

12/11/18

5:00pm
Study Session
Item #3



**City of
Santa Clara**
The Center of What's Possible

Total Compensation Overview

Total Compensation generally consists of four primary elements:

1. Salary – compensation paid to an employee
2. Insurance – Medical, Dental, Vision, VEBA, Life Insurance
3. Retirement – CalPERS and Social Security
4. Other Benefits – Medicare, Employee Assistance Program (EAP), Long-term Disability

Note: May differ based on negotiated MOU

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Components of CalPERs Pension Costs

The minimum required employer contribution includes the sum of two components:

1. **Employer Normal Rate** – the annual cost for the fiscal year for active employees' pension. This is shown as a percentage of payroll and is paid as part of the payroll reporting process
 - FY 19/20 Safety Rate – 20.877%
 - FY 19/20 Miscellaneous Rate – 10.667%
2. **Employer Amortization of Unfunded Accrued Liability (UAL)** – a fixed dollar amount needed to fully fund past service credit earned by current and former employees. The UAL is billed monthly to the City or can be paid in a lump sum.
 - FY 19/20 Safety Cost – \$16.6 million
 - FY 19/20 Miscellaneous Cost - \$20.2 million

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Components of CalPERs Pension Costs

- **Employee Rate** – employee's share of pension costs
 - Safety Rate – 9%
 - Police Safety Classic members pay an additional cost sharing rate of 2.25%
 - Miscellaneous Rate – 8%
- **PEPRA** – California Public Employees' Pension Reform Act of 2013
 - FY 19/20 Safety Rate – 10.50%
 - FY 19/20 Miscellaneous Rate – 6.50%

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PERSable Wages

- Normal rate of pay
- Not all compensation is “PERSable” - generally excludes:
 - Overtime
 - Bonuses or one-time payments
 - Leave payouts

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Pension Trends

- Significant year over year increases of contribution rates both in the past and future
- Unfunded liability increasing
- Pension costs rising due to actuarial methodology changes, demographic assumption changes, de-risking policies
- CalPERS investment returns have large fluctuations

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Unfunded Accrued Liability (UAL)

- Cost of benefits provided by employer but not yet fully funded
- Current unfunded liability totals more than \$500 million
- Changes each year dependent on investment returns and CalPERS Board changes to actuarial methodology changes, demographic assumption, de-risking policies

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Fiscal Planning

- As a current practice, City contracts with Bartel to do an analysis of the CalPERS actuarial report to advise on the fiscal impact
- CalPERS reports come out each year and provide two years of projections
- Bartel projects long term rates
- City incorporates Bartel projections into the 10 year financial forecast

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Pension Cost – Forecasted Impacts

- Large increases in projected contributions
- With FY 2019/20 Preliminary Forecast
 - Change in methodology funding of UAL from percentage to fixed dollar to create budgetary savings
 - UAL Dollar increase \$2.4m Safety, \$2.6 Misc from 18/19
- 10-Year Impact - FY 2029/30 UAL contribution
 - Safety UAL \$32.2m up 94% from 19/20
 - Misc UAL \$31.7m up 57% from 19/20

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Bartel Associates, LLC Presentation

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BARTHEL
ASSOCIATES, LLC

CITY OF SANTA CLARA
MISCELLANEOUS & SAFETY PLANS

CalPERS Actuarial Issues – 6/30/17 Valuation
Final Results

John Bartel, President
Bianca Lin, Assistant Vice President
Kevin Yang, Actuarial Analyst
Bartel Associates, LLC

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HOW WE GOT HERE

- Investment Losses
- CalPERS Contribution Policy
- Enhanced Benefits
- Demographics

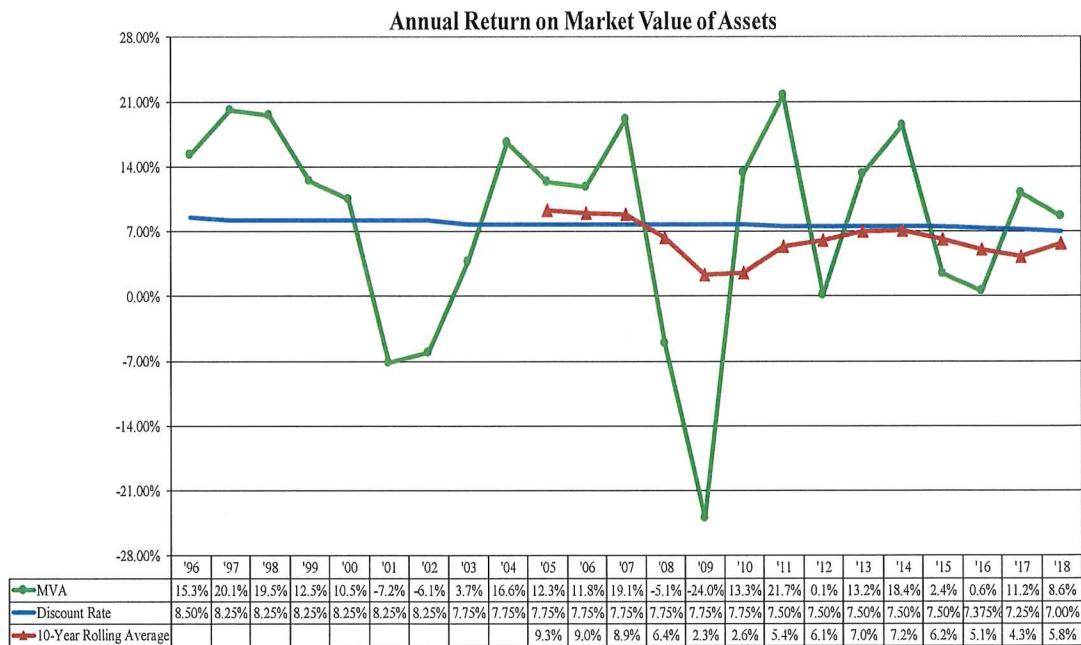


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HOW WE GOT HERE – INVESTMENT RETURN



Above assumes contributions, payments, etc. received evenly throughout year.



