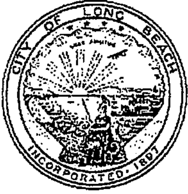

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City of Long Beach
Working Together to Serve

Memorandum

Date: May 18, 2010

To: Patrick H. West, City Manager

From: Lori Ann Farrell, Director of Financial Management/CFO

For: Mayor and Members of the City Council

Subject: **Responses to Questions from the April 20, 2010 Pension Study Session Part II**

Below are responses to the questions raised by members of the City Council during the Pension Study Session Part II on April 20, 2010. This memo provides responses to questions that were not answered on the floor.

1. **What is the savings to the City from not reporting the Employer Paid Member Contribution (EPMC) or the employer pick-up of the employee share to PERS?**

   If the City continued to pick up a portion of the Employee Share but not report this to PERS as additional PERSable compensation, the savings to the City would be approximately $4.8 million in All Funds and $2.8 million in General Fund in FY 11. The additional cost for reporting EPMC is 1.687 percent of payroll for Safety and 1.056 percent of payroll for Miscellaneous.

2. **What are the high, low and average pension numbers for the City's retirees broken out by Safety and Miscellaneous?**

   The following figures are as of June 30, 2008, the most recent actuarial valuation from PERS.

Annual Pensions

	Low	Average	High
Miscellaneous	$ 0.96	$21,997	$194,320
Safety	$49.56	$49,205	$177,316

3. **In 1995, what was the background and reason for such a large projected unfunded liability, leading the City to issue Pension Obligation Bonds?**

   During the 1990s, PERS rates were volatile every year – increasing or decreasing significantly depending on PERS' market earnings. In 1994, the

City was notified of an increase in its annual PERS costs due to PERS market losses, creating a $6 million General Fund deficit in the FY 95 Proposed Budget.

In the wake of the unexpected PERS rate increase, the City formed a state-wide coalition that succeeded in getting PERS to freeze pension rate changes for a year in order to fix the problem of unforeseen rate increases. Eventually, over the next 10 years, a modified rate-smoothing methodology was established so that cities would not be burdened with significant increases or decreases in rates on a yearly basis, depending on the annual PERS investment rate of return.

In the meantime, however, the City opted to bring down the City's annual rates through Pension Obligation Bonds (POBs). The idea was that if the City could issue debt to pay down a portion of the unfunded accrued actuarial liability with proceeds from the POBs, the City could stabilize future rate increases and be better able to budget for pension payments to PERS. This led to the $108.6 million issuance of the 1995 POBs.

4. **With recent gains in PERS portfolio earnings since 2009, will the costs to the City from 2009 market losses be lowered? When will the City see a reduction in its pension costs from any recovery in PERS earnings?**

At the end of FY 09, there was an approximately $110 billion funding shortfall on estimated pension liabilities at PERS of $288 billion. This was the result of a two-year loss totaling 45.4 percent (12.85 percent in 2008 and 32.55 percent in 2009). From this deficit position, current year's gains are estimated at approximately 18.6 percent, or only 10.85 percent more than the standard already assumed annual earnings of 7.75 percent.

As a result of the gains so far in FY 10, PERS has recovered approximately $12 billion of the shortfall. However, this still leaves a projected $98 billion shortfall that will need to be recouped with a combination of investment gains *that are greater than 7.75 percent* and/or additional local government agency contributions. Please note that in order for rates and costs to remain stable, the portfolio must achieve at least a 7.75 percent return each year. Investment returns less than 7.75 percent will likely lead to increased PERS rates and costs, as it results in an actuarial loss to the plan. Hence, even when the stock and bond markets enjoy positive gains, if the gains do not exceed 7.75 percent, they will not help to address the losses the plan incurred in FY 08 and FY 09.

In the past PERS estimated that investment earnings would contribute a significantly larger portion of pension liabilities, leaving a much smaller portion to be recovered through local agencies' contributions. The severity of

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FY 09 PERS losses, however, has shifted a much larger portion of the pension liability costs from investment earnings to employer and employee contributions.

Therefore, the gains from the current year will help to contribute to the plan's funded status, which has declined from 100 percent to 55 percent as of FY 09. However, many more years of PERS investment performance at the same 18.6 percent rate of return—assuming no negotiated salary increases statewide, no changes in longevity (retiree lifespan), and no additional retirees—are required to recoup the remaining $98 billion without increases in local government contribution rates. Given the unlikelihood of these cost and investment return assumptions, it is unlikely that PERS costs will decline in the near future.

5. **What is the annual value of projected pension costs that are estimated at 13.1 percent of the General Fund in FY 10 and 17.6 percent in FY 14?**

   If pension costs are 13.1 percent of the General Fund in FY 10 and 17.6 percent in FY 11, this correlates to a $50.1 million impact in FY 10 and $81.7 in FY 14.

