

**Costa Mesa Pensions and
Retiree Medical Liabilities**
Pension Oversight Committee
May 8, 2013

Prepared by Jeff Arthur

Unfunded Public Pension and Retiree Health Care Liabilities

—In Costa Mesa, Anaheim, Fullerton, Huntington Beach,
Newport Beach, Orange, and Santa Ana

Joe Nation, Ph.D.
Professor of the Practice of Public Policy
Stanford Institute for Economic Policy Research (SIEPR)
Stanford University
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How Did We Get Here?

-1990's: "Dot-com" Boom

-1999: SB400 Increases CA Pensions

-2000: "Dot-com" Bubble burst

-12/1/00: CM Police 2% to 3%@50

-7/1/08: CM Misc. 2% to 2.5%@55

What does 3% at 50 mean?

Years of Service X

Factor (3% at age 50) X

Final Compensation (12 or 36 months) =

Pension + 2% COLA

+ 80% Purchasing Power Guarantee

Example:

25 Years X 3% Factor X \$100,000 =

\$75,000 Pension + COLA, etc.

Public Sector “Rules” Push Costs to Future

<i>Pension Background</i>	Benefit Levels	Funded Status	Contribution Rates & Budgets	Moving Forward
Assumption or Method	CalPERS^a		Private Sector DB	
Discount rate	7.5%		~4-5%	
Investment rate of return (percent)	7.5%		Varies	
Amortization period (years)	30 years ^b		7 years	
Asset smoothing period	15 years		2 years	

^aPublic Employees' Retirement Fund (PERF).

^bThe amortization period is 20 years for unfunded liability attributable to changes in plan provisions or actuarial assumptions.

Sources: CalPERS, "Comprehensive Annual Financial Report Fiscal Year Ended June 30, 2010," p. 41, <https://www.calpers.ca.gov/eip-docs/about/pubs/member/calpers-reports/comprehensive-annual-financial/comprehensive-annual-fina-rept-10.pdf>, retrieved Oct. 14, 2011; Internal Revenue Code Section 430, 436, http://www.taxalmanac.org/index.php/Internal_Revenue_CodeSec_430_Minimum_Funding_Standards_for_Single-Employer_Defined_Benefit_Pension_Plans, retrieved Nov. 3, 2011.

How is CalPERS doing?

