County of San Mateo

Inter-Departmental Correspondence

Department: COUNTY MANAGER
File #: 18-958 Board Meeting Date: 10/23/2018

Special Notice / Hearing: None
Vote Required: Majority

To: Honorable Board of Supervisors

From: John L. Maltbie, County Manager

Subject: Board of Supervisors' Response to the 2017-2018 Civil Grand Jury Report, "County Pension Costs - Hard Choices Paying Off"

RECOMMENDATION:
Approve the Board of Supervisors' response to the 2017-2018 Grand Jury Report, "County Pension Costs - Hard Choices Paying Off."

BACKGROUND:
On July 17, 2018, the 2017-2018 San Mateo County Civil Grand Jury issued a report titled "County Pension Costs - Hard Choices Paying Off." The Board of Supervisors is required to submit comments on the findings and recommendations pertaining to the matters over which it has some decision making authority within 90 days. The Board's response to the report is due to the Honorable V. Raymond Swope no later than October 16, 2018.

DISCUSSION:
The Grand Jury made twenty-one findings and four recommendations in its report. The Board responses follow each finding and the four recommendations that the Grand Jury requested that the Board respond to within 90 days.

FINDINGS

Finding 1:
As of June 30, 2017, SamCERA's Funded Ratio (Total Plan Assets/Total Plan Liabilities) was 84.3 percent. By comparison, the average Funded Ratio of cities in San Mateo County was 70.5 percent and the average of CalPERS agencies statewide was just 68 percent.

> **Response:**
> Agree that the Total Plan Assets/Total Plan Liabilities for the SamCERA Retirement Fund was 84.3 percent. The remainder of this finding contains facts of which the Board of Retirement does not have direct knowledge to independently verify and as such the

Board of Retirement submits no response to the remainder of finding.

Finding 2:
As of June 30, 2017, SamCERA had a significant system-wide Unfunded Liability of $743 million, while the County portion constituted a significant Unfunded Liability of $707.1 million.

Response:
Agree to the fact in this finding that as of June 30, 2017, the Unfunded Liability of the Retirement Fund was $743 million, however the term “significant” is subjective and as such the Board of Retirement submits no response to that portion of the finding. As for the $707.1 million, the Board of Retirement does not have direct knowledge of this fact to independently verify and as such the Board of Retirement submits no response to that portion of the finding.

Finding 3:
In FY 2016-2017, the County’s Normal Cost payments to SamCERA were $51 million, while its payments to SamCERA of principal and interest on the Unfunded Liability (“Amortization Cost”) came to $108 million. In addition, the County made supplemental payments to SamCERA of nearly $34 million to pay down the Unfunded Liability. The County’s total payments of $192 million represented about 18 percent of total General Fund spending and 39 percent of its total covered payroll costs in FY 2016-2017.

Response:
Agree that in FY 2016-2017, the County’s Normal Cost payments to SamCERA were $51 million, its payments to SamCERA of principal and interest on the Unfunded Liability (“Amortization Cost”) came to $108 million and that it made supplemental payments to SamCERA of nearly $34 million to pay down the Unfunded Liability. The remainder of this finding is directed toward the County of San Mateo and as such the Board of Retirement submits no response to the remainder of finding.

Finding 4:
The County’s payment of Amortization Cost diverts money that could otherwise be used to pay for public services that it provides.

Response:
This finding is not directed to the Board of Retirement, and as such the Board of Retirement submits no response to this finding.

Finding 5:
In 2013, the County approved a Memorandum of Understanding (MOU) with SamCERA that would result in the County eliminating its Unfunded Liability by FY 2022-2023, if actuarial assumptions are met. The County’s participation is not mandatory, but it has implemented the MOU on schedule. Currently, SamCERA projects that the County will eliminate its Unfunded Liability on schedule.

Response:
Agree with the finding, with exception to the phrase that the MOU would result in the County “eliminating its Unfunded Liability.” It should instead read “reduce its Unfunded Liability.” In 2012, the County approved an MOU with SamCERA that provides for the County to make supplemental contributions to “reduce the County’s long-term costs of contribution to the System by accelerating the reduction of the UAAL.” The MOU further provides that the County understands that “the cumulative effect of depositing supplement funding amounts above the

County's Statutory Contribution Rate (SCR), in accordance with this MOU will accelerate the reduction of the County's SCR over what the County's SCR would have been had the County not deposited such supplemental funding."

