CITY OF LONG BEACH

CalPERS and Other Unfunded Liabilities

Budget Oversight Committee | July 29, 2020

CALPERS COST AND VOLATILTY

No asset smoothing - increased volatility and contributions (2013, effective FY 16)

- Value of portfolio no longer smoothed over time

Assumption changes - increased contributions (2014, effective FY 17)

- Updated demographic assumptions, e.g., mortality

Reduce expected earnings (discount rate) – increased contributions (2016, effective FY 19)

- Expected investment earning lowered from 7.5% to 7%. 7% may also be too high for next 10 years

Amortization change - increased volatility and contributions (2018, effective FY 22)

- Gains/losses recognized over 20 years instead of 30. More volatility and likely higher costs in early years

Risk Mitigation Strategy – will increase contributions and lower volatility (2016, effective FY 21)

- More conservative investments and associated reduced earnings assumption (to 6%) over time

These changes are all intended to improve the financial soundness of the CalPERS pension plan

CALPERS PENSION REFORM IMPLEMENTED

- **2012: Employee contribution rate increase** (PERS pick up) – From 2% of pay to 8% for Misc and 9% for Safety
  - Saved $13.8 million per year in the General Fund ($24.7 million in All Funds)

- **2012: Public Employees' Pension Reform Act (PEPRA)** – 2% @ 62 for Misc / 2.7% @ 57 for Safety
  - Previously, new employees received 2.5% @ 55 for Misc and 3% @ 50 for Safety

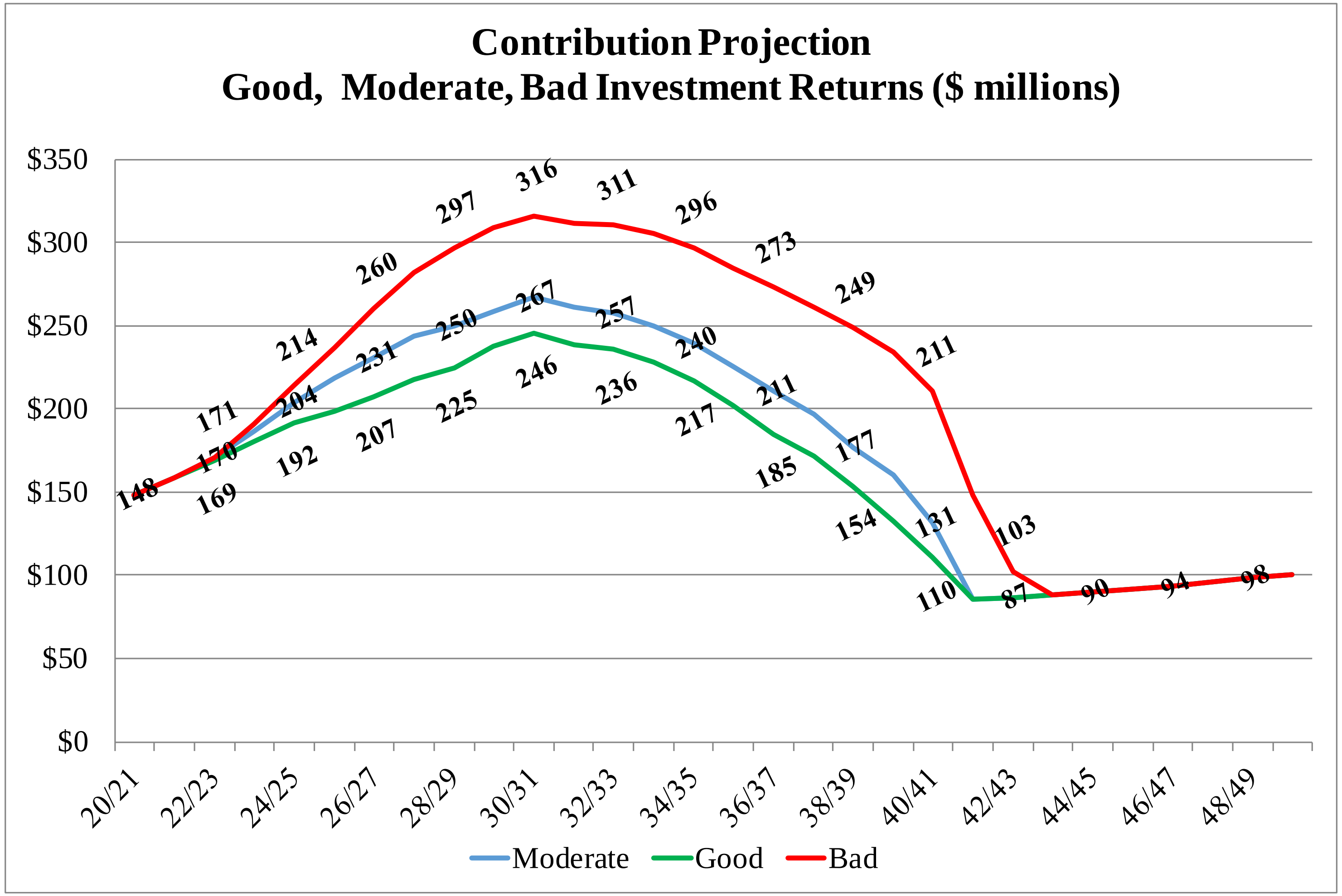
- **2014: City's Stabilization Fund –** Established in 2014 to smooth volatile CalPERS contributions
  - Discontinued due to CalPERS risk mitigation changes that make it unlikely it could be funded in the future

