Closing the Pension Funding Gap

Dane Hutchings, Legislative Representative, League of California Cities
How the Fund Operates

- Pooled investments called the Public Employee Retirement Fund (PERF).
- All 3000+ employers money is pooled together and invested in a series of asset classes (e.g. Growth, equity, real estate, infrastructure etc.)
- BUT… each employer has their own independent pool with their own “funded level” (think Honeycomb).
- If one pool (Agency) is terminated, they move to the Terminated Agency Pool (TAP) fund and benefits may be reduced. (See LA Works)
- “Discount Rate” equals the Floor that CalPERS must earn. Anything below the employer must pick up the difference.
By The Numbers

- According to CalPERS:
  - In 2001 there were two active workers for every retiree.
  - In 2016 there were 1.3 active employees for every retiree.
  - It is projected that within the next 10-20 years there will be 0.6 workers for every retiree (CalPERS 2016 Annual Review of funding levels and Risk September 20, 2016).
How’d we get Here!?!?

January 1, 2000 — SB 400/ AB 616
Public Employees Retirement Benefits

- Immediate 5% increase for all current state and school retirees
- Eliminated second tier benefits, ensuring everyone has the top tier benefits
- Improved pension benefits:
  - 2.0% at 55 – State Miscellaneous and Industrial
  - 2.5% at 55 – State Safety
  - 3.0% at 55 – State Peace Officer/Firefighter
  - 3.0% at 50 – California Highway Patrol

The Silver Bullets

- Retroactivity Credit (e.g. Peace Officer retires Before 1999, average pension equals 62,218. Same Peace officer retires After 1999 pension is $96,270).
- Local Governments followed suit amidst recruitment challenges, CalPERS actuarial data and political climate (at the time).
2000-2001 — CalPERS takes significant hit due to the dot.com bubble
Fund drops below “Super Funded Status”

2008-2009 — The Great Recession Hits
The Fund loses 27% or $67 billion in value—drops to 61.00% funded status. True Impact is 34.75% loss [27 loss + 7.75 (discount rate) = 34.75% Loss]

2012 — PEPRA signed into law which established a new tier of employees with less generous benefits (Classic vs. PEPRA)—Does not modify “Classic” active formulas or retiree benefits.

Important Note: Agencies won’t feel significant impacts of PEPRA for 20+ years due to “classic” benefit payouts.
December 21, 2016 — CalPERS Board Takes Further Action.

- CalPERS Board moves to lower its discount rate from 7.5% to 7.00% over a phased in process (eight years in total).

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Fractions of Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>18-19</td>
<td>1/5 of 7.375</td>
</tr>
<tr>
<td>19-20</td>
<td>2/5 of 7.375 and 1/5 of 7.25</td>
</tr>
<tr>
<td>20-21</td>
<td>3/5 of 7.375, 2/5 of 7.25, 1/5 of 7.00</td>
</tr>
<tr>
<td>21-22</td>
<td>4/5 of 7.375, 3/5 of 7.25, 2/5 of 7.00</td>
</tr>
<tr>
<td>22-23</td>
<td>Full impact of 7.375, 4/5 Impact of 7.25, 3/5 impact of 7.00</td>
</tr>
<tr>
<td>23-24</td>
<td>Full Impact of 7.375, Full Impact of 7.25, 4/5 Impact of 7.00</td>
</tr>
<tr>
<td>24-25</td>
<td>Full impact of 7.375, full impact of 7.25, Full Impact 7.00</td>
</tr>
</tbody>
</table>
January 19, 2017 — CalPERS releases Circular Letter on Increased Contribution Rates

- Circular Letter (CL# 200-004-17) assists employers in calculating their increase contribution rates (30-40% unfunded liability increases)

