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SUBMITTAL TO THE BOARD OF SUPERVISORS
COUNTY OF RIVERSIDE, STATE OF CALIFORNIA

FROM: Executive Office

SUBMITTAL DATE: April 3, 2014

SUBJECT: Pension Advisory Review Committee 2014 Annual Pension Report [Districts: All] [$0]

RECOMMENDED MOTION: That the Board of Supervisors:

1. Receive and file the attached FY 2013/14 Annual Report;
2. Adopt the recommendation to use the money in the Liability Management Fund to reduce the County's CalPERS' liability by transferring the funds to CalPERS; and,
3. Adopt the recommendation to pre-pay a portion up to two-thirds of the County's FY 2014/15 pension cost if, in the judgment of the County Executive Officer or his designee, if market conditions prove to be favorable.

BACKGROUND:

Summary

Board Policy B-25 (Pension Management Policy) requires the Pension Advisory Review Committee (PARC) to file an annual report on the County's pension plan status. The attached report fulfills that requirement.

(Continued)

Departmental Concurrence

Don Kent
County Treasurer-Tax Collector

Michael Stock
Assistant County Executive Officer
Human Resources Director

Ed Corser
County Finance Director

FINANCIAL DATA	Current Fiscal Year:	Next Fiscal Year:	Total Cost:	Ongoing Cost:	POLICY/CONSENT (per Exec. Office)
COST	$ N/A	$ N/A	$ N/A	$ N/A	Consent ☐ Policy ☒
NET COUNTY COST	$ N/A	$ N/A	$ N/A	$ N/A	

SOURCE OF FUNDS:

Budget Adjustment: No

For Fiscal Year: 2013/14

C.E.O. RECOMMENDATION: APPROVE

BY: George A. Johnson

County Executive Office Signature

MINUTES OF THE BOARD OF SUPERVISORS

☐ Positions Added ☐ Change Order ☐ A-30 ☐ 4/5 Vote

Prev. Agn. Ref.: 3-1 of 04/30/13 | **District:** ALL | **Agenda Number:** 3-3

BACKGROUND:
<u>Summary (continued)</u>

REPORT SUMMARY

Pension Reform:
The Board of Supervisors took the initiative on pension reform. As a result of labor negotiations, employees took on the responsibility of making the Employee Paid Member Contributions (EPMC). Based on projections made by Bartel Associates, in FY 2014/15, it is anticipated that the County will realize $73.7 million annual savings.

Due to the passage of Assembly Bill (AB) 340, which created the Public Employee's Pension Reform Act (PEPRA), a third tier was added to the County's pension plan. The attached report has additional detail outlining the changes; however, listed below is a table of the changes.

				Plan	EPMC	Earliest Retirement Age	PEPRA Compensation Limits	Final Benefit	Effective Date
County Plan Tier I									
	Misc			3% at 60	No	50	N/A	12 months	N/A
	Safety			3% at 50	No	50	N/A	12 months	N/A
County Plan Tier I with Tier II									
	Misc			2% at 60	No	50	N/A	36 months	8/23/2012
	Safety			2% at 50	No	50	N/A	36 months	8/23/2012
County Plan Tier I, Tier II and Tier III (PEPRA)									
	Misc			2% at 62	No	52	$115,064*	36 months	1/1/2013
	Safety			2.7% at 57	No	50	$138,077*	36 months	1/1/2013
*2014 Compensation Limits are Indexed Annually									

Funded Status:

As of June 30, 2013, the County was projected to be funded at 86%. Effective this year, Government Accounting Standard Board (GASB), has eliminated the use of Actuarial basis of valuation and required the County to adopt the Market basis of valuation. As result of the change, the June 30, 2014 projected funded status based on Market Value for the Miscellaneous Plan, including Pension Obligation Bonds (POB), is expected to be 80 percent. The Safety Plan, including POB, is also expected to be 80 percent funded. PARC Advisor, Bartel Associates, projects a combined Miscellaneous and Safety projected June 30, 2014 funded Accrued Value of Assets of $6.226 billion on a Market Value Basis and POB of $334 million. The County has a projected Unfunded Accrued Actuarial Liability of $1,556 billion.