- **2017 Early unfunded liability payment to CalPERS –** Beginning in FY 18 – saved $1.7 million General Fund
  - Discontinued for FY 21 over cash flow concerns and potential investment losses from early contributions

ANNUAL COSTS

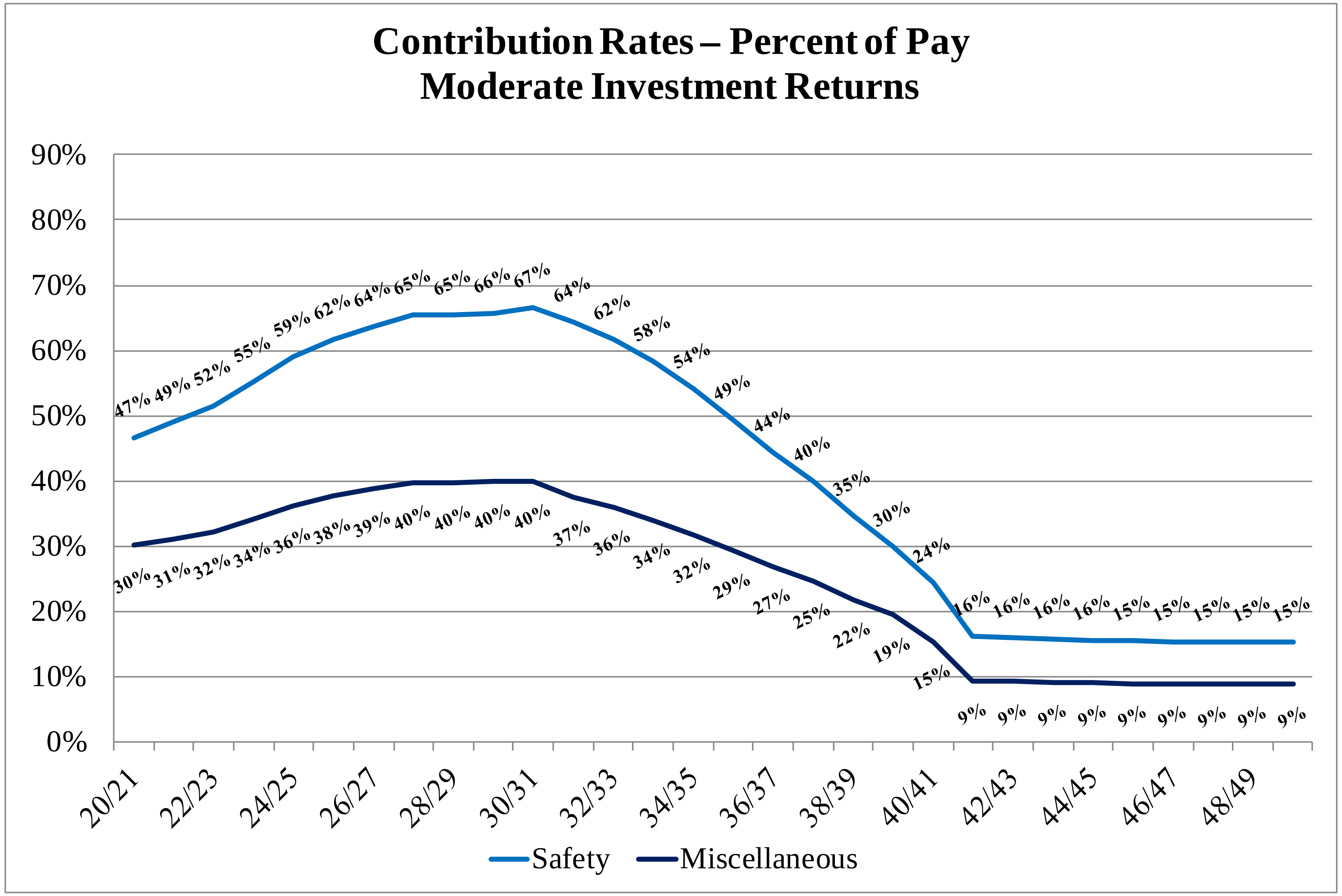
- Contributions are expected to eventually eliminate the unfunded liability
- Assuming current 7% returns with risk mitigation - fully funded in about 20-25 years
- Contributions projected to peak in FY 31
- Investment returns greatly impact contributions

