City of Sierra Madre Agenda Report

TO: Honorable Mayor Capoccia and Members of the City Council

FROM: Elaine I. Aguilar, City Manager

INITIATED BY: Elisa C. Cox, Assistant City Manager

DATE: December 8, 2015

SUBJECT: California Public Employees' Retirement System

SUMMARY

At a previous meeting, Council Member Delmar requested that information regarding the City's CalPERS program be placed on a future agenda.

The City provides a defined benefit retirement benefit (pension) to its employees through the California Public Employees' Retirement System (CalPERS). Approximately 60% of the City's CalPERS costs are paid from the General Fund. This is attributed to the fact that Police and Fire Departments are funded by the General Fund, and 56% of the City's CalPERS costs are associated with the Police and Fire Departments. However, Police and Fire employees only represent approximately 40% of the total employees enrolled in CalPERS. The other 44% of CalPERS costs are associated with non-public safety employees (60% of the total employees enrolled in CalPERS). The higher cost for public safety employees occurs for two reasons: first, the higher benefit formulas for public safety employees cost more than the retirement plans for non-safety employees. Secondly, part-time employees, Classified employees, Fire employees, Confidential Exempt and Executive Management employees are paying 100% of the employees' contribution to the pension. The City is still paying a portion of the employees' contribution to the pension (referred to as the Employer Paid Member Contribution or EPMC) for employees in the Police Association.

In 2012 Governor Brown signed the Public Employees' Pension Reform Act (PEPRA) into law, which provided a number of changes to the Public Employees' Retirement Law; including implementing a new lower retirement formula for any new member into CalPERS after January 1, 2013. If the City hires an employee who worked for a neighboring CalPERS agency, that employee is considered a "Classic Member" and he/she will receive the retirement formula the City had in place on December 31, 2012. If the City hires a new employee who has only worked in the private sector, then that

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employee would be a “New Member” and will receive the new, lower retirement formula. As time goes on, more employees will fall under the lower retirement formulas for New Members, resulting in a decrease in the City’s CalPERS expense.

ANALYSIS

History of the City in CalPERS
The City of Sierra Madre first entered into a contract with CalPERS on September 1, 1962. There have been a number of amendments over the years. Some were instituted by the City, generally as a result of collective bargaining, others by CalPERS due to changing legislation. The most current contract with CalPERS is attached, as well as “CalPERS at a Glance” for quick facts on pension, investments, and health from CalPERS.

Public Employees’ Pension Reform Act
PEPRA froze each employers’ Classic Member rates as of January 1, 2013. This included any EMPCs, where the City pays a portion of the employees’ share of the pension. This means the City Classic rates of 2.5% @ 55 and 3% @ 55 can no longer be modified. Although the City is allowed to continue providing any EPMCs negotiated prior to January 1, 2013 (in Sierra Madre this only applies to members of the Police Association), this can be negotiated away. However, the City cannot impose a reduction of the EMPC until after January 1, 2018. The current Classic and PEPRA rates are illustrated in the table below:

Plan	Effective Date	Formula	Employee Rate	City Rate	Police EPMC	Net Employee Rate	Net City Rate
Classic Misc.	09/01/1962	2.5% @ 55	8%	10.612%	5%	3%	15.612%
Classic Safety	09/01/1962	3% @ 55	9%	18.191%	4%	4%	22.191%
PEPRA Misc.	01/01/2013	2% @ 62	6.5%	6.5%	0%	6.5%	6.5%
PEPRA Safety	01/01/2013	2.7% @ 57	12.25%	11.923%	0%	12.25%	11.923%

Beginning on January 1, 2018, public agencies that have collectively bargained in good faith and have completed impasse procedures, including mediation and fact finding, have the ability to unilaterally require Classic Members to pay up to 50% of the total normal cost of their pension benefits. However, the employee contribution may only be increased up to an 8% contribution rate for miscellaneous members and up to a 12% contribution rate for police officers.

PEPRA also permits public agencies and their employees to agree to share the cost of the employer contribution with, or without, a change in benefit. These contributions are paid in addition to the member contribution rate. This, however, must be agreed with the bargaining units and cannot be imposed upon the employees.

A practical example of how PEPRA is already saving the City money is by comparing two Police Officers who are both at Step Three; one is a Classic PERS Member and the other is a New Member.

