CITY OF SANTA MONICA
Pension Overview

January 2019

Background

This presentation provides information on the City's 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 its permanent employees working more than **1,000 hours per year for at least five years** with a defined benefit retirement plan. Santa Monica pays for benefits earned during an employee's time in Santa Monica only.
- This plan is administered by CalPERS, the California Public Employee Retirement System. CalPERS serves the majority of California cities, counties and special districts and manages an investment portfolio of $334.4 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 modified, even for future work. This is called the "California Rule;" currently under review in three cases.

*** Market value 10/25/2018. Source: CalPERS**

Santa Monica Employee Benefit Plans

Tier	Miscellaneous (non-sworn) 85% of workforce		Police (sworn)		Fire (sworn)	
	Rate	Retirement Age	Rate	Retirement Age	Rate	Retirement Age
Classic (hired before 7/1/2012)	2.7%	55	3.0%	50	3.0%	55
Tier 2 (hired 7/1/2012-12/31/2012 or transferring to City from another PERS plan)	2.0%	55				
PEPRA (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 salary*
  * highest year for Classic, avg of 3 highest consecutive years 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?** 1/3 of the City's staff is currently under the Tier 2 and PEPRA Tiers.

What does the City pay?

Annual Required Contribution = Normal cost + Unfunded Liability

- Normal cost: benefit earned during the year
- Unfunded liability: gap between value of prior contributions and cost of future payments. CalPERS factors in a portion of this to the City's required annual contribution. Annual contributions are sufficient to pay down the City's unfunded liability over 30 years.

Do employees contribute?

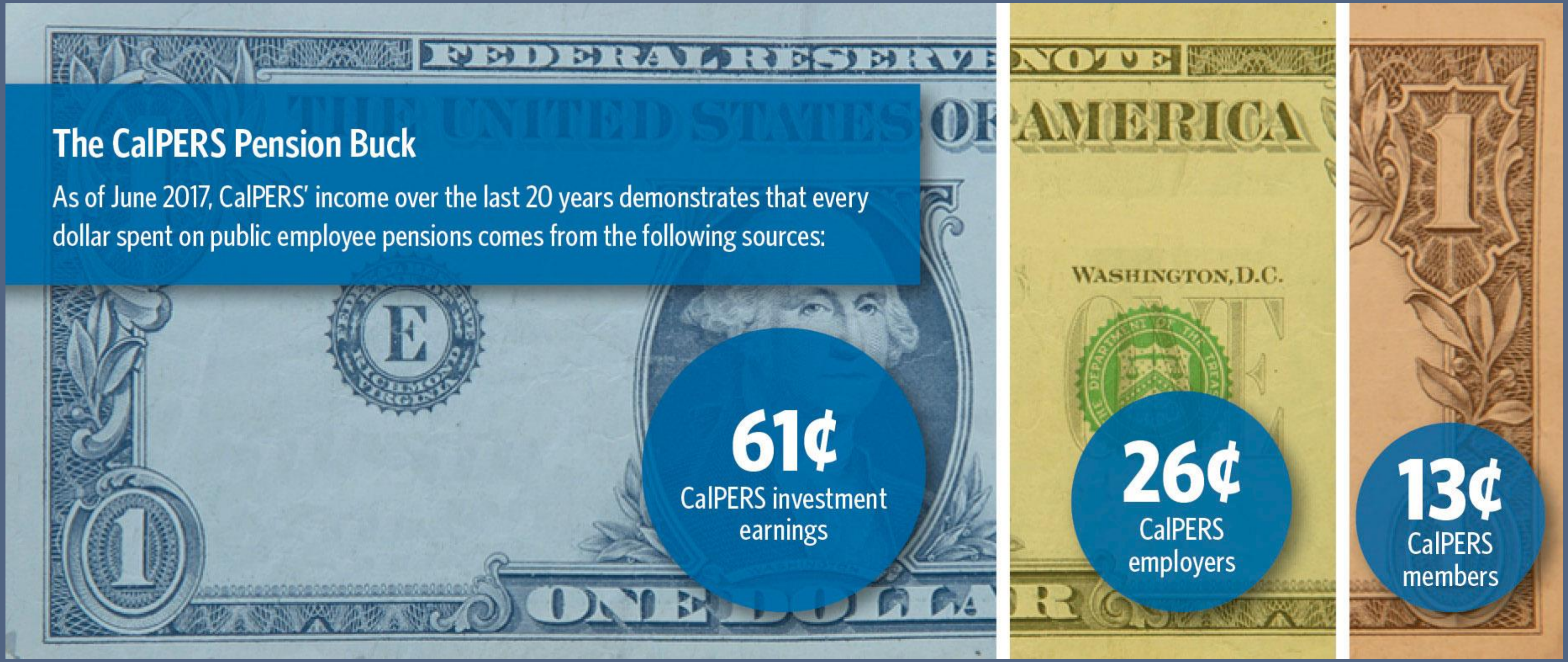
Yes. Employees contribute up to 29% (depending on the plan/tier) of the total payment each year. Employees do not participate in Social Security, so this is their only retirement income.

