



Actions Supporting a Transition to Virginia Retirement System (VRS)

Finance and Economic Development Committee
October 19, 2023



Section 1: Actions to Date Summary and actions to date



TRANSITION TO VIRGINIA RETIREMENT SYSTEM APPROVED

- September 25, 2023: Council adopted Resolution 2023-R050 to transition to VRS
- Adopting this the resolution is an irrevocable decision

"WHEREAS, subject to the approval of the Virginia Retirement System ("VRS") Board of Trustees, Code of Virginia § 51.1-130 permits a political subdivision of the Commonwealth of Virginia to make an irrevocable election to join VRS and to provide retirement benefits for its eligible employees..."

• October 3, 2023: Letter from VRS approving the city's joining:

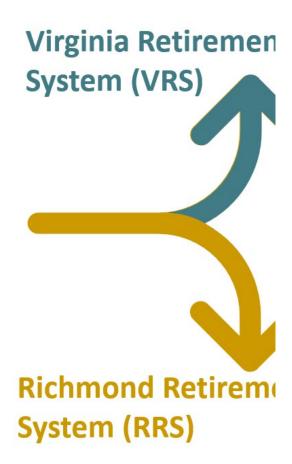
"This election is irrevocable and coverage for eligible employees is effective January 1, 2024."



MOVING FORWARD

- RRS will close to new employees as of January 1, 2024
- From January 1, 2024, new hires will go into VRS
- If employed with the city as of December 31, 2023, employees have until December 31, 2024 (one-year)
- Prior VRS employees may return to their previous plan
- The decision is irrevocable





Section 2: Consideration of Papers

Financial Strategy



CHALLENGES OF RRS

High unfunded liability

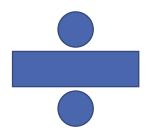
Low employee contribution

Various contribution Rates



HOW THE 67.9 PERCENT FUNDED STATUS IS CALCULATED

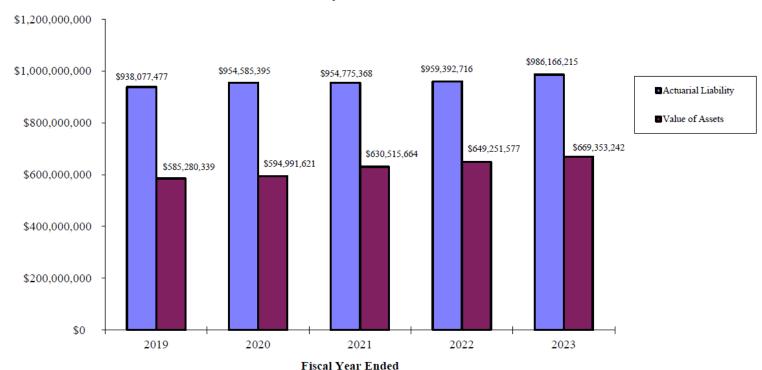
Value of Assets (how much \$ we have)



Actuarial Liability (how much we owe)

Page 7 of the RRS 2023 Valuation Report:
Five-Year History of Actuarial Liability and Value of Assets

Actuarial Liability v. Actuarial Value of Assets



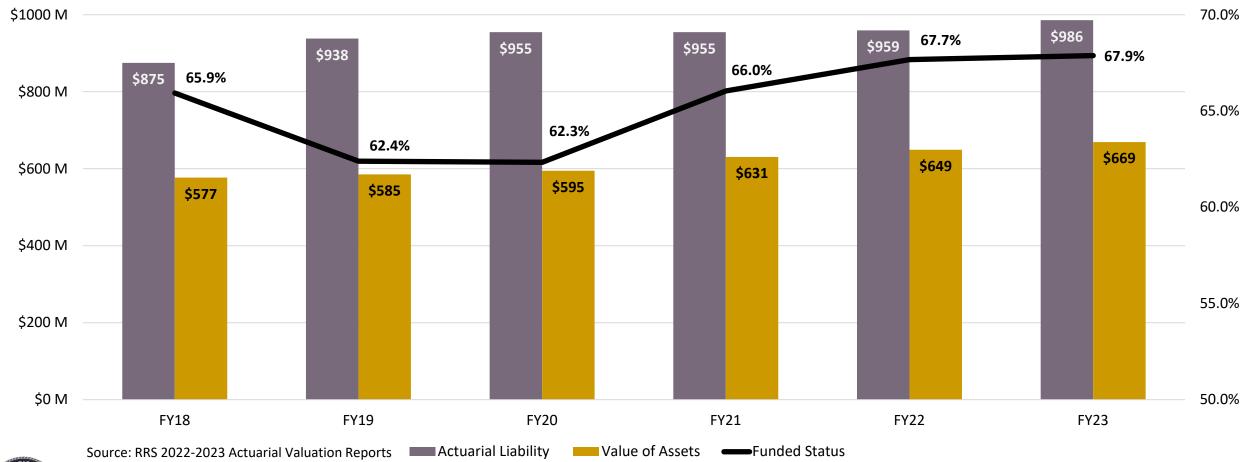
Page 6, RRS FY 2023 Valuation Report:



For purposes of determining contribution rates, the System's unfunded actuarial liability is measured by comparing the actuarial value of assets with the actuarial liability. The actuarial liability is determined under the entry age actuarial cost method. On this basis, the System's unfunded actuarial liability is \$316,812,973 as of July 1, 2023. The unfunded actuarial liability is based on an actuarial value of assets of \$669,353,242 and an actuarial liability of \$986,166,215.

RRS LIABILITY NEEDS TO BE ADDRESSED

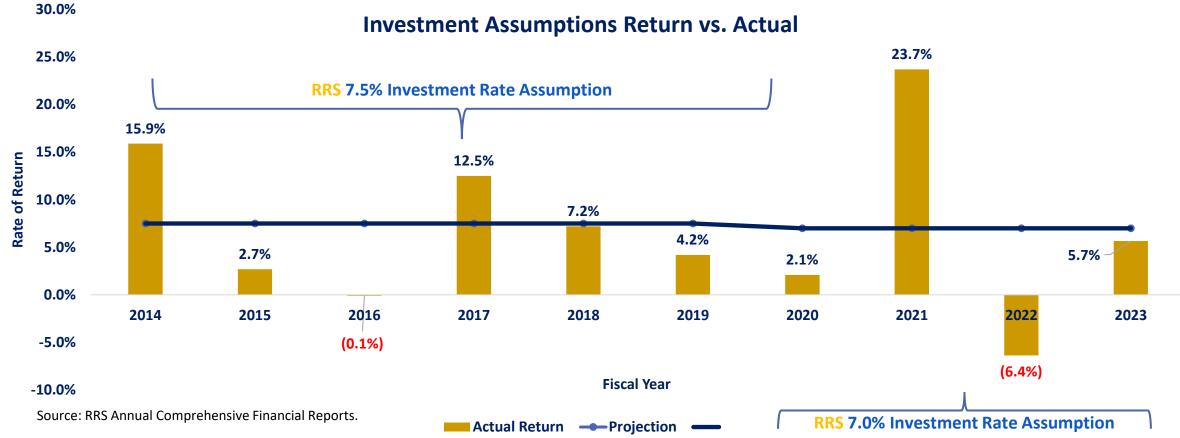
RRS' Five-Year History of Value of Assets vs. Actuarial Liability





Note: Liability only applies to Defined Benefit employees. Defined Contribution employees do not have an impact on the unfunded liability.

