

**CITY OF COSTA MESA
PENSION OVERSIGHT COMMITTEE**

DATE: September 29, 2014

TO: City Council

COPY: Tom Hatch, CEO
Rick Francis, Assistant CEO
Steve Dunivent, Finance Director
Lance Nakamoto, Human Resources Manager
Finance Advisory Committee (FAC)

FROM: Pension Oversight Committee (POC)

SUBJECT: Updated PERS findings and risks of long-term escalating unfunded pension liability payments.
Recommend caution in approving long-term budget expenditures and staffing.

Executive Summary & Recommendations

The California Public Employees' Retirement System (CalPERS) recently approved major pension rate hikes. Because retirees live longer, retire earlier and earn higher salaries, cities will pay significantly more for employee pensions, phased-in over the next 5 years and beyond. Since these rate hikes further increase pension payments that have risen dramatically in recent years, the Pension Oversight Committee (POC) cautions the Council to carefully consider the higher long-term pension costs when making staffing decisions.

Background/Summary

Today, Costa Mesa owes \$228 million more in pension benefits than it has in assets needed to fund these obligations. This deficit is commonly referred to as an unfunded pension obligation. According to CalPERS, our city's unfunded pension obligation rose more than 2,500% from \$9 million as of 6/30/2001 to \$228 million today.¹

This dramatic increase in pension debt is widely attributed to:

- 1) four pension benefit increases retroactively applied to employees that had not earned or paid for the new benefits:
 - a) Police- 3%@50 from 2%@50 effective 12/31/2000,
 - b) Fire- 3%@55 from 2%@50 effective 5/20/2001,
 - c) Miscellaneous- 2.5%@55 from 2%@55 effective 9/28/2008,
 - d) Fire- 3%@50 from 3%@55 effective 6/6/2010;
- 2) investment losses of 30% during the financial crisis years 2007-08 and 2008-09. Typically, investments earnings are expected to generate two-thirds of pension payments; and
- 3) two early retirement incentives or "golden handshakes" of two years additional service credit for 57 employees in 2009 and 14 Fire employees in 2010;
- 4) salary increases that resulted in larger pensions;

¹ PERs unfunded pension obligation and valuation as of 6/30/12. Excludes retiree medical obligations.

New Developments

This year, the CalPERS Board announced that pension obligations will rise even faster than anticipated due to employees living longer, retiring earlier and CalPERS Board's decision to establish a fixed 30 year amortization period for Cities to pay their unfunded obligations. CalPERS is also transitioning to Public Employee Pension Reform Act of 2013 rates (PEPRA).

Even before the announced increases, Costa Mesa's pension obligations had been projected to rise substantially. [Updated projections for Costa Mesa were supplied by a CalPERS actuary, Kerry Worgan.] For fiscal year 2013-14, total pension costs are more than \$22 million. This will rise by 43% to more than \$32 million by fiscal year 2019-2020. While employees contribute to their retirement,² the City will pay nearly the entire amount: a projected \$28.3 million, 88% of the total, by fiscal year 2019-2020.

Unfortunately, Costa Mesa will pay ever-greater pension³ contributions until they peak for Police at \$21 million in 30 years, and peak for Miscellaneous employees at \$14 million in 20 years. Based on the new assumptions, unfunded pension obligations will increase \$10 million for Miscellaneous and \$13.7 million for Police in the next three years⁴. Fire contributions and unfunded pension obligations are expected to increase at a similar rate to Police, although PERS has not yet provided projections for Fire.

Costa Mesa contributes a weighted average of \$39,771 per year for each active employee's pension. For Fire and Police employees, these amounts are much higher: \$65,496 and \$61,561 respectively. By fiscal year 2019-2020, these amounts will rise by 48% to \$58,873 on average for all employees. For Fire and Police employees, PERS projects these amounts to be \$96,522 and \$86,299 respectively.

The financial impact of pension obligations for new hires is significant. For example, if the City hires 25 new police officers, their pensions will cost \$1,539,025 in the first year alone. In six years' time, the annual pension contribution would be \$2,025,575⁵ and \$10,445,875 would have been paid for their pensions through fiscal year 2019-2020.

