COUNTY OF SAN MATEO
Inter-Departmental Correspondence
County Manager

Date: July 29, 2013
Board Meeting Date: August 6, 2013
Special Notice / Hearing: None
Vote Required: Majority

To: Honorable Board of Supervisors

From: John L. Maltbie, County Manager

Subject: Additional Contributions – Unfunded Pension Liability

RECOMMENDATION:

Direct staff to develop for the Board's consideration a Memorandum of Understanding with SamCERA to reduce unfunded pension liabilities by using one-time sources such as Reserves and Excess ERAF.

BACKGROUND:

As of the most recent actuarial valuation date of June 30, 2012, the County's unfunded actuarial accrued liability (UAAL) for pension benefits was $962 million. The plan is 72% funded with annual pension costs of approximately $150 million. Annual pension costs have increased considerably since FY 2005-06 when such costs totaled approximately $78 million per year. The County has not issued pension bonds and has no pension related bond indebtedness in addition to the ongoing annual pension costs.

During initial Board discussions on spending priorities for Measure A sales tax proceeds, one suggestion was made to contribute a lump sum and/or additional amounts to SamCERA to increase funded status, accelerate elimination of the liability and reduce annual pension costs. The County approached SamCERA to analyze a few scenarios to determine the impact of additional contributions from other sources such as Reserves and Excess ERAF. Option 5, based on the actuarial assumptions, would reduce the County's Annual Required Contribution (ARC) by $13 million in FY 2024-25.

DISCUSSION:

Milliman, Inc., who serves as SamCERA's actuary, provided five options for prefunding the retirement fund, including the option of doing nothing (Option #1) and simply continuing to fund the Annual Required Contribution (ARC). Options #2 through #5 all consider slightly different variations on contributing $50 million in FY 2013-14 and $10 million annually through FY 2022-23 (the year that Measure A sunsets). Though we are not recommending that Measure A funds be used to prefund retirement, we think it is important to tie the prefunding with the sunset of Measure A as the retirement savings that accrue to the County as a result of this initiative could be used to continue Measure A funded programs in the event that the tax measure is not reauthorized by the voters.

A synopsis of the five options is provided below. All options assume that over the 15-year amortization period that SamCERA achieves its 7.50% earnings target in each year, which of course may or may not occur. Also, the Superior Court and Mosquito Abatement District, which are part of the SamCERA retirement fund, have been factored out of these calculations.

<u>Option #1</u> – Do not make any additional contributions. The County would achieve a 90% funded ratio in nine years (FY 2021-22) and 100% in 13 years (FY 2025-26).

<u>Option #2</u> – Contribute $50 million in FY 2013-14 and $10 million in each of the following nine years, through FY 2022-23, and realize the contributions immediately when calculating the ARC. The advantage to this scenario is the County reaps the benefits of the ARC rate reductions sooner but the funded ratio increases at a slower pace than Options #3 through #5. The County would achieve a 90% funded ratio in eight years (FY 2020-21) and 100% in 12 years (FY 2024-25).

<u>Option #3</u> – Contribute $50 million in FY 2013-14 and $10 million in each of the following nine years, through FY 2022-23. These funds, and the investment earnings on these funds, would be set aside in a separate SamCERA account and the ARC would be calculated as if these contributions had not been made. This approach would accelerate the increase in the funded ratio. The advantage to this scenario is that the County's ARC would be equal to that under Option 1 where no additional contributions are made, but the funded ratio would increase at a faster pace than option #2, although at a slower pace than with Options #4 or #5. The County would achieve a 90% funded ratio in eight years (FY 2020-21) and 100% in 11 years (FY 2023-24).

<u>Option #4</u> – Contribute $50 million in FY 2013-14 and $10 million in each of the following nine years, though FY 2022-23. These funds, and the investment earnings on these funds, would be set aside in a separate SamCERA account. Under this approach, a blended (average) contribution rate of no less than 37% would be used each year. For comparison purposes, the current blended rate for FY 2013-14 is 36.16% and it is expected to increase to 38.52% in FY 2014-15 when the final outstanding losses from FY 2008-09 are amortized. The advantage to this approach is that the County's ARC is still less than the projected contribution rate for FY 2014-15 and it modestly accelerates the pay down of the County's UAAL. The County would achieve a 90% funded ratio in eight years (FY 2020-21) and 100% in 11 years (FY 2023-24).

<u>Option #5</u> – This option is essentially the same as Option #4 except that the ARC would be no less than 38%, modestly accelerating the pay down of the County's UAAL. The County would essentially achieve a 90% funded ratio in seven years (FY 2020-21) and 100% in 11 years (FY 2023-24).