RRS INVESTMENT PROJECTIONS FELL BELOW THE EXPECTED RATE OF RETURN SEVEN OF TEN YEARS

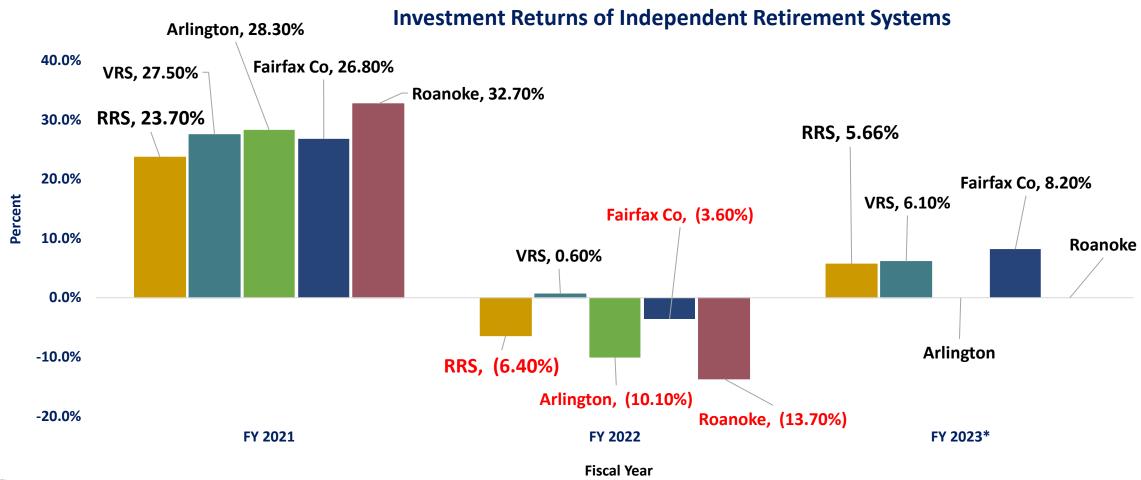


Notes:

- In 2014, it was estimated that the unfunded amortization would be largely done by 2026 based on investment assumption of 7.5%. The estimates at the time projected achieving 80% funded status in 2023 & approximately 90% in 2026.
- The Investment assumption was reduced from 7.5% to 7.0% in 2019 and the unfunded liability was re-amortized and extended until 2032.



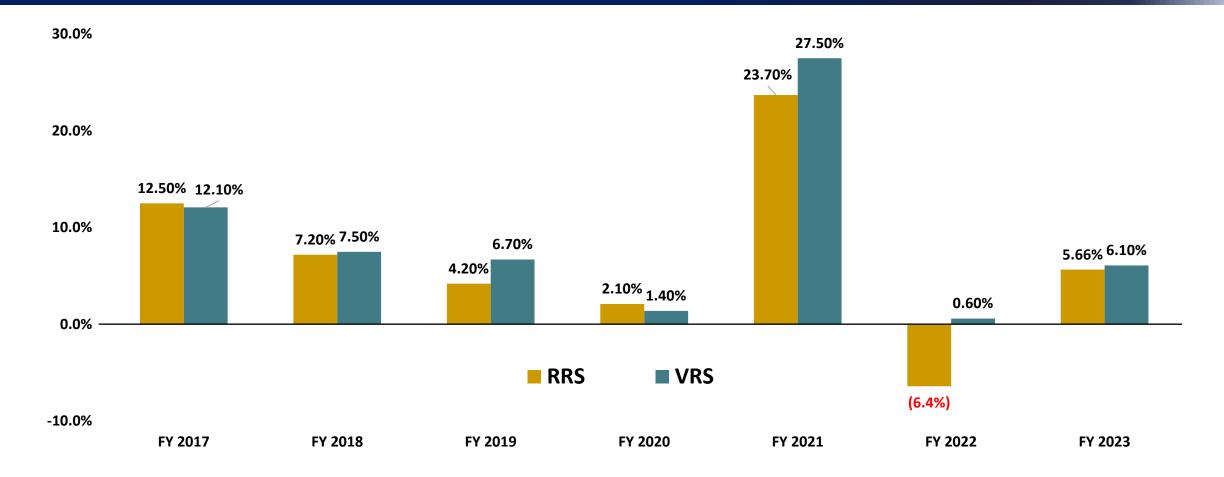
RRS' INVESTMENT RETURNS ARE LOWER THAN OTHER INDEPENDENT RETIREMENT SYSTEMS





* FY 2023 data not available for all localities.