Mission of Pension Oversight Committee

The Pension Oversight Committee consists of a group of 8 Costa Mesa residents (originally 9) who were appointed by the City Council to analyze the City's pension issues. Since its first meeting on May 1, 2013, we have worked with CalPERS to better understand the current and long term pension obligations for the City's three employee groups - Police, Fire, and Miscellaneous (other employees). We have published educational materials. The public is invited to attend our meetings on the 1st and 3rd Wednesday of each month at 4:30 pm in room 1A at City Hall.

² These projections utilize employee contribution rates of 9% for Miscellaneous employees and 5% for Fire and Police employees.

³ CalPERS also calculates contributions as a percentage of payroll and they assume that payroll will increase by 3% every year indefinitely. These calculations are found in the exhibits. To the extent that payroll does not increase 3% annually, the projected pension obligations as a percentage of payroll would be underestimated.

⁴ These future projections are from CalPERS Actuary, Kerry Worgan's 2014 calculations.

⁵ Assumes 25 non-PEPRA hires with average pension obligations found in Exhibits page 5. (25 x total annual contribution)

Conclusion

In light of the already significant increase in pension payments, which are expected to further accelerate in the near future, we caution the Council to carefully consider the long-term financial impacts of any staffing increase and its attendant pension obligations.

Please see attached supporting tables and charts for your reference.

We thank you for the opportunity to serve Costa Mesa and hope our research and recommendation will be helpful to City Council and management.



Jeff Arthur, Chair
Pension Oversight Committee

**CITY OF COSTA MESA
PENSION OVERSIGHT COMMITTEE
EXHIBITS**

TABLES	Page
Unfunded Pension Payments Comparison – PERS versus Fixed	1
Normal and Unfunded Contribution Rates	2
Contribution Dollars and Payroll Bases	3
Employee and Employer Contribution Rates and Dollars	4
Contributions by Active Employee and PERS Employee Counts	5

CHARTS

Based on PERS 6/30/12 Valuations - 2013-14 through 2019-20

Unfunded Pension Payments Comparison – PERS versus Fixed	6
Total Contribution Rates by Plan	7
Total Contribution Dollars by Plan	8
Contribution Rates by Employee and Employer	
Miscellaneous	9
Police	10
Fire	11
Contribution Dollars by Employee and Employer	
Miscellaneous	12
Police	13
Fire	14
Annual Contribution Dollars per Active Employee by Plan	15
Annual Contribution Dollars by Employee and Employer	
Miscellaneous	16
Police	17
Fire	18

Based on PERS Actuary Projections

“New” includes February 18, 2014 CalPERS Board actuarial assumption changes

Contribution Rates and Dollars	
Miscellaneous	19
Police	20
Unfunded Liabilities	
Miscellaneous	21
Police	22

Costa Mesa
Pension Oversight Committee
September 2014 Council Letter

Website: <http://www.costamesaca.gov/index.aspx?page=1603>

September 2014 Council Letter
TABLES

Costa Mesa

Unfunded Pension Payments Comparison

PERS versus Fixed Loan Amortization

Valuations as of 6/30/12 (dated October 2013)

	PERS 2013-14 Required Contributions ^{1/}			Unfunded
	Normal	Unfunded	Total	Balances ^{2/}
MISCELLANEOUS	3,901,154	3,922,624	7,823,778	83,960,536
POLICE	5,513,755	3,636,126	9,149,881	83,627,245
FIRE	3,038,460	2,585,067	5,623,527	60,650,648
TOTAL	<u>12,453,369</u>	<u>10,143,817</u>	22,597,186	<u>228,238,429</u>

1/ Before any pre-payment discounts

2/ PERS pension unfunded MVA liabilities as of 6/30/12. Does not include Retiree Medical or Police 1% Supplemental plans.

