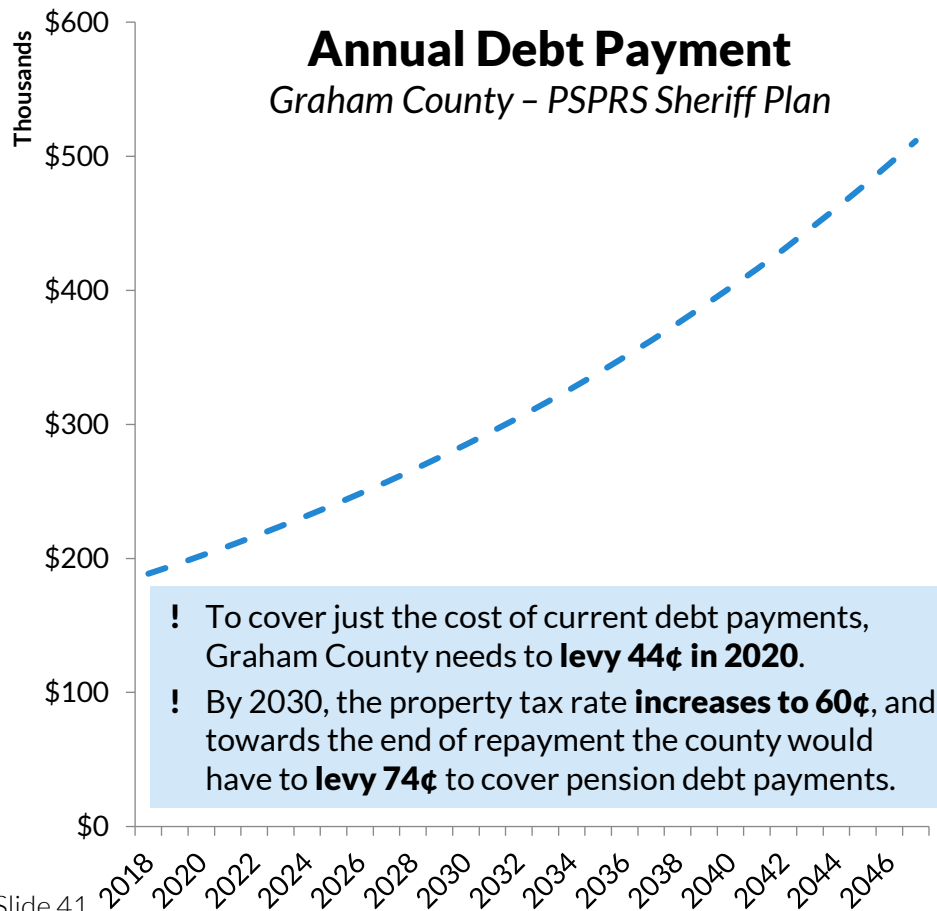
What is the problem?



For most employers, payroll growth has significantly underperformed the 3.5% assumption.

- This leads to chronic underpayments towards the plan debt.
- Absent adjustments, large payment deficits would occur causing many plans to accumulate even more debt.

What is the problem?