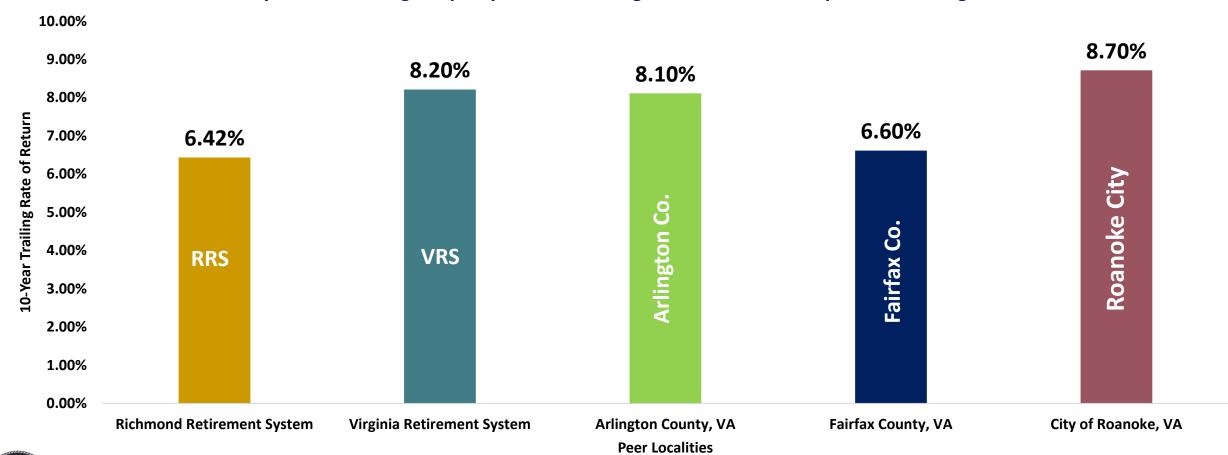
VRS HAS HAD HIGHER RATE OF RETURN IN FIVE OF SEVEN YEARS





COMPARISON OF 10-YEAR ANNUALIZED RETURNS

10-year return is a good proxy for determining if investment assumptions are being met





SALARY CHANGES IMPACT THE LIABILITY OF RRS

- Salary and retirement benefit changes can significantly impact the actuarial gain/loss and add to the unfunded liability.
- Approximately two-thirds of the actuarial changes were due to FY 2023 salary actions.

RRS Details of Actuarial (Gain) / Loss for the			
	FY 2022	FY 2023	
Active salary	\$8,530,000	\$25,220,000	



TRANSITION INVOLVES A 3-PRONGED FINANCIAL STRATEGY



2

Issue Pension Obligation Bonds (POBs) to reach minimum of 80% actuarial funded status of RRS



Establish financial policies
which target 100%
actuarial funded status and
maintains minimum 80%
threshold



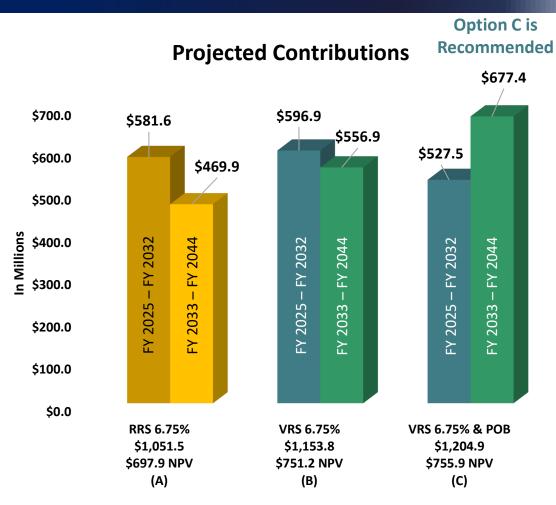
AN INFUSION OF CASH IS NECESSARY TO INCREASE RRS' FUNDED STATUS

- Minimum threshold for a pension system is 80 percent
- In the most recent FY 2023 Valuation Report, RRS' actuarial funded status is 67.9 percent, and the net funded status is 65.0 percent
- Based on the new FY 2023 results, approximately \$120 million is needed to bring the funded status to 80 percent
- Credit rating agencies view the low funded status of the pension plan as a credit weakness



BENEFITS OF TRANSITIONING TO VRS USING PENSION OBLIGATION BONDS (POB)

- Compared to (A), transitioning to VRS (Scenario B) without POBs results in an estimated \$15.2 million increase through 2032
- Transitioning to VRS with POBs provides a lower estimated annual contribution through 2032
 - Average of \$6.8 million less through 2032



