Strategies for Addressing Long Term Benefits and Pension Obligations

2017 ACBO Spring Conference

Questions To Frame This Session

- What long-term structural problems are with in my control to address?
- What policy advice can CBOs give elected officials and administrators, who are pressured constantly by public employees and their unions to continue often-unsustainable benefits?
- How can public employers balance the dilemma of unsustainable long-term costs and short-term demands for public services and stable employment relations?

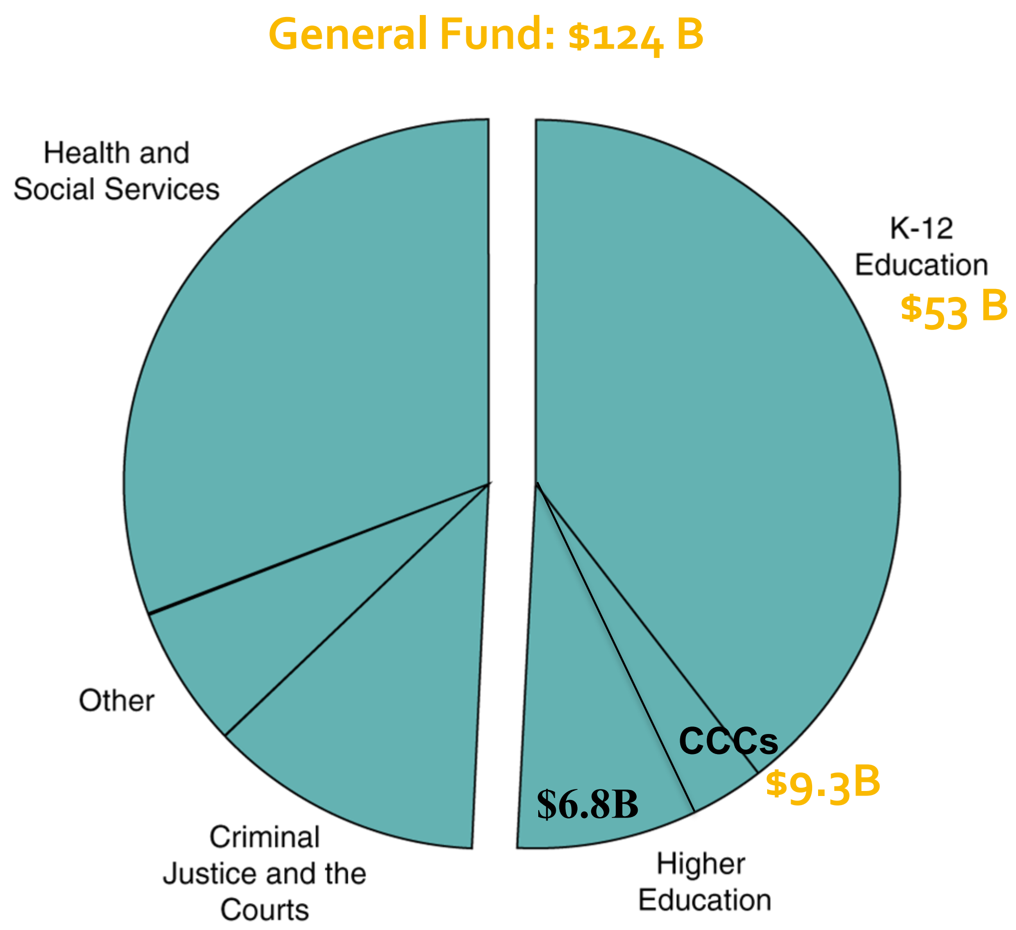
STRS & PERS Future Rates

Fiscal Year	STRS – Employer Rates	STRS – Employee Rates (Pre/Post PEPRA)	PERS – Employer Rates	PERS – Employee Rates (Pre/Post PEPRA)
2013-14	8.25%	8.00%	11.44%	7.00%/6.00%
2014-15	8.88%	8.15%	11.77%	7.00%/6.00%
2015-16	10.73%	9.20%/8.56%	11.85%	7.00%/6.00%
2016-17	12.58%	10.25%/9.205%	13.89%	7.00%/6.00%
2017-18	14.43%	10.25%/9.205%	15.53%*	7.00%/6.50%*
2018-19	16.28%	10.25%/10.205%	18.10%*	7.00%/6.50%
2019-20	18.13%	10.25%/10.205%	20.80%*	7.00%/6.50%
2020-21	19.10%	10.25%/10.205%	23.80%*	7.00%/6.50%

* Revised per 4/18/17 CalPERS Finance and Administration Committee agenda due to change in discount rate

Cost Pressures Throughout the Budget

Education makes up half of state spending.



Political Dynamics

What Problem?