In FY 2017-18, the City's portion of pension cost was approximately $49.4M (8% of the City's operating budget) and employees paid $18.2M. The City's payment included $24.6M toward unfunded liability.

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.



Source: CalPERS Newsroom 10/31/17

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 cities. These increases reflects CalPERS' attempt to lower its 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 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 superfunded, meaning that it had more than 100% of the assets needed to cover all liabilities (retiree payments).

Source: CalPERS

What about Santa Monica's pensions?

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

Unfunded liability is calculated in two ways. Each incorporates assumption changes differently.

CalPERS valuation

- Found in CalPERS actuarial valuations
- Used in annual calculation of contributions
- More updated participant data and assumptions (due to valuation timing)
- Doesn't show full phase in of discount rate decrease

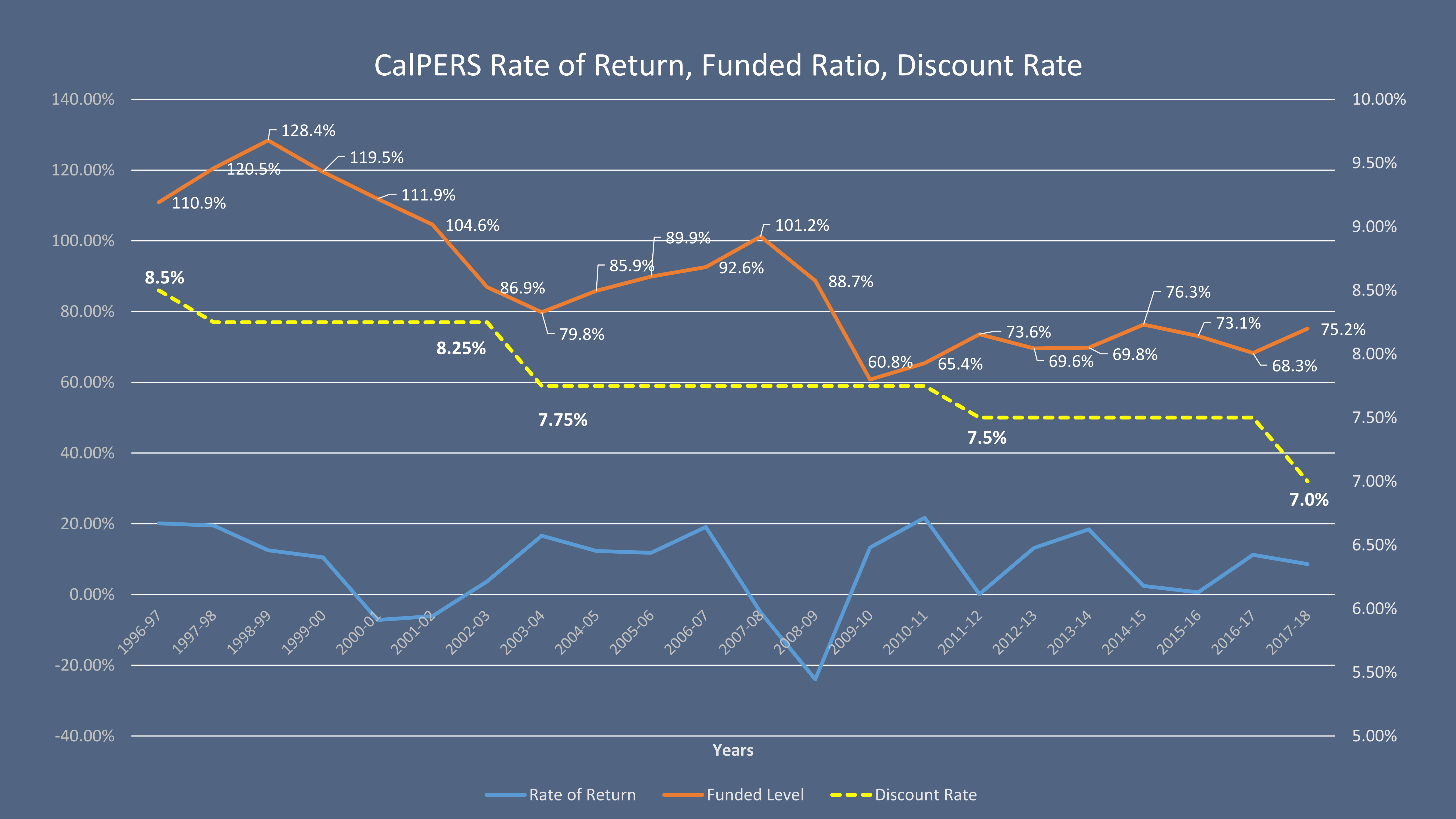
Current level: **$438 M**

State and Local Government Accounting Reporting (GASB)

- Found in the City's annual financial statements