RRS rate of return equalized to 6.75% to be comparable to VRS

ESTIMATED COST TO TRANSITION IS COMPARABLE TO ADDRESSING THE CURRENT LOW FUNDED STATUS OF RRS

Status Quo @ 6.75% Compared to VRS Transition with POBs

	Option A	Option C	
Fiscal Year	Current RRS @ 6.75%	New RRS, VRS, POB	Variance
2025	\$65,086,136	\$59,234,963	\$5,851,172
2026	\$68,541,163	\$61,489,182	\$7,051,981
2027	\$69,903,496	\$62,214,696	\$7,688,801
2028	\$72,938,604	\$65,605,977	\$7,332,627
2029	\$74,440,504	\$67,438,346	\$7,002,157
2030	\$75,394,955	\$68,705,415	\$6,689,540
2031	\$76,884,874	\$70,493,921	\$6,390,953
2032	\$78,440,389	\$72,332,881	\$6,107,508
2033	\$33,140,197	\$47,386,979	(\$14,246,781)
2034	\$34,111,473	\$48,937,284	(\$14,825,811)
2035	\$35,133,966	\$50,529,727	(\$15,395,760)
2036	\$36,204,957	\$52,167,883	(\$15,962,926)
2037	\$37,324,557	\$53,845,291	(\$16,520,734)
2038	\$38,495,602	\$55,562,582	(\$17,066,980)
2039	\$39,720,711	\$57,325,767	(\$17,605,055)
2040	\$41,000,716	\$59,137,020	(\$18,136,304)
2041	\$42,335,262	\$60,996,652	(\$18,661,390)
2042	\$42,195,687	\$61,379,151	(\$19,183,463)
2043	\$44,958,311	\$64,662,471	(\$19,704,161)
2044	\$45,283,032	\$65,486,368	(\$20,203,336)
Total	\$1,051,534,593	\$1,204,932,555	(\$153,397,962)
NPV @ 5%	\$697,861,454	\$755,922,988	(\$58,061,534)

- Expected savings over the short-term
- Expected increase in estimated costs over the long-term
- Considering the current low funded status of RRS and the need to fund above the expected ADC, costs will increase regardless of transitioning to VRS



will differ

SHIFT IN ESTIMATED COSTS OVER TIME TO VRS

Cost Components of Transition with POB – Scenario C

1	2	3	4	5	6
Fiscal Year	RRS ADC	RRS DC	VRS	Debt Service	Total
2025	\$37,472,064	\$4,016,036	\$7,705,344	\$10,041,520	\$59,234,963
2026	\$36,405,681	\$3,824,246	\$11,217,735	\$10,041,520	\$61,489,182
2027	\$35,632,248	\$3,608,164	\$12,932,764	\$10,041,520	\$62,214,696
2028	\$37,518,118	\$3,400,596	\$14,645,744	\$10,041,520	\$65,605,977
2029	\$37,833,332	\$3,201,311	\$16,362,184	\$10,041,520	\$67,438,346
2030	\$37,559,316	\$3,011,117	\$18,093,462	\$10,041,520	\$68,705,415
2031	\$37,776,828	\$2,825,640	\$19,849,934	\$10,041,520	\$70,493,921
2032	\$38,015,877	\$2,645,443	\$21,630,041	\$10,041,520	\$72,332,881
2033	\$11,448,096	\$2,478,293	\$23,419,070	\$10,041,520	\$47,386,979
2034	\$11,354,975	\$2,321,021	\$25,219,768	\$10,041,520	\$48,937,284
2035	\$11,277,432	\$2,169,783	\$27,040,993	\$10,041,520	\$50,529,727
2036	\$11,209,840	\$2,022,401	\$28,894,123	\$10,041,520	\$52,167,883
2037	\$11,156,508	\$1,878,755	\$30,768,508	\$10,041,520	\$53,845,291
2038	\$11,119,975	\$1,739,150	\$32,661,937	\$10,041,520	\$55,562,582
2039	\$11,098,827	\$1,603,886	\$34,581,534	\$10,041,520	\$57,325,767
2040	\$11,092,064	\$1,476,235	\$36,527,202	\$10,041,520	\$59,137,020
2041	\$11,098,747	\$1,353,437	\$38,502,949	\$10,041,520	\$60,996,652
2042	\$9,586,610	\$1,233,641	\$40,517,379	\$10,041,520	\$61,379,151
2043	\$10,929,197	\$1,119,483	\$42,572,272	\$10,041,520	\$64,662,471
2044	\$9,800,261	\$812,134	\$44,832,454	\$10,041,520	\$65,486,368
Total	\$429,385,995	\$46,740,770	\$527,975,397	\$200,830,392	\$1,204,932,555
NPV @ 5%	\$306,587,813	\$32,353,894	\$291,841,752	\$125,139,529	\$755,922,988

Migration Assumptions

- 90% non-vested migration of current RRS DC plan members to VRS
- 10% of vested RRS DC members to VRS
- 25% non-vested RRS DB members to VRS
- 10% vested RRS DB members to VRS
- Based on RRS FY 2022
 Valuation Report