- Due to term-limits, mistakes of the past are vaguely understood by elected officials
- Many assumed the problem would resolve itself once the economy began recovering.
- Without an intimate understanding of local budgets, leaders don't see the depth of the problem.

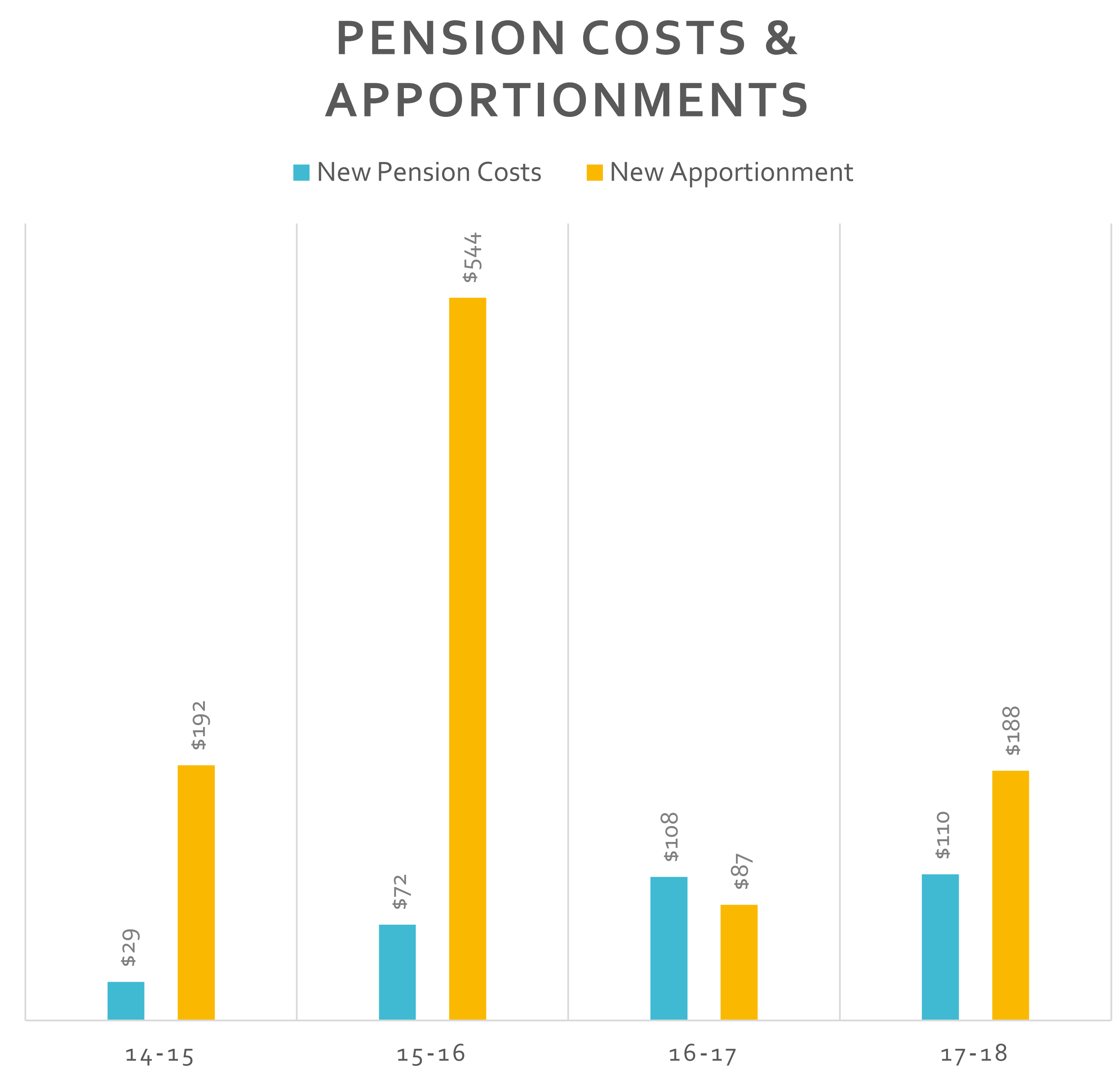
We Gave You Resources…

- Legislator Perspectives
  - Base increase should be used to cover obligations
- Legislators reluctant to allocate general operating costs above pension increase
- Belief that we did this to ourselves.
- Concern with making new investment but getting nothing new in return.

Political choice - pay more into state pension and potentially crowding out other spending in the budget, or let funding levels drop and pushing costs into the future.

