

TO: Board of Trustees for the
Police and Fire Retirement Plan

FROM: Prabhu Palani

SUBJECT: Annual Pre-funding Contributions by the City

DATE: March 18, 2026

RECOMMENDATION

Discussion and action on the City's prefunding option for fiscal year 2026-27:

Staff recommends reducing the pre-funding discount rate offered to the sponsor by 30% to 4.6375%

ANALYSIS

In 2015, the Plans' legal counsel opined that while the Municipal Code reserves the exclusive right for the City to elect to pre-fund its contributions, the Boards have the discretion to determine the "actuarial equivalence" when calculating the pre-funding amount ("Board Discretion Regarding the Discount Rate Used for Determining Actuarial Equivalence of the City's Pre-Funding Option," April 20, 2015).

In 2015, staff began utilizing an incremental reduction approach to determining "actuarial equivalence" predicated on the average duration of business expansions and the absolute returns of broad indices ("Prefunding Risk Mitigation Process Recommendation," September 15th, 2015). At the February 22, 2022 Investment Committee meeting for each Plan, Staff recommended (and the ICs approved) modifying the existing methodology by adding equity valuations as an additional triggering metric for incrementally reducing the pre-funding discount rate ("Staff Recommendation to update Prefunding Discount Rate Calculation," February 22, 2022).

Three of the triggers for reducing the discount rate have been activated for FY 2026-27:

- the equity valuations trigger (CAPE ratio more than two standard deviations above the long-term mean),
- the business cycle trigger (more than 58 months since the last business cycle trough),
- and the performance since the most recent S&P 500 trough (>130% since the last S&P 500 trough).

The triggers imply that the pre-funding discount rate should be reduced by an incremental 15%; this is the second year in which at least one trigger was activated. The full discount rate is 6.625%. Last year, a 15% reduction resulted in a proposed pre-funding discount rate of 5.63125%. A further 15% reduction implies a pre-funding discount rate of 4.6375%.

If any of the three indicators is similarly triggered next year, an additional 15% reduction would be recommended; alternatively, the absence of any trigger would result in a recommendation of extending the full discount rate to the sponsor.

CONCLUSION

Staff recommends reducing the pre-funding discount rate offered to the sponsor by a total of 30% from 6.625% to 4.6375%



Prabhu Palani
Chief Investment Officer