

CITY OF SANTA MONICA

Pension Overview

May 2022



Background

This presentation provides information on the City's defined benefit pension plan, including its structure, cost, and actions the City has taken to mitigate the impacts of ongoing pension costs and liability.

- The City of Santa Monica provides a defined benefit retirement plan to its permanent employees working more than **1,000 hours per year for at least five years**. The benefit is calculated by a formula based on the position they have at the City, length of service and qualifying compensation. Santa Monica primarily pays for benefits earned during an employee's time in Santa Monica only. However, when an employee is hired from another agency at a higher salary, their former agency contributes part of the pension cost of the new employee.
- This plan is administered by the California Public Employee Retirement System (CalPERS). CalPERS serves the majority of California cities, counties and special districts and manages an investment portfolio of \$453.5 billion*.
- Santa Monica, like other cities, joined CalPERS in 1944. Specific retirement benefits are negotiated with bargaining groups, based on a set of plans offered by CalPERS. According to a 1955 State Supreme Court ruling, public employee pension benefits, once granted, cannot be unilaterally reduced, even for not-yet-earned benefits. This is sometimes referred to as the "California Rule". The courts have declared that some specific additional pension benefits do not fall under this rule, but the basic retirement benefit must be kept intact.

Santa Monica Employee Benefit Plans

Tier	Miscellaneous (non-sworn) 82% of workforce		Police (sworn)		Fire (sworn)	
	Rate	Retirement Age	Rate	Retirement Age	Rate	Retirement Age
<u>Classic</u> (hired before 7/1/2012)	2.7%	55	3.0%	50	3.0%	55
<u>Tier 2</u> (hired 7/1/2012-12/31/2012 or transferring to City from another PERS plan)	2.0%	55				
<u>PEPRA</u> (new to CalPERS and hired on/after 1/1/2013)	2.0%	62	2.7%	57	2.7%	57

- **How it works:** payment to retiree = years worked x rate x highest base compensation*
* highest rolling twelve months for Classic, avg of highest rolling 36 months for Tier 2 and PEPRA
- **Why different tiers?** The California Public Employees’ Pension Reform Act (PEPRA) created lower benefit levels for new employees in all plans effective January 1, 2013. Before this, Santa Monica added a new, lower “**Tier 2**” for miscellaneous employees only. Under Tier 2, employees transferring from another CalPERS agency receive a lower benefit rate.
- **Who has the new reduced plans?** As of June 30, 2021, **43%** of the City’s staff is currently under the Tier 2 and PEPRA Tiers. That will increase every year as more Classic members leave the City.

What does the City pay?

Actuarially Determined Contribution (paid annually) = Normal cost + Amortization of the Unfunded Liability

- Normal cost: Annual payment to fund benefits earned by active members during the year
- Amortization of the Unfunded liability: Annual payment to fund the gap between value of prior contributions plus investment earnings and discounted cost of future benefit payments. These contributions are sufficient to amortize the City's unfunded liability over a period of 30 years.

Do employees contribute?

Yes. In addition to the EMPLOYEE portion of the contribution, they also contribute up to 35% (depending on the plan/tier) of the total EMPLOYER payment each year. Employees do not participate in Social Security while at the City, so this is their only City-sponsored retirement income.

In FY 2020-21, the City's total pension cost was approximately \$56.1M (9% of the City's operating budget) and employees paid \$17.8M. The City's payment included \$38.2M towards the unfunded liability.

