Agenda Item IV.C.

CITY OF NEWPORT BEACH
FINANCE COMMITTEE STAFF REPORT

November 7, 2011

TO: HONORABLE CHAIR AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
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SUBJECT: Latest PERS Actuarial Valuations

ABSTRACT:

Staff has received and analyzed the CalPERS Actuarial valuation reports that describe the status of the plans as of June 30, 2010, and sets the rates for Fiscal Year (FY) 2011-12. As is the case with most public sector pension plans, the current funded status of the plans has deteriorated near their lowest levels in twenty years. Pension contribution rates are projected to increase for the next several years although at a much slower pace effective FY 2013-14.

BACKGROUND:

CalPERS prepares an actuarial valuation annually for each of the City's defined benefit pension programs. One valuation is prepared for the Safety plan, which encompasses our sworn Police, Fire and Lifeguard employees, and one valuation is for our "Miscellaneous" employees which encompass all other eligible non-sworn employees. The valuations that we received in October 2011 set the contribution rates effective July 1, 2012, and are based on plan data as of June 30, 2010.

Different than 401k plans or other defined contribution arrangements, where an employer's obligation is limited to an annual contribution (if any), the employer guarantees a specified lifetime benefit level. When plan assumptions do not work out as planned, the employer is still on the hook to fulfill vested benefit promises. The employer, therefore, retains the funding risk, which can be very substantial under volatile situations. For this reason, most private sector employers have closed their defined benefit plans to new participants in order to transfer these risks to the employee.

Actuarial valuations are extremely important because they provide important details concerning the health of the plan and the City's related near and long-term funding obligations. The funded status of plans is simply the net difference between plan assets and plan liabilities.

Some of the variables that influence the funded status of plans include plan contributions, actual and assumed investment earnings, the level of benefits provided, payroll growth rates, longevity of employment, retirement age and life expectancy. In recent years, most of these variables have worked against the City. Benefit levels have been enhanced, employees are able to retire earlier than originally projected, life expectancy has increased and investment losses throughout 2008 and 2009 have contributed to a broad deterioration of the funded status of plans across the country.

NOTABLE CHANGES FROM THE PRIOR VALUATION

According to our actuaries, the Safety plan liability grew slower than expected due to lower than expected payroll increases amongst older employees. In the Miscellaneous plan, liabilities grew faster than expected due to heavy Miscellaneous retirements and a lower than expected payroll due to the Early Retirement Incentive Plan (ERIP) and other City restructuring efforts. A small payroll requires a larger contribution rate increase to cover outstanding plan obligations.

FUNDED STATUS

When considering the volatility associated with equities-based investments, it is not uncommon for the funded status of plans to be relatively volatile when measured on a Market Value Asset (MVA) basis. Therefore, plans also measure plan assets on Actuarial Value Asset (AVA) basis which smooths the asset value over time. While volatility in funded status on an MVA basis is to be expected, a significant disparity between AVA and MVA basis cannot be ignored for too long. Otherwise, plans can become insolvent. Stop losses or corridor limits are put in place to maintain the solvency of the plan

As of June 30, 2010, the City's unfunded pension liability (plan assets less plan liabilities) totaled $148.9 million on an AVA basis of which $51.2 million was attributable to the Miscellaneous Plan and $97.7 million was attributable to the Safety Plan. The unfunded liability on a MVA basis was $256.5 million of which $97.5 million is attributable to the Miscellaneous Plan and $159 million is attributable to the Safety Plan. On an AVA basis, the funded status of Miscellaneous was 81.0% while the safety plan was 74.4%. More relevant today, on an MVA basis, the funded status of the Miscellaneous Plan was 63.8% and the Safety plan was 58.4% respectively. Statewide, the average funded status for Miscellaneous plans is approximately 66% and approximately 60% for Safety plans putting the funded status of Newport Beach plans slightly below the average.

The funding status trend for the City plans has been as follows:

PERS Funded Status Trend

Valuation Date	Accrued Liability (Millions)	Unfunded Liability - AVA Basis (Millions)	Unfunded Liability - MVA Basis (Millions)	Funded Status AVA(1)	Funded Status MVA(2)
Misc Plan					
2006	$ 183.7	$ 20.5	$ 10.6	88.80%	94.20%
2007	$ 192.2	$ 13.6	$ (14.8)	92.90%	107.70%
2008	$ 217.4	$ 21.4	$ 17.6	90.10%	91.90%
2009	$ 249.7	$ 41.9	$ 97.0	83.20%	61.10%
2010	$ 269.5	$ 51.2	$ 97.5	81.00%	63.80%
Safety Plan					
2006	$ 296.5	$ 64.7	$ 50.0	78.20%	83.10%
2007	$ 308.6	$ 58.5	$ 16.5	81.00%	94.70%
2008	$ 336.1	$ 71.4	$ 64.0	78.70%	81.00%
2009	$ 366.9	$ 92.3	$ 165.9	74.90%	54.80%
2010	$ 382.3	$ 97.7	$ 159.0	74.40%	58.40%

(1) Actuarial Value Asset basis.