- Used in reporting of liability
- **Includes full accounting of discount rate decrease**

Current level: **$467 M**

For 2018, Santa Monica will use the GASB number, **$467 M**. This is due to its more accurate consideration of the scheduled discount rate decrease.



CalPERS Rate of Return, Funded Ratio, Discount Rate
140.00%
120.00%
100.00%
80.00%
60.00%
40.00%
20.00%
0.00%
-20.00%
-40.00%
10.00%
9.50%
9.00%
8.50%
8.00%
7.50%
7.00%
6.50%
6.00%
5.50%
5.00%
110.9%
120.5%
128.4%
119.5%
111.9%
104.6%
86.9%
79.8%
85.9%
89.9%
92.6%
101.2%
88.7%
60.8%
65.4%
73.6%
69.6%
69.8%
76.3%
73.1%
68.3%
75.2%
8.5%
8.25%
7.75%
7.5%
7.0%
1996-97
1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
2017-18
Years
Rate of Return
Funded Level
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 to past years worked (see example below)
  - Benefits were based on highest year vs. 3-year average
- CalPERS underestimated costs and assumed continuing strong market returns
- In some years CalPERS did not require 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.

In Santa Monica, non-public safety employees paid for enhanced benefits beginning in 2007. We've been increasing employee contributions since then.

How did we get here?