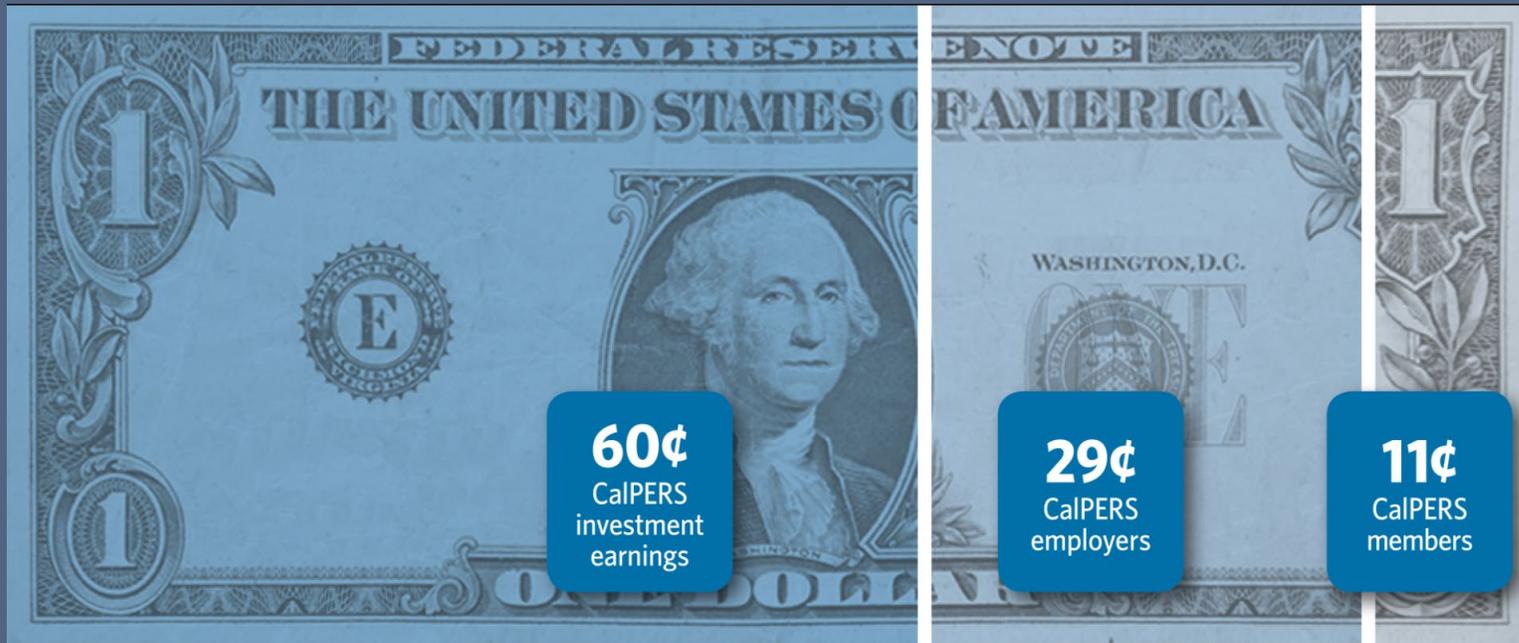
Santa Monica Employee Contribution Rates

Tier	Miscellaneous (non-sworn) 82% of workforce		Police (sworn)		Fire (sworn)	
	Rate	Additional	Rate	Additional	Rate	Additional
<u>Classic</u> (hired before 7/1/2012)	8.00%		9.00%	8.50%	8.0%	6.0%
<u>Tier 2</u> (hired 7/1/2012-12/31/2012 or transferring to City from another PERS plan)	7.00%					
<u>PEPRA</u> (new to CalPERS and hired on/after 1/1/2013)	6.75%		13.00%		10.0%	

Where does the money come from?

Benefit payments come from employer contributions (**what the City pays**), employee contributions (**what workers pay**), and from CalPERS investment earnings.

The graphic below demonstrates the breakdown.



What is the story on pensions?

Cities' required CalPERS contributions have increased significantly since the Great Recession and continue to grow, creating a big fiscal challenge for many. These increases reflect CalPERS' effort to lower the unfunded liability (the gap between the assets it expects to have to make retiree payments, and the amount of assets it needs). The end goal is long-term sustainability.

This is a big change from the early and mid 2000s, when the CalPERS portfolio was relatively well funded at over 80%; and at one point was super-funded, meaning that it had more than 100% of the assets needed to cover all projected liabilities (retiree payments).

What about Santa Monica's pension?

Santa Monica's pension liability is approximately 75% funded.

Unfunded liability is calculated in two different ways for different purposes.

CalPERS valuation

- Found in CalPERS actuarial valuations
- Used by CalPERS in calculation of annual contributions
- Uses more current actuarial information
- Valuation date of 6/30/2020