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HOW WE GOT HERE – OLD CONTRIBUTION POLICY

- Effective with 2003 valuations:
 - Slow (15 year) recognition of investment losses into funded status
 - Rolling 30 year amortization of all (primarily investment) losses
- Designed to:
 - First smooth rates and
 - Second pay off UAL
- Mitigated contribution volatility



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HOW WE GOT HERE – ENHANCED BENEFITS

- At CalPERS, Enhanced Benefits implemented using all (future & prior) service
- Typically not negotiated with cost sharing

■ City of Santa Clara	Tier 1	Tier 2	PEPRA
● Miscellaneous	2.7%@55 FAE1	N/A	2%@62 FAE3
● Safety Police	3%@50 FAE1	N/A	2.7%@57 FAE3
● Safety Fire	3%@50 FAE3	N/A	2.7%@57 FAE3

- Note:
 - ☐ FAE1 is highest one year (typically final) average earnings
 - ☐ FAE3 is highest three years (typically final three) average earnings



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HOW WE GOT HERE – DEMOGRAPHIC

- Around the State
 - Large retiree liability compared to actives
 - State average: 55% for Miscellaneous, 65% for Safety
 - Declining active population and increasing number of retirees
 - Higher percentage of retiree liability increases contribution volatility
- City of Santa Clara percentage of liability belonging to retirees:
 - Miscellaneous 64%
 - Safety 71%



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HOW WE GOT HERE – DEMOGRAPHIC

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CALPERS CHANGES

- Contribution policy changes:
 - No asset smoothing
 - No rolling amortization
 - 5-year ramp up
 - Included in 6/30/13 valuation (first impact 15/16 rates; full impact 19/20)
- Assumption changes:
 - Anticipate future mortality improvement
 - Other, less significant, changes
 - Included in 6/30/14 valuation (first impact 16/17 rates; full impact 20/21)
- CalPERS Board changed their discount rate:

	<u>Rate</u>	<u>Initial</u>	<u>Full</u>
● 6/30/16 valuation	7.375%	18/19	22/23
● 6/30/17 valuation	7.25%	19/20	23/24
● 6/30/18 valuation	7.00%	20/21	24/25
- December 2018: CalPERS Board selected asset allocation similar to current portfolio. No change to the discount rate.



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CALPERS CHANGES

- Risk Mitigation Strategy
 - Move to more conservative investments over time
 - Only when investment return is better than expected
 - Lower discount rate in concert
 - Essentially use ≈50% of investment gains to pay for cost increases
 - Likely get to 6.0% over 20+ years
 - Risk mitigation suspended until 6/30/18 valuation
 - February 2018 CalPERS adopted new amortization policy
 - Applies only to newly established amortization bases
 - Fixed dollar amortization rather than % pay
 - Amortize gains/losses over 20 rather than 30 years
 - 5-year ramp up (not down) for investment gains and losses
 - No ramp up/down for other amortization bases
 - Minimizes total interest paid over time and pays off UAL faster
 - Effective June 30, 2019 valuation for 2021/22 contributions
- Included in this study



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SUMMARY OF DEMOGRAPHIC INFORMATION - MISCELLANEOUS

	1997	2007	2016	2017
Actives				
■ Counts	641	645	636	691
■ Average				
• Age	45	47	46	45
• City Service	11	13	12	10
• PERSable Wages	\$ 55,500	\$ 79,300	\$ 98,400	\$ 102,100
■ Total PERSable Wages	39,700,000	56,300,000	68,400,000	76,800,000
Inactive Members				
■ Counts				
• Transferred	118	204	223	217
• Separated	66	147	185	205
• Retired				
□ Service		517	737	771
□ Disability		61	63	62
□ Beneficiaries		96	103	106
□ Total	454	674	903	939
■ Average Annual City Provided Benefit for Service Retirees ¹	N/A	\$ 26,400	\$ 42,100	\$ 43,100
■ Active / Retiree Ratio (City)	1.5	1.0	0.7	0.7
■ Active / Retiree Ratio (All CalPERS)	N/A	1.7	1.3	1.3

¹ Average City-provided pensions are based on City service & City benefit formula, and are not representative of benefits for long-service employees.

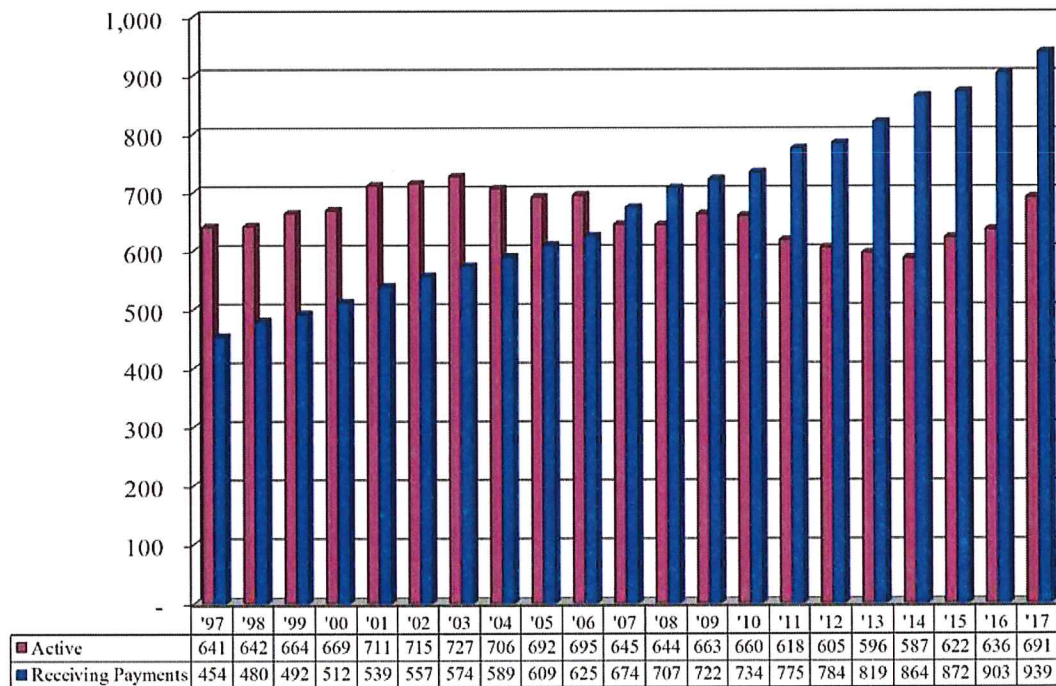


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SUMMARY OF DEMOGRAPHIC INFORMATION - MISCELLANEOUS



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PLAN FUNDED STATUS - MISCELLANEOUS

	<u>June 30, 2016</u>	<u>June 30, 2017</u>
Active AAL	\$ 216,100,000	\$ 222,300,000
Retiree AAL	417,800,000	449,600,000
Inactive AAL	23,600,000	25,300,000
Total AAL	657,500,000	697,200,000
Assets	396,900,000	432,100,000
Unfunded Liability	260,600,000	265,100,000
Funded Ratio	60.4%	62.0%



