

## **CalPERS (Pension) Employer Contribution Rates: What Can You Expect?**

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President  
December 7, 2017

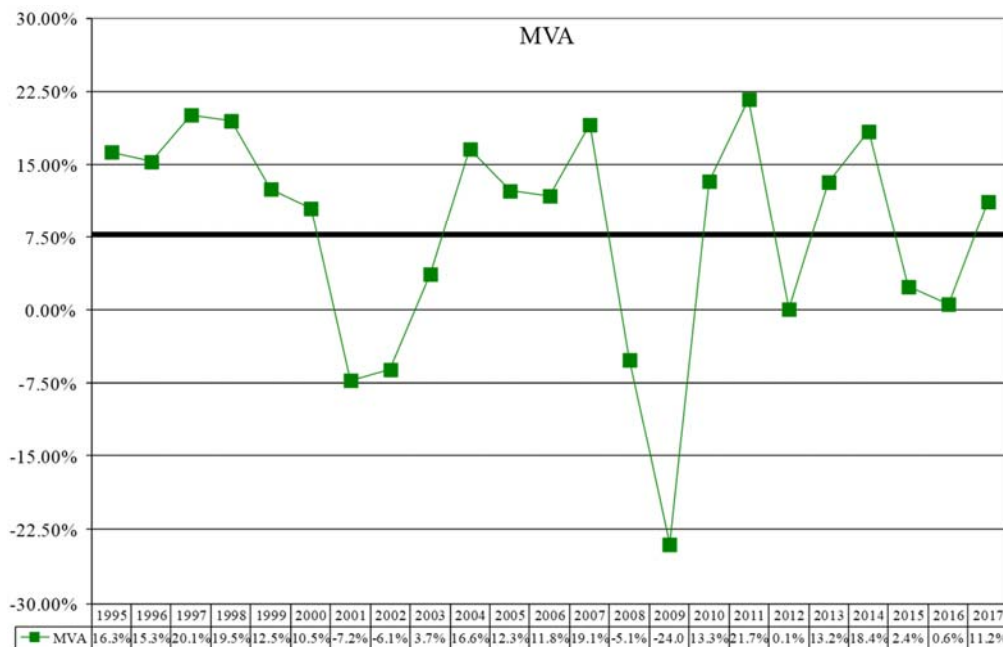
### **Agenda**

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- Where are CalPERS Rates Going? 18
- Paying Down Unfunded Liability and Rate Stabilization 34

# How Did We Get Here?

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

# Historical Investment Returns



## Enhanced Benefits

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

## CalPERS Old 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
  - Second pay off UAL and
- Mitigated contribution volatility

# Demographics

- Around the State
  - Large retiree liability compared to actives
  - Declining active population
- Common to have 60%-75% of liability for retirees

# Recent CalPERS Changes

- Contribution Policy
- Assumptions
- Risk Mitigation Strategy
- Discount Rate
- Other

## Contribution Policy Changes

- No asset smoothing
- 5-year ramp up
- All amortization bases have fixed amortization periods
  - No rolling amortization

## Contribution Policy Changes

- June 30, 2013 Valuation (15/16 rates)
- Designed to:
  - First pay off UAL and
  - Second smooth rates
- Uses MVA so only one funded status/ratio
- If assumptions are met then:
  - Contributions go up in the short run but then come down
  - UAL will be paid off

## Assumption Changes

- June 30, 2014 Valuation, 2016/17 rates
- No changes to economic assumptions
- Anticipate future mortality improvement
- Other, modest, changes to assumptions

## Risk Mitigation Strategy

- Move to more conservative investments over time
  - Only when investment return is better than expected
- Lower discount rate in concert with investment allocation changes
- Essentially use  $\approx 50\%$  of investment gains to pay for cost increases
- Likely reduces discount rate 100 basis points over  $\approx 20$  years

## Timing

	Valuation	First Impact	Full Impact
■ Contribution Policy	6/30/13	2015/16	2019/20
■ Assumptions	6/30/14	2016/17	2020/21
■ Risk Mitigation	Because based on investment gains timing is uncertain		