Balance as of 6/30/2020: **\$520 M**

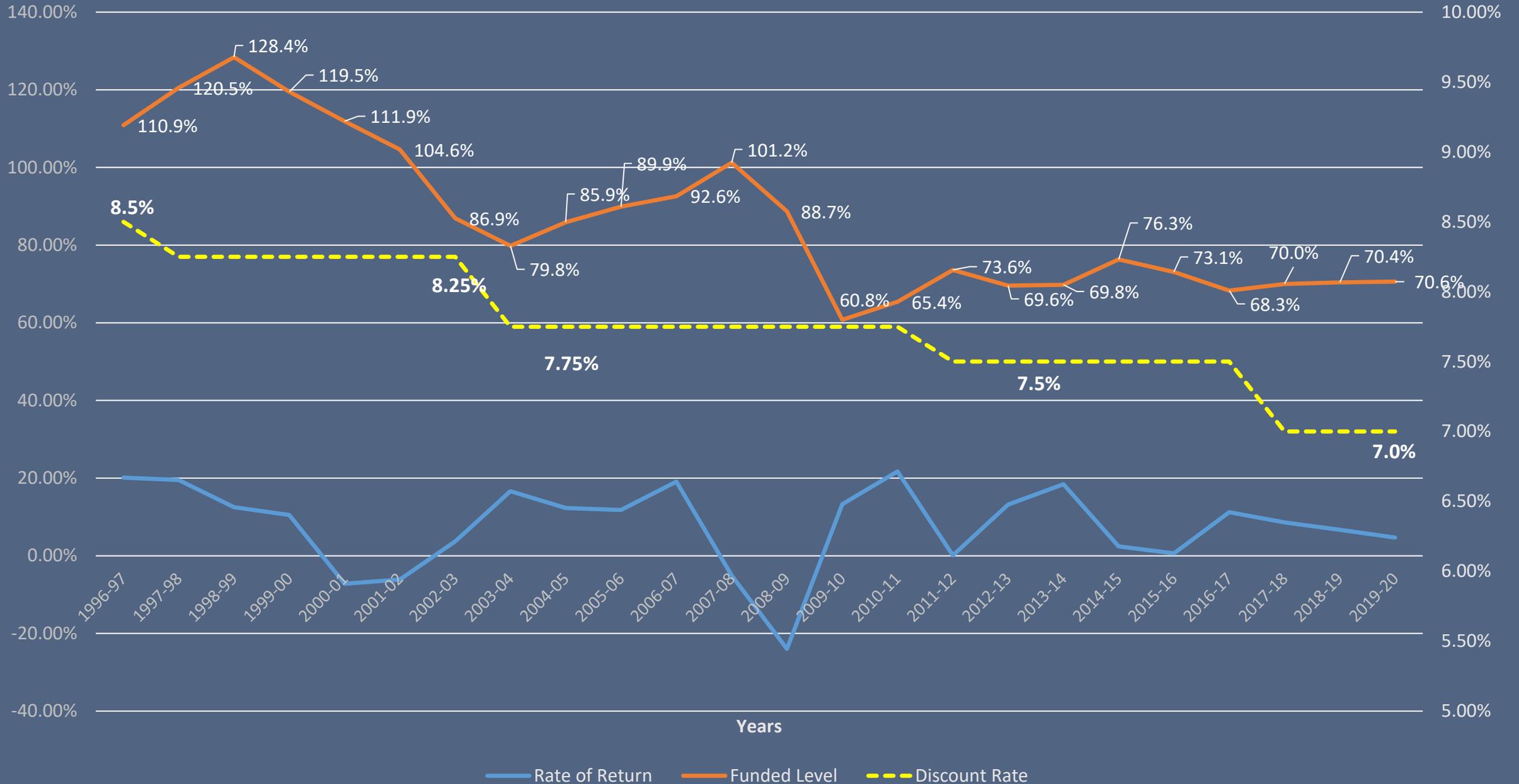
Governmental Accounting Standards Board (GASB)

- Used for financial reporting purposes
- Uses the 6/30/2019 valuation rolled forward with contribution, payment and investment return activity to 6/30/2020 which is reported in the 6/30/2021 financial statements.

Balance as of 6/30/2020: **\$481 M**



CalPERS Rate of Return, Funded Ratio, Discount Rate



How did we get here?

I: Structural Problems & Short-sighted Decisions

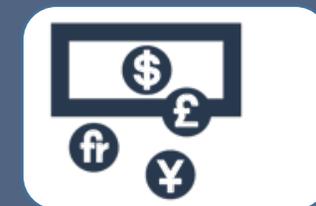
For many years, strong market returns, optimistic assumptions, and less conservative methodology hid system vulnerability until the 2008 market crash. Actions taken during this time further weakened fund health:

- In FY 1999-00, the State passed a law that greatly increased pension benefits without an associated contribution increase (SB 400).
 - Enhanced benefits were applied retroactively (see example below)
 - Benefits were based on highest rolling twelve months vs. 3-year average
- CalPERS underestimated costs and used an unrealistic discount rate
- In some years CalPERS did not require contributions (however, the City set aside funds equivalent to the annual payments to fund future contributions).