Limited Revenue Sources

- Growth – Few colleges growing
- COLA – Not a reliable source
- Base – May Revise proposes $183.6 million in base resources



Long-Term vs. Short-Term Strategies

Short-Term

- **Get the Costs and Make Them Visible in Public**
  - Evaluate actual revenue with ALL ongoing expenses
- **Provide Visual Representations**
  - Continue to make the case for base increase
- **Solve for the Long Term First**
  - Monitor the long-term fiscal health of districts
  - Annual Financial Report requires a plan

Long-Term vs. Short-Term Strategies

Long-Term

- **Establish a Defined-Contribution OPEB Benefit**
  - A tools available to public employers seeking to restructure their OPEB benefits is a defined contribution retiree health savings plan.
- **Pension Rate Stabilization Programs**
  - Irrevocable trust designed to prefund pension costs and help districts get ahead of rising STRS/PERS rate increases.
- **Consider Labor Relations**
  - Employees and their labor representatives must first be informed of the long-term true-cost trajectory.

Our Key Message:
Invest In Our Future Now!

- Should Invest in Higher Community College Per-Student Funding.
- Colleges cannot maintain their quality and grow innovation without a base augmentation!

CalSTRS & CalPERS Employer Contribution Rate Increases Impact on Districts' Annual Budgets – Presented at ACBO Spring 2017 Conference

How San Diego Community College District Is Attempting To Address The Challenge
Prepared by Executive Vice Chancellor Bonnie Ann Dowd

CalSTRS Update (Post AB 1469, 2014)

- At its February 2017 meeting, the Teacher's Retirement Board voted to adopt recent recommended actuarial assumptions reflecting increasing life expectancies of its members and a phased-in reduction in the assumed long-term investment return of the fund.
- Projections for the unfunded liability as of June 30, 2015 was $76.2 billion as compared to $22.5 billion in 2008.
- As of June 30, 2016, the unfunded liability estimate has increased to $96.7 billion, $20.5 billion more than what was estimated as of June 30, 2015.
- The $96.7 billion represents a CalSTRS funded ratio of 63.7%, which is a reduction in the system's funding ratio, which was 68.5% as of June 30, 2015.
- AB 1469, which passed in 2013, provided the CalSTRS Board with the authority to increase or decrease the state, employer and employee contribution rates through FY 2020-21 and each year thereafter. However, if a rate adjustment is required after FY 2020-21, the rate cannot increase by more than 1% in any given year or 12% overall by June 30, 2046, which is when the remaining unfunded actuarial obligation was anticipated to be eliminated.

CalSTRS Employer Contribution Rates through FY 2020-21

Under the 2014 statutory funding plan, the employer contribution rate of 8.25% would continue to increase each year until it reaches 19.10% in FY 2020-21. Employer contributions may be subject to additional change (up or down) as of FY 2020-21; however, there are restrictions as to how much the rates may increase.

Increase Date	% Increase	Contribution Rate
July 1, 2014	0.63%	8.88%
July 1, 2015	2.48%	10.73%
July 1, 2016	4.33%	12.58%
July 1, 2017	6.18%	14.43%
July 1, 2018	8.03%	16.28%
July 1, 2019	9.88%	18.13%
July 1, 2020	10.85%	19.10%
July 1, 2021		<19.10%

CalPERS Update

- In March 2014, the CalPERS Board estimated rate changes through FY 2020-21, which they anticipated would put CalPERS on a plan to resolve its unfunded liability in 30 years while also avoiding the need for large rate increases in years where there are large investment losses.
- CalPERS Board has the ability to adjust its rates annually.
- In 2017, the CalPERS Board adopted an employer contribution rate of 15.53% for FY 2017-18 or 2% higher than the FY 2016-17 rate of 13.89%.
- By FY 2020-21, the CalPERS employer contribution rate is estimated to be 23.80%.
- As of June 30, 2016, the CalPERS unfunded liability is projected at $21.8 billion, which represents a funded ratio of 71.9%.
- As of June 30,2015, CalPERS unfunded liability was projected at $16.5 billion with a funded ratio of 77.5%

CalPERS Employer Contribution Rates through FY 2020-21

FY 2013-14 Employer contribution rate was 11.44% and is expected to increase to 27.30% by FY 2024-25 for a nearly 16% increase.

Increase Date	% Increase	Contribution Rate
July 1, 2014	0.33%	11.77%
July 1, 2015	0.41%	11.85%
July 1, 2016	2.45%	13.89%
July 1, 2017	4.09%	15.53%
July 1, 2018	6.66%	18.10%
July 1, 2019	9.36%	20.80%
July 1, 2020	12.36%	23.80%
July 1, 2021	13.76%	25.20%
July 1, 2022	14.66%	26.10%
July 1, 2023	15.36%	26.80%
July 1, 2024	15.90%	27.30%

Anticipated Impact to SDCCD

- Rate increase cost estimates based upon the FY 2013-14 salaries of:
  - ❖ CalSTRS covered employees - $88,422,180
  - ❖ CalPERS covered employees - $58,858,113

- Annual salary costs are likely to increase beyond the FY 2013-14 level, which will further increase the CalSTRS and CalPERS actual employer expenses.

