ATTTACHMENT F

Council Information Items

February 3, 2017

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INFORMATION ITEMS DISTRIBUTED (February 3, 2017)				
DATE	TYPE OF DOC.	AUTHOR	NAME OF DOC.	WHERE FILED
2/3/17	Info Memo	David Bilby, Finance Director	CALPERS Circular Letter - Discount Rate Change	Original in Chron File

CITY OF
CHULA VISTA

FINANCE DEPARTMENT

DATE:	February 3, 2017
TO:	Honorable Mayor and City Council
VIA:	Gary Halbert, City Manager GH Maria Kachadoorian, Deputy City Manager MK
FROM:	David Bilby, Director of Finance DB
SUBJECT:	**CALPERS CIRCULAR LETTER – DISCOUNT RATE CHANGE**

On December 21st, 2016 the CalPERS Board of Directors decided to lower the expected rate of return (discount rate) on future investments from 7.5% to 7.0% over the next few years. This change will result in higher unfunded pension liabilities resulting in higher annual payments. We are projecting that the annual budgetary impacts to the General Fund will be significant over the next 10 years. Combining the normal costs with the unfunded liability payments, as discussed in this memo, the City will pay up to 45% more or an additional $11 million more annually in pension payments beginning in FY 2021 and this is projected to significantly increase through FY 2027.

As a member of the CalPERS retirement system, our retirement benefits are based on a shared responsibility between CalPERS, the City, and its employees. CalPERS makes many assumptions (also called Actuarial Assumptions) to calculate the cost of retirement for its members. The major assumptions include mortality rate, or how long we are projected to live, return on investments (stocks, bonds, real estate, etc.), and risk/volatility which is how much loss CalPERS can take on their investments before they jeopardize their ability to make promised retirement benefit payments to retirees.

While the change in the expected rate of return from 7.5% to 7% may not sound like much of a change, when you compound that rate reduction over a period of 20+ years it results in a 30-40% increase in our City's unfunded pension liability (what we owe CalPERS for benefits already earned by employees/retirees). This will result in the City's unfunded pension liability increasing by approximately $100 million.

As of June 30, 2015, the City had an unfunded pension liability of $261 million. We anticipate this number growing to $300 million as of June 2016 because of the poor investment return (0.6% vs. 7.5% assumed rate) by CalPERS in fiscal year 2016. With the CalPERS reduction of their expected rate of return to 7% over the next three years, we anticipate that the City's unfunded pension liability will grow to over $400 million dollars.

The annual CalPERS pension cost to the City is the sum of the current or "normal" costs of active employees and the cost of paying the unfunded pension liability over a 20 year period. We anticipate total pension costs rising from approximately 30% of salaries to over 50% of salaries over the next ten years for public safety employees and over 40% for miscellaneous employees. This has been confirmed by our independent Actuarial Consultant, Bartel & Associates. We have included these new calculations within our Long Term Financial Plan which will be presented to City Council at a workshop on March 2nd, 2017.

Employees will be impacted based upon their employment Tier. PEPRA employees (Tier 3) are required to contribute 50% of their normal pension costs. As CalPERS makes the rate of return reduction over a period of years, we anticipate that Tier 3 required employee contributions will grow. The performance of CalPERS investments over the next three years will impact the cost for employees and employers in the system. If CalPERS meets existing investment assumptions over the next three years, Tier 3 normal retirements costs may likely increase by approximately 2% resulting in an additional 1% cost to Tier 3 employees. Tier 1 & 2 employees do not have a 50% share requirement.

We will provide periodic updates to the City Council on the status of the pension.

If you have any questions, please feel free to contact David Bilby at ext. 3818

Attachments: CalPERS Circular Letter dated January 19, 2017

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CalPERS

Actuarial
Circular Letter

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January 19, 2017

Circular Letter: 200-004-17
Distribution: VI

To: **All Public Agency Employers**

Subject: **Discount Rate Change**

The purpose of this Circular Letter is to inform you of recent changes to the CalPERS discount rate assumption and the impact these changes are expected to have on required employer and PEPRA member contributions. This Circular Letter will assist you in calculating projected pension cost increases in future years. The June 30, 2016, annual valuations will provide updated projections of expected future year pension contributions. These reports will be available this summer.

At the December 21, 2016, meeting, the CalPERS Board of Administration approved lowering the CalPERS discount rate assumption, the long-term rate of return, from 7.50 percent to 7.00 percent over the next three years. This will increase public agency employer contribution costs beginning in Fiscal Year 2018-19.