Example: An employee retiring on 12/31/99 (pre-SB400) received a \$60,000 annual pension payment, while the same employee retiring on 1/1/2000 (post-SB400) received a \$90,000 annual payment.

How did we get here?

II: External factors & response



Market Performance. During the 2008 market crash, the CalPERS portfolio experienced investment losses in line with the broader market, including losses in all asset classes. The loss in the portfolio's value exceeded 30%, reducing the funded level (amount of liabilities covered by assets) to 61%.

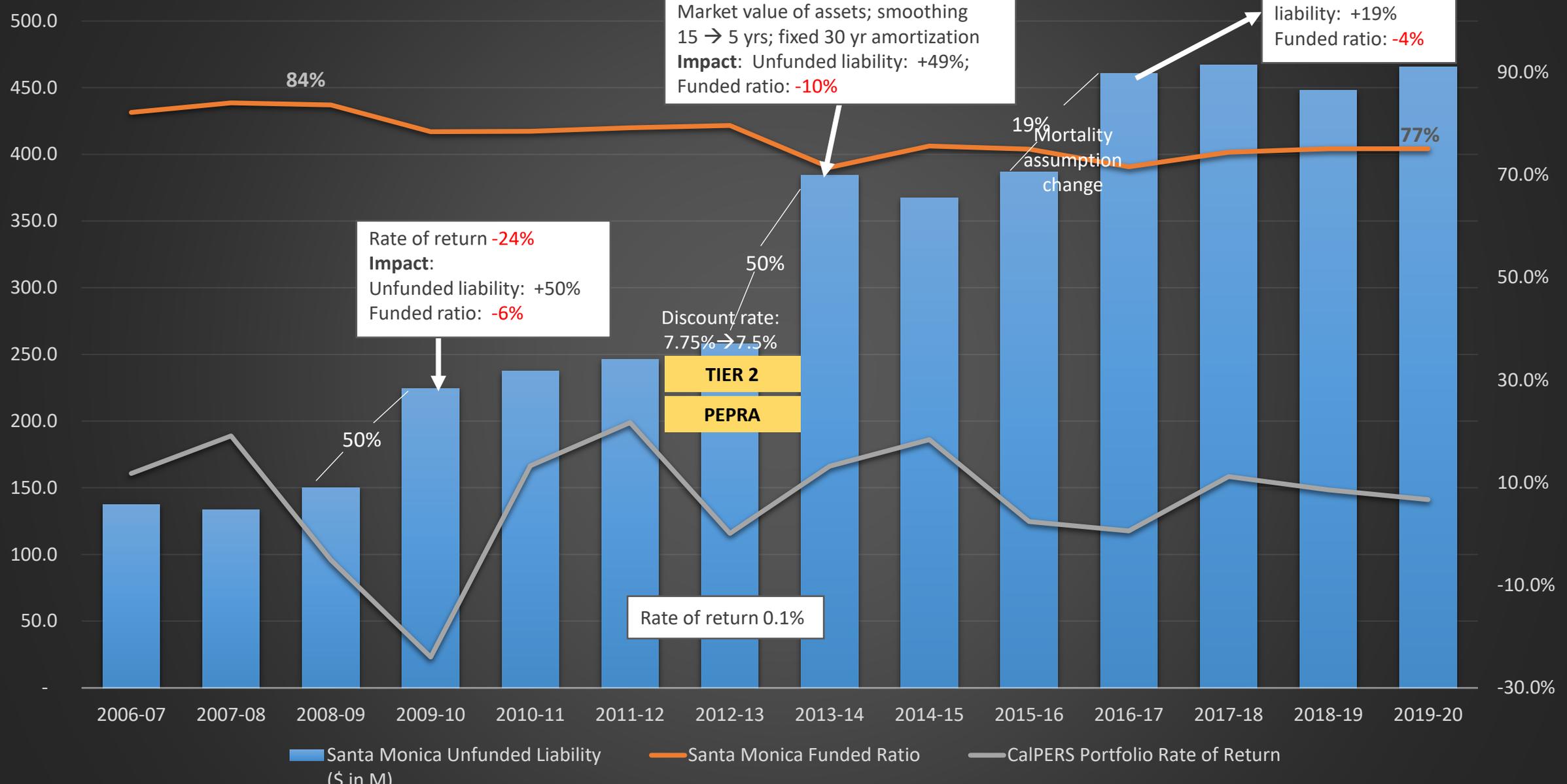
Assumption / Valuation Methodology Changes. CalPERS adjusted their methods based on their experience with the Great Recession by:

- 1) A new investment portfolio allocation to be more stable and less risky
- 2) Adjusting amortization/valuation methodologies. Transitioning from rolling to fixed 30 year amortization period now 20 years for new amortization bases, from 15 to 5 year smoothing period, and from actuarial to market valuation of assets
- 3) Updating projected demographic assumptions such as life expectancy and retirement age
- 4) Reducing the discount rate from 7.75% to 7.0% from 2011-12 to 2019-20; and implemented a new Risk Mitigation Policy which kicked in causing the discount rate to be further reduced to 6.8% due to the extraordinary market returns in 2020-21.