6. **Considering that other cities may be paying a higher percentage of payroll for their PERS and retirement benefits, does this make Long Beach's retirement plan sustainable?**

   The sustainability of the City's pension plan is not based at all on the sustainability or lack thereof of any other cities' plan. Each local government's plan has its own liabilities and funded status that drives its future costs, in addition to PERS' investment performance. Evaluating the rate of cost growth of the plan is a strong indicator of sustainability in addition to the percentage of payroll it is consuming. The most important gauge of sustainability is whether the City's retirement costs are outpacing the City's rate of revenue growth and ability to pay. The more the costs grow at a rate that exceeds the City's ability to pay, the more unsustainable retirement benefits will become.

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ATTACHMENT C

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Date: May 12, 2010
Reference No.:
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Circular Letter

TO: PUBLIC AGENCIES

SUBJECT: **ACTUARIAL EXPERIENCE STUDY**

This circular letter is intended to provide you with information about recent changes in the actuarial assumptions and the impact this will have on employer contribution rates.

At its meeting on April 20, 2010, the CalPERS' Board of Administration adopted updated actuarial assumptions based on a recently completed experience study. This Board action will affect the employer contributions rates beginning in fiscal year 2011-2012. Generally, employer contributions rates will increase as a result of this actuarial assumption change.

Background

An experience study measures actual plan demographic experience over a defined period of time. An experience study is used to refine and improve actuarial assumptions used in future actuarial valuations. This recently completed experience study presents the results of the (demographic) experience study on the California Public Employees Retirement System using data from 1997 to 2007. It focused on patterns of termination, death, disability, retirement and salary increases.

The last study was completed in May 2004. This experience study was originally scheduled to be completed in the summer of 2009 but was delayed in part due to the mandatory furloughs that were imposed on CalPERS employees.

The majority of the liabilities of a retirement system such as CalPERS are in the retirement benefits. Other sources of liability include benefits related to death, disability and employment termination. Assumptions that affect retirement benefits will have a larger impact on employer contribution rates than assumptions that only affect death, disability or termination benefits. Since retirement rates, salary increases and post-retirement mortality all affect the valuation of retirement benefits, these assumptions generally have a much greater impact on contribution rates than do other assumptions.

Discussion

The new demographic assumptions adopted by the Board will be substantially better at predicting future experience than the current assumptions and will result in more secure retirement benefits.

This experience study is the first one in which we were able to collect data for the most recent enacted retirement formulas available for public agency miscellaneous members (2.5% @ 55, 2.7% @ 55 and 3% @ 60). Prior to this study, the current assumptions were extrapolated from data under another formula and were based on age only. We moved to an age and service based retirement assumption for these formulas similar to all of the other retirement formulas. This change should more accurately predict future retirements.

Results

The new assumptions have the following estimated impacts on local public agency employers:

- An average increase of 0.4% of payroll in the employer contribution rates for public agency miscellaneous plans covered under either the 2% at age 60 or 2% at age 55 formula.
- An average increase ranging between 1.1% to 1.7% of payroll in the employer contribution rates for public agency miscellaneous plans covered under the 2.5% @ 55, the 2.7% @ 55 or the 3% @ 60 formulas (based on a small sample of plans).
- An average increase ranging between 1% and 2% of payroll in the employer contribution rates for public agency safety plans (based on a small sample of plans).

The new assumptions predict:

- Longer post-retirement life expectancy. The life expectancy of males is increasing on average by a full year while it is increasing on average by about 0.3 years for female.
- Slightly earlier retirement ages overall for all State plans, the Schools pool and local agency miscellaneous members while they produce slightly higher retirement ages on average for local agency safety members.
- Higher salary increases for members with longer service.
- Mixed results for other assumptions (these are described in detail in the experience study report).

The assumptions causing the biggest impact on employer rates for all plans are the assumptions for post-retirement mortality, service retirement and salary increases. Of these, the one assumption causing the biggest increase in rate for all plans is the

proposed change in post-retirement mortality. Since the life expectancy of male members continues to increase at a faster pace than female members, safety plans, which tend to have a much higher proportion of male members, are affected more by this change than miscellaneous plans. The impact from the change in post-retirement mortality alone is causing employer rates for miscellaneous groups to increase by about 0.6% to 1% of payroll, while causing the employer rates for safety plans to go up by about 1% to 1.8% of payroll.

This new experience study provided a basis to establish and apply age and service based retirement assumptions to the 2.5% @ 55, 2.7% @ 55 or the 3% @ 60 formulas. Previous experience studies had already applied age and service based retirement assumptions to other retirement benefit formulas. The age and service based retirement assumptions predict the timing and cost of future retirements more accurately. In this case, the experience study revealed that members in these formula groups (miscellaneous 2.5% @ 55, 2.7% @ 55 or the 3% @ 60 formulas) with higher credited service were more likely to retire than was previously known. This result also added to the employer contribution rate increase.

The measured impact for public agencies will be known when the Actuarial Office has completed the June 30, 2009 actuarial valuations for all employers in the fall of 2010. The June 30, 2009 actuarial valuations will set the employer contribution rates that take effect on July, 1 2011.

If you have any questions, please contact the Employer Contact Center at **888 CalPERS** (or **888**-225-7377).

ALAN MILLIGAN
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Actuarial & Employer Services Branch