## Ultimate Cost Increase

	<u>Misc.</u>	<u>Safety</u>
Next 15 Years		
■ Contribution Policy	≈ 7%	≈ 9%
■ Assumptions	≈ <u>4%</u>	≈ <u>7%</u>
■ Total	≈11%	≈16%
Next 25+ Years		
■ Risk Mitigation	≈ 8%	≈12%

## Discount Rate

### ■ Combination of

● Expected Inflation	2.75%	2.50%
● Real Rate of Return (above inflation)	4.75	4.50
● Margin for Adverse Deviation	<u>0.00</u>	<u>0.00</u>
● Total	7.50%	7.00%

### ■ 7.5% based on 2010 Capital Market Assumption study (updated in '14) & current asset allocation

### ■ 7.0% likely result of 2017 Capital Market Assumption study & updated asset allocation

## Discount Rate

### ■ CalPERS Board was told at the end of last year:

- 2017 Capital Market Assumption Study real rate of return will likely be 50 basis points lower
- Delivered by:
  - Outside investment advisors
  - CFO
  - CIO
  - Actuarial staff

### ■ Based on above, Board reached a compromise deal lowering the discount rate



## Discount Rate

- Decrease discount rate from 7½% to 7% over next 3 valuations, for public agencies:

	<u>Rate</u>	<u>Initial</u>	<u>Full</u>
● 6/30/16 val.	7.375%	18/19	22/23
● 6/30/17 val.	7.25%	19/20	23/24
● 6/30/18 val.	7.00%	20/21	24/25
● Risk mitigation suspended until after 6/30/18			

## Discount Rate

	<u>Misc.</u>	<u>Safety</u>
■ Normal Cost	2.0%	3.5%
■ UAL	<u>5.5</u>	<u>9.5</u>
■ Total	7.5%	13.0%
■ Standard Deviation	1%	2%

# Ultimate Cost Increase

	<u>Misc.</u>	<u>Safety</u>
Next 10-15 Years		
■ Contribution Policy	≈ 7%	≈ 9%
■ Assumptions	≈ <u>4%</u>	≈ <u>7%</u>
■ Subtotal	≈11%	≈16%
■ Discount Rate	≈ <u>8%</u>	≈ <u>13%</u>
■ Total	≈19%	≈29%

## Where Are CalPERS Rates Going?

## 2024/25 Contribution Rates<sup>1</sup>

Cities/Towns		
Percentile	Miscellaneous	Safety
10th	18.8%	35.2%
25th	25.2	44.8
50th	30.8	54.0
75th	37.7	63.8
90th	43.0	76.0

<sup>1</sup> CalPERS projected rates adjusted for 6/30/17 actual investment return and PEPRRA.

## 2024/25 Contribution Rates<sup>1</sup>

Special Purpose Districts		
Percentile	Miscellaneous	Safety
10th	12.4%	22.7%
25th	16.1	30.3
50th	21.5	40.6
75th	28.0	48.7
90th	35.0	56.3

<sup>1</sup> CalPERS projected rates adjusted for 6/30/17 actual investment return and PEPRRA.

## 2024/25 Contribution Rates<sup>1</sup>

Counties		
Percentile	Miscellaneous	Safety
10th	24.0%	40.7%
25th	26.2	42.2
50th	28.7	48.1
75th	32.4	54.5
90th	36.4	58.4

<sup>1</sup> CalPERS projected rates adjusted for 6/30/17 actual investment return and PEPRRA.

## 2024/25 Contribution Rates<sup>1</sup>

All Public Agencies		
Percentile	Miscellaneous	Safety
10th	13.5%	28.7%
25th	18.1	39.7
50th	24.8	50.2
75th	31.9	59.3
90th	39.3	70.5

<sup>1</sup> CalPERS projected rates adjusted for 6/30/17 actual investment return and PEPRRA.