PERS Actuary: 73.6% funded

Assumes 7.5% Rate of Return

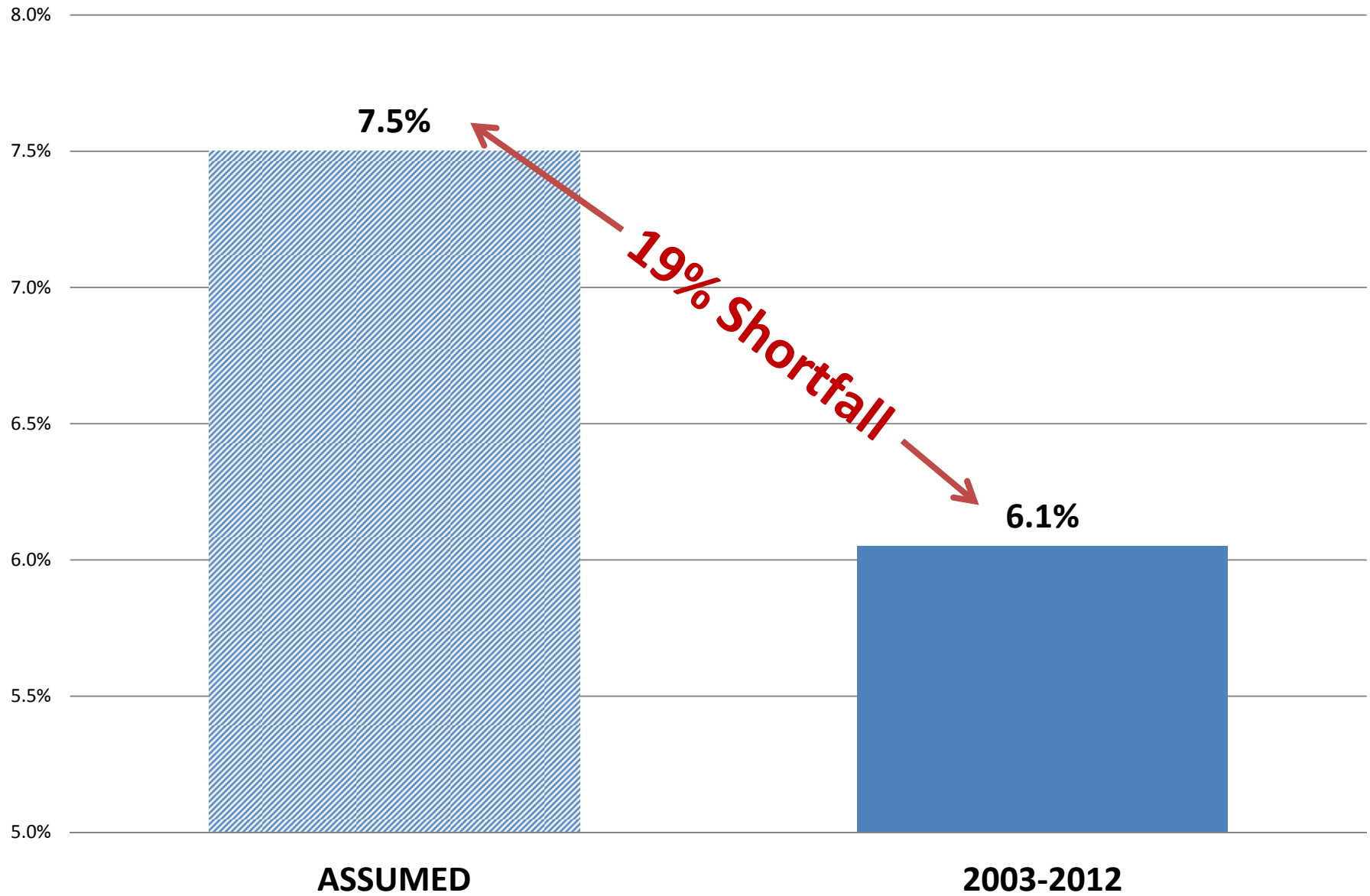
FY2012 Actual was 0.14%

How about the last 10 years?