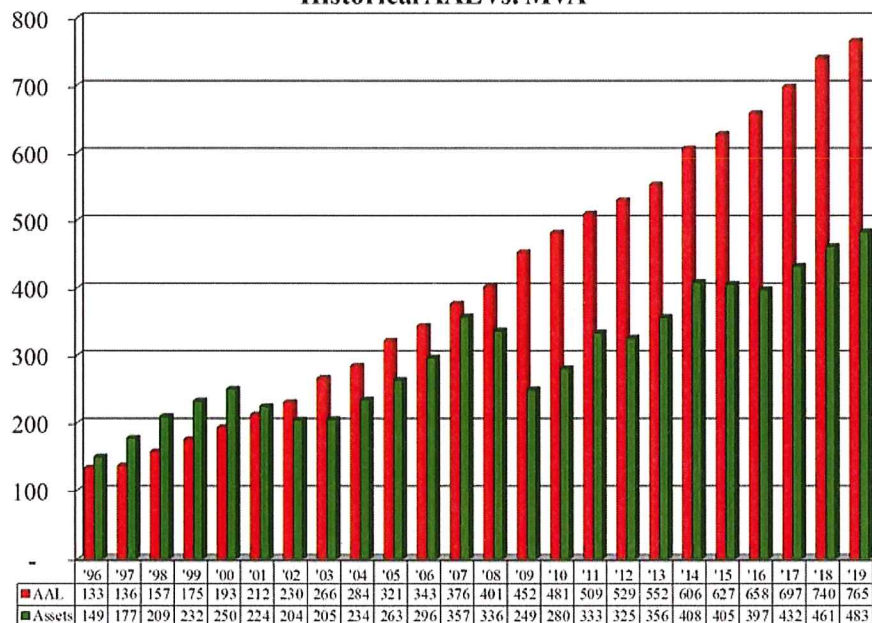
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FUNDED STATUS (MILLIONS) - MISCELLANEOUS

Historical AAL vs. MVA



6/30/18 & 6/30/19 funded status estimated



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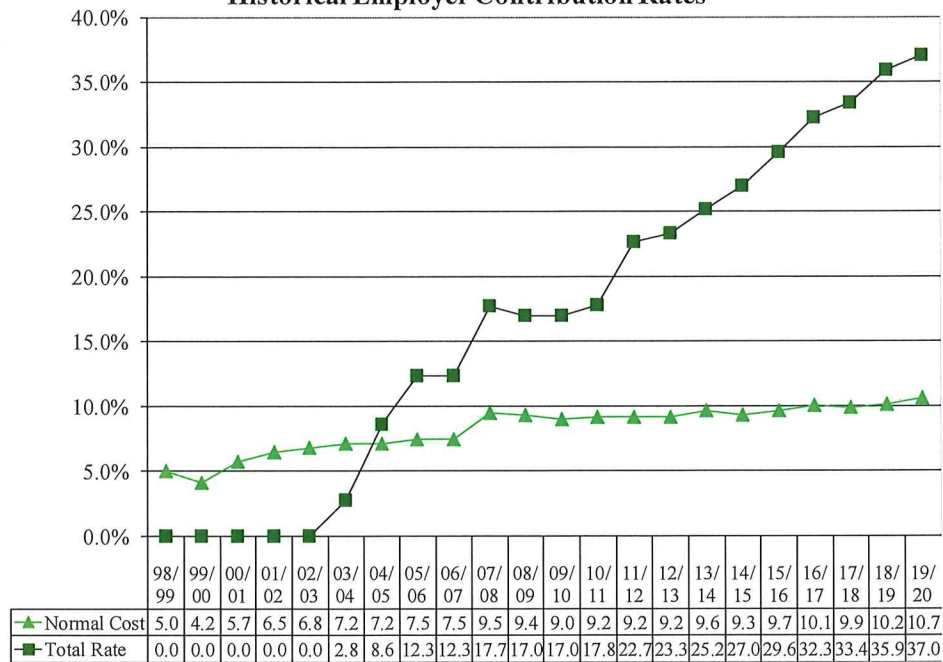
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CONTRIBUTION RATES - MISCELLANEOUS

Historical Employer Contribution Rates



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CONTRIBUTION RATES - MISCELLANEOUS

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CONTRIBUTION PROJECTIONS - MISCELLANEOUS

■ Investment Return:

- June 30, 2018 8.6%²
 - Future returns based on stochastic analysis using 1,000 trials³
- | | <u>25th Percentile</u> | <u>50th Percentile</u> | <u>75th Percentile</u> |
|-------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| Current Investment Mix | 0.1% | 7.0% | 14.8% |
| Ultimate Investment Mix | 0.8% | 6.0% | 11.4% |
- Assumes investment returns will generally be 6.5% (as compared to 7.0%) over the next 10 years and higher beyond that.

■ Assumption Changes – Discount Rate

- Decrease to 7.0% by June 30, 2018 valuation
- Additional Discount Rate decreases due to Risk Mitigation policy.

■ No Other: Gains/Losses, Method/Assumption Changes, Benefit Improvements

■ Different from CalPERS projection

² based July 2018 CalPERS press release

³ Nth percentile means N percentage of our trials result in returns lower than the indicated rates.



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CONTRIBUTION PROJECTIONS - MISCELLANEOUS

■ New hire assumptions:

- 62.5% of 2018/19 hires are PEPRA members and 37.5% are Classic members
- Percentage of PEPRA member future hires to increase from 62.5% to 100% over 15 years



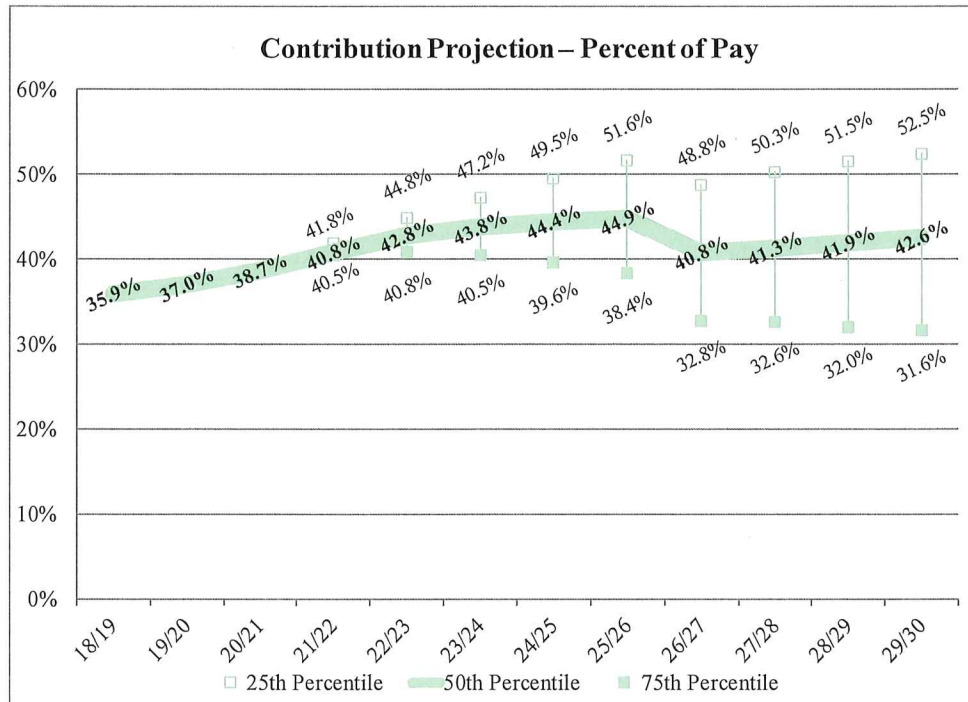
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CONTRIBUTION PROJECTIONS - MISCELLANEOUS