## CalPERS Projected Rates

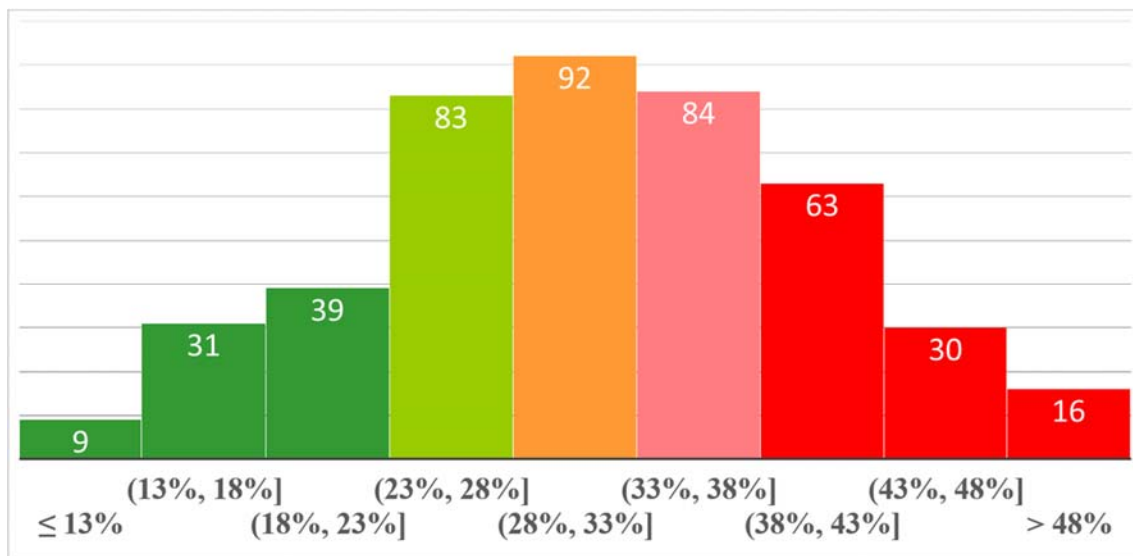
### ■ Generally higher if:

- Mature City with large retiree liability
- Enhanced formulas for Classic employees
- Did not implement an unenhanced 2<sup>nd</sup> benefit tier before PEPR

### ■ Generally lower if:

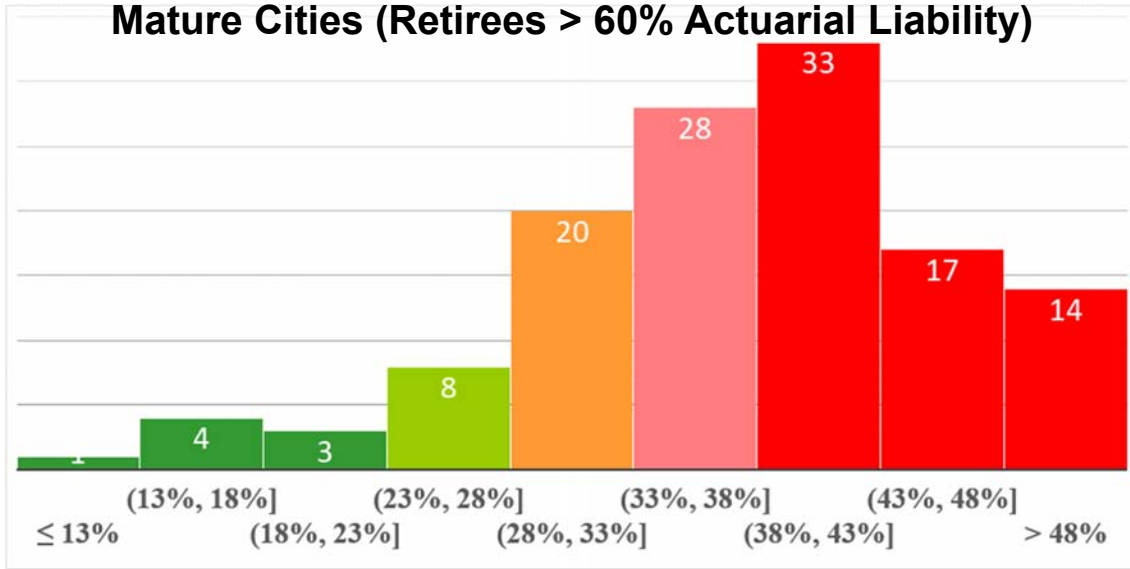
- Younger City with small retiree liability
- No enhanced formulas for Classic employees
- Implemented an unenhanced 2<sup>nd</sup> benefit tier before PEPR

