The New Reality of Rising Pension Costs

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Panel

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Community College League of California

Strategies for Addressing Long Term Benefits and Pension Obligations

Community College League of California

Questions To Frame This Session

- What long-term structural problems are with in my control to address?
- What policy advice do elected officials and administrators need to address pressure 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?

Governor's Proposed Budget

State Impact

- The Governor's budget proposal include a one-time, $2.3 billion CalSTRS payment that would reduce school and community college districts' share of the unfunded liability for teacher pensions. According to CalSTRS.

- The payment would come from non-Proposition 98 General Fund— this is a welcome approach!

- In practice, this reduce the district contribution rate by about four-tenths of a percentage point beginning in 2021-22.

- The exact rate reduction depends on a number of factors and is likely to fluctuate from year to year.

Governor's Proposed Budget (cont.)

Local Impact

- Additional funding is proposed to pay districts' statutory employer contributions to CalSTRS for 2019-20.
- The Governor also proposed a payment of $350 million in each of the next two years to reduce these districts contributions. The May Revision increases the 2019-20 payment to $500 million.
- As a result, districts' required contributions for 2019-20 would drop from 18.1% of covered payroll to 16.7% for 2019-20 and from 19.1% to 18.1% for 2020-21.

Governor's Proposed Budget (cont.)

How to Leverage these Funds?

- State fiscal experts caution that the proposed budget relief is temporary and should be treated as a one-time savings with no ongoing benefit.
- Districts should set aside funds from the proposed budget relief, if adopted, to help them pay growing pension costs when state funding for districts flattens or declines.

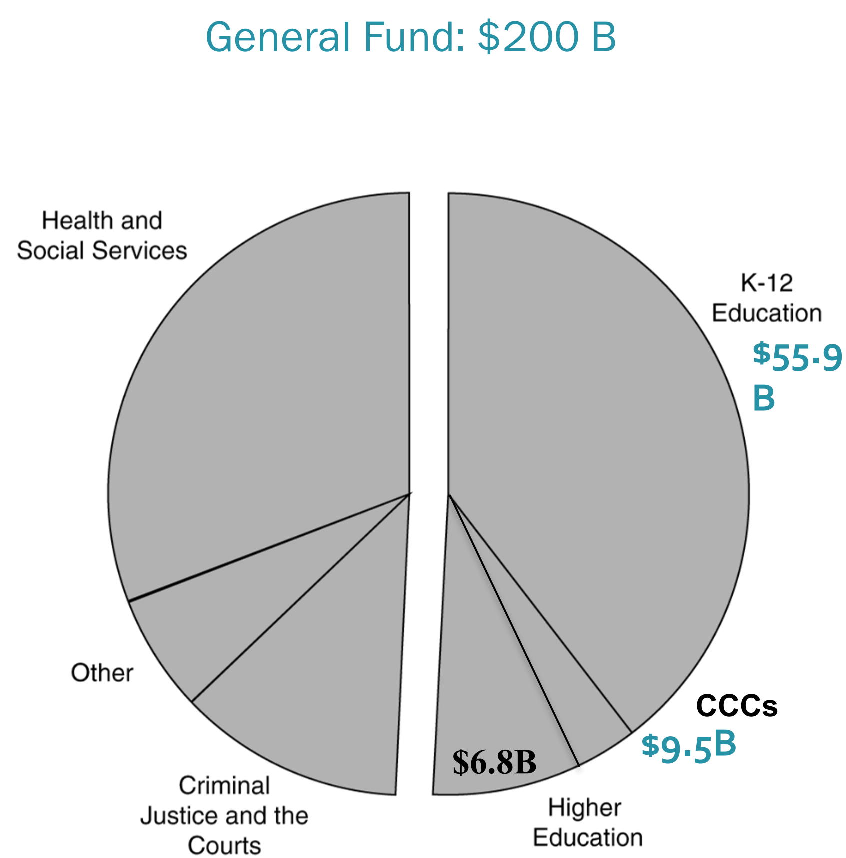
STRS & PERS Future Rates

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%	20.73%	7.00%/6.50%
2020-21	19.10%	10.25%/10.205%	23.60%	7.00%/6.50%
2021-22	18.6%	10.25%/10.205%	24.90%	7.00%/6.50%
2022-23	18.10%	10.25%/10.205%	25.70%	7.00%/6.50%
2023-24	18.10%	10.25%/10.205%	26.40%	7.00%/6.50%
2024-25	18.10%	10.25%/10.205%	26.60%	7.00%/6.50%
2025-26	18.10%	10.25%/10.205%	26.50	7.00%/6.50%