Employer Rate Outlook:
While we expect pension costs to continue to trend upward, this year, our rates are going to be lower. Last year, the County elected not to use the smoothing method for the change in the discount rate. As a result, we paid higher rates in the first year and will pay lesser amounts over the amortization period. Employer Contribution rates for the Miscellaneous Plan will decrease from 15.6 percent of payroll in FY 13/14 to 14.5 percent in FY 14/15. Safety Employer Contribution rates will decrease from 24.1 percent in FY 13/14 to 21.9 percent in FY 14/15. The combined decrease is $16.4 million, based on current payroll, however, when other factors are added including POBs, step increases and Cost of Living Allowance (COLA) increases, the savings is approximately $9 million.

Over the last year, CalPERS made several changes that will increase contribution rates beginning July 1, 2015. Some of the primary changes in rates are mortality improvement, fixed amortization periods, elimination of caps on rate increases and no asset smoothing. We expect the impact of these changes to start with the FY 2015/16 rates. The full impact is expected to take effect in FY 2020/21. On page 4 of the PARC report, tables are provided that show the impact to the County.

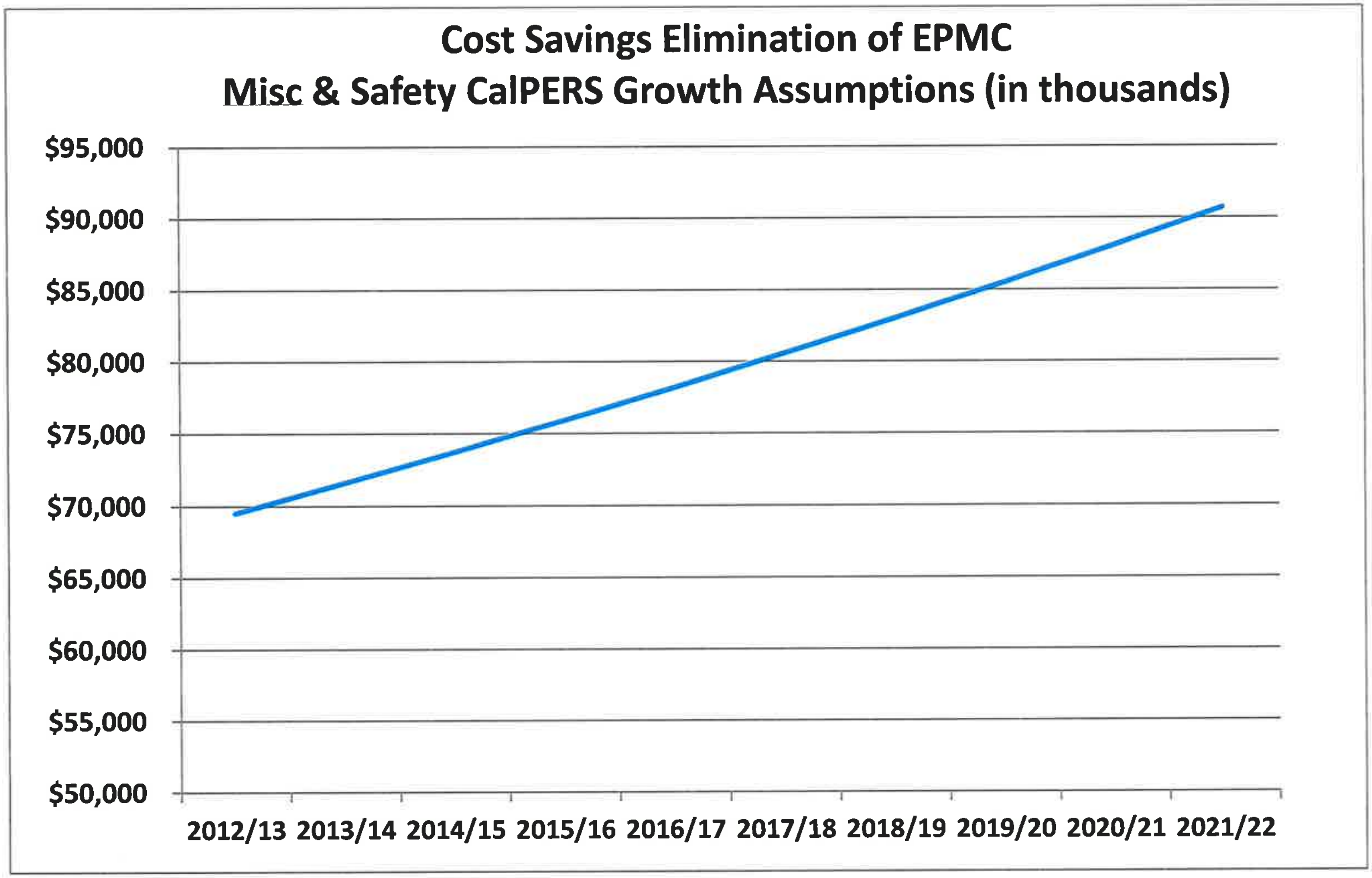
Liability Management Fund:
The purpose of the fund is to reduce pension costs and accelerate the repayment of pension liabilities. By Board policy, each year PARC recommends whether the funds should be used to pay down the CalPERS' unfunded liability or buy down the POBs. At the end of the last fiscal year, a payment of $1 million was made to PERS from this fund. As of the writing of this report, the fund has a balance of $2.0 million.