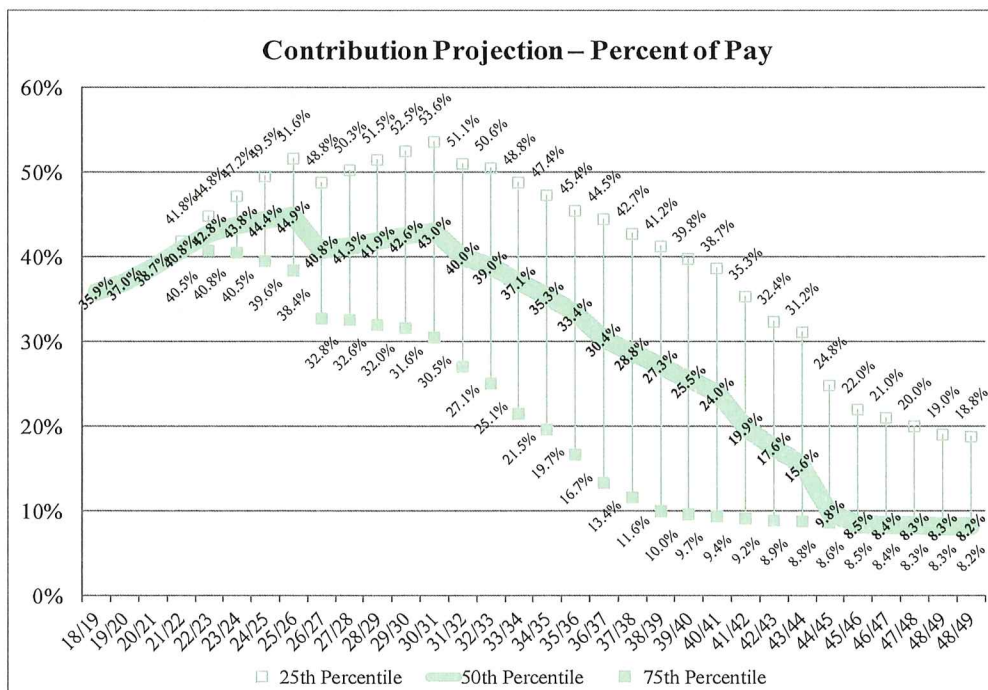


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CONTRIBUTION PROJECTIONS - MISCELLANEOUS

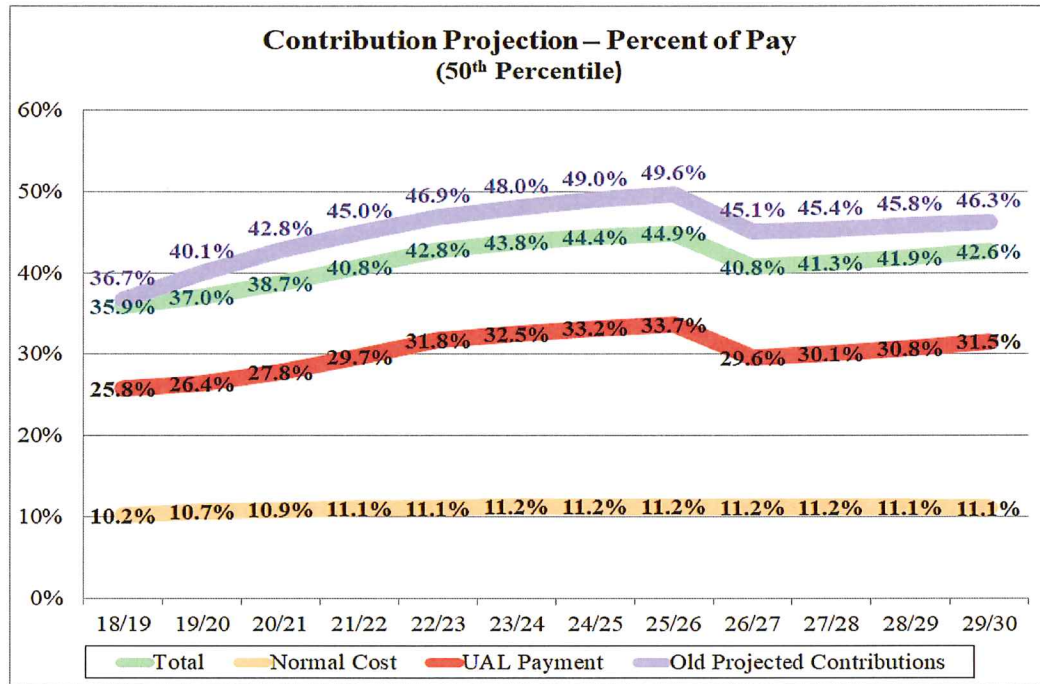


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CONTRIBUTION PROJECTIONS - MISCELLANEOUS

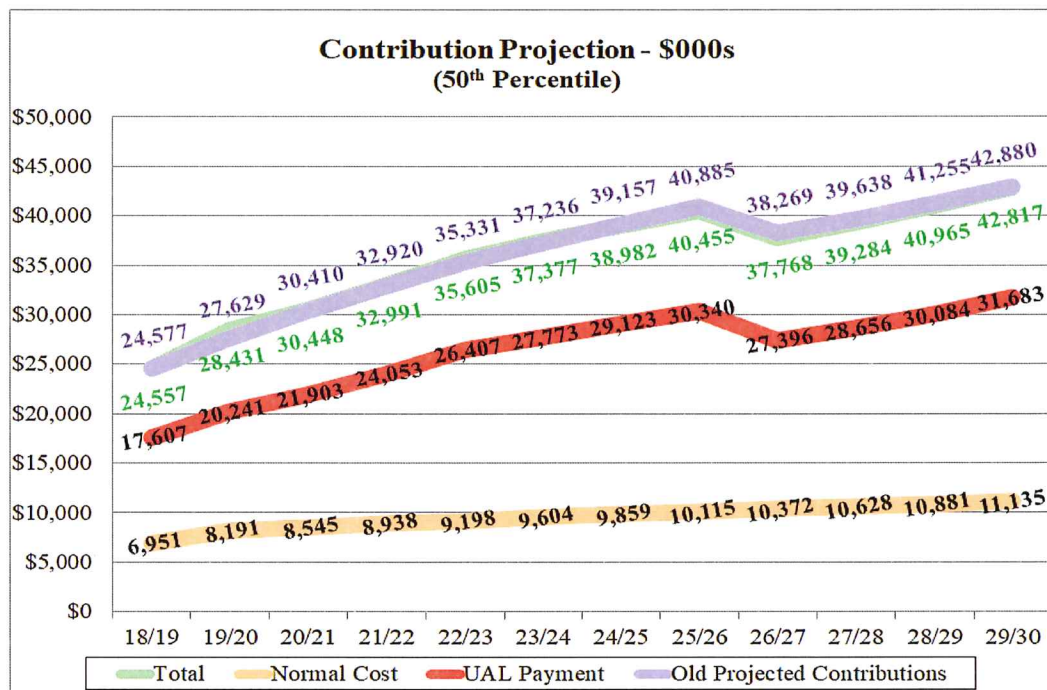


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CONTRIBUTION PROJECTIONS - MISCELLANEOUS



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SUMMARY OF DEMOGRAPHIC INFORMATION - SAFETY

	1997	2007	2016	2017
Actives				
■ Counts	293	283	286	285
■ Average				
• Age	42	41	41	41
• City Service	14	13	11	12
• PERSable Wages	\$ 82,400	\$ 126,200	\$ 144,800	\$ 157,800
■ Total PERSable Wages	27,000,000	39,300,000	45,300,000	49,000,000
Inactive Members				
■ Counts				
• Transferred	11	31	28	30
• Separated	13	16	29	29
• Retired				
□ Service		183	253	259
□ Disability		123	139	141
□ Beneficiaries		42	55	59
□ Total	191	348	447	459