These changes contributed to an increase in the **unfunded liability**.



Santa Monica Unfunded Liability & Contributing Factors



How are we managing costs for the future?

Employee contributions & Lower cost benefit plans

- **Tier 2 & PEPRA.** New and transferring Santa Monica employees are earn a lower pension benefit than Classic members.
- Employees are contributing more towards retirement.

Payment strategies

- **Prepayment.** To receive a 3.5% discount, we prepay the current year's amortization of the unfunded liability at the start of the year.
- **Discretionary Additional Payments.** To amortize the unfunded liability faster, the City used available funds to pay down an additional \$88.1 million towards unfunded liability through 2020-21, including a \$45 million payment made on June 13, 2017.
- **Accelerated Paydown.** In 2019-20, at the recommendation of a City Manager-appointed Pension Advisory Committee, the City began making additional payments to replicate amortizing the unfunded liability over a 13-year period in order to save the City an estimated \$100 million (\$41 million present value) in interest payments. Due to the financial constraints brought on by the pandemic in 2020, Council voted to pause these extra payments for two years. Payments will resume in 2022-23.

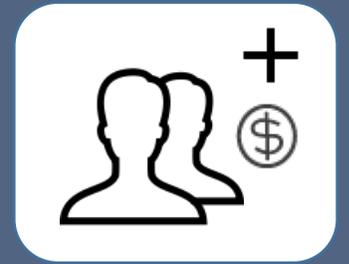


City of Santa Monica Principles for Pension Funding

Developed by the Pension Advisory Committee and incorporated in the in the City's [Fiscal Policies](#)

1. The GFOA and the California Actuarial Advisory Panel (CAAP) believe it is financially advantageous to repay or amortize unfunded pension liabilities. The Pension Advisory Committee believes the unfunded liability represents a looming threat to Santa Monica's safety and quality of life through erosion of vital services; undermining workforce compensation and job security; and damaging the City's long-term fiscal health.
2. The Pension Advisory Committee believes the City should maintain prudent funded status levels and an aggressive repayment plan to ensure that funds are available in the long run to meet City obligations and preserve financial flexibility to meet or maintain City obligations consistent with values of the City.
3. The Pension Advisory Committee believes the City should formally commit to a repayment period of not-to-exceed 13 years for the current unfunded pension liability, concluding in 2032-33. By following this recommendation, the City is projected to save approximately \$100 million.
4. In the event of a fiscal emergency, the Council would have the option to reduce the annual payment for that fiscal year to the amount required for a 15-year repayment schedule (as calculated in 2019), concluding in 2034-35, only after holding a public hearing and making appropriate findings.

How are we managing costs for the future?



Reduction of benefits

- The City negotiated with each of the employee groups to eliminate what's known as Employer Paid Member Contributions where the City previously paid for employees' contributions as part of their compensation package.

Reduction in Workforce

- Due to the pandemic the City reduced its workforce by several hundred employees which reduces normal pension cost going forward, but not the amortization of the unfunded liability.

