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April 23, 2020

The Honorable Budget and Finance Committee
City Council, City of Los Angeles
c/o City Clerk, City Hall, Room 435
Los Angeles, CA 90012
Attn: Mandy Morales, Legislative Assistant

Re: 2020-21 LAFPP Proposed Budget

Honorable Members:

Thank you for the opportunity to provide the Budget and Finance Committee information on the Los Angeles Fire and Police Pension (LAFPP) System. On January 16, 2020, the Board of Fire and Police Pensions adopted a revised valuation which showed that the System's combined health and pension funding ratio on an actuarial basis remains well-funded at 88.5%, a notable increase from the prior year's 86.9%.

The City, Harbor, and Airport Departments' combined contribution rate will decrease by 0.59%, from 47.19% to **46.60%** of sworn payroll for FY 2020-21 (with the City's contribution rate, excluding Harbor and Airports, decreasing from 47.37% to 46.79%). This is a result of a higher than expected return on the valuation value of assets (after smoothing), loss layers from the June 30, 2004 valuation being fully amortized, lower than expected salary increases for active members, and a change in Plan provisions (i.e., modifications to the DROP program affecting members who enter on or after February 1, 2019). This decrease was offset by a change in mortality assumptions, lower than expected employer contributions (due to the budgeted payroll being lower than what was assumed in the prior valuation) and amortizing the prior year's unfunded actuarial accrued liability (UAAL) over a smaller than expected payroll.

Based on the Mayor's Proposed Budget, the City's contribution amount, including the Excess Benefit Plan, will increase from \$711.95 million to approximately **\$759.99 million**. Once the City Council, Harbor, and Airport Commissions adopt their final sworn payroll account figures, the City's actual 2020-21 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 18, 2020.

Preliminary Budget

The Board of Fire and Police Pensions adopted a preliminary budget on March 19, 2020, which was compiled prior to the realization of the severe economic effect of the COVID-19 pandemic. Staff is re-evaluating all prior revenue estimates and will submit final estimates to the Board for approval on June 18, 2020.

Additionally, LAFPP is re-evaluating both the preliminary investment and administrative expense budgets for potential reductions. Given the drop in portfolio asset values, investment expenses may be adjusted downward in conjunction with the overall portfolio value. Likewise, the administrative budget will be reviewed for belt-tightening measures and adjusted accordingly.

The information summarized below will provide the Committee information on LAFPP's anticipated receipts and expenditures. Please note the vast majority of LAFPP's expenditures are based on the provision of retirement benefits as negotiated by the City.

2020-21 Proposed Budget: Anticipated Receipts

Total projected receipts for 2020-21 are expected to increase by \$70.95 million (5.3%) to **\$1.41 billion**. Total receipts are comprised of the sources below:

- \$759.99 million for the City (employer) contribution (includes the Excess Benefit Plan amount of \$2.38 million that is not transferred to LAFPP);
- \$168.75 million for member (employee) contributions;
- \$479.00 million in estimated Earnings on Investments (this also does not include the Gain (Loss) Sale of Investments, which are provided as an audited amount after the fact and therefore not included in the budget); and
- \$1.50 million in anticipated miscellaneous receipts from various sources.

2020-21 Proposed Budget: Projected Expenditures

For 2020-21, expenditures are expected to total **\$1.45 billion**, an increase by \$50.07 million (3.6%) over the prior year. This increase is made up of:

- \$40.42 million net increase attributed to Pension and Health Benefits expenses. Pension Benefits are projected to increase approximately \$35.17 million (3.1%) from the 2019-20 adopted budget for a total of \$1.16 billion. The bulk of the increase (\$58.00 million) is due to increases in the service pension payments to members and surviving spouse and domestic partner pension payments. Additionally, Health Benefits are expected to total \$153.70 million, an increase of \$5.25 million (3.5%). This amount will be adjusted to reflect the non-Medicare subsidy rate effective July 1, 2020, as adopted by the Board of Fire and Police Pensions on March 19, 2020.
- \$7.52 million is attributed to investment management expenses anticipated to total \$114.43 million in 2020-21 due to anticipated plan fund size. LAFPP recognizes the potential for changes in the plan fund size and associated investment management expenses given the current market volatility in response to the

COVID-19 crisis and will adjust accordingly for the Final Budget as necessary.

- \$2.13 million is attributed to administrative expenses anticipated to total \$24.62 million in 2020-21, mainly due to an increase in the nondiscretionary expenses, including increased salary obligations, one-time payouts, and retroactive salary adjustments pursuant to various new labor agreements. LAFPP recognizes the belt-tightening measures the City will be implementing and likewise, will be implementing budgetary reductions appropriate for the System.

2020-21 Proposed Business Plan

The LAFPP 2020-21 Proposed Budget was developed in conjunction with the 2020-21 Business Plan, which is comprised of several projects aligned with the goals and objectives contained within the 2019-21 LAFPP Strategic Plan. We remain committed to continued superior service to our membership through several projects:

- *Continually enhancing member services* – Additional member services for direct deposit of contribution refunds, DROP exit rollovers via wire payment, and creation of shorter, flexible LAFPP Benefits Information Sessions.
- *Prioritizing staff training and knowledge transfer* – Development of Pension Core Staff Training materials, and expansion of Cross-Training Program department-wide.
- *Identifying operational efficiencies* – Improvements to the Disability Claims Database, Pensions Division Business Process Reengineering, and upgrade of LAFPP Support Request System.
- *Fulfilling periodic best practice and compliance reviews* – Fund asset allocation strategy review and implementation, Cybersecurity enhancements and ALGA (Association of Local Government Auditors) Peer Review.

Neighborhood Budget Advocates' White Paper

Once again, the Neighborhood Council Budget Advocates released their 2020 White Paper providing several recommendations to the Mayor and City Council, as well as to the respective pension systems. These recommendations were drawn from meetings with LACERS and LAFPP. As in prior years, the Neighborhood Council Budget Advocates are recommending both Pension Plans reduce their assumed rate of return to 7% or lower. We appreciate the due diligence and review of the unfunded liabilities of the pension systems. Both Plans have implemented prudent funding policies to address these liabilities to balance the needs of the City while achieving the long-term goal of retirement sustainability.

While LAFPP's year-end investment return number is not known at this time, the Plan has alleviated some of the potential losses due to anticipated changes in the market earlier in the fiscal year. The Plan is actively pursuing both long-term and short-term strategies to help mitigate the market swings and deploy capital in select markets.

The Honorable Budget and Finance Committee

April 23, 2020

Page 4

Thank you again for the opportunity to provide relevant budget information to the Committee. We are available to answer any questions the Committee may have regarding our System.

Sincerely,

A handwritten signature in black ink, appearing to read "Raymond P. Ciranna". The signature is fluid and cursive, written over a light gray rectangular background.

Raymond Ciranna
General Manager

cc: LAFPP Board

Miguel Sangalang, Deputy Mayor

Richard H. Llewellyn, City Administrative Officer