■ Average Annual City Provided Benefit for Service Retirees ⁴	N/A	40,500	94,600	95,400
■ Active / Retiree Ratio (City)	1.5	0.8	0.6	0.6
■ Active / Retiree Ratio (All CalPERS)	N/A	1.7	1.3	1.3

⁴ Average City-provided pensions are based on City service & City benefit formula, and are not representative of benefits for long-service employees.

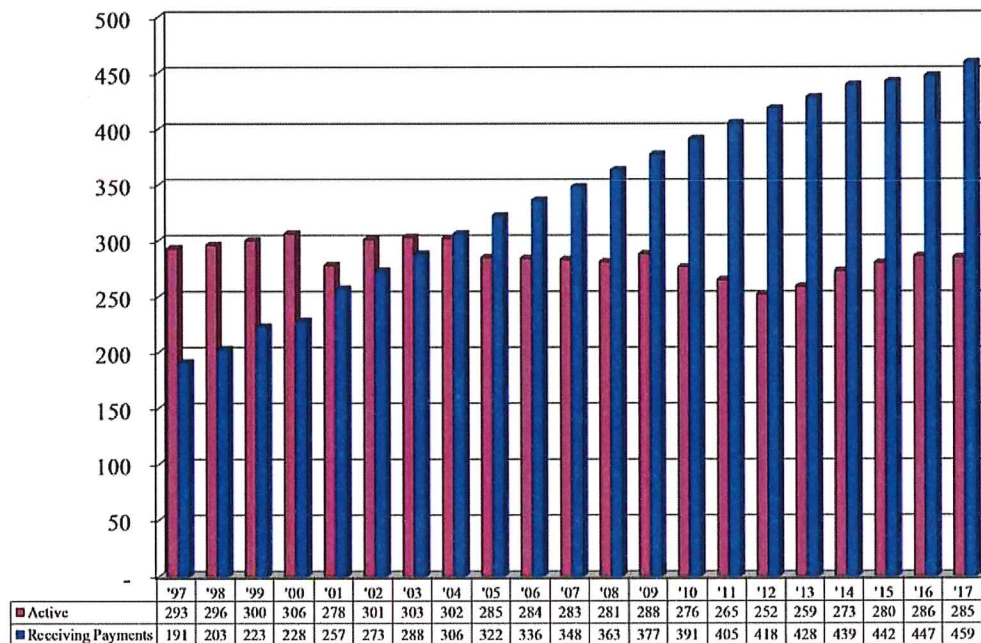


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SUMMARY OF DEMOGRAPHIC INFORMATION - SAFETY



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PLAN FUNDED STATUS - SAFETY

	<u>June 30, 2016</u>	<u>June 30, 2017</u>
Active AAL	\$ 187,100,000	\$ 206,400,000
Retiree AAL	495,000,000	516,600,000
Inactive AAL	6,800,000	5,600,000
Total AAL	688,900,000	728,600,000
Assets	445,000,000	481,000,000
Unfunded Liability	243,900,000	247,600,000
Funded Ratio	64.6%	66.0%



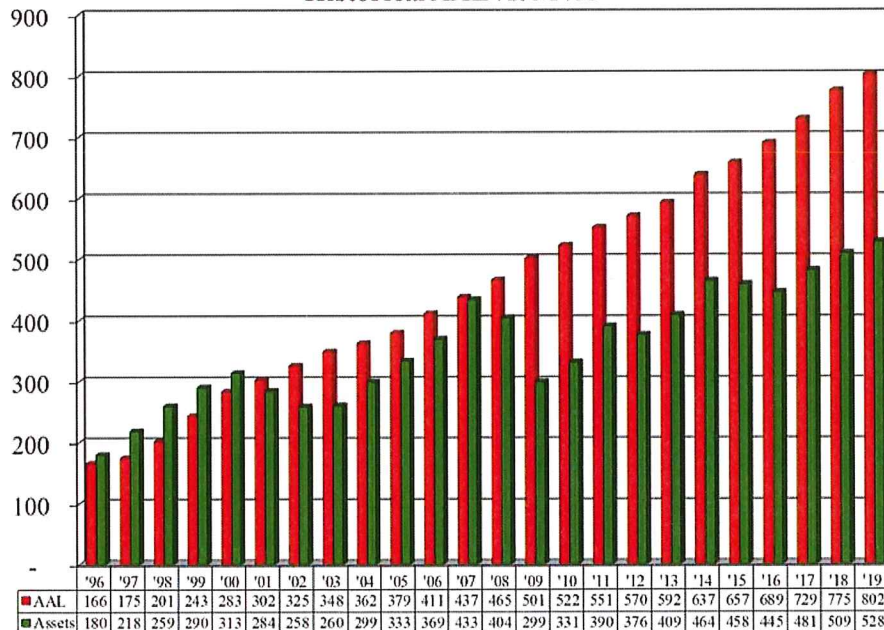
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FUNDED STATUS (MILLIONS) - SAFETY