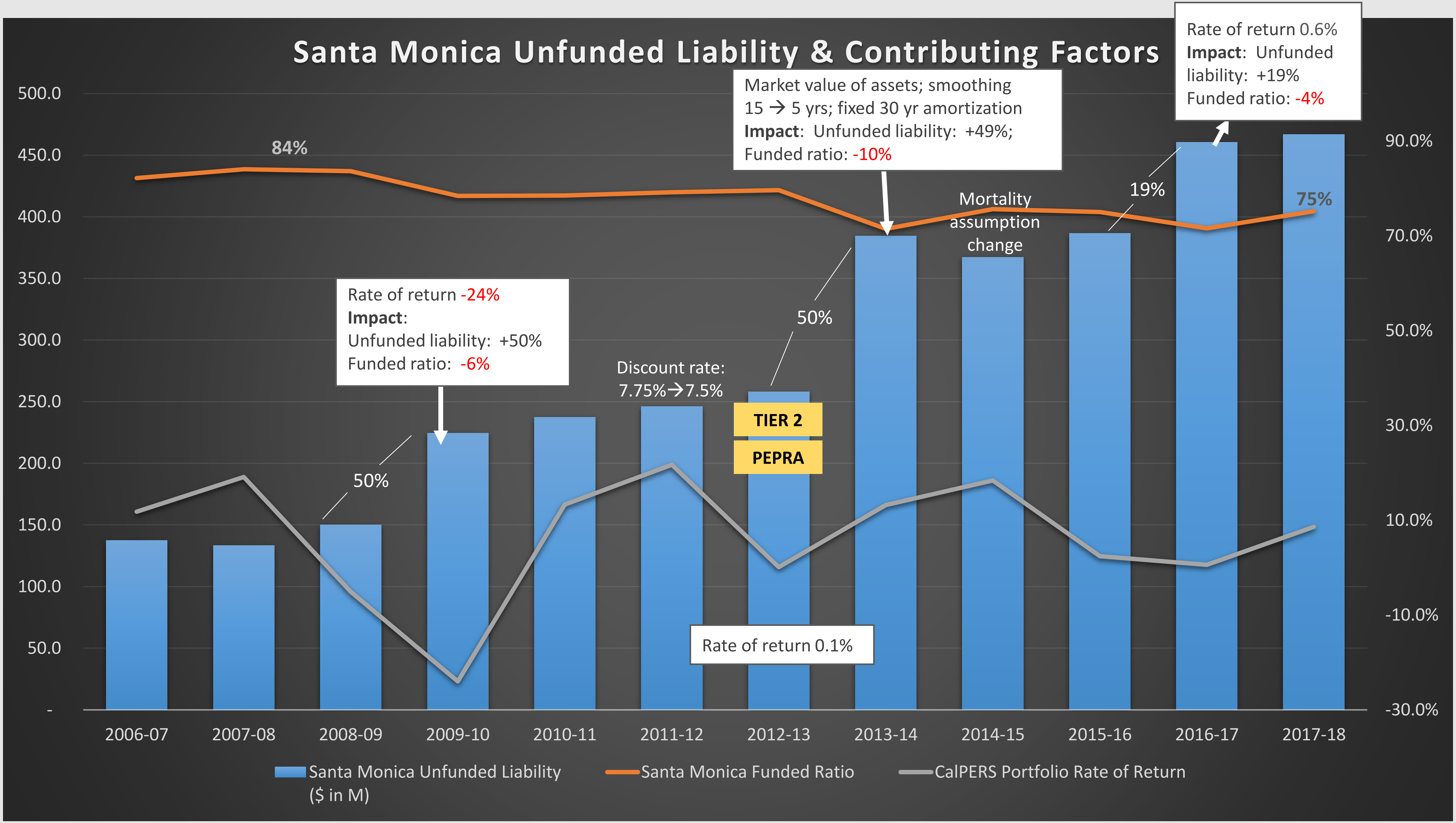
II: External factors & response

Market Performance. During the Great Recession, CalPERS experienced investment losses in line with the market, including losses related to real estate and hedge fund positions. The outcome was an over 30% loss in the portfolio's value, which decreased the funding level (amount of liabilities covered by assets) to 61%.

Assumption / Valuation Methodology Changes. Reacting to the lessons learned during the Great Recession, CalPERS:

1) Transitioned to a less risky, and therefore lower earning, portfolio
2) Adjusted amortization/valuation methodologies. Transitioned from rolling to fixed 30 year amortization period, from 15 year to 5 year smoothing period, and from actuarial to market valuation of assets
3) Updated life expectancy
4) Changed assumed return on investment first from 7.75%to 7.5%, and then from 7.5% to 7.0%

These changes contributed to an increase in unfunded liability.