**Revised per 5/1/19 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?

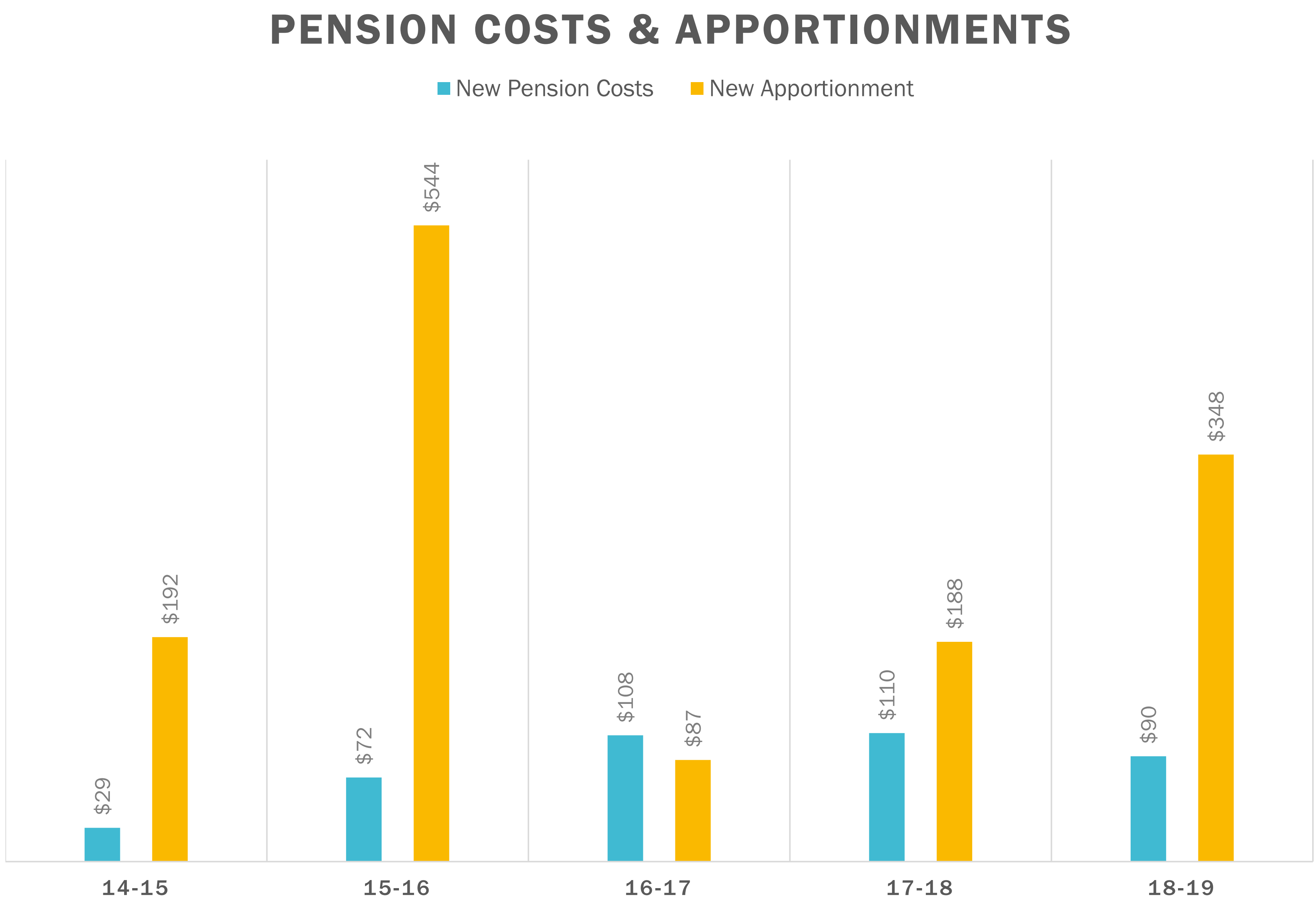
- Due to term-limits, mistakes of the past are vaguely understood by elected officials
- Many assumed the problem would resolve itself once the economy began recovering.
- Without an intimate understanding of local budgets, leaders don't see the depth of the problem.
- Legislator Perspectives
  - Base increase should have been used to cover obligations

We Gave You Resources...