Plan	City PERS Cost	EPMC	Total Cost
Classic Safety	$13,680	$2,466	$16,146
PEPRA Safety	$7,350	0	$7,350
		Difference	*$8,796*

As the City continues to hire New Members, both its current cost and ongoing liabilities will continue to decrease. Long-term, the City's PERS costs are anticipated to decrease 40 - 50% over the next 20 - 30 years.

How much does a Retiree Earn?
The retirees' benefit varies from person to person. It is based on the number of years the employee works, the employee's salary, and the retirement formula.

Take for instance a Water Pump Operator who works for the City for 10 years and retires at age 65 making $41,615 (top step). As a classic miscellaneous employee, his formula is 2.5% @ 55 (meaning he must retire after 55 to receive the full benefit). His retirement benefit is calculated as: 10 years X $41,615 X 2.5% = $10,404 per year or $867 per month.

If the same employee retires with the PEPRA formula of 2% @ 62, his benefit is calculated as: 10 years X $41,615 X 2% = $8,323 per year or $694 per month.

A Police Officer who retires at 60 after working for the City for 10 years making $67,925 (top step) will have the following retirement benefit: 10 years X $67,925 X 3% = $20,378 per year or $1,698 per month.

Under PEPRA, the same officer would have the following retirement benefit: 10 years X $67,925 X 2.7% = $18,340 per year or $1,528 per month.

Recent Changes to CalPERS
In 2013, the CalPERS Board approved a change to the CalPERS amortization and rate smoothing policies. Beginning with the June 30, 2013 valuations that set the 2015-2016 rates, CalPERS employed an amortization and smoothing policy that will pay for all gains and losses of the "Great Recession" over a fixed 30-year period with the increase or decrease in the rate spread over a 5-year period, starting with Fiscal Year 2015-2016.

When PEPRA took effect it created the new (lower) retirement formulas for newly hired members. It also effectively closed all the existing active risk pools to new employees. Without new employees in the risk pools, the funding of the risk pools would not continue to grow to cover the costs of the defined benefit. To continue funding the promised pensions as a percentage of payroll, as was previously done, would have led to underfunding of the plans and unacceptable levels of employer rate volatility.

In May 2014 the CalPERS Board made structural changes to the risk pools with two important changes which begun on July 1, 2015:

1. Beginning with FY15-16 CalPERS began to collect employer contributions toward the unfunded liability and side fund as a specific dollar amount (flat rate) instead of the prior method of a contribution rate (percentage). Employers are now invoiced at the beginning of each fiscal year for the unfunded liability and side fund payments. However, the plan's normal cost contribution continues to be collected as a percentage of payroll.
2. The pool's unfunded liability has been allocated to each individual plan based on the plan's total liability rather than the plan's individual payroll. This allows the City to track its unfunded liability and pay it down more quickly if it so chooses.

Plans' Funded Status				
	Miscellaneous Plan		Safety Plan	
	06/30/12	06/30/13	06/30/12	06/30/13
1. Present Value of Projected Benefits (PVB)	23,034,179	23,819,563	19,934,195	20,976,446
2. Entry Age Normal Accrued Liability	19,024,712	20,138,768	15,885,619	16,761,222
3. Plan's Market Value of Assets (MVA)	12,949,467	14,603,361	11,147,746	12,627,851
4. Unfunded Liability [(2)-(3)]	6,075,245	5,535,407	4,737,873	4,133,371
5. Funded Ratio [(3)/(2)]	**68.1%**	**72.5%**	**70.2%**	**75.3%**

The following projected employer contribution rates (not including EMPC for Police Association Members) assume that CalPERS earns 18% for Fiscal Year 2013-2014 and 7.5% every fiscal year thereafter. The Annual Valuation Report, as of June 30, 2014, is anticipated at the end of November 2015; at which time staff will receive updated projections to these numbers.[1]

Required Employer Contribution							
		Actual		Projected			
Tier	Group	15-16 % of Payroll	15-16 Unfunded Liability	16-17 % of Payroll	16-17 Unfunded Liability	17-18 Unfunded Liability	17-18 Unfunded Liability
Classic	Misc.	10.612%	$ 371,846	11.000%	$ 413,266	11.000%	$ 456,835
Classic	Safety	18.191%	$ 306,417	19.100%	$ 342,183	19.100%	$ 379,817
PEPRA	Misc.	6.730%	$ -	6.730%	$ -	6.730%	$ -
PEPRA	Safety	11.923%	$ -	12.300%	$ -	12.300%	$ 2

[1] The Annual Valuation Report as of June 30, 2014 was not available as of the writing of this report; if the number are delivered before the December 8, 2015 meeting, staff will bring the updates to the December meeting.