Annual Prepayment:
CalPERS offers early payment discounts of 3.75 percent in lieu of periodic payments that coincide with payroll disbursements. PARC first recommended seizing this opportunity in 2004 and expects to continue to do so if market conditions prove to be favorable in funding the pre-payment. The amount we pay is based on up to two-thirds of the County's annual liability. During FY 2013/14, the County prepaid $83.4 million of its PERS' liability. In FY 2014/15, we expect to prepay CalPERS $90 million. We will be calculating the final amount as part of our Tax Revenue Anticipation Notes (TRANs) financing. If market conditions remain consistent up to the time of the TRANs financing, and the County is able to issue notes at approximately 0.4 percent with the prepayment savings from CalPERS of approximately 3.75 percent, which will produce a net savings of 3.35 percent, or approximately $3 million.

Other Post-Employment Benefits (OPEB):
The County invests its OPEB assets with the California Public Employers' Retirement Benefit Trust program (CERBT). Effective January 1, 2011, CalPERS introduced three new investment allocation strategies for CERBT. PARC reviewed the details of the strategies and adopted Strategy 1, an asset allocation strategy most similar to the investment allocation strategy followed by CERBT prior to January 1, 2011, with an expected rate of return of 7.61 percent. It is anticipated CERBT will lower its investment strategy expected return in the near future to 7.36 percent.

Impact on Citizens and Businesses
For the FY 2014/15, pension costs will be down by $9 million. As a result, there will be no direct impact to citizens and business as County Departments will realize the rate relief.

ATTACHMENT 1



2014

Pension Advisory Review Committee

2014 Annual Pension Report

ANNUAL PARC REPORT

The County's Pension Advisory Review Committee (PARC) was established in 2003 to guide policy decisions about retirement benefits. PARC is a Brown Act Committee and consists of those members appointed by the Board of Supervisors, including the Treasurer/Tax Collector, County Finance Director, and the Human Resources Director.

A key responsibility of PARC is to report to the Board and the public about important developments affecting County retirement benefit plans and provide information about projected costs and funding status. This report includes information from the most recent actuarial report prepared for the County by John Bartel of Bartel Associates, LLC. (Attachment 2). It also includes the latest CalPERS' Valuation Reports for Miscellaneous and Safety (Attachments 3 and 4).

