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VIA EMAIL ONLY

December 12, 2018

Mr. Scott Hood
Chief Executive Officer
San Mateo County Employees' Retirement Association
100 Marine Parkway, Suite 125
Redwood Shores, CA 94065-5208

Re: Analysis of Negotiated SEIU Salary Increases

Dear Scott:

California Government Code Section 31515.5 requires a notice be provided of the estimated financial impact that proposed benefit changes or salary increases would have on the funding status of SamCERA 's retirement fund, the County's retirement system. We understand that San Mateo County may agree to increases in salaries over the next three years for the 1,453 General members who are in the SEIU bargaining group. The purpose of this letter is to provide information that can be used to satisfy the requirement.

Background

As you communicated to us, the SEIU proposal provides that its members would receive 4% salary increases for the next two years. In the third year, these employees would receive the actual increase in the Consumer Price Index (CPI) plus 1%, not less than 3% and not more than 4%. Also, longevity adjustments would be increased over the prior scheduled amounts by 1% for employees with 5 to 25 years of service and by 2% for employees with 25 or more years of service. These proposed increases are greater than the actuarially assumed annual wage increases used in the valuation.

As you are aware, the actuarial valuation calculates the liabilities (the estimated value of future payments) of the system and the statutory contribution rates for the employers and members. To make these calculations, the actuary relies on assumptions of future events. Future experience will not exactly match these assumptions. Each year, as this occurs, the actual liabilities will differ from those projected by the assumptions. These differences are referred to as actuarial gains and losses. As the proposed salary increases are greater than the assumption, it is expected that actuarial losses will occur as these increases are granted and recognized in future valuations. Therefore, there is no immediate impact of the proposed changes, but the impact will be reflected over time as the increases occur. We have calculated this projected impact as of the most recent valuation date (June 30, 2018) in our analysis.

Estimated Financial Impact

The proposed agreement includes 4% annual across-the-board salary increases for the next three years (the third year is contingent on the actual CPI increase) for County General members who participate in SEIU. Additionally, for employees with five or more years of service, longevity adjustments are proposed to increase over the prior schedule by 1% or 2% depending on years of service. These proposed across-the-board increases are greater than the actuarially assumed 3% annual general wage increase, and the longevity increases are larger than the current longevity component of the merit increase assumption. Therefore, the proposed salary and longevity increases are expected to result in future actuarial losses as the greater-than-assumed salary increases occur and affect SamCERA's future funded status. Actuarial losses are increases in the actuarial accrued liability greater than that projected by the valuation assumptions. It is estimated that the present value of these future actuarial losses is approximately $21 million. Note that this impact will not be immediate, but will be reflected in future valuations with increases in the statutory contribution rate, which are amortized over 15 years under SamCERA's funding policy. It is equivalent to a reduction of 0.4% in SamCERA's Funded Ratio (currently 87.5%) if the full estimated future impact had been reflected in the 2018 valuation. It is still projected that SamCERA's Funded Ratio will increase in the future, just at a fractionally lower rate than projected in the 2018 valuation.

The County contributes to SamCERA based on a percentage of its payroll. Therefore, an increase in salaries above the valuation assumption will result in an increase in the contributions (both by the County and the affected General members) made to SamCERA, as compared to the contributions projected in the valuation. It should be noted that SamCERA is a cost-sharing retirement system, so the estimated increase in the future actuarial accrued liability will be borne by all SamCERA employers, not just the County.

Data, methods, and assumptions

These estimates are based on the results of the June 30, 2018 actuarial valuation. We did not receive information on which specific General members would receive the scheduled salary increases, but we were provided the total number of SEIU members (1,453) eligible for the increases. This number represents 32% of the total active General member population of 4,603 members as of June 30, 2018. Therefore, we have assumed that 32% of General members will be affected by the proposed salary increases. We have also assumed that the SEIU population is similar to the overall General member population in terms of age, service and salaries.

In the third year, the actual increase is dependent on the CPI increase. For purposes of this calculation, we have assumed that CPI plus 1% will be equal to the maximum increase of 4% for the year. In aggregate, we are assuming actual future general wage increases will exceed the valuation assumption by 3% over the three-year period.

Our understanding is that the scheduled salary increases are independent of other increases. That is, these employees would still be eligible for increases for other reasons, such as promotion and longevity. We refer to these types of increases as merit increases. For purposes of this analysis, we have assumed that future merit increases will be equal to the valuation assumption, except that we have assumed that over time the increase in the longevity adjustments will result in an additional 1.5% increase in the actuarial accrued liability. Therefore, for purposes of this estimate, we are assuming that the aggregate long-term impact will be an increase of 4.5% in the actuarial accrued liability for the affected General members.

Certification

Except as noted elsewhere in this letter, all data, methods, assumptions, and plan provisions are consistent with those described in the June 30, 2018 actuarial valuation. We have assumed that the scheduled salary increases would not affect future member behavior. All statements of reliance and limitations on use described in that report also apply to this work product.

The actuarial computations presented in this letter are for the specific purpose described in this letter. Determinations for other purposes may be significantly different from the results contained in this letter. Accordingly, additional determinations may be needed for other purposes. These computations are subject to the uncertainties of a regular actuarial valuation; the costs are inexact because they are based on assumptions that are themselves necessarily inexact, even though we consider them reasonable. Thus, the emerging costs will vary from those presented in this letter to the extent actual experience differs from that projected by the actuarial assumptions.

Future actuarial measurements may differ significantly from the current measurements presented in this letter due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the retirement system, and changes in plan provisions or applicable law. Due to the limited scope of our assignment, we did not perform an analysis of the potential range of future measurements.

Milliman’s work is prepared solely for the internal business use of SamCERA. To the extent that Milliman's work is not subject to disclosure under applicable public records laws, Milliman’s work may not be provided to third parties without Milliman's prior written consent. Milliman does not intend to benefit or create a legal duty to any third party recipient of its work product.

The consultants who worked on this assignment are pension actuaries. Milliman’s advice is not intended to be a substitute for qualified legal or accounting counsel.

On the basis of the foregoing, we hereby certify that, to the best of our knowledge and belief, this cost projection letter is complete and accurate and has been prepared in accordance with generally recognized and accepted actuarial principles and practices I am a member of the American Academy of Actuaries and meet the Qualification Standards to render the actuarial opinion contained herein.

Please let us know if you have any questions.

Sincerely,

Nick J. Collier, ASA, EA, MAAA
Consulting Actuary

Craig Glyde, ASA, EA, MAAA
Consulting Actuary

NJC/CJG/nlo