There is an annual lump sum prepayment option for the unfunded liability, which the City took advantage of in FY15-16. It saved the City $24,000 (the City actually paid $358,640 and $295,535 for miscellaneous and safety groups respectively). The City intends to continue to take advantage of the lump sum option in future years. Furthermore, should the City Council provide direction, the unfunded liability can be paid down at any time by making larger lump sum payments.

Alternatively, the City could formally change its amortization schedule from the CalPERS 30-year amortization policy. If the City formally changes its schedule (shortens the payback period) it cannot later amend it for a longer period at a later time. For that reason, staff does not recommend shortening the amortization schedule; rather staff would recommend that the City make additional lump sum payments if the Council wanted to reduce the liability.

Alternate Amortization Schedules				
Period	**FY15-16 Payment**	**Total Payments**	**Total Interest**	**Savings**
20 years - Misc	436,180	11,720,320	5,943,513	1,445,552
20 years - Safety	317,557	8,532,876	4,327,129	1,029,543
			Total Savings	***2,475,095***
15 years - Misc	529,557	9,849,185	4,072,378	3,316,687
15 years - Safety	385,539	7,170,607	2,964,860	2,391,812
			Total Savings	***5,708,499***

Additional Changes to CalPERS
On November 18, 2015 the California Public Employees' Retirement System (CalPERS) adopted a funding risk mitigation policy that will incrementally lower the discount rate in years of good investment returns, help pay down the pension fund's unfunded liability, and provide greater predictability and less volatility in contribution rates for employers.

Under the policy adopted by the CalPERS Board of Administration, a mechanism will be established to reduce the discount rate - or assumed rate of return - by a minimum of 0.05 percentage points to a maximum of 0.25 percentage points in years when investment returns outperform the existing discount rate, currently 7.5 percent, by at least four percentage points. The four percentage point threshold would work to offset increases to employer contribution rates that would otherwise increase when the discount rate is lowered, and help pay down CalPERS' unfunded liability.

Reducing the volatility of investment returns will increase the long-term sustainability of CalPERS pension benefits for members. But a lower, albeit less volatile, rate of return will necessitate higher employer and member contributions. CalPERS estimates miscellaneous plans will see employer contribution rates increase up to 12% over 50 years and rates for safety plans to increase up to 21% over 50 years.

This action is in large part a response to the maturing of the workforce. For example, where the ratio of active workers to retirees was over 2 to 1 just a decade ago, the ratio is now 1.6 workers to every retiree, and that downward trend is likely to continue until 20 years from now when the ratio of actives to retirees is expected to be less than one. Last fiscal year, CalPERS saw a 13 percent increase in state retirements over the previous year, and for the first time in the pension fund's history, CalPERS is paying out more in retirement benefits than taking in contributions. CalPERS paid $18 billion in pension benefits in the 2014-2015 fiscal year, compared to $13 billion in contributions.

Hypothetical Termination Liability

Below are estimates of the financial positions of the City's various plans if the City had terminated its contract with CalPERS as of June 30, 2013. The plans' liability on a termination basis is calculated differently compared to the plans' ongoing funding liability. For this hypothetical termination liability, both compensation and service is frozen as of June 30, 2013 and no future pay increases or service accruals are included.

Hypothetical Termination Lability		
Plan	**As of 06/30/12**	**As of 06/30/13**
Classic Miscellaneous Plan	$35,182,925	$32,821,726
Classic Safety Plan	$29,534,269	$27,120,311
PEPRA Safety Fire Plan	--	$1,070
PEPRA Safety Police Plan	--	$1,630
Total	**$64,717,194**	**$59,944,737**

Please note that as of June 30, 2013 the City did not have any employees enrolled in the PEPRA Miscellaneous Plan, but does today. The above numbers are provided in the Annual Valuation Report. The Annual Valuation Report as of June 30, 2014 was not available as of the writing of this report; if the number are delivered before the December 8, 2015 meeting, staff will bring the updates to the December meeting.

Cost of Social Security

The current tax rate for Social Security is 6.2% for the employer and 6.2% for the employee (12.4% total). For the City's Fiscal Year 2015-2016 budgeted wages the employer portion of the Social Security tax would be approximately $334,000.