PERF Total Fund Performance | 10-Year Review, One-Year Returns



PERS Ten Year Rates of Return



Source: CalPERS 2012 CAFR

Much Debate Over the “Correct” Investment Rate of Return for CalPERS

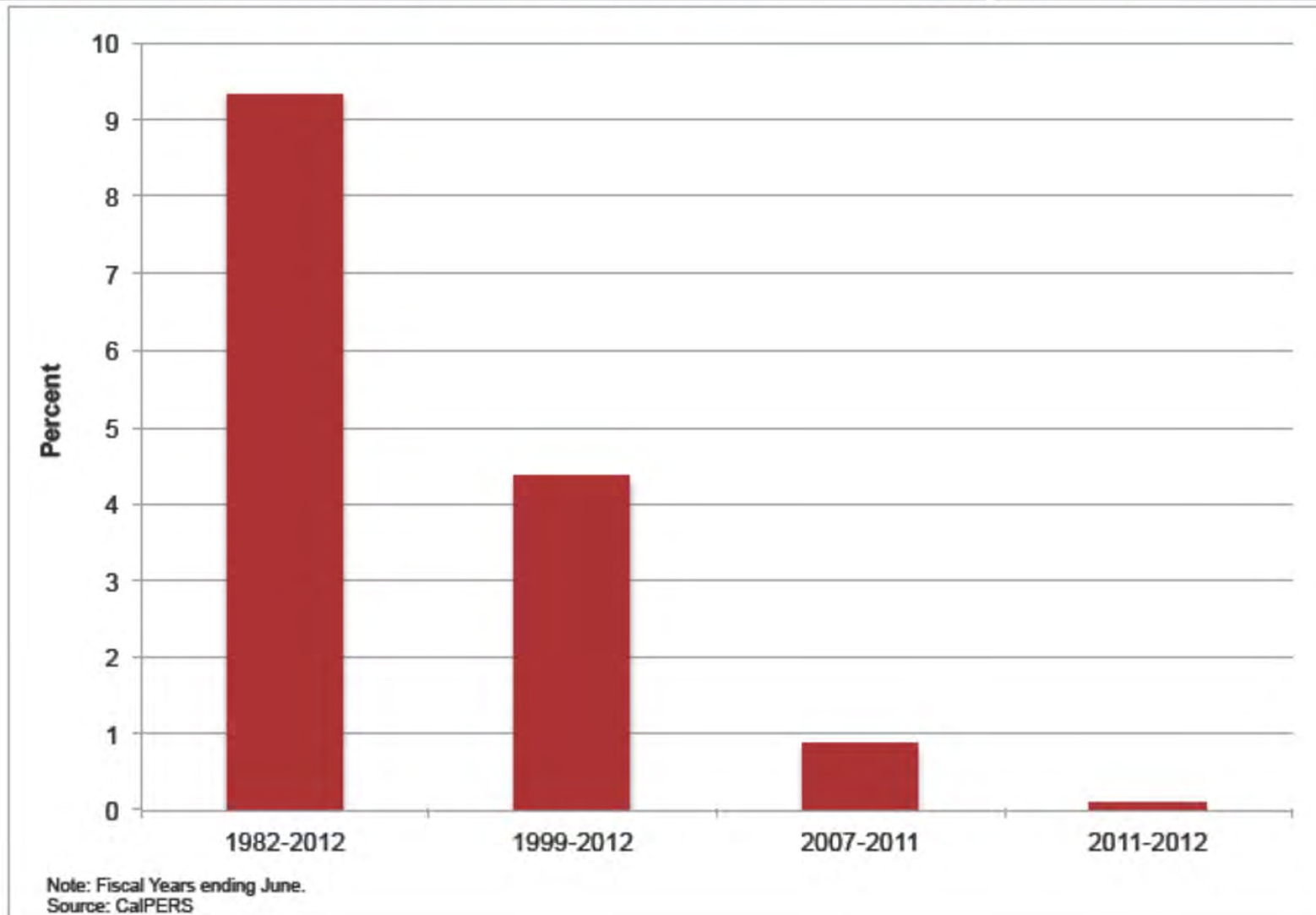
Pension Background

Benefit Levels

Funded Status

Contribution Rates
& Budgets

Moving Forward



***Moody's Investor
Services recommends:***

5.5%

Boeing using 3.8%

Sources:

<http://californiapublicpolicycenter.org/the-impact-of-moodys-proposed-changes-in-analyzing-government-pension-data/>

<http://online.wsj.com/article/SB10001424127887324338604578324831195349470.html?KEYWORDS=pension+gap>

Higher Contribution Rates Translate into Higher Annual Costa Mesa Pension Spending