- The total CalSTRS and CalPERS combined annual employer expenses of :
  - ❖ $14,028,198 based upon FY 2013-14 salaries will increase to
  - ❖ $30,896,867 as of FY 2020-21 assuming salary expenses remain at the FY 2013-14 level, which is unlikely.

SDCCD Board Designated Reserve Fund

- The SDCCD Board of Trustees established a Designated CalSTRS and CalPERS Reserve fund at its January 2016 meeting to assist with addressing the employer contribution rate increases projected through FY 2020-21.
- In January 2016 one-time funds of $23,637,781, for outstanding state mandated claims were paid to the District. The funds were distributed to all districts on a per FTES basis.
- The Board of Trustees took action to place the outstanding state mandated claims one-time dollars into the CalSTRS and CalPERS Reserve Fund with agreement from the employee unit representatives.
- Additionally, $1,181,782 of mandated revenue was received by SDCCD in FY 2015-16 and placed into the Designated Reserve Fund for CalSTRS and CalPERS based on the projected earned and funded FTES of 42,224 at $28 per FTES.
- In FY 2016-17 $6,867,780, SDCCD has budgeted the following one-time revenues to also be placed into the Board Designated Reserve:
  - ➢ $ 1,631,199 One-Time Apportionment Revenue
  - ➢ $ 3,992,261, for the 2016-2017 Outstanding Mandated Claims of the $105.5 million Statewide Budget
  - ➢ $ 1,244,320 for the current 2016-2017 Mandated cost reimbursement (44,440 FTES at $28 each)
- The uses (decreases) to the Designated Reserve fund as a result of the increased employer contribution rates for CalSTRS and CalPERS has been charged against the Board Designated fund in the amount of $4,092,217 through FY 2016-17.
- The Board Designated Reserve fund total as of May, 2017 is projected at $27,595,126.

SDCCD Board Designated Reserve Fund (cont'd)

- Continue to place the current state mandated claim funds of $28 per earned and funded FTES into the Board Designated CalSTRS and CalPERS Reserve Fund, which on average is anticipated to be approximately $1.25 million annually. (Note: This is one-time revenue dollars and dependent upon enacted annual state budget.)

- Calculate the actual revenue and expenses each year under the RAF and deduct the dollar value required above the $1.25M anticipated from an estimated 1% (approximately $2.2M on-going dollars) to be taken "off the top" from annual revenue dollars received through the RAF before finalizing the "Funds Available for Distribution to Units" and place those funds into the Board Designated Reserve Fund.

- Fund the actual expense cost associated with the annual employer's CalSTRS and CalPERS rate increases from the Board Designated Reserve Fund.

- SDCCD's Board, Administration and Employee Unit Representatives recognize that if we don't continue to address the CalSTRS and CalPERS employer contribution rate increases NOW it will impact the ability of the District's Resource Allocation Formula (RAF) to provide employee units with future compensation increases; and, may in fact result in a need to identify "take away options" in order to offset the increased operating costs associated with CalSTRS and CalPERS employer contribution costs on annual budgets.

SDCCD and OPEB (retiree health benefits obligation)

- On June 26, 2006, the District's Board of Directors took action to contribute $11 million of one-time revenue funds to the Community College League of California – Joint Powers Authority (CCLC-JPA) to address its retiree health benefits obligations. SDCCD was one of the first districts to participate in the newly established JPA.

- The Board also took action to adopt a plan to fully fund the OPEB obligation on a fully projected basis by allowing the $11 million to grow with interest until it is sufficient to pay all future retiree benefits, which is anticipated to occur by 2026 (20 years).

- GASB Statement 45 provides for up to 30 years for amortization of the current and future retiree health benefit liabilities.

- The District had previously eliminated life time benefits.

- Based upon the most recent actuary study, SDCCD's OPEB is funded at nearly 80% as of June 30, 2016 and continues to be on track to be fully funded by 2026 for its OPEB obligations as currently projected.