Unfunded Liability Fixed Payments Over 20 Years				
	5% Interest	Increase over PERS	6% Interest	Increase over PERS
MISCELLANEOUS	6,737,211	2,814,587	7,320,062	3,397,438
POLICE	6,710,466	3,074,340	7,291,004	3,654,878
FIRE	4,866,765	2,281,698	5,287,800	2,702,733
TOTAL	<u>18,314,442</u>	<u>8,170,625</u>	<u>19,898,866</u>	<u>9,755,049</u>

Unfunded Liability Fixed Payments Over 30 Years				
	5% Interest	Increase over PERS	6% Interest	Increase over PERS
MISCELLANEOUS	5,461,753	1,539,129	6,099,642	2,177,018
POLICE	5,440,072	1,803,946	6,075,428	2,439,302
FIRE	3,945,412	1,360,345	4,406,204	1,821,137
TOTAL	<u>14,847,237</u>	<u>4,703,420</u>	<u>16,581,273</u>	<u>6,437,456</u>

Costa Mesa PERS Total Contribution Rates

Valuations as of 6/30/12 (dated October 2013)

Valuations use "Standard" Employee contributions; Miscellaneous 8% and Safety 9%

	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
<i>Miscellaneous</i>							
Total Normal Cost	17.643%	16.990%	16.99%	16.99%	16.99%	16.99%	16.99%
Total Unfunded Cost	17.740%	20.766%	22.51%	24.31%	26.01%	27.81%	29.51%
TOTAL RATE	35.383%	37.756%	39.50%	41.30%	43.00%	44.80%	46.50%
Source: pages 6 & 26							
<i>Police</i>							
Total Normal Cost	28.649%	28.928%	28.93%	28.93%	28.93%	28.93%	28.93%
Total Unfunded Cost	18.893%	21.528%	23.37%	25.17%	26.97%	28.87%	30.67%
TOTAL RATE	47.542%	50.456%	52.30%	54.10%	55.90%	57.80%	59.60%
Source: pages 6 & 26							
<i>Fire</i>							
Total Normal Cost	29.511%	29.128%	29.13%	29.13%	29.13%	29.13%	29.13%
Total Unfunded Cost	25.107%	27.324%	29.34%	31.44%	33.54%	35.54%	37.64%
TOTAL RATE	54.618%	56.452%	58.47%	60.57%	62.67%	64.67%	66.77%
Source: Section 1 page 4, Section 2 pages 4 & 26							
Projected Fire REC p26	25.168%	26.881%	28.900%	31.000%	33.100%	35.100%	37.200%
Fire Unfunded Change		1.713%	2.019%	2.100%	2.100%	2.000%	2.100%

Costa Mesa PERS Total Contribution Rates

Valuations as of 6/30/12 (dated October 2013)

Valuations use "Standard" Employee contributions; Miscellaneous 8% and Safety 9%

	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
<i>Total Rates Chart</i>	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
MISCELLANEOUS	35.383%	37.756%	39.500%	41.300%	43.000%	44.800%	46.500%
POLICE	47.542%	50.456%	52.300%	54.100%	55.900%	57.800%	59.600%
FIRE	54.618%	56.452%	58.471%	60.571%	62.671%	64.671%	66.771%
<i>Payroll Base</i>	Payroll Growth:		3.0%	3.0%	3.0%	3.0%	3.0%
Miscellaneous	22,111,629	21,418,822	22,061,387	22,723,229	23,404,926	24,107,074	24,830,286
Police	19,245,888	18,133,294	18,677,293	19,237,612	19,814,740	20,409,182	21,021,457
Fire	10,296,027	10,513,535	10,828,941	11,153,809	11,488,423	11,833,076	12,188,068
TOTAL	51,653,544	50,065,651	51,567,621	53,114,650	54,708,089	56,349,332	58,039,811
<i>Total Contributions</i>	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
MISCELLANEOUS	7,823,758	8,086,890	8,714,248	9,384,694	10,064,118	10,799,969	11,546,083
POLICE	9,149,880	9,149,335	9,768,224	10,407,548	11,076,440	11,796,507	12,528,788
FIRE	5,623,484	5,935,101	6,331,790	6,755,974	7,199,910	7,652,569	8,138,095
TOTAL	22,597,122	23,171,326	24,814,262	26,548,216	28,340,468	30,249,045	32,212,966