Expected costs and savings are based on RRS' 2023 valuation report

PROPOSED FINANCIAL STRATEGIES

- Strategy 1: Increase RRS actuarial funded status (City Code Section 12-265.1.(b)-(d))
 - o It is the city's policy that the RRS ADC shall be funded in each fiscal year.
 - o It is the city's policy that the RRS actuarial funded status shall be at least 80 percent in each fiscal year.
 - It is the city's long-term goal that the RRS actuarial funded status shall be 100 percent.
- Strategy 2: Changes to RRS benefits (City Code Section 12-265.1.(e))
 - Additions only if RRS funding ratio at or above the 85 percent level
 - Conduct fiscal impact analysis of potential changes prior to approval of benefits
 - Pay for changes upfront to not impact the actuarial funded status of RRS (i.e.: do not spread-out additional cost)
- Strategy 3: Establish reserve account (City Code Section 12-265.1.(f)-(g))
 - Invest savings achieved from the transition and corresponding issuance of the POBs
 - o Issue additional POBs as needed when there is a more favorable interest rate climate
 - Invest funds such that it allows the city to support RRS funded status when it falls below the established minimum threshold of 80 percent

ISSUING POB DOES NOT NEGATIVELY IMPACT OUR CREDIT RATING

- The impact of the POBs and the increase in funded status have been modeled in estimates of Moody's new scorecard
- Transitioning to VRS with POBs effectively results in no material change
- The impact in the Fixed Costs Ratio is de minimis, as the debt liability is substituted for POBs for pension liability

	% of total	Richmond (Current)	Richmond (With POBs)
Economy (30%)			
Resident Income (%)	10%	81.1%	81.1%
Full Value Per Capita	10%	154,384	154,384
Economic Growth (%)	10%	-0.3%	-0.3%
Financial Performance (30%)			
Available Fund Balance Ratio (%)	20%	37.6%	37.6%
Liquidity Ratio (%)	10%	52.8%	52.8%
Institutional Framework (10%)			
Institutional Framework	10%	Aa	Aa
Leverage (30%)			
Long-Term Liability Ratio (%)	20%	204.8%	204.8%
Fixed Costs Ratio (%)	10%	13.8%	13.7%
Raw Score		3.19	3.18
Unadjusted Rating		Aa2	Aa2



Aaa Range0.50-1.50Aa1 Range1.50-2.50Aa2 Range2.50-3.50Aa3 Range3.50-4.50

Section 4: Consideration of Papers

Current Plan Changes



DB/DC PLAN EMPLOYEE BASE EMPLOYEE **CONTRIBUTION ALIGNMENT**

Current

Change To

DB Plan

Employee and Employer Contribution

General = 1% + ADC

Sworn = 1.5% + ADC

Employer Contribution Only

DC Plan

<5 years = 5.00%5 - 9 years = 6.00%10 - 14 years = 8.00%15 + years = 10.00%

Employee and Employer Contribution

General = 5.00 + ADCSworn = 5.00 + ADC

Employee and Employer contribution

> - 9 years = EE: 5.00% + ER: 1.00% = 6.00% 10 - 14 years = EE: 5.00% + EE: 3.00% = 8.00%15+ years = EE: 5.00% + ER: 5.00% = 10.00%



INCREASE ALL CITY EMPLOYEE SALARIES NEW CONTRIBUTION AMOUNT + GROSS UP

- Regardless of the decision to transition to VRS, create equity in member contributions
- Adjust salaries to cover the increased contribution and associated costs
 - Currently, DB plan members pay a base of 1.00% or 1.50% and DC members pay 0.00%
 - o Employees would contribute 5.00% base contribution to retirement
 - Additional percentage included in pay to cover retirement contribution and FICA tax costs