## CalPERS City Miscellaneous 2024/25 Projected Rates



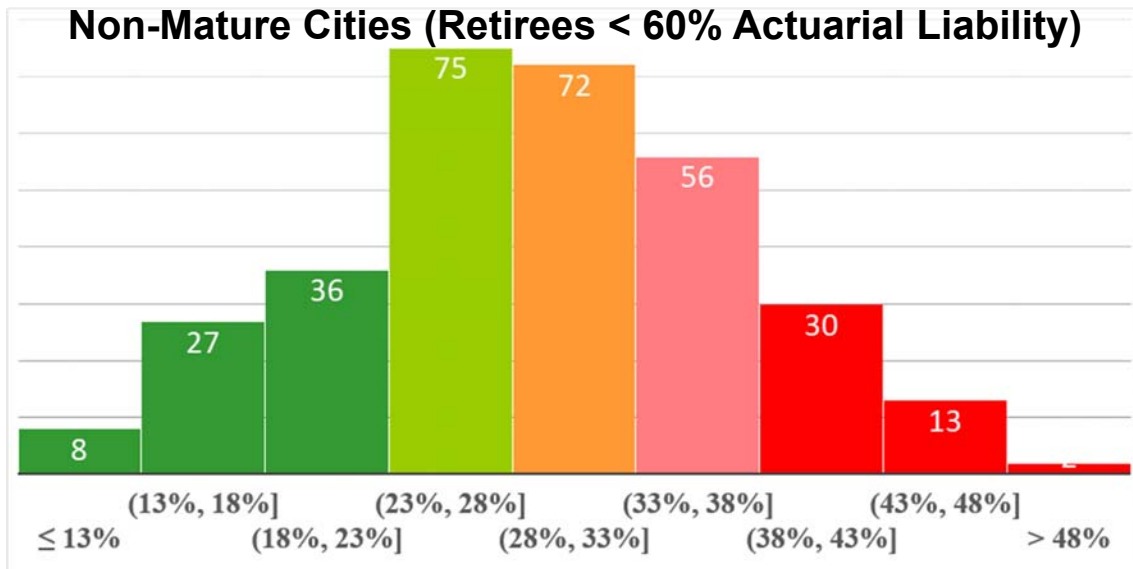
## CalPERS City Miscellaneous 2024/25 Projected Rates

### Mature Cities (Retirees > 60% Actuarial Liability)



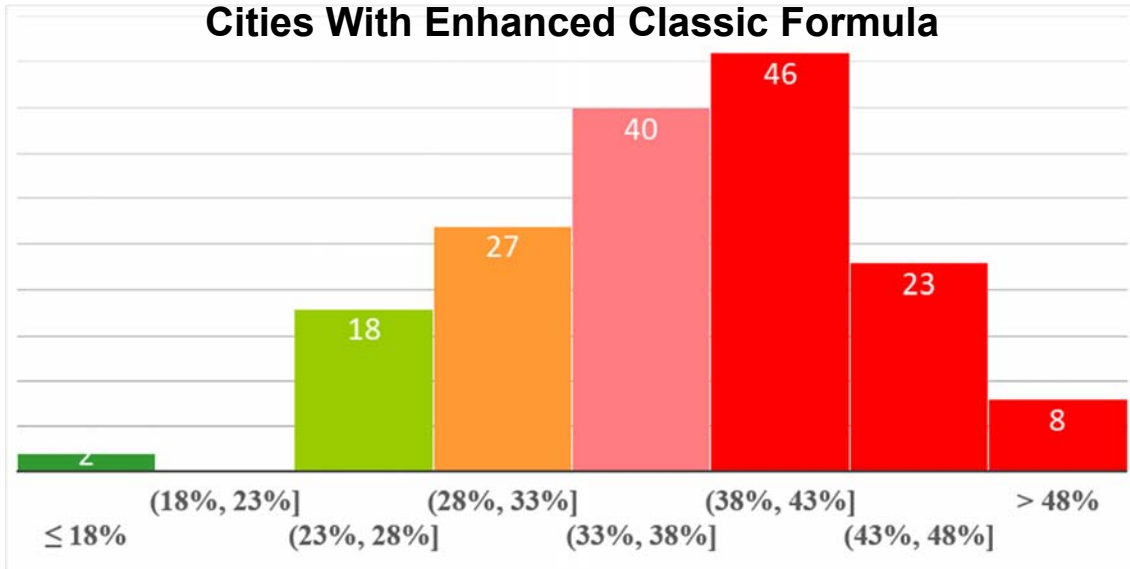
## CalPERS City Miscellaneous 2024/25 Projected Rates