Costa Mesa PERS Total Contribution Rates

Valuations as of 6/30/12 (dated October 2013)

Valuations use "Standard" Employee contributions; Miscellaneous 8% and Safety 9%

	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
<i>Employee Contributions (estimated)</i>							
MISCELLANEOUS	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%
POLICE	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
FIRE	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
<i>Required Employer Contributions (REC balance)</i>							
MISCELLANEOUS	26.383%	28.756%	30.500%	32.300%	34.000%	35.800%	37.500%
POLICE	42.542%	45.456%	47.300%	49.100%	50.900%	52.800%	54.600%
FIRE	49.618%	51.452%	53.471%	55.571%	57.671%	59.671%	61.771%
<i>Employee Contributions (estimated rates above)</i>							
MISCELLANEOUS	1,990,047	1,927,694	1,985,525	2,045,091	2,106,443	2,169,637	2,234,726
POLICE	962,294	906,665	933,865	961,881	990,737	1,020,459	1,051,073
FIRE	514,801	525,677	541,447	557,690	574,421	591,654	609,403
TOTAL	3,467,142	3,360,036	3,460,837	3,564,662	3,671,601	3,781,750	3,895,202
<i>Required Employer Contributions (REC balance)</i>							
MISCELLANEOUS	5,833,711	6,159,196	6,728,723	7,339,603	7,957,675	8,630,332	9,311,357
POLICE	8,187,586	8,242,670	8,834,359	9,445,667	10,085,703	10,776,048	11,477,715
FIRE	5,108,683	5,409,424	5,790,343	6,198,284	6,625,489	7,060,915	7,528,692
TOTAL	19,129,980	19,811,290	21,353,425	22,983,554	24,668,867	26,467,295	28,317,764

Costa Mesa PERS Total Contribution Rates

Valuations as of 6/30/12 (dated October 2013)

Valuations use "Standard" Employee contributions; Miscellaneous 8% and Safety 9%

	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
<u>Active Employees</u>	6/30/12						
MISCELLANEOUS	270	page C-1					
POLICE	133	page C-1					
FIRE	78	page 10					
TOTAL	481						
<u>Total Contributions per Active Employee</u>							
MISCELLANEOUS	28,977	29,951	32,275	34,758	37,275	40,000	42,763
POLICE	68,796	68,792	73,445	78,252	83,282	88,696	94,201
FIRE	72,096	76,091	81,177	86,615	92,307	98,110	104,335
TOTAL	169,869	174,834	186,897	199,625	212,863	226,805	241,299
WEIGHTED AVERAGE	46,979	48,173	51,589	55,194	58,920	62,888	66,971
<u>Employee Contributions per Active Employee</u>							
MISCELLANEOUS	7,371	7,140	7,354	7,574	7,802	8,036	8,277
POLICE	7,235	6,817	7,022	7,232	7,449	7,673	7,903
FIRE	6,600	6,739	6,942	7,150	7,364	7,585	7,813
TOTAL	21,206	20,696	21,317	21,956	22,615	23,294	23,992
WEIGHTED AVERAGE	7,208	6,986	7,195	7,411	7,633	7,862	8,098
<u>Employer Contributions per Active Employee</u>							
MISCELLANEOUS	21,606	22,812	24,921	27,184	29,473	31,964	34,487
POLICE	61,561	61,975	66,424	71,020	75,832	81,023	86,299
FIRE	65,496	69,352	74,235	79,465	84,942	90,525	96,522
TOTAL	148,663	154,138	165,580	177,669	190,247	203,512	217,307
WEIGHTED AVERAGE	39,771	41,188	44,394	47,783	51,287	55,026	58,873

