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April 20, 2018

The Honorable Budget and Finance Committee  
City Council, City of Los Angeles  
c/o City Clerk, City Hall, Room 395  
Los Angeles, CA 90012  
Attn: Richard Williams, Legislative Assistant

**Re: 2018-19 LAFPP Proposed Budget**

Honorable Members:

Thank you for the opportunity to appear before the Budget and Finance Committee to discuss the Los Angeles Fire and Police Pension (LAFPP) System. I am pleased to report that the System's combined health and pension funding ratio on an actuarial basis remains well-funded at 85.6%, despite a slight decrease from the prior year's 87.4%. The City's 2018-19 contribution rate as a percentage of sworn payroll will increase by 2.59%, from 44.26% to 46.85%, due to changes in actuarial assumptions and higher-than-expected salary increase for active members. This increase is partially offset by favorable investment returns and lower-than-expected cost of living increases for retirees.

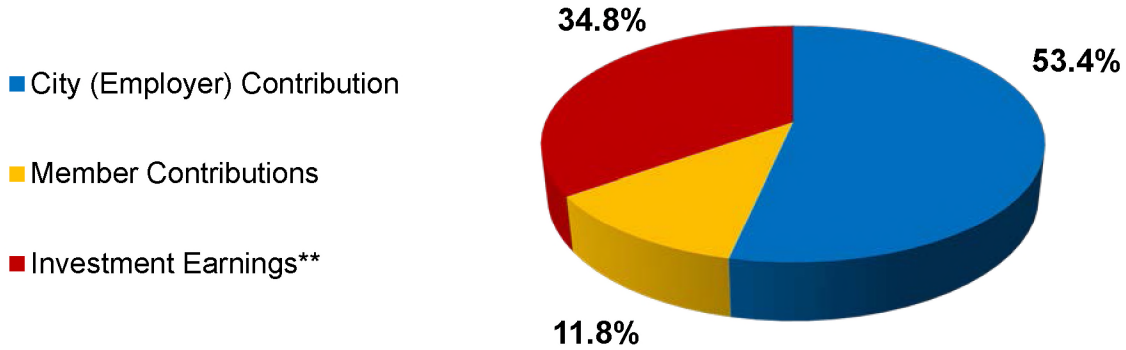
Based on the Mayor's Proposed Budget, the City's contribution amount, including the Excess Benefit Plan, will increase from \$639.6 million to \$698.5 million. This increase is due in part to the transfer and new enrollment of the Los Angeles World Airports Police Officers to LAFPP. Once the City Council and the Harbor and Airport Commissions adopt their final sworn payroll account figures, the City's actual 2018-19 contribution amount will be adjusted accordingly. A final LAFPP Budget reflecting these changes will then be submitted to the Board of Fire and Police Pension Commissioners (Board) for approval on June 21, 2018.

Projected Receipts

Total projected revenues are expected to increase \$56.3 million, to \$1.3 billion. LAFPP revenues are derived primarily from three sources: the City's (employer) contribution, member (employee) contributions, and investment earnings.

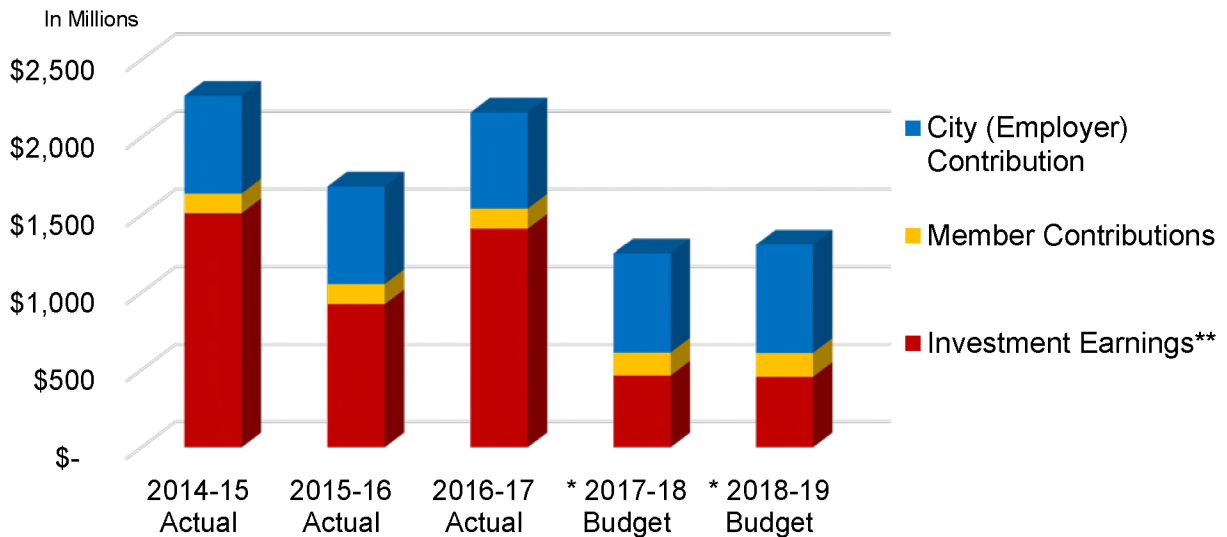


**2018-19 Budget - Receipts\***



\*Receipts do not include Miscellaneous revenue. Percentages may be rounded.  
 \*\*Investment Earnings do not include Gain (Loss) on Sale of Investments.