The following table shows the projected ARC and Funded Ratio for each of the five options:

	Total County Rate					Funded Ratio				
Fiscal Yr	Option 1	Option 2	Option 3	Option 4	Option 5	Option 1	Option 2	Option 3	Option 4	Option 5
2013 - 14	36.16%	36.16%	36.16%	36.16%	36.16%	72.1%	72.1%	72.1%	72.1%	72.1%
2014 - 15	38.52%	38.52%	38.52%	38.52%	38.52%	71.4%	71.4%	71.4%	71.4%	71.4%
2015 - 16	37.22%	36.11%	37.22%	37.22%	38.00%	75.3%	76.7%	76.6%	76.6%	76.6%
2016 - 17	36.23%	34.89%	36.23%	37.00%	38.00%	79.0%	80.7%	80.7%	80.7%	80.7%
2017 - 18	36.40%	34.86%	36.40%	37.00%	38.00%	81.2%	83.1%	83.2%	83.2%	83.3%
2018 - 19	35.86%	34.12%	35.86%	37.00%	38.00%	84.2%	86.2%	86.4%	86.5%	86.8%
2019 - 20	35.72%	33.80%	35.72%	37.00%	38.00%	86.7%	88.7%	89.2%	89.4%	89.7%
2020 - 21	35.61%	33.51%	35.61%	37.00%	38.00%	89.2%	91.2%	91.9%	92.2%	92.7%
2021 - 22	35.49%	33.21%	35.49%	37.00%	38.00%	91.6%	93.7%	94.6%	95.1%	95.6%
2022 - 23	35.38%	32.93%	35.38%	37.00%	38.00%	94.1%	96.2%	97.3%	97.9%	98.6%
2023 - 24	21.22%	16.10%	18.00%	17.27%	16.51%	96.5%	98.6%	100.0%	100.8%	101.6%
2024 - 25	10.56%	9.67%	8.63%	8.19%	7.73%	98.9%	101.0%	102.6%	103.4%	104.3%
2025 - 26	12.79%	9.60%	8.57%	8.14%	7.70%	100.0%	101.5%	103.4%	104.2%	105.0%
2026 - 27	10.24%	9.52%	8.52%	8.10%	7.66%	100.0%	101.5%	103.3%	104.0%	104.8%
2027 - 28	10.16%	9.46%	8.47%	8.07%	7.64%	100.2%	101.4%	103.1%	103.9%	104.6%

ANALYSIS:

There are two options that appear superior: Option 2 and Option 5 Option #2 makes less progress on the Funded Ratio but provides significant savings in ARC contributions compared to the no change/status quo approach (Option #1) beginning in FY 2015-16 until the cumulative contributions for Options #2 through #5 converge in FY 2036-37 (see highlighted row in the table below). Under Option #2 cumulative ARC savings will total $84.2 million by the completion of the FY 2022-23 when Measure A expires.

Going out beyond FY 2036-37, the cumulative contributions are lowest in Option #5. For example, under Option #5 in FY 2041-42 the cumulative savings are $304.2 million compared to $226.8 million under Option #2.

The following table extrapolates the cumulative contributions out to FY 2041-42 under each scenario. A salary increase of 3% is factored into each year beginning in FY 2014-15 and projected actuarial savings that result from the new PEPRA rates have also been factored in to this analysis.