Santa Monica Unfunded Liability & Contributing Factors
Rate of return 0.6%
Impact: Unfunded liability: +19%
Funded ratio: -4%
Market value of assets; smoothing 15 → 5 yrs; fixed 30 yr amortization
Impact: Unfunded liability: +49%;
Funded ratio: -10%
84%
Mortality assumption change
19%
75%
Rate of return -24%
Impact:
Unfunded liability: +50%
Funded ratio: -6%
50%
Discount rate: 7.75%→7.5%
TIER 2
PEPRA
50%
Rate of return 0.1%
500.0
450.0
400.0
350.0
300.0
250.0
200.0
150.0
100.0
50.0
-
90.0%
70.0%
50.0%
30.0%
10.0%
-10.0%
-30.0%
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
2014-15
2015-16
2016-17
2017-18
Santa Monica Unfunded Liability ($ in M)
Santa Monica Funded Ratio
CalPERS Portfolio Rate of Return

How are we managing costs for the future?

Payment strategies

- **Prepayment**. We prepay a portion of the City's contribution at the start of the year, which entitles the City to an annual $0.9 million rebate. The City has saved about $11.5 million from this strategy through FY 2017-18, which it then uses for additional pay downs of the unfunded liability.
- **Voluntary Additional Payments** (beyond the required annual contribution): To help lower unfunded liability, we've used savings to pay down $77.5 million towards unfunded liability through FY 2017-18, including a $45 million paydown on June 13, 2017. These paydowns are estimated to produce over $6 million in annual contribution savings. Our fiscal policy requires us to make additional paydowns of at least $1.3 million annually.

Employee contributions & Lower cost benefit plans

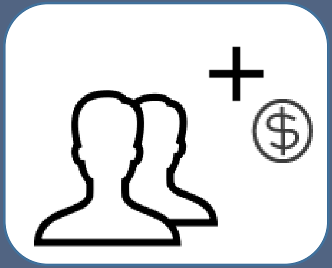
- **Tier 2 & PEPRA.** New and transferring Santa Monica employees are eligible for a lower pension benefit than Classic members.
- Employees are contributing more towards retirement.

How are we managing costs for the future?

Future changes

- CalPERS recently 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 will take effect in FY 2021-22.

- Consider using future year savings to further pay down unfunded liability or establish a rate stabilization fund that will shield the budget from rate fluctuations.