**Five-Year Receipts History\***



\*Receipts do not include Miscellaneous revenue.  
 \*\*Investment Earnings do not include Gain (Loss) on Sale of Investments.

**Projected Expenditures**

Total pension-related benefit expenses are projected to increase approximately \$77.5 million, or 6.9%, from the 2017-18 adopted budget for a total of over \$1.2 billion. The bulk of the increase (\$74.5 million) is due to increased pension payments and Deferred Retirement Option Plan (DROP) payouts to members and beneficiaries. Additionally, health benefits are expected to increase \$3.0 million, or 2.2% from the prior year. This estimate will be adjusted once the Board determines the increase in the non-Medicare

subsidy rate beginning July 1, 2018. The proposed administrative expense budget will increase by \$585,000 in 2018-19 after offsetting the retirement contribution credit from LACERS. Lastly, investment management expenses are anticipated to increase (\$6.2 million) due to the size of the portfolio and commitments within the portfolio.

Our 2018-19 proposed budget was developed in conjunction with the 2018-19 Business Plan projects, which are aligned with the LAFPP 2019-2021 Three-Year Strategic Plan Goals, Objectives and Initiatives as adopted by the Board in February 2018. We remain committed to continued superior service to our membership through several projects, including the final phase of the Pension Administration System Replacement Project, increased member outreach efforts, website redesign, strategies that manage healthcare costs, and a benchmarking study to identify opportunities to become more efficient in our organization.

Prior to the release of the Mayor's Proposed Budget, several recommendations were provided by the Neighborhood Council Budget Advocates. While I appreciate their diligent efforts, I wanted to share some thoughts for each of the recommendations as they relate to LAFPP.

Recommendation 1 - *Establish a temporary Committee for Retirement Security, as recommended by the LA 2020 Commission, to review the City's retirement obligations and to set a schedule to achieve results, with a realistic timeline.*

LAFPP is responsible only for administering the pension system and does not negotiate for or create any benefits for current or former City employees. This recommendation would be a more appropriately considered by the City as the Plan sponsor.

Recommendation 2 - *Immediately address the unfunded pension liabilities of the City.*

Inherent in any well-run pension plan, strong funding policies are key to addressing unfunded pension liabilities. In 2012, the LAFPP Board established a formal statement of funding policy in consultation with the Plan's actuary (<https://www.lafpp.com/sites/default/files/policies/section-ii-board-operating-policies-and-procedures-revised-01-18-18-a1-a5.pdf>). These funding policy goals are:

1. To achieve long-term full funding of the cost of benefits provided by the LAFPP;
2. To seek reasonable and equitable allocation of the cost of benefits over time;
3. To minimize volatility of the Plan sponsors' contribution to the extent reasonably possible, while consistent with other policy goals; and,
4. To support the general public policy goals of accountability and transparency by being clear as to both intent and effect, allowing for an assessment of how and when the Plan sponsors will meet the funding requirements of the Plan.

A pension plan funding policy is designed to determine how much should be contributed each year in total by the employer and the active members to provide for the secure funding of benefits in a systematic fashion. In practice, for a variety of reasons, the assets of the fund will be greater than or less than the plan's accrued liabilities, leaving the plan overfunded (surplus) or underfunded (the Unfunded Actuarial Accrued Liability or UAAL). The funding policy adjusts contributions to reflect any surplus or UAAL in a way that reduces short-term, year-by-year volatility, but still assures that future contributions, together with current assets, will be enough to provide all future benefits.

LAFPP is currently 91.5% funded for retirement benefits and 49.1% for health benefits on an actuarial basis, with unfunded liabilities of approximately \$1.73 billion and \$1.68 billion, respectively. The current funded status is a reflection of the strong funding policies adopted by LAFPP. In addition, the City has continuously demonstrated a strong funding commitment to LAFPP by making the annual required contributions as recommended by the Plan's actuary and staff each and every year.

Recommendation 3 - *Reduce both pension plans' assumption rate to a more realistic rate of 7%, as suggested by the staff and actuaries.*

Over the past five years, LAFPP has reduced its assumed rate of return twice, each time a quarter of one percent from a total of 7.75% to 7.25%. The most recent reduction of 0.25% was adopted on June 1, 2017, as part of LAFPP's most recent triennial actuarial experience study. These actions, along with the non-economic assumption changes, have helped ensure the long-term viability of the Plan to properly fund the benefits for members. The current assumed rate of return of 7.25% more closely aligns with the Plan's expected investment returns based on the current asset allocation and capital market outlook.

It should also be noted that LAFPP's actuary and staff did not recommend lowering the Plan's assumed rate of return to 7.0%. Nor would LAFPP recommend a reduction to 7.0% at this time. The Plan's next triennial experience study will be completed in 2020, which would include a review of the assumption rate again.

Thank you again for opportunity to appear before the Committee. We are always available to answer any questions the Committee may have regarding our System.

Sincerely,



Raymond P. Ciranna  
General Manager

cc: LAFPP Board  
Miguel Sangalang, Deputy Mayor  
Richard H. Llewellyn, City Administrative Officer