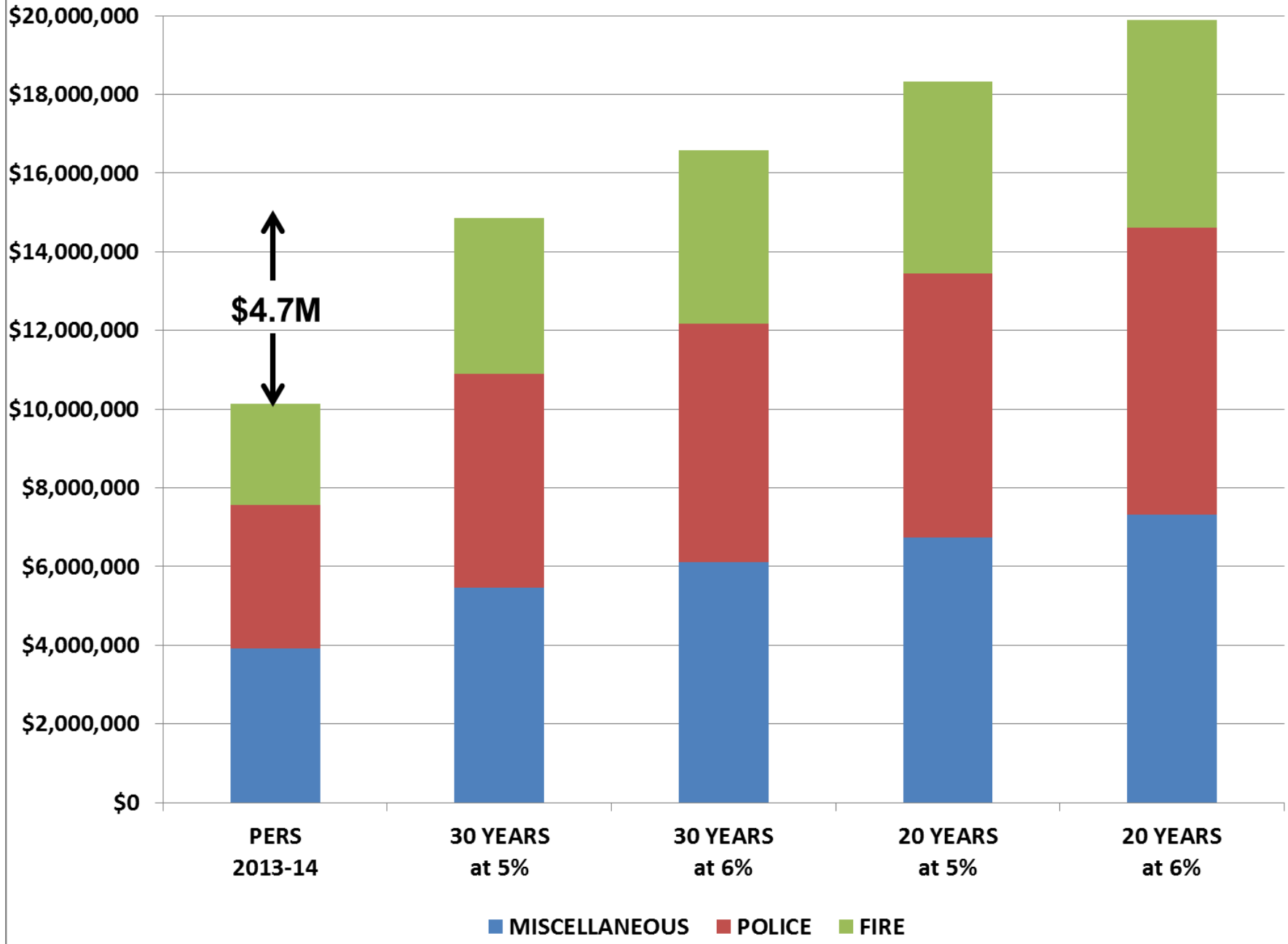
September 2014 Council Letter

CHARTS

From PERS Valuations 2013-14 through 2019-20