Finding 6:
The MOU provides that the County will make annual supplemental contributions totaling $140 million over the 10-year term of the MOU to pay down its Unfunded Liability. Further, the County will maintain a high payroll contribution rate (later determined to be 37.4 percent), even as Annual Required Contributions (ARC) are expected to fall, as the Unfunded Liability declines. Maintaining a contribution rate that is higher than needed to pay the ARC generates additional supplemental contributions.

Response:
Agree.

Finding 7:
The MOU provides that SamCERA will place supplemental contributions from the County into a Supplemental Contributions Account, such that the funds apply to the benefit of the County's plan, rather than the SamCERA system as a whole.

Response:
Agree.

Finding 8:
The County anticipates savings of over $304 million in interest expense as a result of paying down its Unfunded Liability ahead of the schedule provided in the Amortization Period. The County further anticipates that, once the Unfunded Liability is paid off, it will save up to $100 million per year in Amortization Costs and supplemental contributions. However, if the County commits these expected savings to other budgetary purposes, it will be more difficult for the County to meet Unfunded Liabilities in future years, if SamCERA's current actuarial assumptions prove to be too optimistic.

Response:
Agree with the finding. Under any circumstances it would be to meet any change in the future that may put unecpected pressure on the county.

Finding 9:
In 2003 and 2005, the County adopted enhanced pension benefit formulas that were applied retroactively to all employees. Since neither the County nor its employees had made Normal Cost contributions to pay for the enhanced benefits, the County's Unfunded Liability immediately increased. In 2011, the County reversed its previous action and returned to the original benefit formula. However, this only applied to new hires. In 2013, SamCERA implemented new reduced pension formulas required under the California Public Employees' Pension Reform Act.

Response:
Agree.

Finding 10:
Since 2014, the County has eliminated its prior practice of paying a portion of the employees' share of Normal Cost, known as the "employer pickup."

Response:
Agree with the finding that the County has eliminated its prior practice of paying a portion of the employees' share of Normal Cost, known as the "employer pickup;" however, the date is incorrect. The elimination of "pick-ups" occurred through labor negotiations with the various unions. The County commenced the elimination in November 2014 and completed it in July 2016, with a few County members receiving pick-ups until July 2018.

Finding 11:
Since 2014, the County has changed its prior practice of paying the entire cost of annual COLA increases for retirees. It now requires that all employees pay 50 percent of the future cost of this benefit as part of their payroll deduction for Normal Costs.

Response:
Agree, except the finding should read "Since 2015" instead of "Since 2014."

Finding 12:
During the FY 2007-2017 period, the County kept salary increases to an average annual rate of 2.87 percent, well below the rates of increase assumed by SamCERA. This resulted in a cumulative reduction in Unfunded Liability of $154.7 million. However, in the most recent years within the period, FY 2014-2017, the trend showed an increase in Unfunded Liability attributable to salary increases that exceeded SamCERA's assumptions.

Response:
Agree.

Finding 13:
In 2010, the County had 5,327 current employee members of SamCERA. By 2013, this had declined to 4,650 current members before rising back up to 5,080 in 2017.

Response:
Agree.

Finding 14:
SamCERA uses a 15-year layered Amortization Period to determine payments on the Unfunded Liability. That is a shorter period than used by some other pension systems, such as CalPERS. It results in higher employer contributions during the Amortization Period but will ultimately reduce the total interest expense.

Response:
Agree.

Finding 15:
SamCERA conducts Triennial Experience Studies to monitor its demographic actuarial assumptions, including member life-expectancy. Economic assumptions, including the assumed Return on Investment of its plan assets are reviewed annually.

Response:
Agree.

Finding 16:

Based on its latest Triennial Experience Study in 2017, SamCERA has made a change in the mortality assumption that predicts how long members are currently living and adds a projection scale that reflects the gradual year-to-year improvement in mortality that is expected to occur in the future. The new mortality assumption results in a significant increase of Normal Cost contributions equal to 2.19 percent of payroll.