Historical AAL vs. MVA



6/30/18 & 6/30/19 funded status estimated



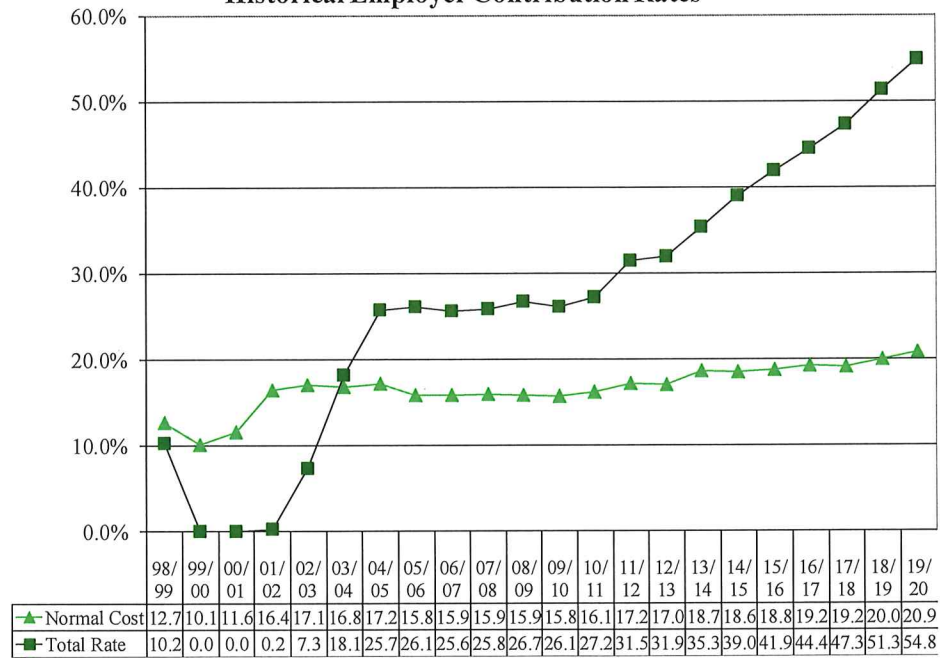
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CONTRIBUTION RATES - SAFETY

Historical Employer Contribution Rates



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CONTRIBUTION RATES - SAFETY

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CONTRIBUTION PROJECTIONS - SAFETY

■ Investment Return:

- June 30, 2018 8.6%⁵
 - Future returns based on stochastic analysis using 1,000 trials⁶
- | | <u>25th Percentile</u> | <u>50th Percentile</u> | <u>75th Percentile</u> |
|-------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| Current Investment Mix | 0.1% | 7.0% | 14.8% |
| Ultimate Investment Mix | 0.8% | 6.0% | 11.4% |
- Assumes investment returns will generally be 6.5% (as compared to 7.0%) over the next 10 years and higher beyond that.

■ Assumption Changes – Discount Rate

- Decrease to 7.0% by June 30, 2018 valuation
- Additional Discount Rate decreases due to Risk Mitigation policy.

■ No Other: Gains/Losses, Method/Assumption Changes, Benefit Improvements

■ Different from CalPERS projection

⁵ based July 2018 CalPERS press release

⁶ Nth percentile means N percentage of our trials result in returns lower than the indicated rates.



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CONTRIBUTION PROJECTIONS - SAFETY

■ New hire assumptions:

- 75.0% of 2018/19 hires are PEPRA members and 25.0% are Classic members
- Percentage of PEPRA member future hires to increase from 75.0% to 100% over 5 years

■ Employee Cost Sharing

- Police Safety Classic employees pay 2.25% toward employer rates



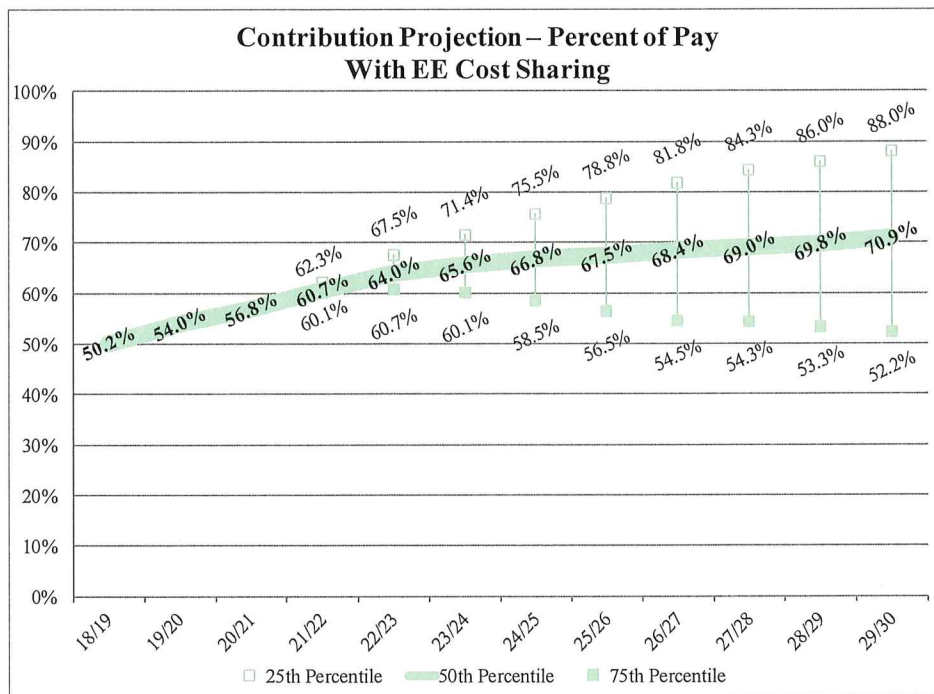
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CONTRIBUTION PROJECTIONS - SAFETY

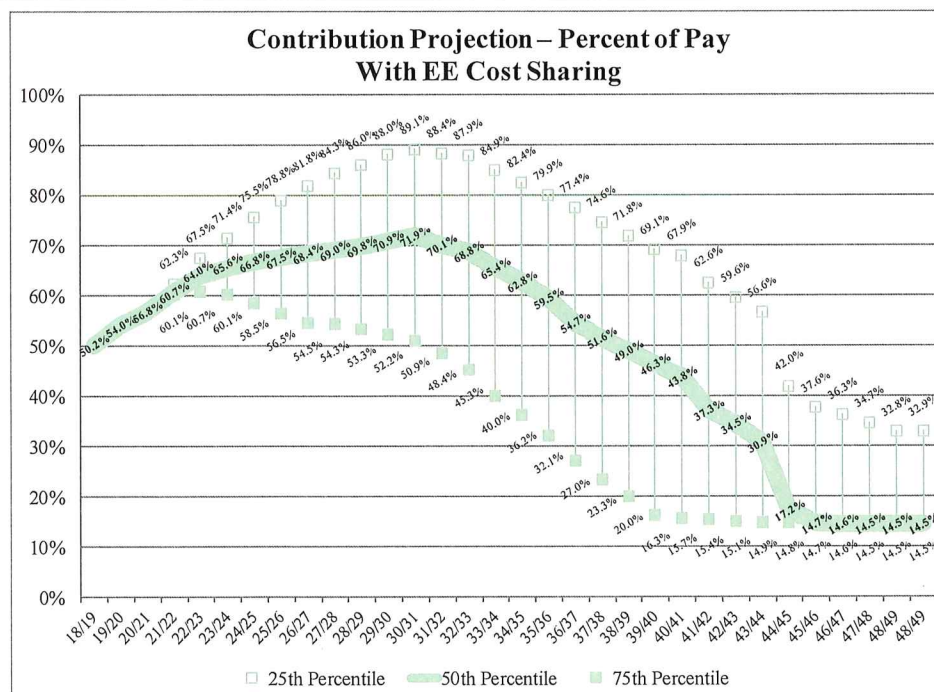


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CONTRIBUTION PROJECTIONS - SAFETY