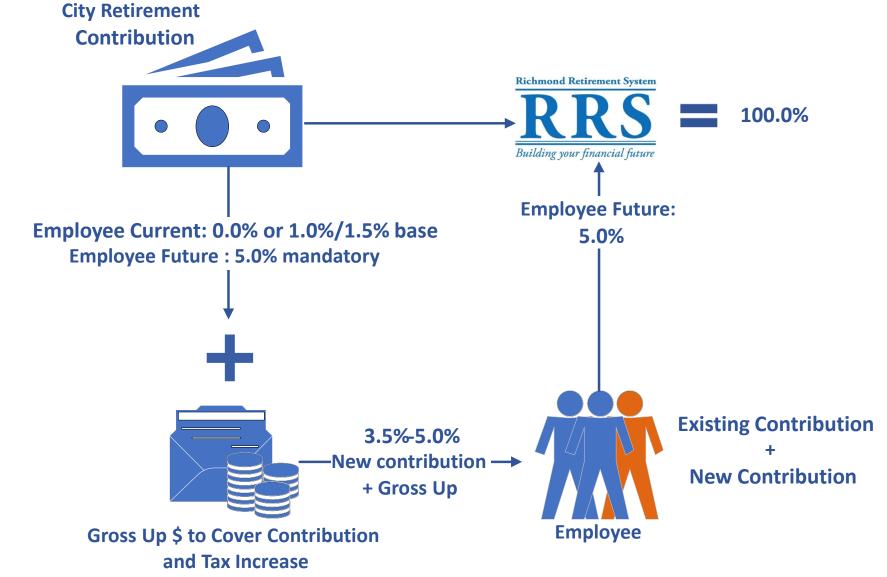
HOW WILL THE CITY SUPPORT THE CURRENT EMPLOYEE INCREASE IN CONTRIBUTIONS?

- Currently, the city funds the retirement system through the ADC and DC contributions
- Move a portion of that payment to the employee's salary
- "Gross up" the salary to negate the FICA tax impact
- Employees pay a 5.0% contribution to RRS
- Gross up amount would be a new cost for the city
- Additional FY 2024 cost is anticipated to be: \$1.3 million



Illustration Only

COMMITMENT TO PERSONAL INVESTMENT





RETIREMENT CONTRIBUTION IMPACTS

Employee Retirement Contribution and Salary Adjustment

Employee	Current Employee Contribution	Proposed Employee Contribution	Employee Salary Impact
DB General	1.00%	5.00%	4.58%
DB Sworn	1.50%	5.00%	4.01%
DC All	0.00%	5.00%	5.72%



llustration Only

ADJUSTMENT COVERS COST INCREASE

DB General Employee New Contribution Scenario

Employee Impact	Current	Revised (4.58%)
Base Salary	\$50,000	\$52,290
FICA	\$3,825	\$4,000
Current 1% Retirement	\$500	\$523
New Employee Contribution (+4%)	\$0	\$2,092
Total after FICA taxes	\$45,675	\$45,675