The phase-in of the discount rate change approved by the Board for the next three Fiscal Years is as follows:

Valuation Date	Fiscal Year for Required Contribution	Discount Rate
June 30, 2016	2018-19	7.375%
June 30, 2017	2019-20	7.25%
June 30, 2018	2020-21	7.00%

Lowering the discount rate means plans will see increases in both the normal costs (the cost of pension benefits accruing in one year for active members) and the accrued liabilities. These increases will result in higher required employer contributions.

In addition, active members hired after January 1, 2013, under the Public Employees' Pension Reform Act (PEPRA) may also see their contribution rates rise.

The benefits of reducing the discount rate include:

- Strengthening long-term sustainability of the fund
- Reducing negative cash flows; additional contributions will help to offset the cost to pay pensions
- Reducing the long-term probability of funded ratios falling below undesirable levels
- Improving the likelihood of CalPERS investments earning our assumed rate of return
- Reducing the risk of contribution increases in the future from volatile investment markets

Results

Employer contribution increases as a result of the discount rate changes are estimated below by Normal Cost and required Unfunded Accrued Liability (UAL) payment. The Total Employer Contribution is the sum of the Normal Cost Rate applied to reported payroll plus the Unfunded Accrued Liability payment. The Normal Cost portion of the Employer Contribution is expected to increase by the listed percentages of payroll. Increases to the UAL payments are provided as relative increases to be applied to the projected UAL payments in the June 30, 2015, valuation report.

		Normal Cost		UAL Payments	
Valuation Date	Fiscal Year Impact	Misc. Plans	Safety Plans	Misc. Plans	Safety Plans
6/30/2016	2018-19	0.25% - 0.75%	0.5% - 1.25%	2% - 3%	2% - 3%
6/30/2017	2019-20	0.5% - 1.5%	1.0% - 2.5%	4% - 6%	4% - 6%
6/30/2018	2020-21	1.0% - 3.0%	2.0% - 5.0%	10% - 15%	10% - 15%
6/30/2019	2021-22	1.0% - 3.0%	2.0% - 5.0%	15% - 20%	15% - 20%
6/30/2020	2022-23	1.0% - 3.0%	2.0% - 5.0%	20% - 25%	20% - 25%
6/30/2021	2023-24	1.0% - 3.0%	2.0% - 5.0%	25% - 30%	25% - 30%
6/30/2022	2024-25	1.0% - 3.0%	2.0% - 5.0%	30% - 40%	30% - 40%

The changes to the Unfunded Accrued Liability (UAL) due to changes of actuarial assumptions are amortized over a fixed 20-year period with a 5-year ramp up at the beginning and a 5-year ramp down at the end of the amortization period. The 5-year ramp up means that the payments in the first four years of the amortization schedule are 20 percent, 40 percent, 60 percent and 80 percent of the ultimate payment, which begins in year five. The 5-year ramp down means that the reverse is true and the payments in the final four years are ramped down by the above percentages. A new ramp is established with each change to the discount rate. There will be three ramps established in the first three years. As a result of the 5-year ramp up and effective date of the increase, it will be seven years until the full impact of the discount rate change is completely phased in. The shaded rows above are the expected increases beyond the five year projection quoted in your June 30, 2015, valuation report.

To illustrate how this table can be used as a guide to include the change in the discount rate in the calculation of pension contributions, a Miscellaneous plan with a current normal cost of 15 percent of payroll can expect an increase to 15.25 percent to 15.75 percent of payroll in the first year (Fiscal Year 2018-19), and 16 percent to 18 percent in the fifth year (Fiscal Year 2022-23). For the UAL payment, a plan with a projected payment of $500,000 in Fiscal Year 2018-19 and $600,000 in Fiscal Year 2022-23 can expect the revised payment to be $510,000 - $515,000 ($500,000x2.00%/$500,000x3.00%) for Fiscal Year 2018-19, and $720,000 - $750,000 ($600,000x20%/$600,000x25%) for Fiscal Year 2022-23. These estimated increases incorporate both the impact of the discount rate change and the ramp up.

Please keep in mind the above table is a tool for you to calculate broad estimates and should only be used as a general guide. The annual valuation report that will be released this summer will provide updated projections for your specific plan.

If you have any questions about the information provided or how to apply it to your current valuations, please call our CalPERS Customer Contact Center at **888 CalPERS** (or **888**-225-7377) and ask to have your plan actuary contact you.

Scott Terando
Chief Actuary