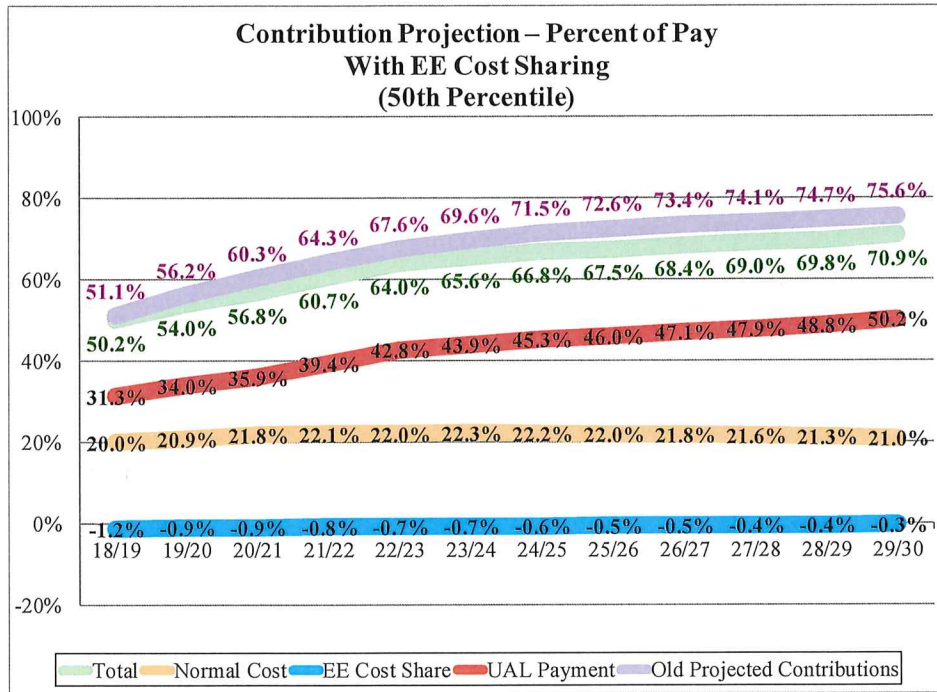


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CONTRIBUTION PROJECTIONS - SAFETY

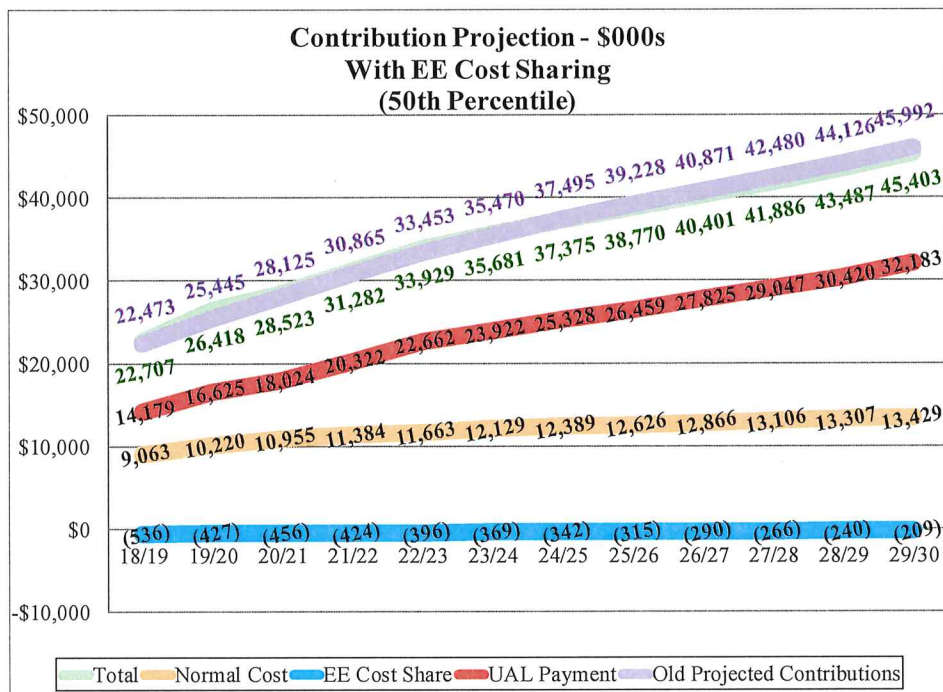


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COMBINED MISCELLANEOUS AND SAFETY

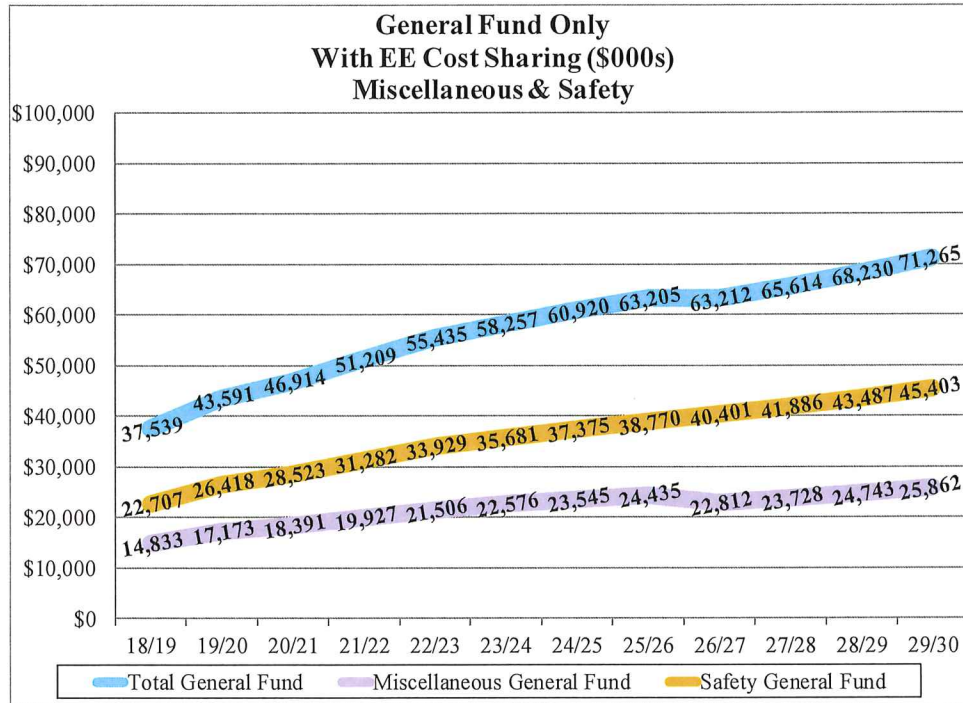


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COMBINED MISCELLANEOUS AND SAFETY