<table>
<thead>
<tr>
<th>Valuation Date</th>
<th>FY Impact</th>
<th>Normal Cost</th>
<th></th>
<th>UAL Payments</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>6/30/2016</td>
<td>2018-19</td>
<td>0.25% - 0.75%</td>
<td>0.5% - 1.25%</td>
<td>2% - 3%</td>
<td>2% - 3%</td>
</tr>
<tr>
<td>6/30/2017</td>
<td>2019-20</td>
<td>0.5% - 1.5%</td>
<td>1.0% - 2.5%</td>
<td>4% - 6%</td>
<td>4% - 6%</td>
</tr>
<tr>
<td>6/30/2018</td>
<td>2020-21</td>
<td>1.0% - 3.0%</td>
<td>2.0% - 5.0%</td>
<td>10% - 15%</td>
<td>10% - 15%</td>
</tr>
<tr>
<td>6/30/2019</td>
<td>2021-22</td>
<td>1.0% - 3.0%</td>
<td>2.0% - 5.0%</td>
<td>15% - 20%</td>
<td>15% - 20%</td>
</tr>
<tr>
<td>6/30/2020</td>
<td>2022-23</td>
<td>1.0% - 3.0%</td>
<td>2.0% - 5.0%</td>
<td>20% - 25%</td>
<td>20% - 25%</td>
</tr>
<tr>
<td>6/30/2021</td>
<td>2023-24</td>
<td>1.0% - 3.0%</td>
<td>2.0% - 5.0%</td>
<td>25% - 30%</td>
<td>25% - 30%</td>
</tr>
<tr>
<td>6/30/2022</td>
<td>2024-25</td>
<td>1.0% - 3.0%</td>
<td>2.0% - 5.0%</td>
<td>30% - 40%</td>
<td>30% - 40%</td>
</tr>
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2016-17 — Current State of the Fund

- Fiscal year 2016-17 CalPERS Announced a **11.2% return** on Investment well above the assumed rate of return (discount rate) of **7.375% (State) 7.50 (Locals)**.
  - **Note: FY 15-16 return was 0.61% well below 7.5%**
- In 2016: 50 percent probability that Public Safety Contribution Rates exceed 60 percent of payroll. *(September Finance Committee Materials-Agenda Item 8c, Attachment 1)*

- Limited Fund Growth Despite Positive Market Trends: Seven years of positive economic growth yet the fund has only gained 7 percent in value *(2008: Approx 61% Funded. 2017: Approx. 68% funded after 11.2% was announced).*
Closing the Pension Funding Gap

*Political Landscape, Next Steps, Key Takeaways*
Political Realities

- Currently, very limited “political will” to address the problem in Sacramento.

- Pending Litigation Re: Vested Rights (Could take multiple years for a resolution).

- Politically charged issue with multiple stakeholders

- The Economy is Healthy… (For Now).

- November – December 2017: ALM Cycle will be completed and presented to the PERS Board.
The Keys...

- **Education**: Seek education opportunities through the League, continue to educate your area managers, council members etc. on the issues. (This includes attending monthly CalPERS Board meetings).

- **Collaboration**: Continue to work with stakeholders to find common ground on legislative policies to stabilize the pension system.

- **Communication**: Groundswell approach needed. What do these numbers mean for jobs, raises, services for your community? Encourage your locals to engage their State Reps.
  - Open a dialogue with the public, your councils, locals… Keep all stakeholders engaged and educated.
Major Takeaways: Ramp up Begins Now

- **Knowledge is Power**: Run your numbers and share
  - CMFO created a tool (as well as a tutorial on how to use it) that we are asking every city to use to calculate their UAL and Normal cost and then share that information with your stakeholders.

- **This will NOT be Easy, Utilize Best Practices**: The toughest decisions will be made locally. Each city will need to make their own decisions on how to use best practices to stabilize their budgets.
  - Identify New Sources of Revenue
  - Reduce Plan Benefits
  - Review Services and Staffing Models
  - Establish Rate Stabilization 115 Trust and/or UAL Pre-Payments

- **It’s not about how we got here… Its about how we fix it… together.**
  - The League has committed to CalPERS, the Administration and our employee partners to work together to address these challenges.