### Non-Mature Cities (Retirees < 60% Actuarial Liability)



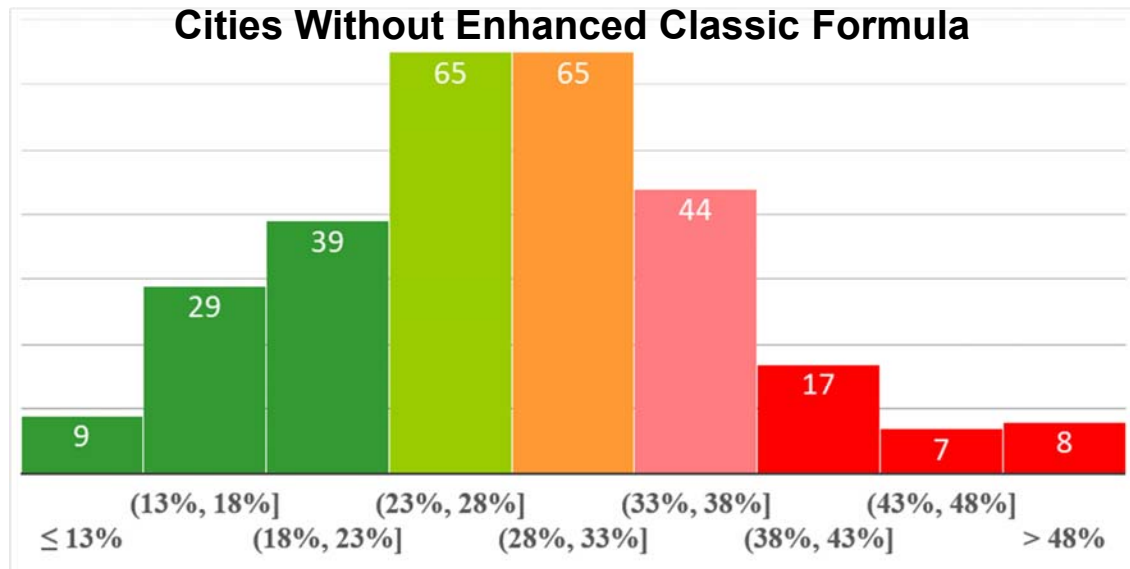
## CalPERS City Miscellaneous 2024/25 Projected Rates