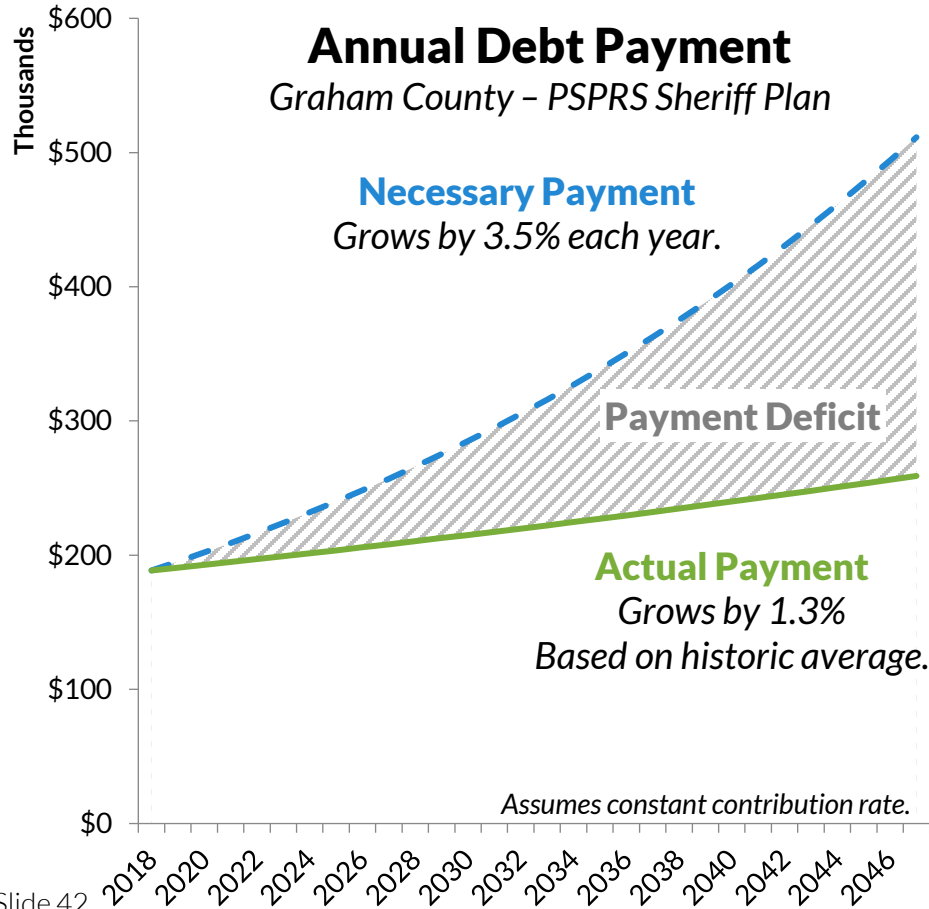


Even under the best circumstances, the current plan quickly becomes prohibitively expensive.

- Since 2015, 11 counties have had NAV growth less than 3.5%.
- If that continues, **higher and higher property tax rates** would be necessary to cover the increase in debt payments.

Assumes constant contribution rate.

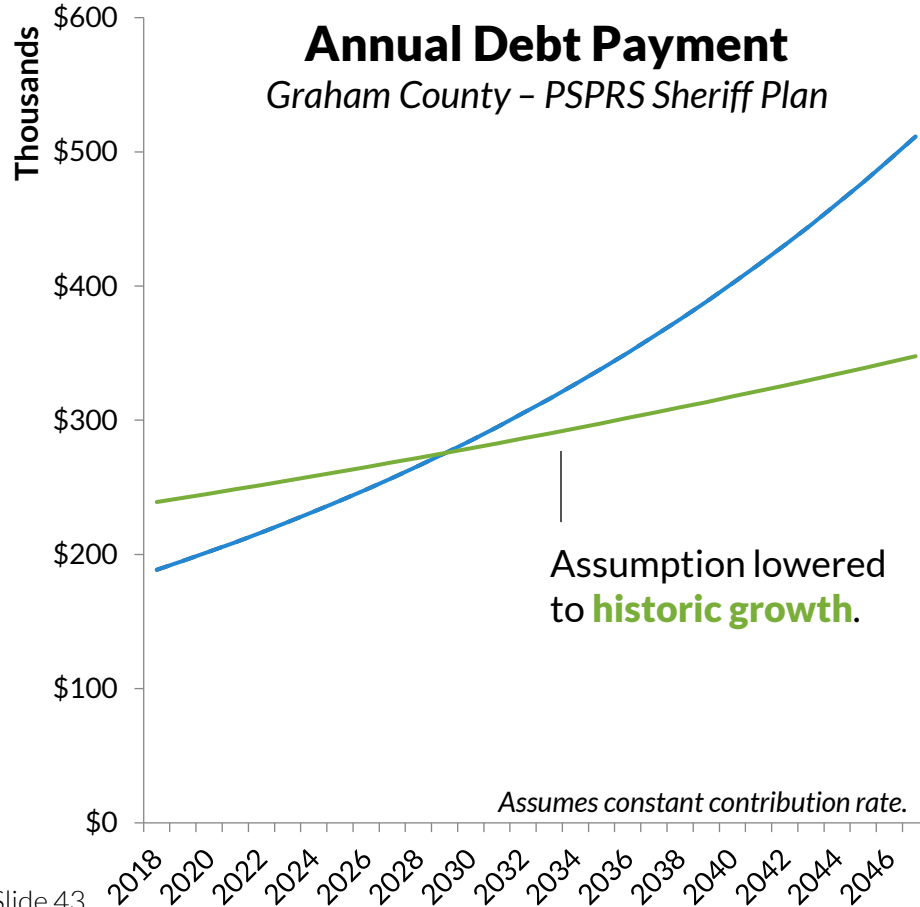
What is the alternative?