(2) Market Value Asset basis.

CONTRIBUTION RATES AND PROJECTIONS

As a result of the deteriorating funding status, plan contribution requirements have risen rapidly to close the gaps between the market value of assets, the actuarial value of assets and plan liabilities.

In June of 2009, the CalPERS board adopted a three-year temporary change to the actuarial smoothing methodologies in order to phase in the impact of the 2008 investment losses more gradually. Among other things, the CalPERS board changed the maximum distance that the actuarial value of assets can lag behind market value of assets. The temporary corridor limit of 70-130% of market value will be returned to 80-120% of market value effective June 30, 2011, at which time the 2008 investment losses will be fully incorporated into the actuarial asset values. As a result, the contribution rate ascent will slow down effective FY 2013-14 (set by the June 30, 2011 valuation).

In May of 2012, we understand Chief CalPERS actuary will again make a recommendation to the CalPERS board to lower the current assumed discount rate of 7.75% down to 7.50% or 7.25% and may consider additional inflation-related assumptions. If the board approves his recommendations, the assumption changes would not impact contribution rates until FY 2014-15. A summary of recent PERS rate trends can be found in the table below.

PERS Rate and Annual Required Contribution (ARC) Trend

		Employer Rate						
Fiscal Year	Employee Rate(1)	Normal Cost	Unfunded Rate	Total Employer Rate(1)	Combined Contribution Rate(1)	Rate Change as a % of Payroll	Estimated Annual Covered Payroll(2) (Millions)	Annual Required Contribution (Millions)
Miscellaneous Plan								
2011	8.00%	7.53%	3.30%	10.83%	18.83%		$ 42.90	$ 8.08
2012	8.00%	7.75%	6.88%	14.63%	22.63%	3.80%	$ 44.29	$ 10.02
2013	8.00%	7.75%	8.66%	16.40%	24.40%	1.78%	$ 45.73	$ 11.16
2014(4)	8.00%	7.75%	8.95%	16.70%	24.70%	0.30%	$ 47.22	$ 11.66
2015(4)	8.00%	7.75%	9.15%	16.90%	24.90%	0.20%	$ 48.75	$ 12.14
Safety Plan								
2011	9.00%	15.41%	14.80%	30.20%	39.20%	1.44%	$ 30.68	$ 12.03
2012	9.00%	16.46%	18.57%	35.03%	44.03%	4.83%	$ 31.68	$ 13.95
2013	9.00%	16.09%	19.84%	35.93%	44.93%	0.91%	$ 32.71	$ 14.70
2014(4)	9.00%	16.09%	20.21%	36.30%	45.30%	0.37%	$ 33.77	$ 15.30
2015(4)	9.00%	16.09%	20.51%	36.60%	45.60%	0.30%	$ 34.87	$ 15.90

(1) Rates reflect the total contribution rates required by the plans irrespective of current employee paid member contributions and or negotiated cost sharing agreements.

(2) Estimated Covered Payroll estimated using actuarial assumed growth rate of 3.25% per annum.

(3) Estimated Annual Required Contribution to plan irrespective of employee paid member contributions or negotiated cost sharing agreements.

(4) Projected by PERS Actuaries assuming no substantial actuarial gains, losses or changes in plan assumptions.

MITIGATING MEASURES

While the pace of annual contribution rate increase has been slowing, the annual required contribution rates are extremely high by historical standards and as percent of payroll. Pension reform was identified by City Council as one of its top priorities in 2011 and is an integral part of the City's 15-point Fiscal Sustainability Plan. The City is addressing pension cost issues by seeking increased employee contributions to the pension plans, lower benefit tiers and restructuring departments to achieve greater efficiencies. Already, the City has reached agreement with most Miscellaneous bargaining units for an 8% employee contribution and is working with Public Safety during the current fiscal year.

With respect to the funded status and the amortization of the unfunded liability, the Finance Committee may wish to consider evaluating the option to amortize our current unfunded liability over a fixed declining period rather than a rolling 30-year amortization which negatively amortizes indefinitely. While the fixed amortization schedule requires a higher annual required contribution, it provides a more certain path toward plan funding. We would be happy to discuss this option or provide additional analysis of this option as directed.

Complete actuarial valuations are available for your review upon request.

Prepared by:

/s/Dan Matusiewicz
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