### Cities With Enhanced Classic Formula

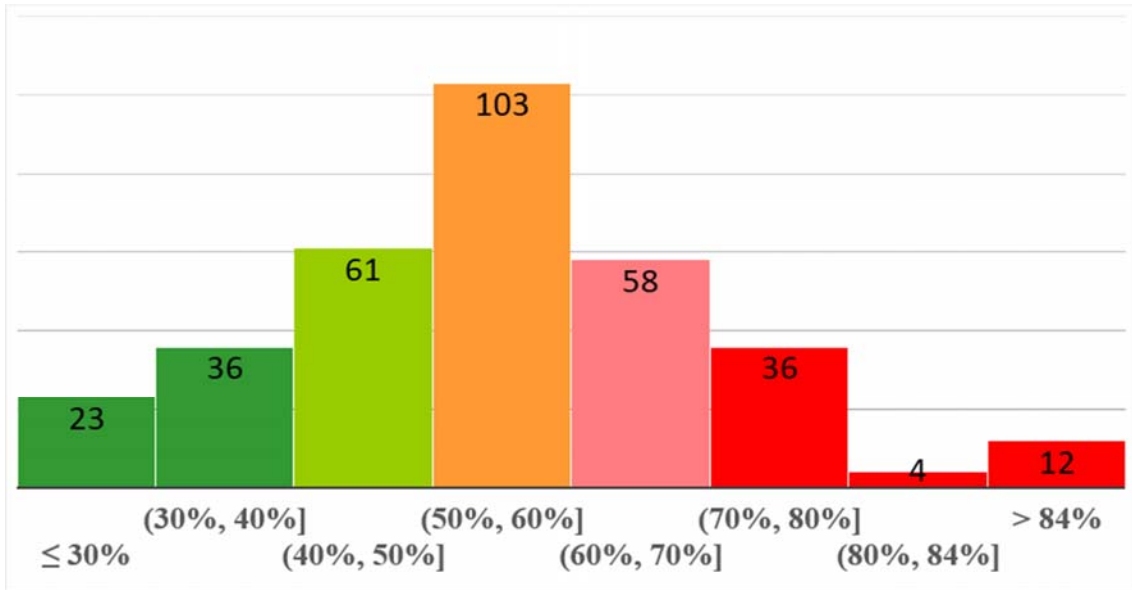


## CalPERS City Miscellaneous 2024/25 Projected Rates

### Cities Without Enhanced Classic Formula

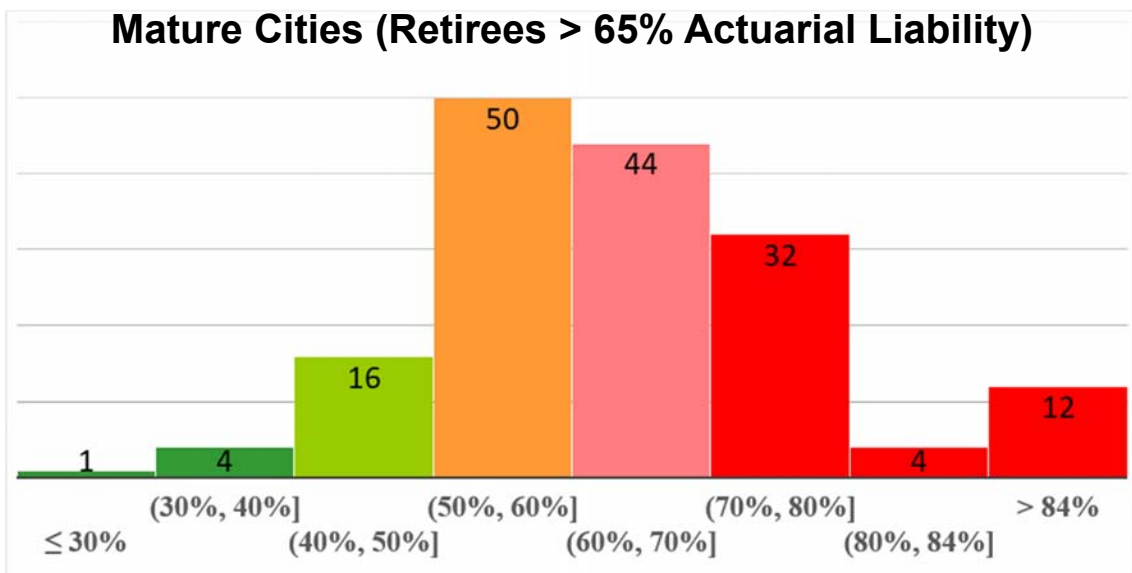


## CalPERS City Safety 2024/25 Projected Rates