CalPERS Medical and Other Post-Employment Benefits

The City of Sierra Madre provides medical benefits to its employees through CalPERS, which is governed under the Public Employees Medical and Hospital Care Act (PEMHCA). PEMHCA requires that the employer contribution to retiree health care be an amount equal for both employees and retired annuitants, and sets minimum employer contributions each year to these benefits each year. For 2015 the minimum amount is $122, and in 2016 it will be $125 (the cost is increased by the CalPERS Board by CPI Medical each year). However, this equal contribution rule means that whatever an agency provides to its current employees for medical coverage, it must provide the same amount to its retirees. Any employee who retires directly from a PEMHCA agency has the right to receive this medical benefit.

There are three exceptions to the “equal” employer contributions. The City utilizes the Cafeteria Plan exception, whereby a portion of the employees’ medical benefit is specifically identified in the collective bargaining agreement and a Section 125 cafeteria plan is set up for the remainder of the employee’s Health and Welfare benefit. Since retired annuitants cannot participate in the cafeteria plan, the “equal” amount is the amount specified for the employees’ health care plan.

The City’s other post-employment benefits (OPEB) negotiated above and beyond the required contributions explained above are relatively nominal. For employees hired after 1995 (2011 for Police Association Members) retiree medical coverage is only earned:

> *“…upon retirement from the City and with an application approved by PERS for retirement benefits, an employee will be extended "employee only" health insurance coverage for the lowest cost plan available from the City at the time of retirement until age 65. An employee must be a minimum of age 60 on the effective date of retirement and have worked 30 years of full-time service with the City to be eligible for this coverage.”*

For employees hired before 1995 (or 2011 for Police Association Members), the benefit is:

> “…*employee only health insurance coverage will be extended for the lowest cost plan available through the PERS Health Program upon retirement to age 65, based on the vesting level the employee has reached. … Partial vesting shall be accrued at 5% per full year of service.”*

There are very few employees who will qualify for either retirement benefit, making the City’s OPEB liability quite low. Furthermore, the City has historically been aggressive in funding the City’s OPEB. The City fully funded its OPEB in July 2013, a feat not many agencies can claim. By fully-funding the OPEB, the City saved $100,000 in both fiscal years 2014-15 and 2015-16. Staff will be recommending that the City obtain a new actuarial report as of July 1, 2015 in order to meet the GASB 43 and 45 requirement. The City Council may consider changing its funding model based on the new reports which are anticipated by the end of this fiscal year.

FINANCIAL REVIEW

Fiscal Year	Total CalPERS Costs	Difference
2011-2012	$1,290,000	4%
2012-2013	$1,200,000	-8%
2013-2014	$1,135,000	-6%

2014-2015 (midyear budget)	$1,120,000	-1%
2015-2016 (budgeted)	$1,413,000	21%

Beginning in 2012 the City began laying people off and freezing vacant positions, which resulted in an overall lower payment to CalPERS year-after-year. You can see the impact of CalPERS' new policy to collect a flat amount towards the unfunded liability in Fiscal Year 2015-2016 instead of the prior method of a percentage of payroll.

What can the City do to reduce its CalPERS cost and liabilities?

- Continue to hire New Members[2]
- Negotiate with the Police Association to remove the EPMC[3]
- Negotiate with employee groups to pay a portion of the employer's contribution[4]
- Continue to pay the annual lump sum prepayment option for the unfunded liability
- Make additional lump sum payments towards the unfunded liability
- Shorten the City's amortization schedule for the unfunded liability

PUBLIC NOTICE PROCESS

This item has been noticed though the regular agenda notification process. Copies of the report are available via the City's website at www.cityofsierramadre.com, at the City Hall public counter, and the Sierra Madre Public Library.

STAFF RECOMMENDATION

Staff recommends the City Council receive and file this informational report.

Attachments:

1. January 15, 2012 Amendment to the Contract between the Board of Administration California Public Employees' Association and the City Council City of Sierra Madre
2. CalPERS at a Glance
3. CalPERS Finance & Administration Committee November 17, 2015 Staff Report *Funding Risk Mitigation Policy*

[2] There is pending legislation making it illegal to make hiring decisions based on retirement status, including whether a prospective employee is a Classic Member or New Member.
[3] The City cannot impose a reduction of the EPMC until after January 1, 2018.
[4] This must be agreed upon with the bargaining units and cannot be imposed upon the employees.