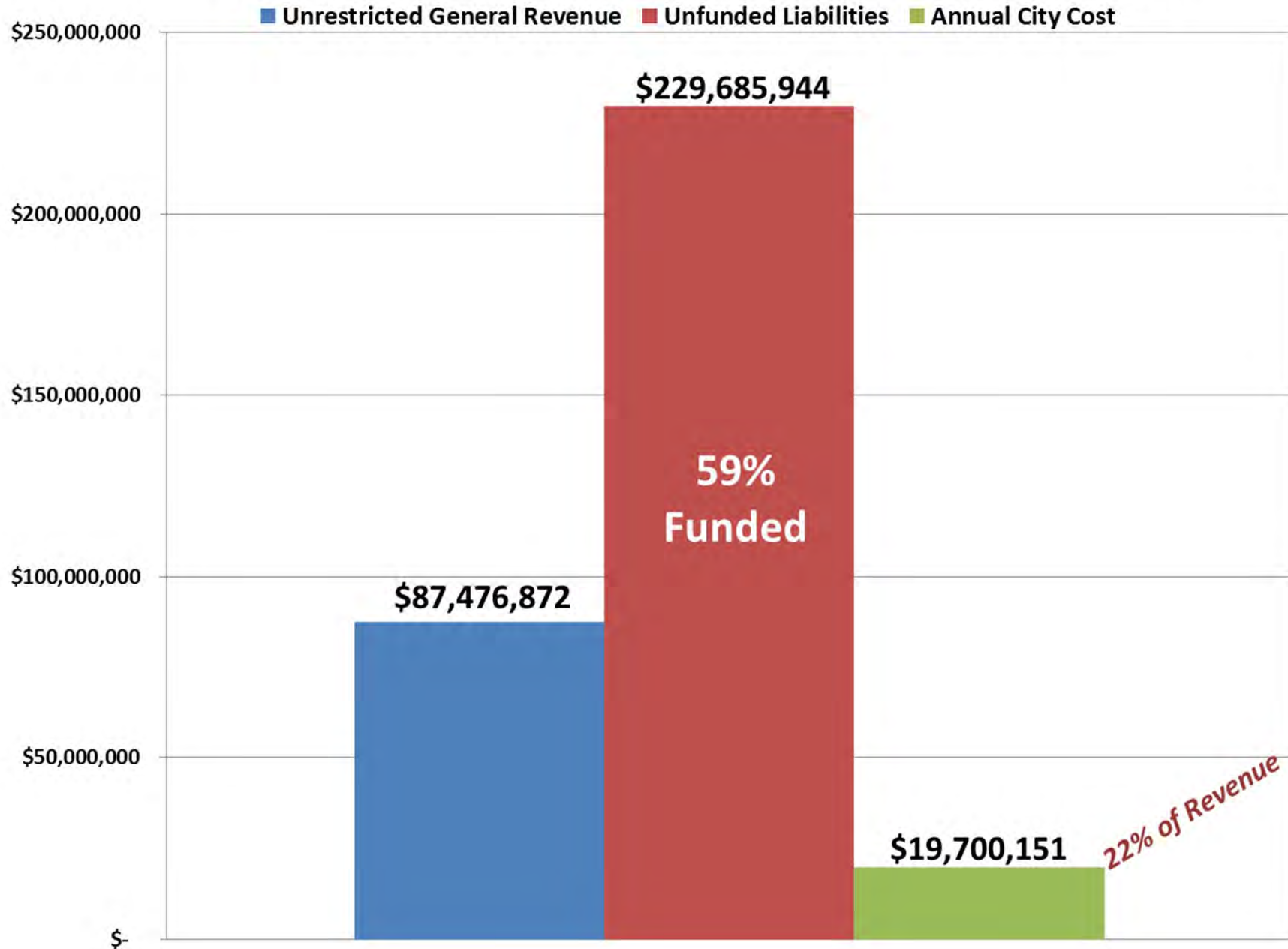
Pension Background	Benefit Levels	Funded Status	Contribution Rates & Budgets		Moving Forward
			Investment Rate of Return		
	2013 Payroll	2013 Payment	7.5%	6.0%	5.0%
Misc.	\$29.9	\$5.8	\$6.5	\$10.6	\$13.4
Safety Fire	\$14.6	\$5.0	\$5.6	\$9.1	\$11.5
Safety Police	\$22.8	\$7.1	\$8.0	\$13.5	\$17.2
Total	\$67.4	\$18.0	\$20.1	\$33.3	\$42.0
Share of city spending		11.4%	12.8%	21.1%	26.6%
Share of 2013 payroll		26.7%	29.9%	49.4%	62.3%

Source: Author's estimates based on current reported contribution rates and CalPERS-reported contribution rate effects.

How is Costa Mesa doing?