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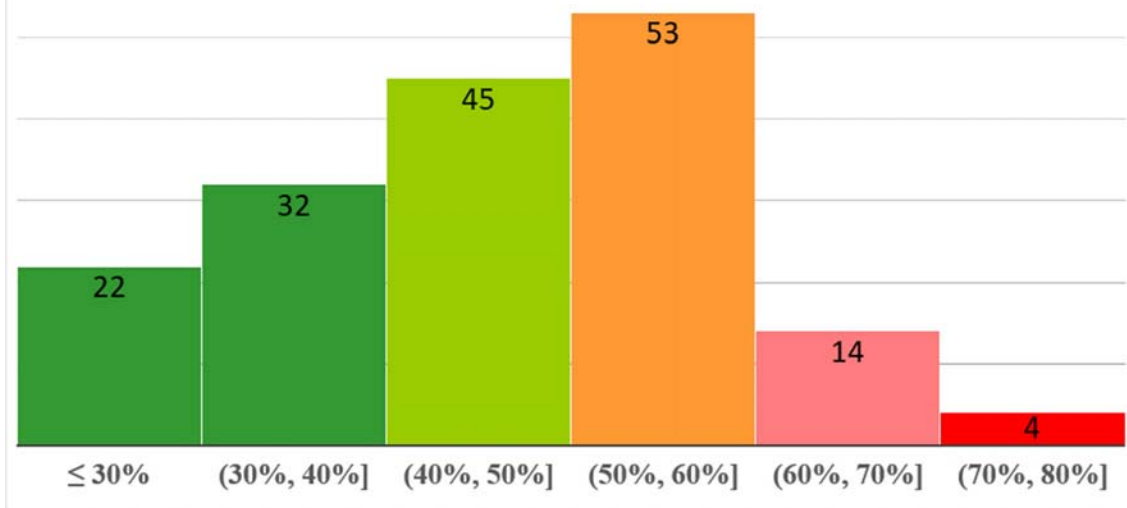
### Mature Cities (Retirees > 65% Actuarial Liability)





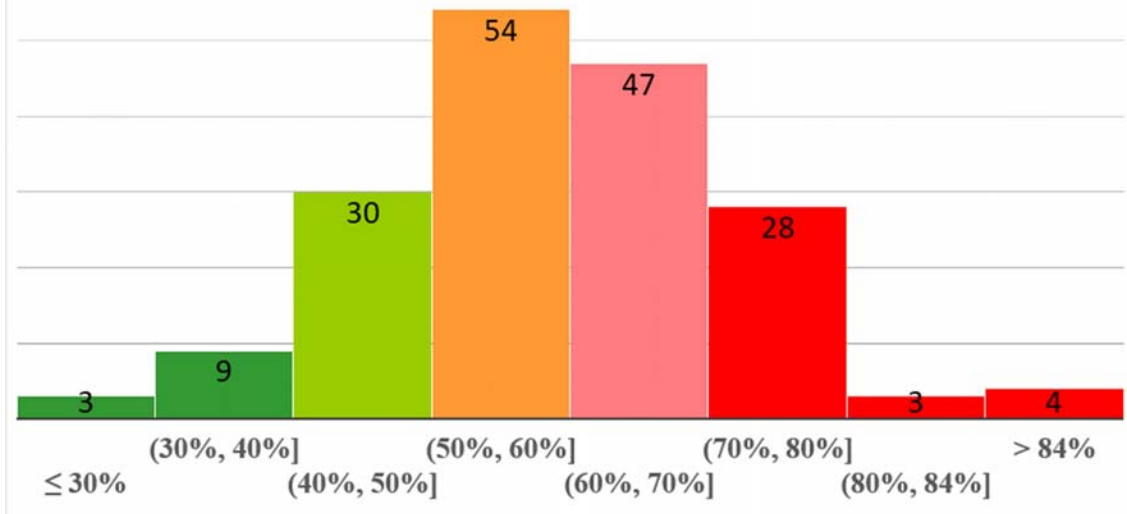
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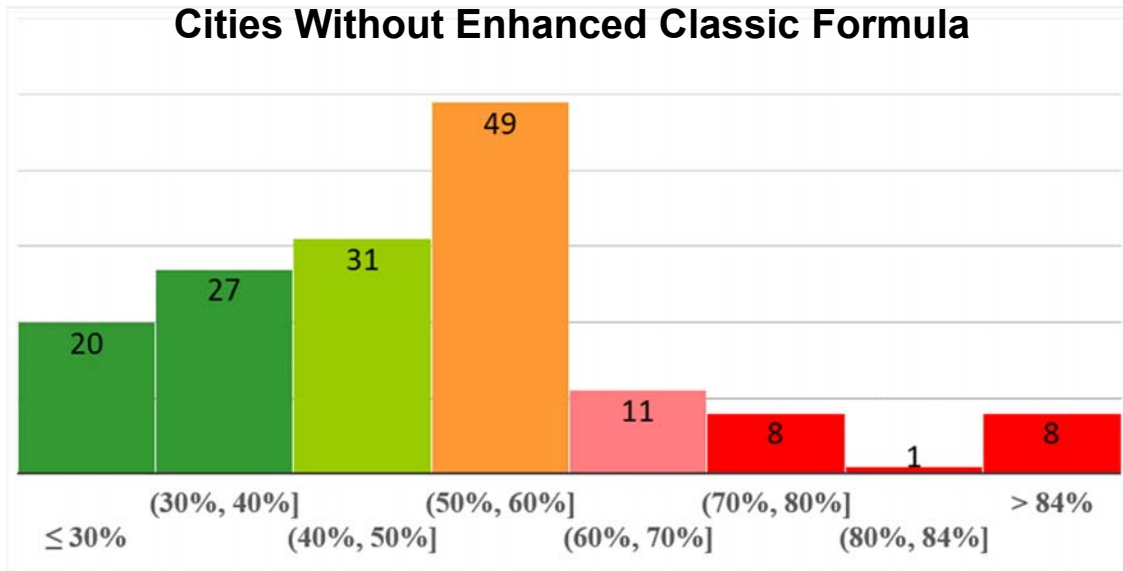
## CalPERS City Safety 2024/25 Projected Rates