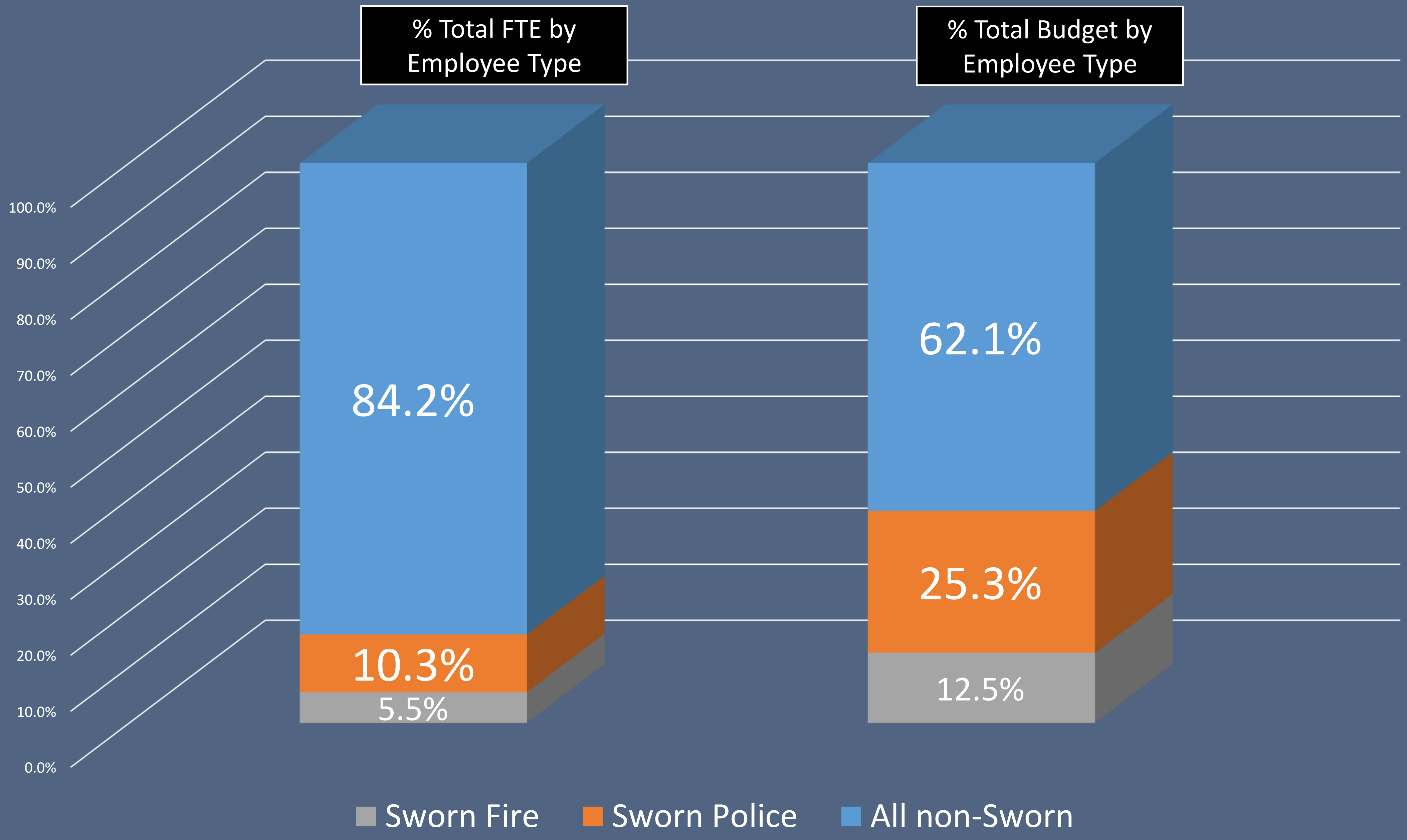


How do plan costs compare?

Employee Type	Retirement Budget / FTE*
Sworn Police	$64,000
Sworn Fire	$59,000
Non-Safety (Misc.)	$19,000

*Average budgeted cost in FY 2018-19 per FTE. Net of employee contribution.

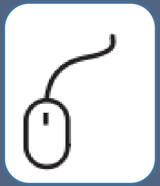
How do these look in the City's budget?



How can I look this up?