***~\$230 Million in
Unfunded Liabilities***

Costa Mesa Revenue vs Pension & Retiree Medical



Sources: CalPERS October 2012 Memos and Costa Mesa 2012 CAFR

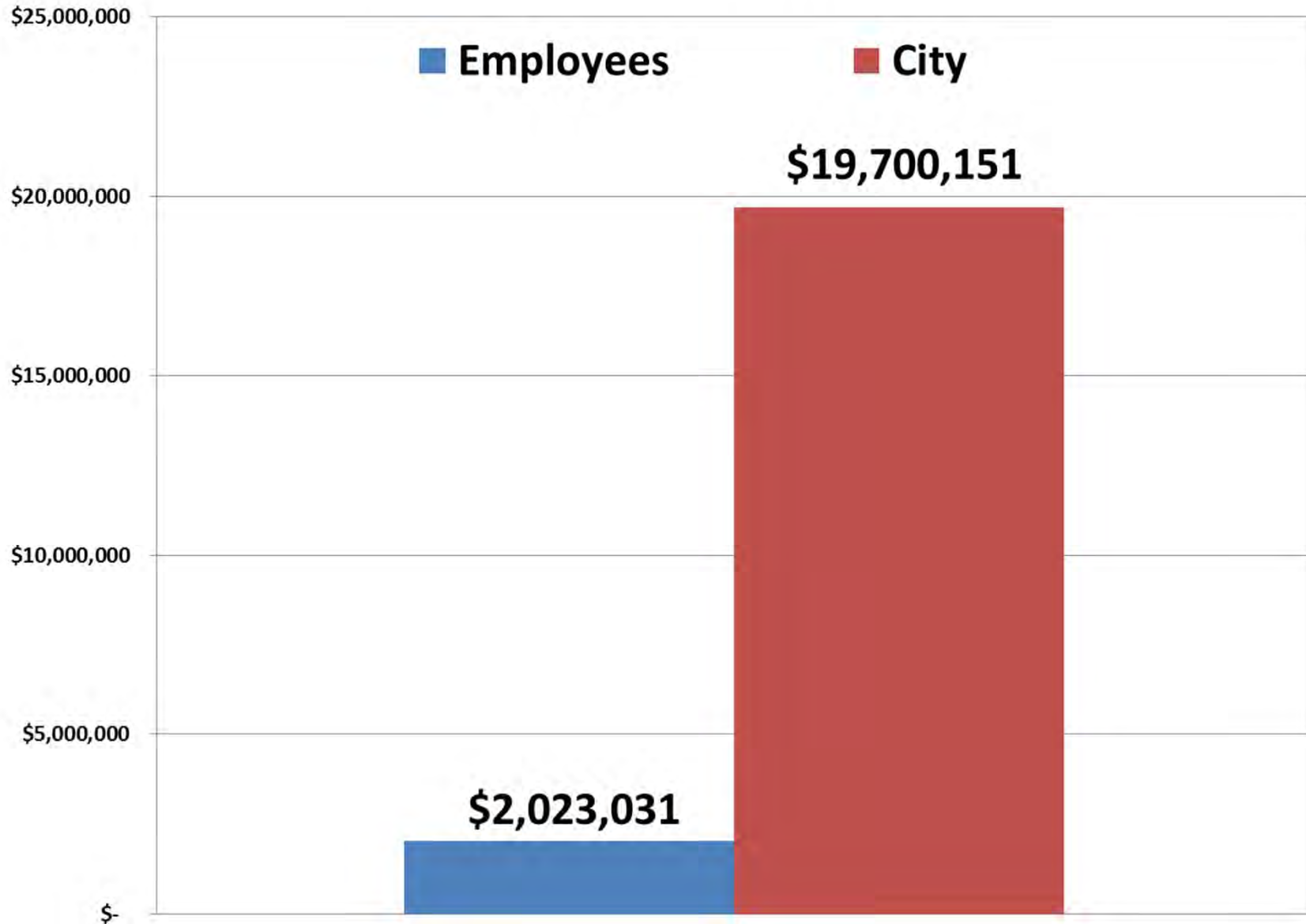
CM Employee PERS Contributions

Police: 5%

Fire: 5%

Misc: 4% + 3.52% for 2008 bump

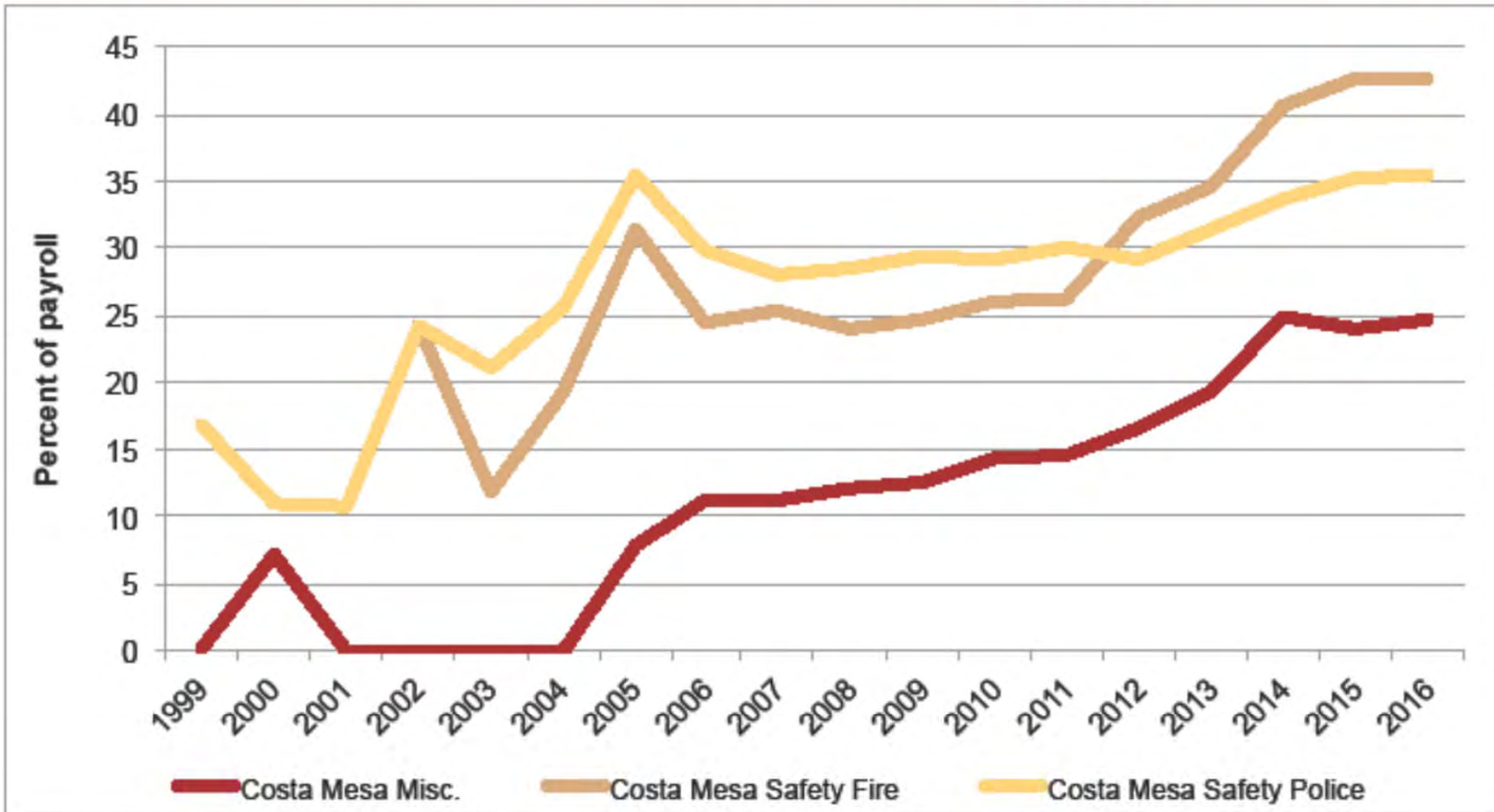
Costa Mesa Annual PERS & Retiree Medical Costs



Sources: CalPERS October 2012 Memos and Costa Mesa 2012 CAFR

Costa Mesa Contribution Rates Have Grown Substantially

Pension Background	Benefit Levels	Funded Status	Contribution Rates & Budgets	Moving Forward
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Sources: State Controller, "Public Retirement Systems Annual Reports," various years, <http://www.sco.ca.gov/Files-ARD-Local/LocRep/retirement0910.pdf>, retrieved May 20, 2012 and CalPERS annual valuation letters.
 Note: 2013-2016 rates include current EPMC and employee pick up of employer rates.

***Possible
Solutions??***

Moving Forward Starts With Recognizing the Magnitude of the Problem

Pension Background

Benefit Levels

Funded Status

Contribution Rates
& Budgets

Moving Forward

- Higher investment rates of return won't solve this
 - CalPERS needs almost a 14% annual investment rate of return to achieve an 85% chance of assets greater than liabilities over next 15-20 years
 - (BTW, Bernie Madoff averaged 10.5% per year for about 17 years)
- Solutions required
 - Benefit reductions
 - Greater cost sharing
 - New revenues

Increased Cost-Sharing Will Also Reduce City Pension Expenditures, But Only Slightly

Pension Background

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Moving Forward

- A 50/50 share of *all* costs could save Costa Mesa \$7.8-\$18.3 million per year
- However, AB 340 permits cost sharing of Normal Costs *only* (and it caps employee contributions), so savings are likely to be a fraction of this
 - In fact, there are no savings to Costa Mesa since current employee contributions exceed AB 340 caps
 - Additional legislative action needed
- In the long-run, shifting pension costs to employees may also lead to recruitment and retention challenges