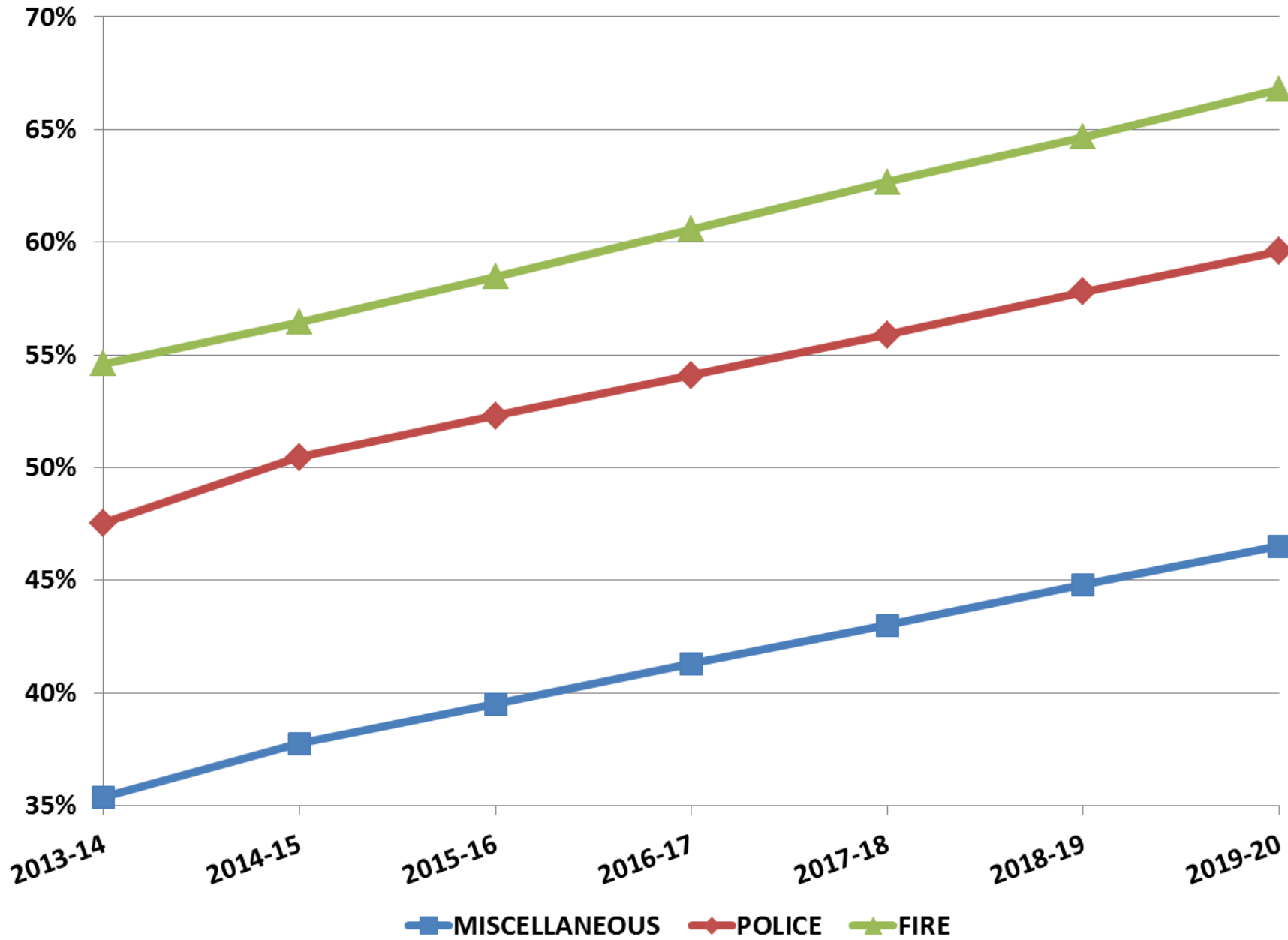
Costa Mesa Unfunded Pension Liability Amortization PERS versus Fixed Loan Payments