CalPERS Changes

Over the last year, CalPERS' actuarial staff recommended several changes. The reasons for their recommendations are as follows:

- Asset Corridor generates volatility with extreme events.
- Slow funded status progress.
- Current method needs improved transparency.
- GASB 68 encourages faster funding by requiring a lower discount rate for slower funding.

As a result of these reasons, CalPERS' staff recommended and the Board adopted the following changes:

a. Five (5) year ramp up.
b. No asset smoothing.
c. Future Gains/Losses 25 year amortization period.
    a. 5-year ramp up period will allow payment over 30 years.
d. Method and Assumption changes to be realized over a 15-year amortization period.
    a. 5-year ramp up period will allow payment over 20 years.
e. No cap on rate increases each year.
f. Change as a result of new experience study, including mortality improvement and other demographic assumptions.

Most of the adopted changes will start to impact the County's FY 2015/16 rates and the full impact is expected to occur in the FY 2019/2020 rates. Mortality and other demographic assumption changes will begin to be reflected in FY 2016/17. The full impact of the assumption changes are expected take effect in FY 2020/21.

1. **Funding Status:** The June 30, 2014 projected actuarial funded status based on the market valuation for:

    a. The Miscellaneous Plan, including Pension Obligation Bonds (POB) proceeds but not amounts owed, is expected to be 80%.
    b. The Safety Plan, including POB proceeds but not amounts owed, is expected to be 80%.

At June 30, 2013, the County was projected to be funded at 86%. This year's funding level is lower due to the change in the asset valuation method. CalPERS adopted provisions for the actuarial valuations commencing June 30, 2013 and thereafter to utilize the market value of assets rather than the actuarial value of assets. The July 2008 State and Local Government Pension Plans report published by the United States Government Accountability Office states, "Many experts consider a funded ratio based on the actuarial asset value of 80% or better to be sound for government pensions." Bartel suggests that in order to increase the funding status, an option is to place additional funds into the pension plan, which would reduce the unfunded liability. However, Bartel also states that a pension plan should be considered a very long-term proposition that should not be viewed in the context of short-term bright line tests.

2. **Employer Rate Outlook:** The County has a pleasant anomaly to deal with in regards to pension costs for the upcoming year. Due to options selected in the prior year, for FY 14/15 Pension costs will be lower. The Employer Contribution rates for the Miscellaneous plan will decrease from 15.6% of payroll in FY 13/14 to 14.5% in FY 14/15. Safety Employer Contribution rates will decrease from 24.1% in FY 13/14 to 21.9% in FY 14/15. The CalPERS' combined decrease is projected to be equivalent to $9 million based on current payroll, however, when other factors are added including Pension Obligation Bonds, the savings will be approximately $9 million. The lower rates are projected for this single year and future rates are expected to rise due to the changes outlined above.

    Effective March 14, 2012, CalPERS lowered its discount rate assumptions from 7.75% to 7.50%. Bartel Associates estimated that this change would increase the County's employer contribution rate for Miscellaneous by 1.9% and for Safety by 3.2% over a two year period, beginning in FY 13/14. The Committee elected not to phase in the assumption change for FY 13/14, as employer rates for 2014/15 through 2032/33 will be lower without a phase in than they would be with a phase in. The Miscellaneous plan without the phase in increased by 0.581% in FY 13/14, and the Safety plan without the phase in increased by 0.766% in FY 13/14. This resulted in an estimated increase in employer contributions of $7.1 million in FY 13/14.

    As described earlier, CalPERS has made several changes that will increase contribution rates beginning July 1, 2015. Listed below are tables with the projected changes for Miscellaneous and Safety. These projections are based on data from the Bartel Associates Report and rates include POB debt service.