Closing Thoughts

- Districts need to engage in dialogue with employee representatives to develop a strategy to avoid the impact to employees in future years related to OPEB (retiree health benefits) and CalSTRS/PERS pension obligations.
- If CalSTRS goes up by the 12% statutorily allowed through 2046, the employer contribution rate after FY 2020-21 through June 30, 2046 could be as high as 31.10% up to and including FY 2046-47.
- CalPERS has authority to raise the employer contribution rate at any time as deemed necessary. The $20.5 billion increase in the projected unfunded liability between June 30, 2015 and June 30, 2016 estimates points to the uncertainty of any actuary projections mainly due to unknowns with regard to investment return assumptions and member life expectancies.
- Given that funding ratio projections for both CalSTRS and CalPERS have each declined over the last couple of years, it is critical that both pension systems diligently work towards fully funding the liability or future retiree benefits will be at risk.
- As Business Officials, we must engage our Board, administrators, faculty and staff in the conversation about the risk of not addressing the increasing costs for CalSTRS and CalPERS employer contribution rates because the state cannot bail any districts out and has its own pension cost challenges to address.
- One-time revenues assist with addressing long-term liabilities; however, continuous/on-going revenues should be used to cover on-going expenses.
- District's are required to include in their Annual Financial Reports a plan as to how they intend to address the CalSTRS and CalPERS employer contribution cost increases.

PUBLIC AGENCY RETIREMENT SERVICES | PARS

TRUSTED SOLUTIONS. LASTING RESULTS.

STRATEGIES FOR ADDRESSING LONG TERM BENEFIT/ PENSION OBLIGATIONS

ACBO Spring 2017 Conference · May 23, 2017

GASB 74 & 75 – NEW OPEB RULES

- Starts after fiscal year 6/15/17 for GASB 74 (funded) and 6/15/18 for GASB 75 (unfunded)
- Moves OPEB from footnote to balance sheet
- Discount rate now tied to 20 year municipal bond index for pay-go
- Blended discount rate applied for partial funding
- Everyone must now complete valuation every 2 years
- New valuation method mandated – Entry Age Normal method required
- New disclosures (similar to GASB 67-68 for pensions)

DETERMINE IMPACT ON DISTRICT

- Will we need to rethink the current approach to funding?
- How will Total OPEB Liability be impacted by change to Entry Age Normal method?
- How will Net OPEB Liability on balance sheet impact credit ratings?
- How will the new blended discount rate compare to the current discount rate?
- How will municipal bond index compare to our current discount rate?
- Do we want the actuary to continue calculating Actuarially Determined Contribution?

PENSION COST: 3 OPTIONS FOR DISTRICTS

1 Pay-as-you-go

2 Set aside reserve funds

3 Fund into Pension Rate Stabilization (PRSP) Trust

COMPARISON OF APPROACHES

RESERVE ACCOUNT	PRSP TRUST
General fund investing restrictions	Govt. Code Section 53216
Fixed income only	Fixed Income or diversified
Investments not tailored for long term	Can be tailored for short or long term
Revocable	Irrevocable
Accessed for other uses	Dedicated solely to pension costs
Not free from creditors	Exclusive benefit/free from creditors
No corporate trustee	Corporate trustee to mitigate fiduciary risk

BACKGROUND - PRSP

- California water district obtains the first single employer trust IRS Private Letter Ruling
- PARS receives IRS Private Letter Ruling of concept for multiple employer trust in **June 2015**
- Partnered with the Community College League of California to provide trust program to community college districts
- First public agencies begin to fund into these trusts in **Summer 2015**
- PERS also does large scale survey to assess interest and concerns; introduces legislation
- 82 colleges, schools, cities, counties and special districts in CA have joined the trust in last 2 years
- Fastest growing retirement-related program in California

STRUCTURE OF PRSP TRUST

IRC SECTION 115

- A governmental trust designed specifically to be used for pension prefunding whereby **any income derived is tax exempt**

IRREVOCABLE

- To comply with GASB rules, trust was set up as irrevocable which means that once contributions are placed into trust, **assets can only be used for retirement plan purposes**

STATE LAW – PERMITTED IN CALIFORNIA

- **Trust type** - Single or multiple employer approaches
- **Separate accounts** - Program is aggregation of separate accounts with centralized administration and pooled investments
- **Payments** – Permitted to pay STRS or PERS directly or reimburse a district

REASONS TO PREFUND

1 **Stabilize Costs**

STRS/PERS costs are a long term burden beyond 2020; prudent diversified investment planning is important to current and future management of obligations

2 **Protect from Diversion**

Funds are protected from diversion to other uses and curtails stakeholder pressure to use funds in other ways

3 **Create a Rainy Day Fund**

Assets can be used as an emergency source of funds for pension-related costs when District revenues are impaired based on economic or other conditions

4 **Strengthen Credit Rating & Accreditation**

Credit rating agencies may look more favorably upon districts who take steps to reduce liabilities