### Cities With Enhanced Classic Formula



## CalPERS City Safety 2024/25 Projected Rates

### Cities Without Enhanced Classic Formula



## Paying Down Unfunded Liability & Rate Stabilization

- Where Do You Get the Money From?
- How Do You Use the Money?

## Where Do You Get the Money?

- Pension Obligation Bonds (POBs)
- Borrow from General Fund
- One time payments

## POBs

- Usually thought of as interest arbitrage between **expected** earnings and rate paid on POB
- No guaranteed savings
- PEPRA prevents contributions from dropping below normal cost
  - Savings offset when investment return is good
- GFOA White Paper

## Borrow from General Fund

- Excess Reserves?
- Pay GF back like a loan
- Payments should come from all funds

## One Time Payments

- Council/Board resolution to use a portion of one time money, e.g.
  - 1/3 to one time projects
  - 1/3 to replenish reserves and
  - 1/3 to pay down unfunded liability

## How Do You Use the Money?

- Give directly to CalPERS
- Establish an Internal Service Fund
- Establish an Irrevocable Supplemental (§115) Pension Trust

## Give Directly to CalPERS

- Treat as Contribution Gain
  - CalPERS default
  - Very modest short term impact
- Apply to all bases in proportion:
  - Lowers payment
  - Does not shorten amortization period

## Give Directly to CalPERS

- Request shorter amortization period
  - Does not require additional payment
  - Higher short term payments
  - Less interest and lower long term payments
- PEPPRA prevents contributions from dropping below normal cost
  - Savings offset when investment return is good

## Give Directly to CalPERS

- Target specific amortization bases
  - Paying off shorter amortization bases
    - Larger annual contribution savings over shorter period
    - Less interest savings compared to paying off longer amortization bases
  - Paying off longer amortization bases
    - Smaller annual contribution savings over longer period
    - More interest savings compared to paying off shorter amortization bases

## Internal Service Fund

- Could be used for rate stabilization
- Restricted investments:
  - Likely low (0.5%-1.0%) investment returns
  - Short term/high quality investments
  - Designed for preservation of principal
- Assets could be used by Board/Council for other purposes
- Does not reduce GASB 68 Net Pension Liability

## Irrevocable Suppl. Pen. Trust

- IRC §115
- Normally used for rate stabilization
- Will not reduce GASB 68 Net Pension Liability
- Investments significantly less restricted than agency investment funds:
  - Designed for long term returns
  - Likely much higher (4%-5%) investment returns than agency investment funds

## Irrevocable Suppl. Pen. Trust

- > 100 agencies
  - PARS, PFM & Keenan
- Can't be used by agency for other purposes
- Can only be used to :
  - Reimburse for pension contributions
  - Make payments directly to pension system
- Does not reduce Net Pension Liability

## Irrevocable Suppl. Trust

- Can mitigate:
  - Investment volatility
  - Impact of plan becoming over funded
- Requires modest seed contribution to trust ( $\approx 10\%$  of annual dollar contribution)