Response:
Agree that the Board of Retirement adopted a new methodology for setting its mortality assumption and this resulted in an increase to the Normal Cost contributions of 2.19 percent of payroll. However, the term "significant" is subjective and as such the Board of Retirement submits no response to that portion of the finding.

Finding 17:
SamCERA has lowered its assumed Return on Investment (ROI) on plan assets in a series of steps since 2005. The assumed ROI for FY 2017-18 is 6.75 percent. That is more conservative than most other public pension systems, such as CalPERS, which is currently at 7.5 percent. (The CalPERS Board has since approved lowering the ROI in steps to 7.0 percent by FY 2020-2021).

Response:
Agree.

Finding 18:
Historically, ROI is the biggest source of funding for SamCERA's pension benefits, comprising approximately 57 percent of total revenues. Contributions by the County provided 29 percent and contributions by employees provided 14 percent of total revenues. As assumed ROI is lowered, Normal Cost increases, so contributions by the County and employees must be increased.

Response:
Agree.

Finding 19:
SamCERA has changed its allocation of assets in different types of investments over time. It has gradually reduced the share of investments in public equities (public stocks) to just 43 percent (as of June 30, 2017) and has diversified its portfolio by increasing the share invested in other asset categories.

Response:
Agree.

Finding 20:
An independent 2018 analysis by Roeder Financial ranks SamCERA third best among California pension plans, based on "funding assumptions." Since the only plans ranked higher than SamCERA were the CalPERS - Legislative (closed) and CalPERS Judges System II, 1, 3 plans, SamCERA has the highest ranking among its peer public pension plans for public agencies.

Response:
Agree.

Finding 21:
ROI can be estimated but not guaranteed. Financial markets have proven to be highly volatile. This

makes long-term financial planning difficult.

Response:
Agree.

RECOMMENDATIONS

Recommendation 1:
The Grand Jury recommends that the County Board of Supervisors continue to implement its MOU with SamCERA to eliminate its Unfunded Liability by the end of FY 2022-2023, provided that actuarial assumptions are met.

Response:
Agree.

Recommendation 2:
The Grand Jury recommends that the County Board of Supervisors keep overall salary increases at or below the actuarial rates assumed by SamCERA.

Response:
Disagree. Meyers-Milias-Brown Act states in law that we must negotiate terms and conditions. Prudent negotiations would factor competitive salary and benefits of other local government agencies and private industry to ensure a stable and effective workforce.

Recommendation 3:
Due to uncertainties regarding future pension liabilities, especially returns on investments, the Grand Jury recommends that the County Board of Supervisors, in budgeting for years beyond FY 2022-2023, ensure that the anticipated savings that accrue from eliminating the need to pay down an Unfunded Liability are not irrevocably committed to other budgetary purposes, such as operational or other ongoing expenses.

Response:
Disagree. Although the Board of Supervisors agrees in principle that it is prudent to not commit to increases in ongoing operational costs within the county's control, it is difficult to anticipate where future costs or needs may arise.

Recommendation 4:
The Grand Jury recommends that the SamCERA Board of Retirement continue to conduct Triennial Experience Studies to address potential demographic changes and continue to conduct annual economic analyses to assess its economic assumptions, including Return on Investment.

Response:
The recommendation will be implemented. SamCERA will continue to have its actuary perform its Triennial Experience Study, in accordance with Government Code section Government Code 31453, which provides, in part:

> "An actuarial valuation shall be made within one year after the date on which any system established under this chapter becomes effective, and therefore at intervals not to exceed three years. The valuation shall be conducted under the supervision of an actuary and shall cover the mortality, service, and compensation experience of the

> members and beneficiaries, and shall evaluate the assets and liabilities of the retirement fund…."

Acceptance of the report contributes to the Shared Vision 2025 outcome of a Collaborative Community by ensuring that all Grand Jury findings and recommendations are thoroughly reviewed by the appropriate County departments and that, when appropriate, process improvements are made to improve the quality and efficiency of services provided to the public and other agencies.

FISCAL IMPACT:
There is no Net County Cost associated with accepting this report.