STRATEGIES FOR PREFUNDING

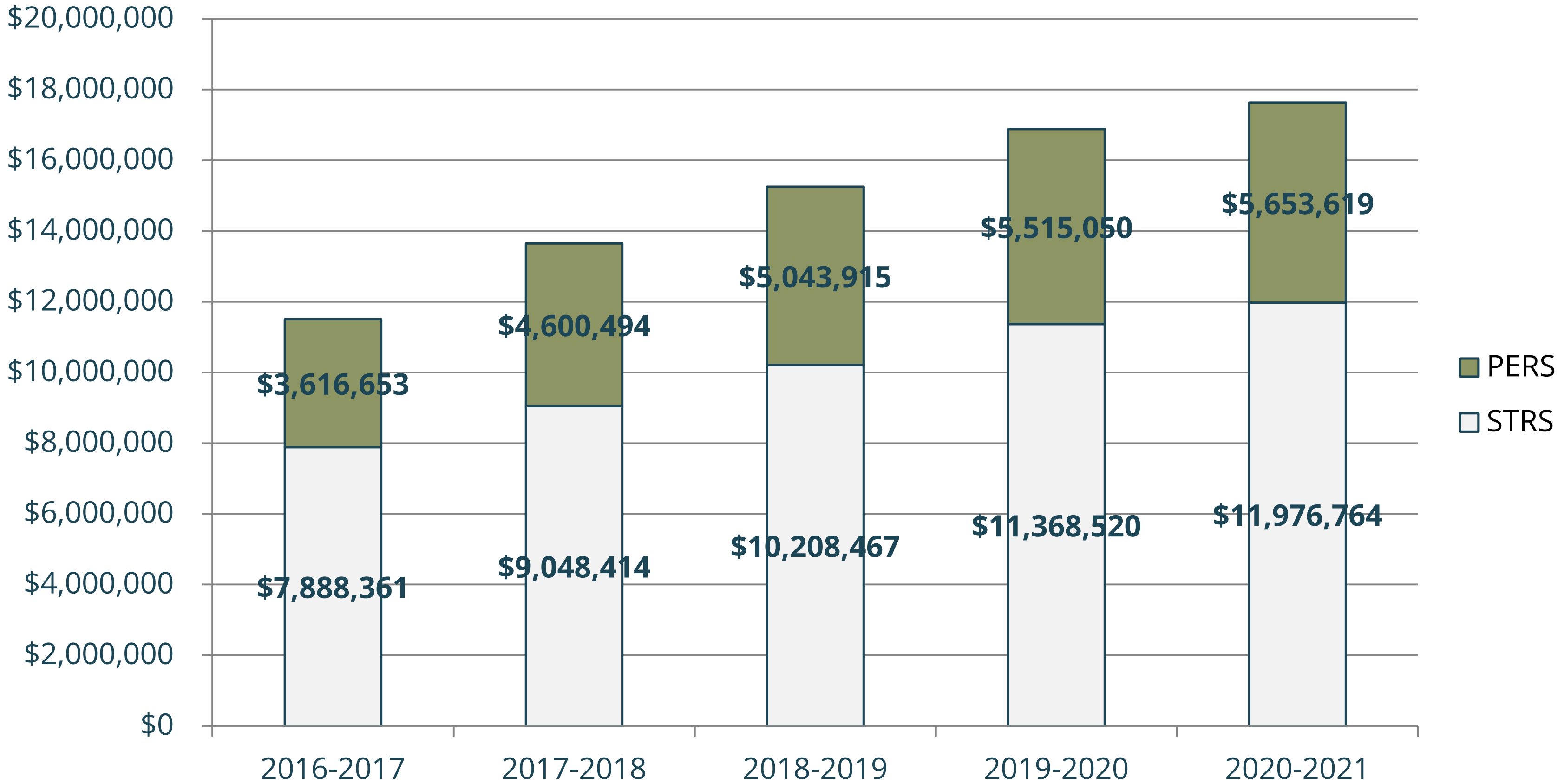
- Leave the funds to accumulate over years without anticipated short term disbursement
- Rainy day use: Allow the assets to grow over a period of years, but make disbursements during tough economic or budgetary times
- Annual rate increases payback: Make disbursements to cover only the rate increase amounts
- Total annual pension costs: Make disbursements to cover annual pension costs
- Invest in fixed income if short term need for funds
- Diversified if longer term need for greater long term returns
- Conservative portfolio with limited equity exposure most common

DISTRICT EXAMPLE

- District wanted to stabilize pension costs for the next 3-4 years or longer depending on future legislation to increase/decrease contributions to STRS/PERS
- If the unrestricted fund balance exceed the mandated 8% threshold approved for 2016/17
- If the OPEB Trust maintains an equal share of assets to liabilities based on the 2017 actuarial study
- The CBO is then authorized to ensure that OPEB Trust is maintained in order that no future resources are needed from unrestricted fund
- If met then that the remaining balance from the current year unrestricted fund may be allocated to PRSP trust
- Authorization shall come in a future resolution authorized by Board