Future changes

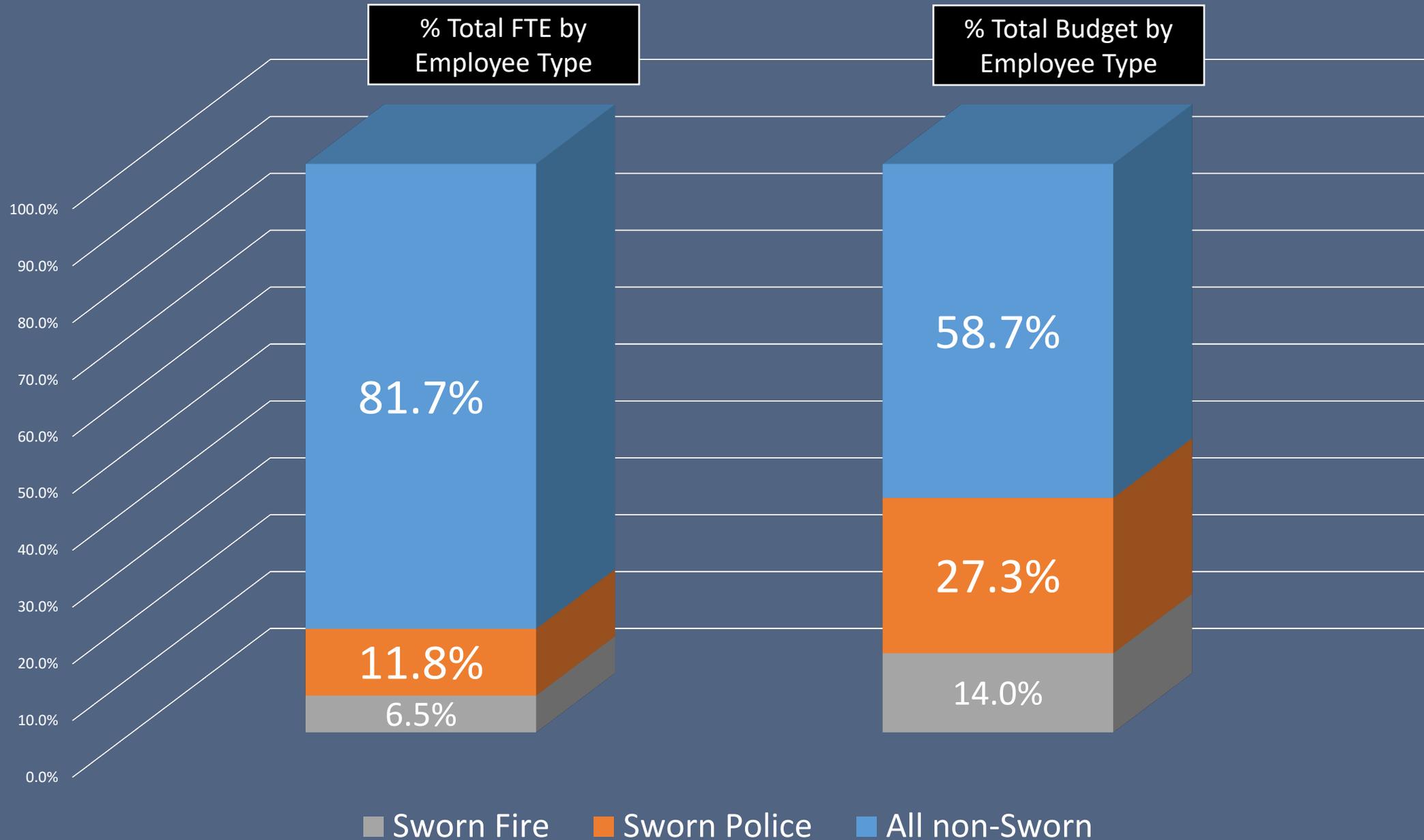
- In 2018, CalPERS voted to shorten amortization periods for future gains and losses to 20 years, helping to reduce negative amortization (when your contribution isn't sufficient to pay even annual interest amounts) and decrease total costs. These changes took effect in FY 2020-21.

How do plan costs compare?

Employee Type	Retirement Budget / FTE*
Sworn Police	\$75,000
Sworn Fire	\$70,000
Non-Safety (Misc.)	\$24,000

*Average budgeted cost in FY 2021-22 per FTE. Net of employee contribution.

How do these look in the City's budget?



How can I look this up?

The amounts are included in retirement line items. You can find this in:

- The City's [operating budget](#)



Where can I find more information?

Staff Reports

- See the [June 13, 2017](#) report on the \$45 million payment towards unfunded pension liability
- See the [April 22, 2019](#) information item on Methods to Manage Santa Monica's Unfunded Pension Liability, including a report of the work conducted by the Pension Advisory Committee
- Ongoing: search [Council agendas](#) for Budget staff's biannual financial status updates to Council.

Annual Comprehensive Financial Report

- View information in the letter of transmittal, management's discussion and analysis, the notes and other required supplementary information.
- As a result of accounting reporting pronouncement [GASB 68](#), the City's [annual financial report](#) includes the net pension liabilities on the statement of net position and detailed pensions information in Note 16.

CalPERS

- An abundance of information on how pension plans work and the detailed valuations for the City as well as other agencies are available on the [CalPERS](#) website

Still have questions?

- Email budget@smgov.net