- Belief that we did this to ourselves.
- Concern with making new investment but getting nothing new in return.
- We now have a Governor that is willing to pay down some pension costs but uncertain if this will be a continued practice.
- Need to make a case for further buy downs.
- Need to demonstrate that "savings" were used to address local obligations.

Political choice - pay more into state pension, potentially crowding out other spending in the budget, or push costs into the future.

Limited Revenue Sources



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
- **Use the Proposed Relief Wisely**
  - Set aside funds from the proposed budget relief

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.

Options to Address Pension Liabilities

1. Pay-as-you-go for increases
2. Set aside reserve funds
3. Set up and prefund into pension pre-funding trust *(at least 15 CCDs currently and over 200 other public agencies in CA)*

Pension Prefunding vs. Reserve Account

Reserve Account	Trust
General fund investing restrictions	Govt. Code Section 53216
Fixed income investing only	Fixed income or diversified investing
Investments not tailored for long term	Can be tailored for short or long term
Revocable	Irrevocable
Can be 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

Benefits of Prefunding Pension

1. Manages Long-Term Liabilities
2. Addresses GASB 68 Liability
3. Protects Assets from Diversion
4. Serves as a Rainy Day Fund
5. Stabilizes Pension Costs
6. Helps to Achieve Better Returns
7. Potentially beneficial in Credit Rating & Accreditation

Rising Pension Costs: Cuesta College's Process

How did we get here?

- 2014 — CalSTRS unfunded liability of $74 billion and CalPERS unfunded liability of $62 Billion
- AB 1469 enacted increases both employee and employer contribution rates – employer rates would grow from 8.25% to 19.1% in 2021-22
- Meanwhile the CalPERS Board has also implemented large increases – from 11.442% in 2013-14 to an estimated 26.6% in 2024-25
- These increased rates act like a negative cost-of-living-adjustment for districts, consuming larger amounts of budget expenditures

Unrestricted General Fund Pension Costs

- Pension costs have grown from 6.2% to 13.2% of UGF expenditures

Pension Costs			
Year	**2013-14**	**2018-19**	**Change (%)**
Amount ($)	$2.9M	$7.2M	**148.3%**
Amount (%)	6.2%	13.2%	**148.3%**

State Response

- State has provided resources to help
  - Unrestricted increases
  - One-time mandate reimbursement funds
- But…
  - This follows significant downturns in funding
  - Unpredictable COLAs
  - Direct funding reductions
  - Declining FTES
  - SCFF uncertainty

Addressing Pensions

- Communication
- Budget Assumptions
- Multi-year Projections
- Actions

Pension Rate Stabilization Program (PRSP)

- Board meeting information item
  - August 2017
- Participatory Governance
  - Committee Initiative
- Identify Resources
  - One-time funds
- Community buy-in
  - Unanimous recommendation from workgroup and full committee

Pension Rate Stabilization Program (PRSP)

- Recommendation to Board of Trustees –
  - Invest $3M of 1-time funds
  - Conservative Fund (4% target)
  - Review 1-time funds annually to consider additional investments

For Consideration

- PRSP alone will not solve problem
  - On-going budget issue
  - District has taken many other significant actions (Faculty SIP, hiring frost, etc.)
- **Key Points: Involve your community and make the right choice for your district**

