Costa Mesa Pension Oversight Committee

CMPOC Fast Facts

$100,000 Pensions – Benefits Paid, Funding, and Taxpayer Exposure

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Across the state, newspaper headlines have reported that nearly 21,000 former California public employees are receiving pension benefits exceeding $100,000 per year. Understanding that the recipients of these benefits are typically career public safety workers (police and fire) or high-level management employees, it is important to recognize the full impact of such pensions. This edition of "Fast Facts" will discuss Costa Mesa $100,000 pensions; their recent growth, the benefits that are paid to the retiree, the cost to fund the pension, and possible taxpayer exposure should CalPERS investment earnings fail to reach projections.

Costa Mesa $100,000 Pensions

Today, Costa Mesa has approximately 410 full-time employees and approximately 500 full time, career retirees receiving annual pension payments that exceed $15,000 (there are approximately 180 additional retirees who served either partial careers or as part-time employees who receive annual pension benefits of less than $15,000.) Of the 500 career retirees, 83 currently receive annual pension benefits exceeding $100,000.

Due to increases in wages and pension benefits, the number of career employees reaching the $100,000 threshold has grown significantly. In the three years beginning in 2003, the city experienced 75 career retirements and 8% of the retirees received first year pensions exceeding $100,000. In the three years beginning in 2010, the city experienced 66 career retirements and 39% of those retirees received first year pensions exceeding $100,000.

Lifetime Benefits Paid on Pensions

All Costa Mesa pension benefits are paid for life and increase 2% annually due to cost of living adjustments (COLA) that are part of the pension formula. To estimate the lifetime benefits paid to retirees, it is necessary to make basic assumptions related to retirement age and life expectancy.

The most recent retirement report from the city indicates that the average retirement age for Police safety employees is 52 years old after 23 years of service. The average retirement age for Fire safety employees is 55 years old after 28 years of service. For all other employees, commonly referred to as "Miscellaneous" employees, the average retirement age is 58 years old after 21 years of service.

Assuming an average retirement age of 55, the United States Social Security administration estimates male life expectancy at 83 years (female life expectancy is slightly longer). Using the example of an employee retiring at 55 and living until age 83, the average retiree will work for 24 years and then receive pension benefits for roughly 29 years.

The impact of the 2% annual increase in benefits results in substantial pension growth over the term of retirement. At age 55, in the first year of retirement, the beneficiary will be paid $100,000. In the second year of retirement, at age 56, the retiree will be paid $102,000. At age 57, the retiree will be paid $104,040. Due to the cumulative effect of the 2% annual increases, at age 83, the beneficiary will receive an annual payment of $174,102. The sum of all pension benefits paid over the 29 years of retirement is $3,879,223.

Funding Pensions

Costa Mesa and city employees make payments to CalPERS, the state agency that manages public employee pensions. Historically, employee contributions towards their pensions have been minimal. However, with significant underfunding of pensions, employee contributions have increased in recent years (this matter will be discussed further in a future "Fast Facts" article).

To fully fund a $100,000 pension for a retiree living to life expectancy, it is necessary to establish two important variables. The first variable is the amount of money that would be set aside during employment to fund the pension payments during retirement. The second variable is the investment rate of return that the employee account will earn to help fund the pension payments.

Currently, CalPERS sets the investment rate of return (called the Discount Rate) at 7.5%. This means CalPERS estimates that the average rate of return on their investments will be a positive 7.5% per year over the 29 years of retirement. Assuming this average rate of return, at age 55, the amount of money that must be set aside to pay the pension benefit is $1,421,724.

City and Taxpayer Exposure to Underfunding

Recent CalPERS investment results have averaged below 7.5%. This has resulted in significant concerns related to the Discount Rate. Numerous studies have concluded that a more conservative discount rate should be used to calculate pension benefits. In 2012, CalPERS made a downward adjustment in the Discount Rate from 7.75% to the current 7.5%, but any further reductions have been opposed by CalPERS.

To demonstrate the impact of a reduced Discount Rate, consider our example of the $100,000 pension being fully funded at $1,421,724 (using the 7.5% Discount Rate). If the average annual investment return is reduced to 6%, the amount of money required to pay the pension benefit increases to $1,680,640 (which is 18% greater than the current savings rate). If the average annual return on investment is reduced to 5%, the amount of money required to pay the pension benefit is $1,895,217 (which is 33% greater than the current savings rate).

Conclusion

State law mandates that public employee pensions are guaranteed benefits. This means that the employers and taxpayers are responsible for their full payment. Recent poor investment performance by CalPERS and increased retirement benefits has resulted in most California public employee pensions being "underfunded." This means that the amount of money set aside to pay these guaranteed benefits is insufficient. A recent estimate of Costa Mesa unfunded pension liabilities was $196,000,000. Additionally, unfunded retiree medical benefits are estimated to be $32,000,000. City leaders and employee groups, aware of this underfunding, are currently reviewing these matters and neither side sees a simple solution.