New Revenues Will Likely Be Needed Along With Reforms

Pension Background

Benefit Levels

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& Budgets

Moving Forward

- A one-quarter cent sales tax in Costa Mesa raises \$5.5 million annually, closing less than one-third of the shortfall in the 6.0 percent investment return case
- A parcel tax of \$370 per household *each year* for about two decades would also address most, if not all of the shortfall

***Calculations
and
Sources***

Costa Mesa Unfunded Liabilities - Updated March 2013

Employee Plan	% Funded	Plan Assets	Liability	Unfunded	City Cost 2012-13	EE Cost 2013-14	Count	Per Employee	Source
Police - Active							145		Oct 2012
Police - Retired							146		CalPERS Memo
Subtotal	64.1%	131,247,164	204,751,113	73,503,949	7,132,798	962,294	291	252,591	as of 6/30/11
Miscellaneous - Active							286		Oct 2012
Miscellaneous - Retired							387		CalPERS Memo
Subtotal	67.8%	147,217,268	217,132,722	69,915,454	5,787,720	545,936	673	103,886	as of 6/30/11
Fire - Active							78		Oct 2012
Fire - Retired							115		CalPERS Memo
Subtotal	66.5%	103,982,067	156,290,468	52,308,401	4,395,863	514,801	193	271,028	as of 6/30/11
Retiree Health		2,470,935	36,429,075	33,958,140	2,153,804				CAFR p59,64-65
Police 1% Ret. Supplement		2,440,991	2,440,991	0	229,966				CAFR p59,63
TOTAL		387,358,425	617,044,369	229,685,944	19,700,151	2,023,031	1,157	198,519	
							Active:	509	
							Retired:	648	
								<u>1,157</u>	
AVERAGE PER CITIZEN		110,000	\$ 2,088						
AVERAGE PER HOUSEHOLD		2.65	\$ 5,533						
<u>Costa Mesa General Fund 6/30/12</u>									
Balance		47,809,926	CAFR p18						
Unfunded Liabilities		(229,685,944)							
Balance Net of Liabilities		(181,876,018)							
Memo: Unassigned		8,464,909	CAFR p18						
Memo: Unrestricted revenue		87,476,872	CAFR p15						
2012-13 Budgeted Appropriations		101,069,710	Budget p71						

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CalPERS PERF Total Fund Performance

from CalPERS 2012 CAFR, page 104

Year	Actual Returns	Beginning Balance	Ending Balance	Assumed Return	Beginning Balance	Ending Balance	Actual Average Rate	Beginning Balance	Ending Balance	Years	
1999											
2000											
2001											
2002											
2003	3.7%	10,000	10,370	7.5%	10,000	10,750	6.05%	10,000	10,605		
2004	16.6%	10,370	12,091	7.5%	10,750	11,556	6.05%	10,605	11,247		
2005	12.3%	12,091	13,579	7.5%	11,556	12,423	6.05%	11,247	11,927		
2006	11.8%	13,579	15,181	7.5%	12,423	13,355	6.05%	11,927	12,649		
2007	19.1%	15,181	18,081	7.5%	13,355	14,356	6.05%	12,649	13,414		
2008	-5.1%	18,081	17,158	7.5%	14,356	15,433	6.05%	13,414	14,225		
2009	-24.0%	17,158	13,040	7.5%	15,433	16,590	6.05%	14,225	15,086		
2010	13.3%	13,040	14,775	7.5%	16,590	17,835	6.05%	15,086	15,999		
2011	21.7%	14,775	17,981	7.5%	17,835	19,172	6.05%	15,999	16,967		
2012	0.1%	17,981	17,999	7.5%	19,172	20,610	6.05%	16,967	17,993		
								Actual Return Balance	17,999		
								Actual Average Rate Balance	17,993		
								Difference	6		
								ASSUMED	7.5%		
								2003-2012	6.1%		
								Shortfall	-19.3%		
							Check:	6.05%	10,000	17,993	10
								7.50%	10,000	20,610	10

Prepared by: Jeff Arthur 1/14/2013

PERS:

Exhibit A: Funding Progress – Unfunded Liability & Funded Ratios

(Dollars in Millions)

Actuarial Valuation Date	Actuarial Value of Assets (1)	Actuarial Accrued Liability (AAL) – Entry Age (2)	Unfunded AAL (UAAL) (AVA Basis) (2)–(1)	Funded Ratio – Actuarial Value of Assets Basis (1)÷(2)	Annual Covered Payroll (3)	UAAL as a % of Covered Payroll [(2)–(1)]÷(3)	Market Value of Assets (MVA) (4)	Unfunded AAL (UAAL) (MVA Basis) (2)–(4)	Funded Ratio – Market Value of Assets Basis (4)÷(2)
PERF									
6/30/02	\$156,067	\$163,961	\$7,894	95.2%	\$32,873	24.0%	\$142,455	\$21,506	86.9%
6/30/03	158,596	180,922	22,326	87.7	34,784	64.2	144,330	36,592	79.8
6/30/04	169,899	194,609	24,710	87.3	35,078	70.4	167,110	27,499	85.9
6/30/05	183,680	210,301	26,621	87.3	36,045	73.9	189,103	21,198	89.9
6/30/06	199,033	228,131	29,098	87.2	38,047	76.5	211,188	16,943	92.6
6/30/07	216,484	248,224	31,740	87.2	40,864	77.7	251,162	(2,938)	101.2
6/30/08	233,272	268,324	35,052	86.9	44,236	79.2	238,041	30,283	88.7
6/30/09	244,964	294,042	49,078	83.3	45,100	108.8	178,860	115,182	60.8
6/30/10	257,070	308,343	51,273 ¹	83.4	44,984	114.0	201,632	106,711	65.4
6/30/11	271,389	328,567	57,178 ¹	82.6	43,901	130.2	241,740	86,827	73.6
LRF									
6/30/07	\$142	\$102	(\$40)	139.2%	\$2	(2,000.0)%	\$142	(\$40)	139.2%
6/30/08	142	103	(39)	137.9	2	(1,950.0)	134	(31)	130.1
6/30/09	134	112	(22)	119.6	2	(1,100.0)	112	—	100.0
6/30/10	127	112	(15)	113.4	2	(750.0)	114	(2)	101.8
6/30/11	126	109	(17)	115.6	2	(850.0)	124	(15)	113.8
JRF									
6/30/07	\$12	\$2,714	\$2,702	0.4%	\$119	2,270.6%	\$12	\$2,702	0.4%
6/30/08	19	3,607	3,588	0.5	111	3,232.4	19	3,588	0.5
6/30/09	41	3,583	3,542	1.1	97	3,651.5	41	3,542	1.1
6/30/10	64	3,429	3,365	1.9	86	3,912.8	64	3,365	1.9
6/30/11	54	3,297	3,243	1.6	76	4,267.1	54	3,243	1.6
JRF II									
6/30/02	\$72	\$76	\$4	94.7%	\$73	5.5%	\$65	\$11	85.5%
6/30/03	96	105	9	91.4	87	10.3	91	14	86.7
6/30/04	129	138	9	93.5	99	9.1	129	9	93.5
6/30/05	168	178	10	94.4	112	8.9	172	6	96.6
6/30/06	213	220	7	96.8	125	5.6	219	1	99.5
6/30/07	268	295	27	90.8	156	17.3	291	4	98.6
6/30/08	335	367	32	91.3	175	18.3	325	42	88.6
6/30/09	379	451	72	84.0	199	36.2	316	135	70.1
6/30/10	461	521	60	88.5	213	28.2	422	99	81.0
6/30/11	561	610	49	92.0	230	21.3	576	34	94.4
CERBTf									
6/30/07	\$11	\$24	\$13	45.8%	\$37	35.1%	\$11	\$13	45.8%
6/30/08	48	4,845	4,797	1.0	5,092	94.2	48	4,797	1.0
6/30/09 ²	873	10,462	9,589	8.3	9,307	103.0	845	9,617	8.1
6/30/10 ³	1,287	14,288	13,001	9.0	10,435	124.6	1,287	13,001	9.0
6/30/11 ^{4,5}	1,818	15,522	13,704	11.7	10,374	132.1	1,864	13,658	12.0