Assumed CalPERS Investment Returns			
	Good	Moderate	Bad
FY 20	4.5%	4.5%	4.5%
FY 21	4.0%	0.0%	-3.0%
FY 22	10.0%	5.0%	3.0%
FY 23	7.0%	12.0%	6.0%
Future	7.0%	7.0%	7.0%



CONTRIBUTION RATES – SAFTEY and MISC

- Employee and employer contributions were originally intended to be the same
- Classic employees share od 8% of pay for Misc, 9% for Fire, and 12% Police
- PEPRA employees pay ½ "normal" cost which does not currently cover ½ of costs (increasing unfunded liability)
- Employer contribution rates are currently 47% of pay for Safety and 30% for Misc. and going significantly higher



CONTRIBUTION RATES – VOLATILE

- CalPERS contribution formula changes have made city contributions in any year highly volatile and sensitive to investment earnings from 3 years earlier
- Chart shows impact of just four years of varied performance

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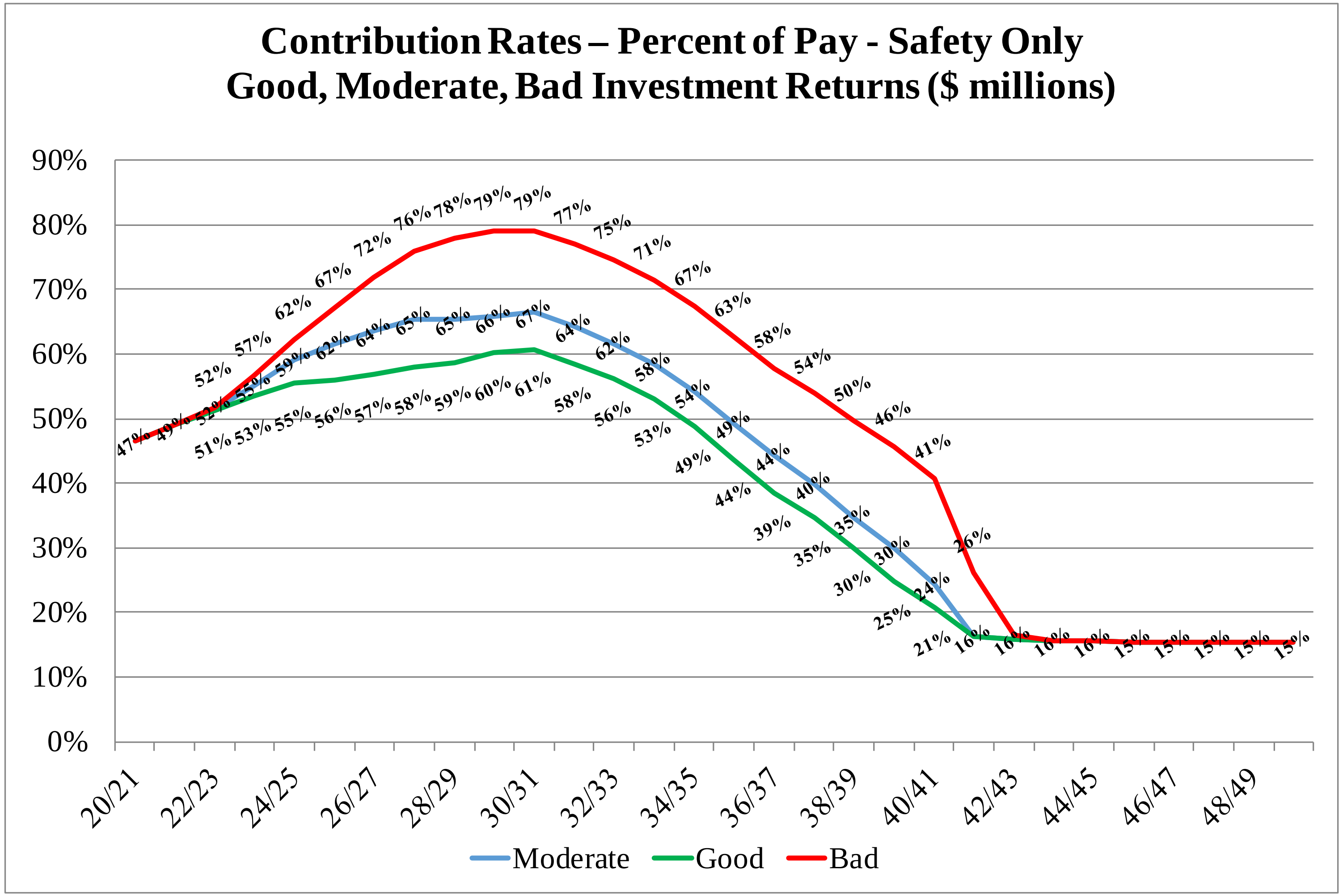

INVESTMENT VOLATILITY – 1 YEAR IMPACT

- The CalPERS policy changes will help pension plan funding but make the city contributions much more variable based on earnings from three years or more years past.
- Chart shows the impact on contributions for just a one-year (FY 20) variance from 7% investment returns

CalPERS Contribution Change Depending on FY 20 Investment Return
All Other Years are 7% ($ in millions)

	0%	4.5%	7%	9.5%	14%
FY 22	1.9	0.6	0.0	(0.6)	(1.9)
FY 23	9.3	3.3	0.0	(3.3)	(9.3)
FY 24	16.7	6.0	0.0	(6.0)	(16.7)
FY 25	24.1	8.6	0.0	(8.6)	(24.1)
FY 26	31.6	11.3	0.0	(11.3)	(31.6)
FY 27	37.1	13.3	0.0	(13.3)	(37.1)
FY 28	37.1	13.3	0.0	(13.3)	(37.1)
FY 29	37.1	13.3	0.0	(13.3)	(37.1)
FY 30	37.1	13.3	0.0	(13.3)	(37.1)