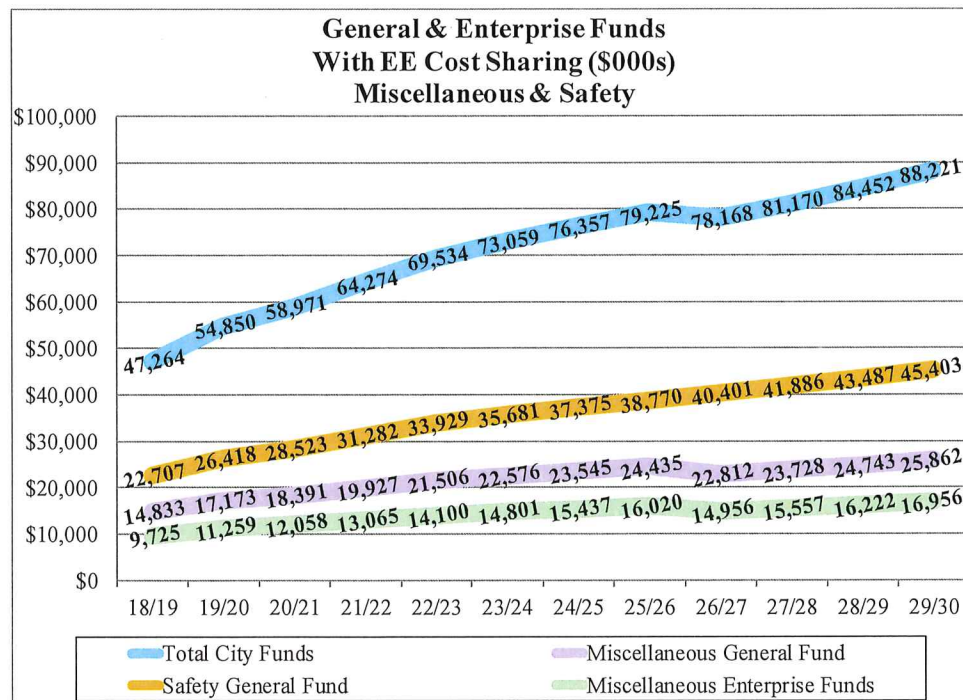


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COMBINED MISCELLANEOUS AND SAFETY



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COMBINED MISCELLANEOUS AND SAFETY

Funded Status Summary on June 30, 2017 (Amounts in \$Millions)

	Miscellaneous	Safety	Total
■ AAL	\$ 697	\$ 729	\$ 1,426
■ Assets	<u>432</u>	<u>481</u>	<u>913</u>
■ Unfunded AAL	265	248	513
■ Funded Ratio	62.0%	66.0%	64.0%



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COMBINED MISCELLANEOUS AND SAFETY

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PAYING DOWN THE UNFUNDED LIABILITY & RATE STABILIZATION

- Where do you get the money from?
- How do you use the money?



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WHERE DO YOU GET THE MONEY FROM?

- POB
- Borrow from General Fund similar to State
- One time payments



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HOW DO YOU USE THE MONEY?

- Internal Service Fund
- Make payments directly to CalPERS
- Irrevocable Supplemental (§115) Trust



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IRREVOCABLE SUPPLEMENTAL (§115) PENSION TRUST

- Consider:
 - How much can you put into Trust?
 - ☐ Initial seed money?
 - ☐ Additional amounts in future years?
 - When do you take money out?
 - ☐ Target budget rate?
 - ☐ Year target budget rate kicks in?
 - Before or after CalPERS rate exceeds budgeted rate?



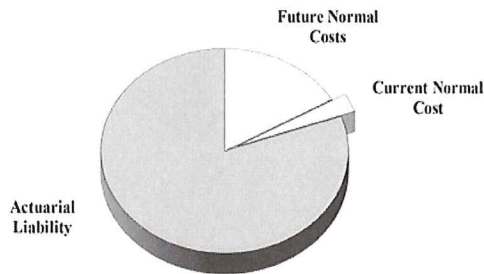
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APPENDIX – DEFINITIONS

Present Value of Benefits
June 30, 2017



■ Present Value of all Projected Benefits:

- The value now of amounts due to be paid in the future

■ PVB - Present Value of all Projected Benefits:

- Discounted value (at valuation date - 6/30/17), of all future expected benefit payments based on various (actuarial) assumptions

■ Current Normal Cost:

- Portion of PVB allocated to (or “earned” during) current year
- Value of employee and employer current service benefit

■ Actuarial Liability:

- Discounted value (at valuation date) of benefits earned through valuation date [value of past service benefit]
- Portion of PVB “earned” at measurement



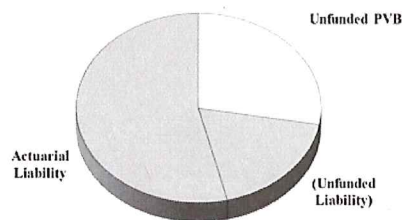
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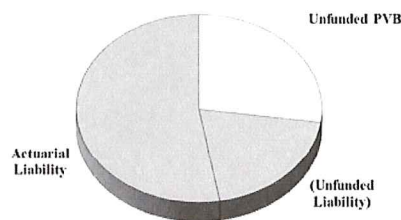


APPENDIX – DEFINITIONS

Present Value of Benefits
June 30, 2016



Present Value of Benefits
June 30, 2017



■ Target- Have money in the bank to cover Actuarial Liability (past service)

■ Unfunded Liability - Money short of target at valuation date

■ Unfunded Liability - Money short of target at valuation date

- If all actuarial assumptions were always exactly met, then the plan assets would always equal AAL
- Any difference is the unfunded (or overfunded) AAL
- Every year, the actuary calculates the difference between the expected UAAL and Actual UAAL. This is a new layer or amortization base
- Each new layer gets amortized (paid off) over a period of time as part of the contribution [rate].



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Key Takeaways

- Pension costs are a significant component of total compensation
- Further adjustments and increases are likely – will be difficult to absorb without additional revenue or cost savings
- Pension costs continue to increase but will eventually decrease as more employees enroll in PEPRA
- Staying disciplined in long term planning will continue to serve the City's residents and businesses well
- Using the 10-year financial forecast provides us with the time to make adjustments