MEMORANDUM

Date:	June 6, 2024
To:	Honorable Mayor and Commissioners
Via:	Albert P. Childress City Manager APC
From:	Christina Bervaldi Director of Finance
Subject:	**24-5995 Proposed Ordinance to Extend the DROP Participation Period for General Employees' Pension Plan**

Introduction

The City Commission has been asked to approve an Ordinance amending Chapter 46, Sections 113 of the Code of Ordinances for members of the General Employees' Retirement Plan to extend the DROP participation period from five years to eight years. While the City is not opposed to this Ordinance, there are still many unknown implications to its passing, which are included in this document.

Background

A request has been made to extend the current Deferred Retirement Option Plan ("DROP") participation period from five years to eight years and to extend the maximum amount of time for a plan participant to be employed by the City of Key West from 30 years to 33 years.

The DROP allows current General Employees to keep working and simultaneously accumulate pension benefits. In other words, the DROP provides its participants to earn two incomes at the same time, with the individuals' pension income being saved and invested. The DROP program represents a method for providing for the deferred receipt of retirement benefits while continuing employment with the City.

When a City employee elects to enter the DROP, their monthly benefits are calculated at that time based on their service years. This monthly benefit is then deposited into an account for the member's benefit and is invested as part of the Plan. The member's investment account shall earn or lose interest based on the actual earnings of the overall Plan. In addition, once the member elects to enter the DROP, they no longer contribute to the Plan.

Once a DROP participant separates employment with the City, the member receives the proceeds from their DROP account and also begins to receive their monthly pension on the first day of the month following their separation.

Per Government Finance Officers Association (GFOA), "the cost impact of a DROP is difficult to assess…testing the cost impact of a proposed or implemented DROP requires making assumptions about when members would have retired without the DROP. Such assumptions cannot be tested by experience because the presence or absence of DROP impacts the real-world retirement decisions employees make. How a DROP impacts retirement patterns may be difficult to accurately assess. Therefore, claims that a specific DROP is "cost neutral" or will not increase the employer's cost of funding the pension plan should be viewed with caution because in many well documented instances, costs have been substantially higher then anticipated for the sponsoring governments. In addition to the cost impact of on the pension plan, if the DROP results in increased retention of experienced employees, higher salary and benefit costs should also be expected."

At a General Employees' Pension Board meeting at the end of 2023/beginning of 2024, a member of City staff, who is enrolled in the DROP program, requested that the Board consider increasing the DROP participation period similar to what the Florida Retirement System had implemented. As a result of this request, at the May 10, 2024 meeting of the General Employees' Pension Board, an action item was on the agenda proposing an Ordinance change to increase the DROP participation period from 5 years to 8 years. The Board had a discussion on the item and the vote failed 4-1.

The discussion included both potential advantages and potential disadvantages to the proposal.

Possible advantages include:

- A means to provide a larger lump sum distribution of a portion of the employees' interest in the retirement plan.
- Valuable, long-term service employees may delay retirement for a longer period of time.
- May be able to better plan for replacement of long service employees with a longer period of time.

Possible disadvantages:

- Pay and service increases during the potentially longer DROP period are not reflected in the monthly benefit at retirement.
- By taking a larger lump sum, the employee's future pension payments will represent a lower percent of final average salary, producing a lower income replacement ratio.
- It is difficult to design a popular truly cost-neutral DROP extension (there will be varying gains or losses for each member who chooses the DROP longer).

Also at the meeting Board Council, Stuart Kaufman, was asked how many General Employees' Pension Plans which are represented by his firm have made the transition to a longer DROP participation period. His response was that although several of his Public Safety Pension Plan clients have made the transition from a 5 Year DROP participation period to an 8 Year DROP participation period, he has not yet had a General Employee Pension Plan complete the transition. Mr. Kaufman currently represents 40 General Employee plans.

Procurement

While the Police Officer and Firefighter Pension Plan actuarial impact statement provided by the Plan actuary stated that there was no cost to the Plan, the City has not received an actuarial impact statement on the proposed DROP period extension for the General Employees' Pension Plan.

Per Florida Statute, Chapter 112, no local government shall agree to a proposed change in retirement benefits unless the administrator of the system, prior to the adoption of the change by the governing body, and prior to the last public hearing, has issued a statement of the actuarial impact of the proposed change upon the local retirement system. The City will either need to engage an actuary to provide an actuarial impact statement or have the General Employees' Pension Board provide this statement.

Recommendation

Many of the concerns with the increase to the Police Officers and Firefighters Retirement Pension Board DROP participation period are also applicable to the increase of the DROP participation period of the General Employees' Pension Plan.

- What is the effect to the City's required contribution if members elect to enter the DROP and remain for the entire 8-year period? This change could potentially increase the number of non-contributing members in the Plan at any given time, therefore, the contribution needed from the City could increase exponentially.
- The change could potentially slow upward mobility for younger professionals.
- The City is currently conducting a salary study. While the current members of the DROP would not be affected, this will also potentially increase the City's required contribution to the General Employees' Pension Plan, therefore compounding the unknown financial impact.
- Extending the DROP may alter the future retirement experience of the Plan. Experience studies may change in the future and need to be monitored.

The City Manager's Office recommends the City Commission postpone the approval of the extension of the DROP period for the General Employees' Pension Plan until such time as there is more experience data for municipalities with defined benefit plans which have adopted this change.