		Cumulative Contribution $ (Millions)				
Fiscal Yr	**Payroll**	**Option 1**	**Option 2**	**Option 3**	**Option 4**	**Option 5**
2013 - 14	500,000,000	180.8	180.8	180.8	180.8	180.8
2014 - 15	500,000,000	373.4	373.4	373.4	373.4	373.4
2015 - 16	515,000,000	565.1	559.4	565.1	565.1	569.1
2016 - 17	530,450,000	757.3	744.4	757.3	761.3	770.7
2017 - 18	546,363,500	956.1	934.9	956.1	963.5	978.3
2018 - 19	562,754,405	1,157.9	1,126.9	1,157.9	1,171.7	1,192.1
2019 - 20	579,637,037	1,365.0	1,322.8	1,365.0	1,386.2	1,412.4
2020 - 21	597,026,148	1,577.6	1,522.9	1,577.6	1,607.1	1,639.3
2021 - 22	614,936,933	1,795.8	1,727.1	1,795.8	1,834.6	1,872.9
2022 - 23	633,385,041	2,019.9	1,935.7	2,019.9	2,069.0	2,113.6
2023 - 24	652,386,592	2,158.4	2,040.7	2,137.4	2,181.6	2,221.3
2024 - 25	671,958,190	2,229.3	2,105.7	2,195.3	2,236.7	2,273.3
2025 - 26	692,116,935	2,317.8	2,172.1	2,254.7	2,293.0	2,326.6
2026 - 27	712,880,443	2,390.8	2,240.0	2,315.4	2,350.7	2,381.2
2027 - 28	734,266,857	2,465.4	2,309.5	2,377.6	2,410.0	2,437.3
2028 - 29	756,294,862	2,541.8	2,380.6	2,441.4	2,470.8	2,494.9
2029 - 30	778,983,708	2,619.8	2,453.6	2,506.9	2,533.2	2,554.1
2030 - 31	802,353,220	2,699.7	2,528.3	2,574.2	2,597.2	2,614.9
2031 - 32	826,423,816	2,781.3	2,604.8	2,643.2	2,662.9	2,677.4
2032 - 33	851,216,531	2,864.9	2,683.2	2,714.0	2,730.4	2,741.6
2033 - 34	876,753,027	2,950.3	2,763.6	2,786.7	2,799.6	2,807.5
2034 - 35	903,055,617	3,037.8	2,845.9	2,861.3	2,870.6	2,875.3
2035 - 36	930,147,286	3,127.2	2,930.2	2,937.9	2,943.4	2,944.9
2036 - 37	958,051,704	3,218.6	3,016.6	3,016.5	3,018.2	3,016.4
2037 - 38	986,793,256	3,312.2	3,105.2	3,097.2	3,094.9	3,089.8
2038 - 39	1,016,397,053	3,407.9	3,195.9	3,180.0	3,173.6	3,165.2
2039 - 40	1,046,888,965	3,505.8	3,288.8	3,264.9	3,254.4	3,242.7
2040 - 41	1,078,295,634	3,605.9	3,384.0	3,352.2	3,337.3	3,322.4
2041 - 42	1,110,644,503	3,708.4	3,481.6	3,441.7	3,422.4	3,404.2

It should be noted that Option #2 provides a significant amount of savings in the early years and this table does not account for the present value of those savings, for which Option #2 is clearly superior. However, Option #5 provides the best scenario in terms of the County's funded ratio, projected to be 104.6% by FY 2027-28 compared to 101.4% for Option #2.

My recommendation would be to pursue Option #5 with the caveat that the County retain full discretion to provide a smaller contribution, but not less than the actuarially calculated ARC, when either (1) other funding priorities take precedence, or (2) the County's General Fund reserves fall below 15% (currently 16.6%). I recommend Option #5 because it is the option that most aggressively pays down the unfunded pension liability. As a result, beginning in FY 2024-25, 15 months after Measure A expires, the ARC would be approximately $13 million a year less under Option 5 than Option 2 and that delta would continue to grow to approximately $16 million by FY 2041-42. This difference would be available for general fund purposes annually.

Finally, because the $50 million proposal in FY 2013-14 would happen in the same year that we are financing the new Replacement Jail, I would recommend that we hold off on transferring the $50 million until such time that the Jail financing has been completed to ensure there are no negative cash flow consequences. With the Board's approval, we will work with SamCERA and County Counsel in drafting a Board resolution and a Memorandum of Understanding with SamCERA to implement this program.

PERFORMANCE MEASURE (S):

Measure	FY 2012 Baseline	FY 2020 Goal	FY 2025 Goal
Unfunded pension liability (UAAL)	$962 million	$495 million	($272) million
Funded ratio	72.1%	89.7%	104.3%
Annual required contribution (minimum)	$150 million	$220 million	$52 million
Additional contribution amounts (cumulative)	None	$110 million	$140 million
Year when 90% funded ratio is reached	2021-22	2020-21	N/A

FISCAL IMPACT:

These additional contributions would be funded with some combination of Excess ERAF and department reserves. As part of the FY 2013-14 Recommended Budget, the County will transfer 25% of FY 2012-13 reserves from operating departments to Non-Departmental Services as well as change the Fund Balance cost-sharing ratio in future years from 75/25 to 50/50. We anticipate that this will generate $8-$10 million in FY 2013-14 and $3-$5 million thereafter. At a minimum, we would expect to use Excess ERAF in the amount of $40 million in FY 2013-14 and $5 million thereafter. The County would make the first $50 million contribution in the Spring of 2014 after reimbursing itself from bond proceeds for out-of-pocket expenditures related to the land acquisition, site preparation and construction of the new Replacement Jail.