Miscellaneous Projected Rates and Payments ($ Thousands)				
FY	CalPERS Base	County Rate	County Payment	Change in Amount
2013/14	$ 887,356	18.2%	$ 161,499	-
2014/15	913,977	17.1%	156,290	(5,209)
2015/16	941,396	18.1%	170,393	14,103
2016/17	969,638	20.0%	193,928	23,535
2017/18	998,727	21.3%	212,729	18,801
2018/19	1,028,689	22.5%	231,455	18,726
2019/20	1,059,550	23.8%	252,173	20,718
2020/21	1,091,336	24.2%	264,103	11,930
2021/22	1,124,076	24.0%	269,778	5,675

Payment Increase FY 13/14 to FY 21/22 = $108,279

Safety Projected Rates and Payments ($ Thousands)				
FY	CalPERS Base	County Rate	County Payment	Change in Amount
2013/14	$ 277,641	26.2%	$ 72,742	-
2014/15	285,971	24.2%	69,205	(3,537)
2015/16	294,550	25.3%	74,521	5,316
2016/17	303,386	28.0%	84,948	10,427
2017/18	312,488	29.8%	93,121	8,173
2018/19	321,863	31.6%	101,709	8,587
2019/20	331,518	33.4%	110,727	9,018
2020/21	341,464	34.0%	116,098	5,371
2021/22	351,708	33.7%	118,526	2,428

Payment Increase FY 13/14 to FY 21/22 = $ 45,784

3. **Pension Reform:** For some time, pension reform has been a topic of debate at local and national levels. Riverside County took the lead in initiating pension reform with its bargaining units. As a result of bargaining, employees of the County took on the responsibility of paying their Employee Paid Member Contribution (EPMC) and a new Tier with lower benefit formula, effective August 23, 2012, was added in both the Miscellaneous and Safety units of the County. At the same time, Governor Brown initiated proposals that resulted in changes to the pension benefits. The passage of Assembly Bill (AB) 340 created the Public Employees' Pension Reform Act (PEPRA) that implemented new lower benefit formulas, final compensation periods, and new contribution requirements for new employees hired on or after January 1, 2013 who meet the definition of a new member under PEPRA. The lower benefit formula for Tier III is 2% at 62 for Miscellaneous and 2.7% at 57 for Safety. Employee contribution rates for Tier III vary based on PEPRA rules. Listed below is a table with the new options and the important changes.

	Plan	EPMC	Earliest Retirement Age	PEPRA Compensation Limits	Final Benefit	Effective Date
County Plan Tier I						
Misc	3% at 60	No	50	N/A	12 months	N/A
Safety	3% at 50	No	50	N/A	12 months	N/A
County Plan Tier I with Tier II						
Misc	2% at 60	No	50	N/A	36 months	8/23/2012
Safety	2% at 50	No	50	N/A	36 months	8/23/2012
County Plan Tier I, Tier II and Tier III (PEPRA)						
Misc	2% at 62	No	52	$115,064*	36 months	1/1/2013
Safety	2.7% at 57	No	50	$138,077*	36 months	1/1/2013
*2014 Compensation Limits are Indexed Annually						

At the end of this report is a chart (Attachment 1) showing the pension costs if no action was taken and the changes in rates as a result of the action taken by the Board of Supervisors.

CalPERS also made changes as a result of several fiscal years of losses. The table below lists the losses and recoveries since fiscal year 2008. CalPERS indicated it has no immediate plans to change the current discounted rate of 7.50%.

	Market Value of Assets	Actuarial Value of Assets	Net Accumulated Market Increase/(Decrease) Since 2008
■ June 30, 2008	(5.1%)	7.6%	
• Gain/(Loss)	**(12.9%)**	**(0.2)%**	**(12.9%)**
■ June 30, 2009	(24.0)%	5.4%	
• Gain/(Loss)	**(31.8)%**	**(2.4)%**	**(44.7%)**
■ June 30, 2010	13.3%	5.9%	
• Gain/(Loss)	**5.5%**	**(1.9)%**	**(39.2%)**
■ June 30, 2011	21.7%	6.7%	
• Gain/(Loss)	**13.9%**	**(1.1)%**	**(25.3%)**
■ June 30, 2012	0.1%	6.1%	
• Gain/(Loss)	**(7.4)%**	**(1.7)%**	**(32.7%)**
■ June 30, 2013	13.2%	7.5%	
• Gain/(Loss)	**5.7%**	**(0.0)%**	**(27.0%)**