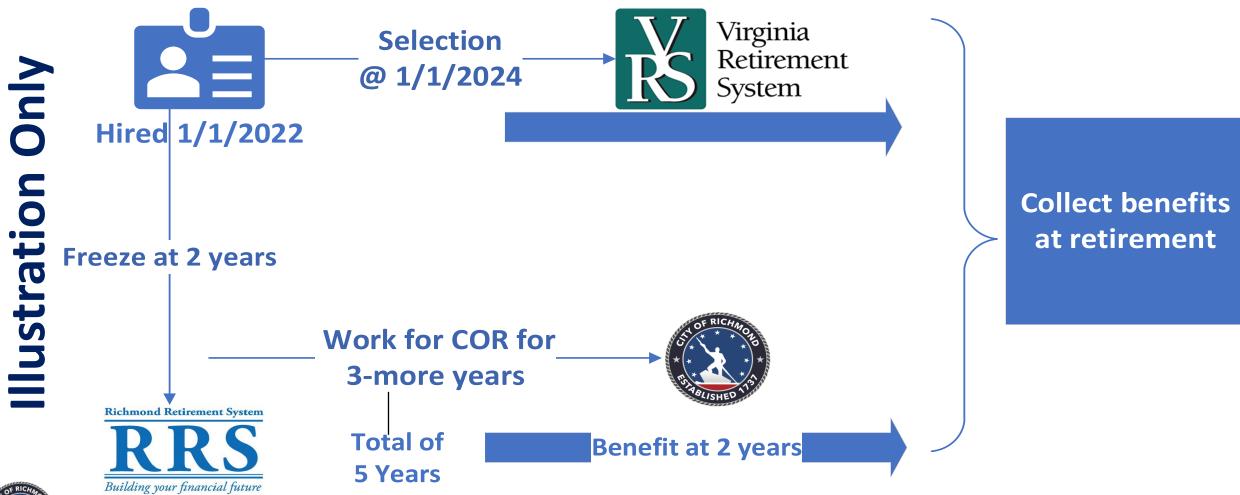


ADDRESSING THE NON-VESTED DC PLAN MEMBERS CHOOSING TO MOVE TO VRS

- DC plan non-vested RRS members choosing to move to VRS will start from day 1. It is recommended to:
 - o Freeze the benefits at the time of for employees choosing to transition
 - Require employees to work for the city for the remainder of the five years to receive benefits at retirement
- Freezing these employees in RRS with a 5-year requirement allows them to:
 - Benefit from the time spent working for the city
 - Move to VRS without feeling like they lost years
 - Achieve equity with other employees who had worked five years to receive RRS benefits
 - These employees are not eligible to purchase Richmond years of service with VRS



HOW FREEZING THE NON-VESTED DC PLAN MEMBERS IN RRS WILL WORK

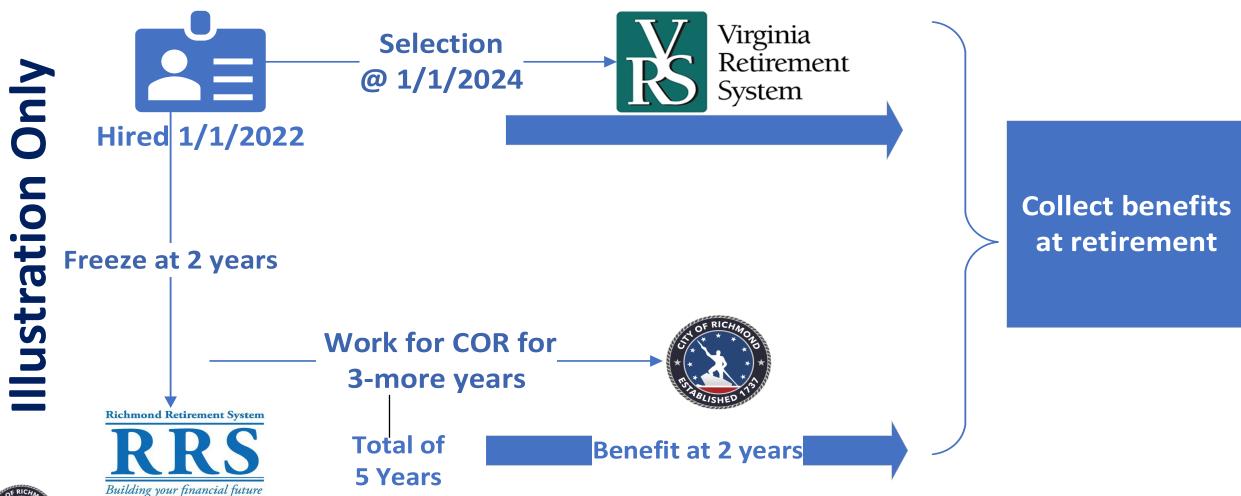


ADDRESSING THE CURRENT NON-VESTED DB PLAN MEMBERS CHOOSING TO MOVE TO VRS

- A trustee-to-trustee transfer will be made for DB plan non-vested RRS members
- Transferred member contributions will be used to buy service time under VRS general purchase of prior service rules
- May not be a 1:1 purchase of time



OR NON-VESTED DB PLAN MEMBERS CAN CHOSE THE FREEZE OPTION



Part 5: Conclusion

TIMELINE OF TRANSITIONING TO VRS



Close RRS to new employees as of December 31, 2023

2. VRS Begins

January 1, 2024

3. Current employees have until

December 31, 2024, to choose



INFORMATION SESSIONS BEFORE JANUARY 1

- Pre-transition informational sessions held with:
 - City Council Members, Mayor, and Chief Administrative Officer Department directors, deputies, and select staff
 - Nine information sessions for over <u>1,100 employees</u>
 - Representatives from council appointee offices
- Post-transition informational sessions:
 - 18 VRS/RRS educational sessions scheduled
 - o Begins October 19 December 31, 2023
- One-on-one counseling sessions will be offered by VRS, RRS, and Mission Square.



TIMELINE FOR IMPLEMENTATION

10/19/23 @ 1 p.m.

Finance and Economic **Development Committee**

12/30/23

First pay period effective for contribution changes











11/6/23 @ 6 p.m.

City Council Formal Session

Consideration of VRS **Transition Papers**



Current employees who have chosen to transition and new employees will begin in VRS



DISCUSSION