The PSPRS Board is likely to move to an assumption based on **historic payroll growth.**

- Moving towards **realistic assumptions** prevents underpayments.
- Making the change rapidly would cause total contributions to increase by almost 20%, so changes should be phased-in.

What are the pros and cons?



Requires more investment short term, but reduces the total cost to the taxpayer.

- Requires higher payments in short term.
 - However, it quickly becomes the cheaper option and there is less risk of underpayment.
- Debt decreases right away (absent other changes).
 - The current plan's repayment causes the debt to increase for several more years in plans with longer repayment periods.
- Lower total cost than current plan.
 - Graham's total contributions would be **\$9.7M** under the current plan, but would be **\$8.7M** under the more realistic assumption.

What happens if nothing changes?

More resources in the system now saves money in the long run and prevents the next generation of local taxpayers from bearing the burden of repaying this debt.



Moving towards more realistic assumptions has a lower total cost.



The current plan risks crowding out services due to mandatory debt payments that are double what they are today.



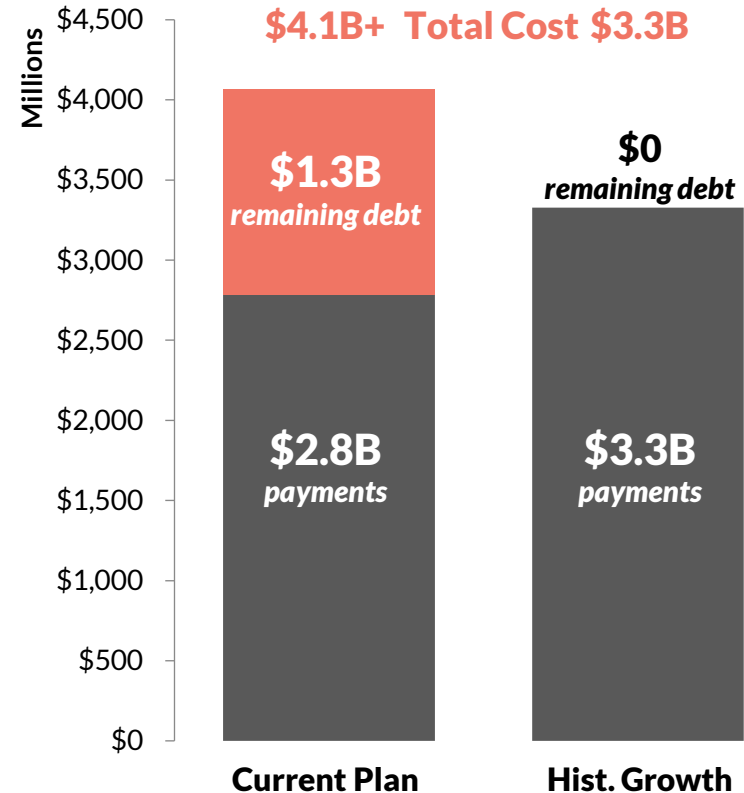
Businesses and residential investors view outstanding pension debt as a future tax liability to avoid. Taking steps to make sure debt payments are manageable helps support local economic development.

Total Est. Debt Payments

Current Debt: \$1.8B



\$4.1B+ Total Cost \$3.3B



Assumes constant contribution rate and payments grow at historic payroll growth.