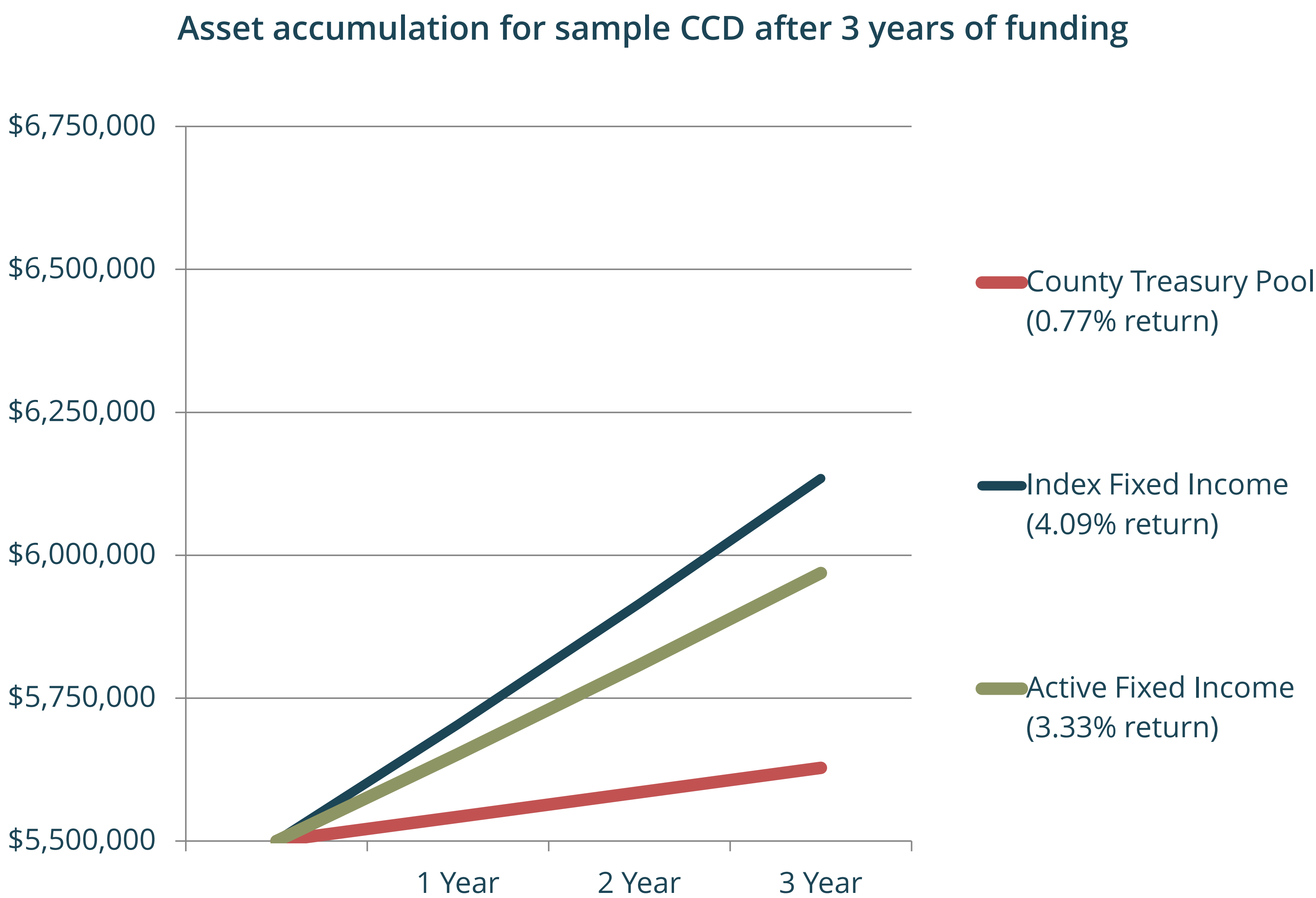
DISTRICT EXAMPLE

Annual pension costs increase from $11.5 million to $17.6 million in 4 years

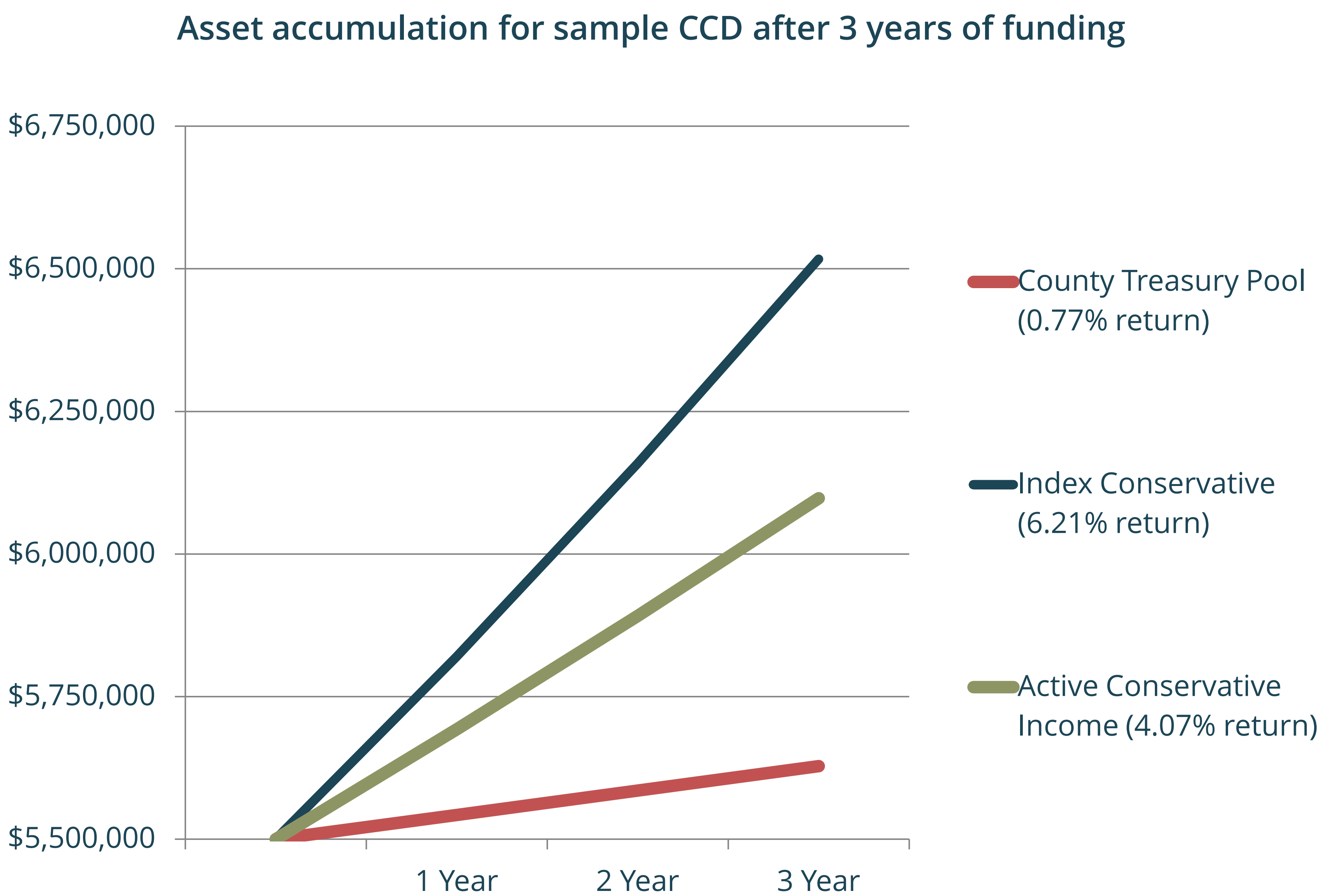


* *Assuming Academic Salaries (including Certificated Managers) totaling $62.7 million do not change year over year*
* *Assuming Classified Salaries (including Classified Managers) totaling $27.7 million do not change year over year*
* *Based off Total 2016-17 Estimated Actual Salaries including Restricted and Unrestricted Staff from the 2016-17 Adopted Budget.*

DISTRICT EXAMPLE



DISTRICT EXAMPLE



DISTRICT EXAMPLE

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
CalSTRS Rate Increases	1.85%	1.85%	1.85%	1.85%	1.85%	0.97%
Est. Payroll 15/16 $24,962,418	$461,805	$461,805	$461,805	$461,805	$461,805	$242,135
CalPERS Rate Increases	0.08%	2.04%	1.61%	1.60%	1.50%	1.20%
Est. Payroll 15/16 $10,681,123	$8,545	$217,895	$171,966	$170,898	$160,217	$128,173
Total Increase	**$470,350**	**$679,700**	**$633,771**	**$632,703**	**$622,022**	**$370,309**

Total Increase between 2015 and 2021 = $3,408,853

DISTRICT EXAMPLE

Choices considered for District.

1. Include it in the fund balance thereby making it a larger than normal ending fund balance percentage. This could raise continuous questions and be confused as having extra budget available for concessions
2. Adding a separate line to the bottom line, earmarking it for the increases, however, it remains in the general fund
3. Opening a separate fund designated by the Board of Trustees, however, it does not make it irrevocable
4. Opening an irrevocable trust

An Irrevocable Trust was the best option:

— Was the most fiscally responsible way for the District to ensure it is in place for the upcoming years.

— Funds are not at risk to any diversion and show employees that the District is protecting assets which can only be used for retirement plan purposes

— Could assist with accreditation as we are in the middle of the self-study

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