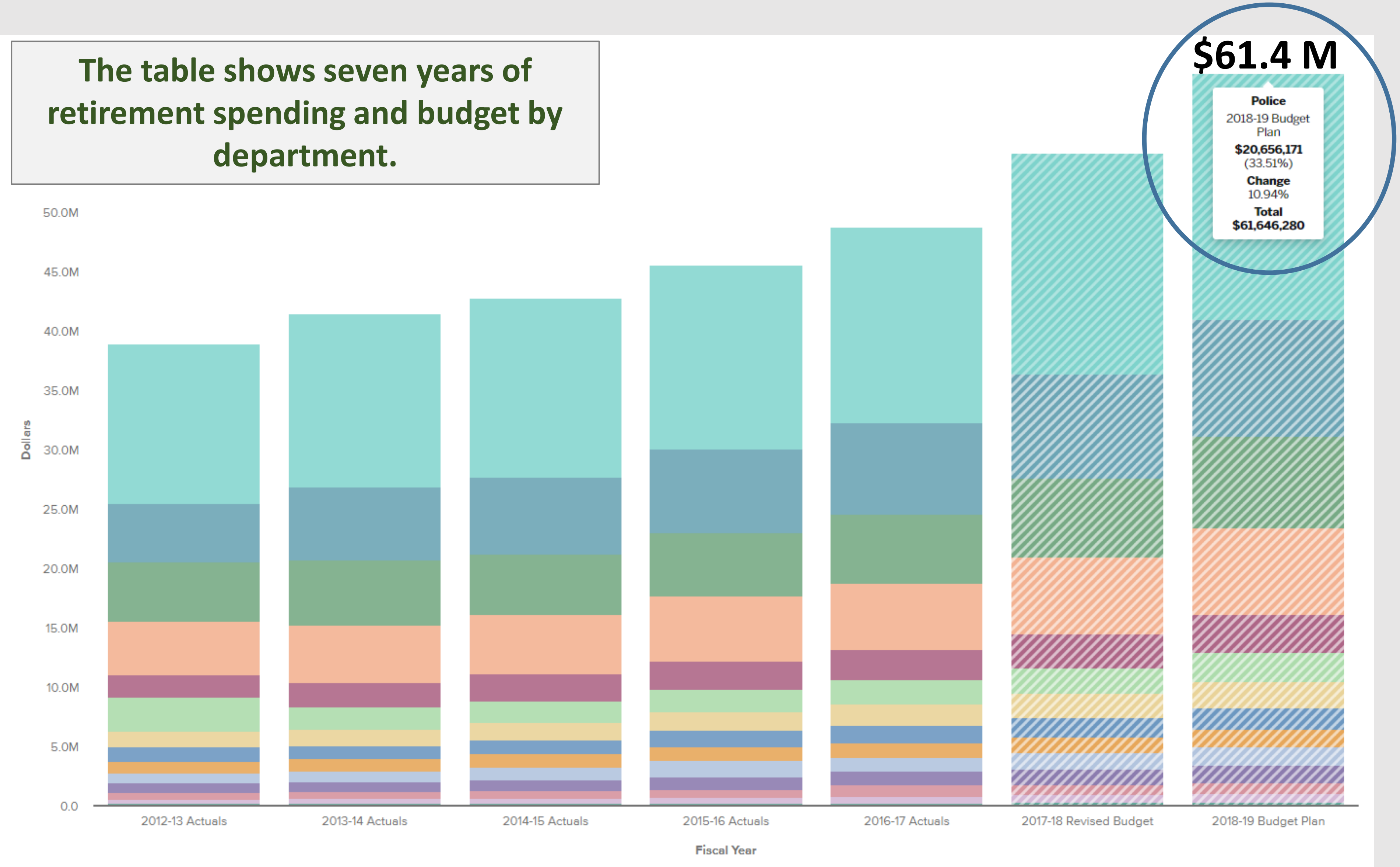
The amounts are included in retirement line items. You can find this in:

- The City’s operating budget
- Using the City’s online data review tool, Open Gov



How to view City retirement costs with Open Gov

The table shows seven years of retirement spending and budget by department.



How to get here:

santamonicaca.opengov.com

Select:

Operating Budget

Expense Type =

Salaries and Wages

Departments =

All except non-Departmental

Specific Expense Types:

- Retirement - As Needed ✔
- Retirement - Fire ✔
- Retirement - Misc. Empl ✔
- Retirement - Police ✔

Where can I find more information?

Budget Staff Reports

- **Recent activity:** See the June 13, 2017 report on Payment Towards Unfunded Pension Liability
- Ongoing: search Council agendas for Budget staff's biannual financial status updates to Council.

Comprehensive Annual Financial Report

- View information in the notes to financial statements, and other areas throughout the document.
- The City's annual financial report reports pension liabilities on its statement of net position. This is a result of new accounting rules (GASB 68) meant to improve reporting. The detailed information is in Note 16.

Questions?

- Email budget@smgov.net