4. At the County, the Board of Supervisors took the initiative on pension reform. With the Board's direction, collective bargaining negotiations have been completed, with all employee unions to implement a Tier II (lower benefit) for new employees. Tier II was implemented on August 23, 2012. Miscellaneous members' retirement formula is 2% at 60, and Safety retirement formula is 2% at 50.

   Additionally, Employer Paid Member Contributions (EPMC) will be eliminated in 2014 for all represented and unrepresented employees, mostly in a phased approach. It is anticipated that the County will realize $73.7 million annual savings once all EPMC payments are eliminated.

5. **Pension Obligation Bond (POB):** The remaining POB debt is $334.5 million and the bonds have a remaining 21-year life maturity. Bartel's analysis shows that as of February 11, 2014, the County has a $31.3 million net savings as a result of the sale of the bonds in February 2005. This is a $26.3 million improvement compared to last year's report. The POB has a relatively low break-even rate (4.91%) and CalPERS' expected return is 7.50%. If CalPERS' estimate earns the assumed targeted rate of return, the County can expect to produce savings over the remaining life of the bonds.

6. **Liability Management Fund:** The purpose of the fund is to reduce pension costs and accelerate the repayment of pension liabilities. By Board policy, each year PARC recommends whether the funds should be used to pay down the CalPERS' unfunded liability or to buy down the POB. At the end of last fiscal year a payment of $1 million was made to PERS from this fund. As of the writing of this report, the fund has a balance of $2.0 million.

7. **Annual Prepayment:** CalPERS offers early payment discounts of 3.75% in lieu of periodic payments that coincide with payroll disbursements. PARC first recommended seizing this opportunity in 2004 and expects to continue to do so if market conditions prove to be favorable in funding the pre-payment. The amount paid can be a portion of up to two-thirds of the County's annual liability. In FY 12/13 the County prepaid $83 million of its PERS liability. In FY 13/14, we prepaid CalPERS $83.4 million (Safety $28.4 + Miscellaneous $55 = $83.4) million. The County will calculate the final amount due as part of the Tax Revenue Anticipation Notes (TRAN's) financing. The County is projecting to issue TRAN's at approximately 0.4% in interest costs. The pre-payment savings from CalPERS are at approximately 3.75%, which equates to approximately $3 million.

8. **Other Post-Employment Benefits (OPEB):** The County invests its OPEB assets with the California Public Employers' Retirement Benefit Trust program (CERBT). Effective January 1, 2011, CalPERS introduced three new investment allocation strategies for CERBT. PARC reviewed the details of the strategies and adopted Strategy 1, an asset allocation strategy most similar to the investment allocation strategy followed by CERBT prior to January 1, 2011, with an expected rate of return of 7.61%. It is anticipated CERBT will lower its investment strategy expected return in the near future to 7.36%.

Recommendations:

1. Receive and file the 2014 PARC Annual Pension Report.

2. Adopt the recommendation to use the money in the Liability Management Fund to reduce the County's CalPERS' liability by transferring the funds to CalPERS.

3. Adopt the recommendation to pre-pay a portion up to two-thirds of the County's FY 2014/15 pension cost if, in the judgment of the County Executive Officer or his designee, market conditions prove to be favorable.

Appendices:

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1. *Pension Savings Chart*
2. *Bartel Associates CalPERS' Actuarial Issues – 6/30/12 Valuation- March 10, 2014*
3. *CalPERS 06/30/12 Miscellaneous Actuarial Valuation Reports*
4. *CalPERS 06/30/12 Safety Actuarial Valuation Reports*