INVESTMENT VOLATILITY – 2 YEAR IMPACT

- The impact on contributions of yearly investment returns differing from 7% is “layered” on each other
- Good and bad years tend to offset each other
- Consistently good or bad years rapidly compound
- Chart show the impact on contributions from just a two year (FY 20/FY 21) variance from 7% investment returns

CalPERS Contributions Change Depending on FY 20/FY 21 Investment Returns All Other Years are 7% ($ in millions)

	4.5%/4%	4.5%/7%	4.5%/10%
FY 22	0.6	0.6	0.6
FY 23	4.1	3.3	2.5
FY 24	10.1	6.0	1.8
FY 25	16.1	8.6	1.1
FY 26	22.1	11.3	0.5
FY 27	27.4	13.3	(0.9)
FY 28	29.9	13.3	(3.4)
FY 29	29.9	13.3	(3.4)
FY 30	29.9	13.3	(3.4)

INVESTMENT VOLATILITY – 6% IMPACT

- The likely overstated assumption by CalPERS on investment returns (7%) will have a big impact
- This chart only has 6% investment returns through FY 24 and 7% thereafter – that why numbers stabilize
- Contribution change would continue to grow if investments returns stayed at 6%
- CalPERS risk mitigation strategy will help if implemented, but it is slow

CalPERS Contributions Change Assuming Multiple 7% or 6% Returns ($ in millions)

	4.5% FY 20 7% thereafter	4.5% FY 20 6% thereafter
FY 22	0.6	0.6
FY 23	3.3	3.6
FY 24	6.0	7.6
FY 25	8.6	12.9
FY 26	11.3	19.4
FY 27	13.3	26.2
FY 28	13.3	30.8
FY 29	13.3	34.3
FY 30	13.3	36.5

OTHER UNFUNDED LIABILITIES

- Pension unfunded liabilities may increase or stay the same in the short-term, but will start a decline in the mid 2030s (if assumptions are correct)
- Progress not being made on reducing other unfunded liabilities. The primary goal should be to not increase unfunded liability
- General liability insurance and oil abandonment are of particular concern and need to be monitored

Key Unfunded Liabilities

($ in millions)

	Unfunded Amount		
	FY 17	**FY 18**	**FY 19**
Employee Benefits			
Pension (CalPERS)	(1,186)	(1,056)	(1,125)
Sick Leave	(113)	(116)	(107)
Retiree Health Subsidy	(50)	(52)	(23)
Worker's Compensation	(94)	(100)	(104)
Total Employee Benefits	(1,443)	(1,324)	(1,359)
Other Unfunded Liabilities			
General Liability	(2)	(12)	(38)
Oil Abandonment (two funds)	(107)	(99)	(98)
Total Other Unfunded Liabilities	(109)	(111)	(136)
Grand Total	(1,552)	(1,434)	(1,495)

Sick Leave/Retiree health Subsidy FY 19 change reflects a recalculation of unfunded amounts

WHERE ARE WE HEADED?

- CalPERS contributions very uncertain if more than three years out. Seem more likely to be higher than expected. Significant variability is very likely
- CalPERS 7% earnings assumption is widely felt to be too high, especially in the short-term
- CalPERS overstatement of expected earnings reduces immediate city and PEPRA employee costs, but increases long-term costs and also results in PEPRA employees not paying their fair share as intended
- Eventually, pension costs will come down as long as CalPERS earnings assumptions are or become realistic, and assuming cities continue to pay the resulting costs
- Pension costs may be the biggest factor impacting ability to provide City services. PEPRA makes a difference – but is it enough
- OPEB liabilities are lower than in many cities, but reform could lower costs
- For liabilities other than pensions, Long Beach should avoid underfunding of the annual costs and minimize pushing costs to future. Pushing costs to the future also tends to reduce the city’s available cash and liquidity or allows infrastructure to deteriorate. These are national issues and problems