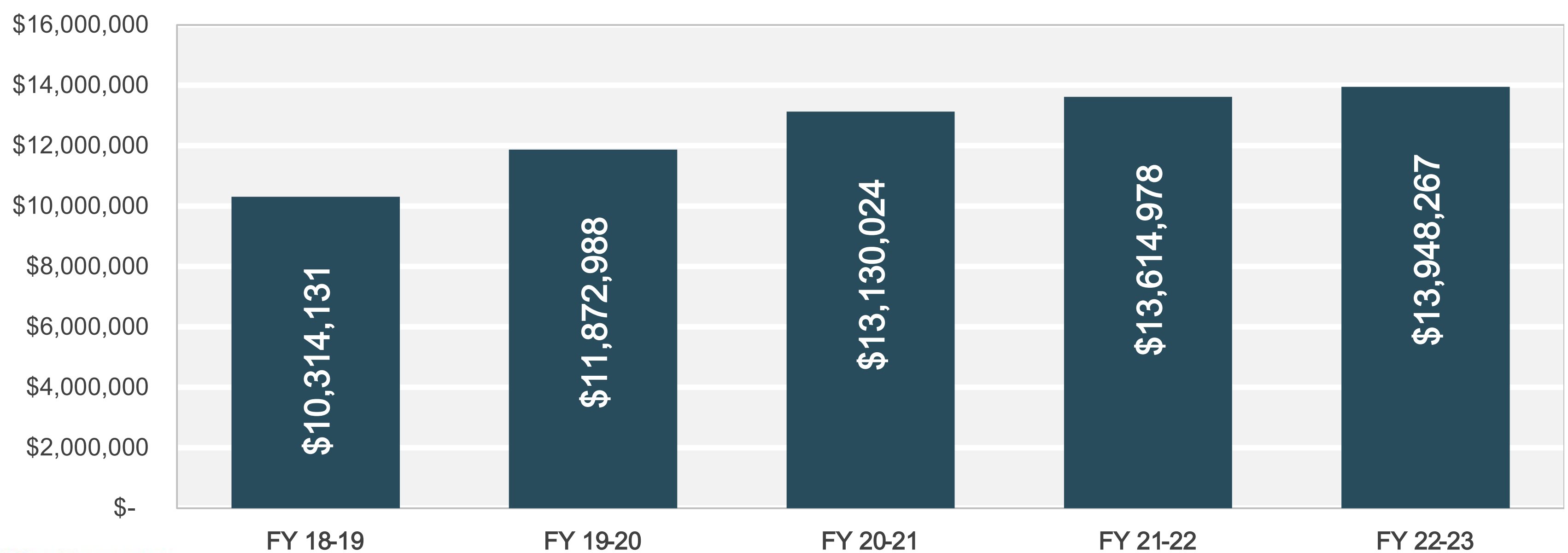
San Bernardino Community College District

Agenda

1. Expected annual retirement costs for SBCCD
2. Why did SBCCD invest in Pension Rate Stabilization Trust (PRST) ?
3. Is it safe to invest in PRST?
4. PRST at SBCCD
5. Process at SBCCD to establish PRST
6. Questions to ask vendors

Expected Annual Retirement Costs

ANNUAL PENSION COSTS AT SBCCD



Why did SBCCD invest in a Trust?

- To address increasing retirement benefit costs
- Found a way to invest excess funds with a higher than expected annual return rate
- Restricted investment policies
- Fixed income interest rate is low
- Flexibility
  - We can withdraw up to 2 years of retirement costs ($22m)
  - Then afterward, we can withdraw up to 1 year of retirement costs ($13m)
- Easy to track multiple sub-accounts
- Restricted for retirement costs?
  - Yes
  - Use General Fund and Other Funds for various purposes

Is it safe to invest in PRST?

- There are risks and investment is subject to market conditions
- PARS offers 4 different investment portfolios
  - Fixed Income (100% Fixed Income & 0% Equity)
  - Conservative (42% Fixed Income & 58% Equity)
  - Balance (60% Fixed Income & 40% Equity)
  - Growth (75% Fixed Income & 25% Equity)
- What's the tolerance level of your board?
- Alternative is your County Treasurer or investment firm

PRST at San Bernardino CCD

San Bernardino CCD Investment				
General Fund	SBVC	KVCR	FCC	TOTAL
$25,000,000	$5,000,000	$21,000,000	$24,000,000	**$75,000,000**

Annual Expected Rates of Return			
Time Period	Asset Size	Rate of Return (%)	Rate of Return ($)
3 Years	$75,000,000	4.17%	**$3,100,000**
5 Years	$75,000,000	5.20%	**$3,900,000**
10 Years	$75,000,000	5.65%	**$4,200,000**

Steps to Implementation

1	Discussion at Chancellor’s Cabinet
2	Staff to meet with PARS
3	Discuss and recommend at District Budget Committee
4	Chancellor’s Cabinet approval
5	Discussion at Board Budget Committee with PARS
6	Approval and Resolution by Board of Trustees with PARS
7	Staff to execute documents
8	Staff to fund Trust
9	Staff to monitor Trust
10	Staff to provide regular updates to Board of Trustees

Questions to Ask Vendors

1. Who manages/administers the investments?
2. What are the investment options for the District?
3. What is the expected rate of return for each investment option?
4. How do these investment options compare with County Treasury Pool and/or LAIF?
5. Why is it that we can have different investment options from our own Investment Policies?
6. What are the fees?
7. Can we easily track various investments (subaccounts)?
8. How often do we receive statements? Please provide example of statement.
9. How often can the Board get a presentation on the investments?
10. How much can the District withdraw from the trust on an annual basis?
11. How often can the District withdraw funds from the trust?
12. What is the turnaround on withdrawals?

Questions?