Source: 6/30/12
PERS Valuations



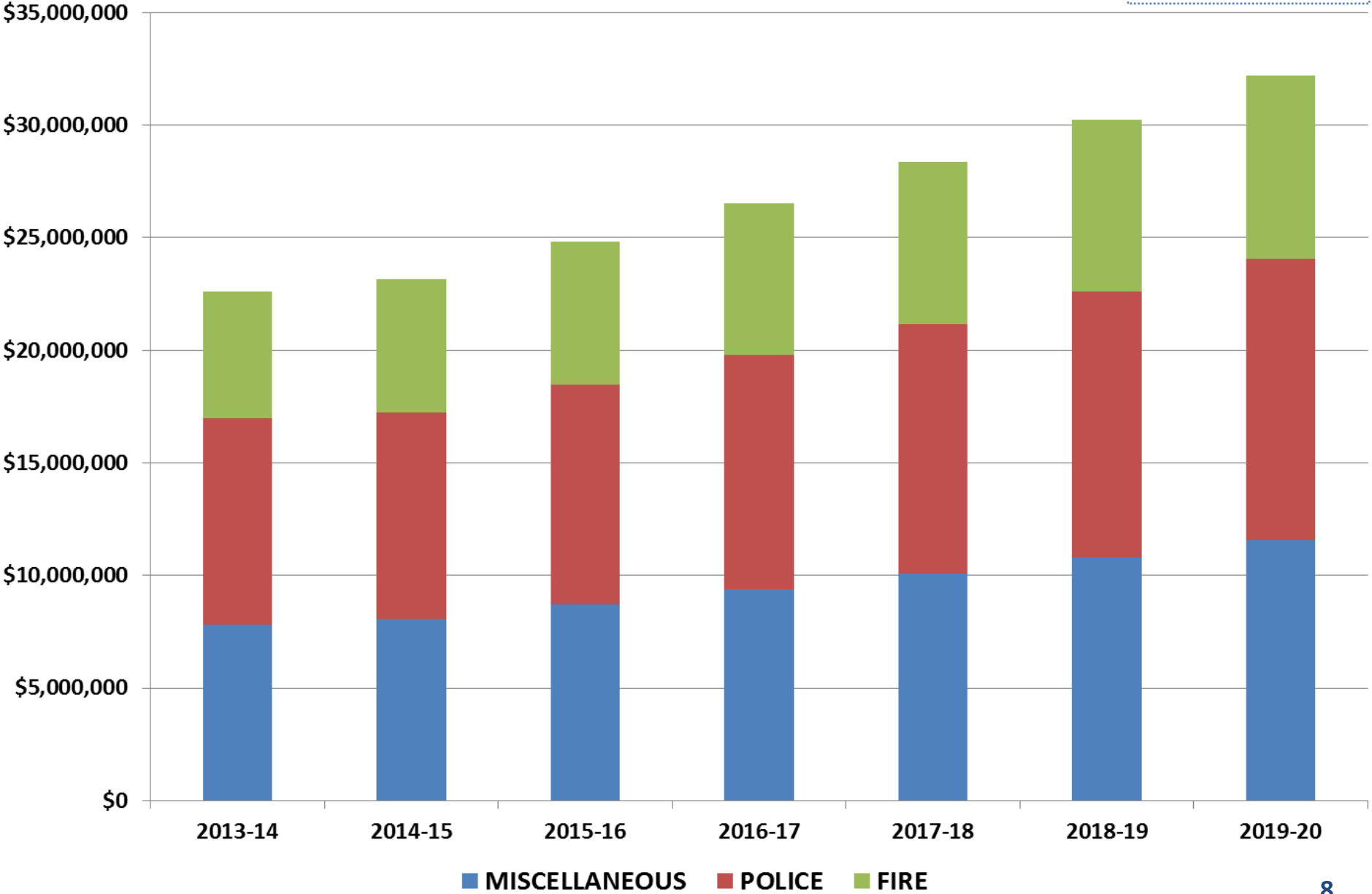
Costa Mesa's TOTAL PERS Contribution Rates

Source: 6/30/12
PERS Valuations



Costa Mesa TOTAL PERS Contributions

*Source: 6/30/12
PERS Valuations*

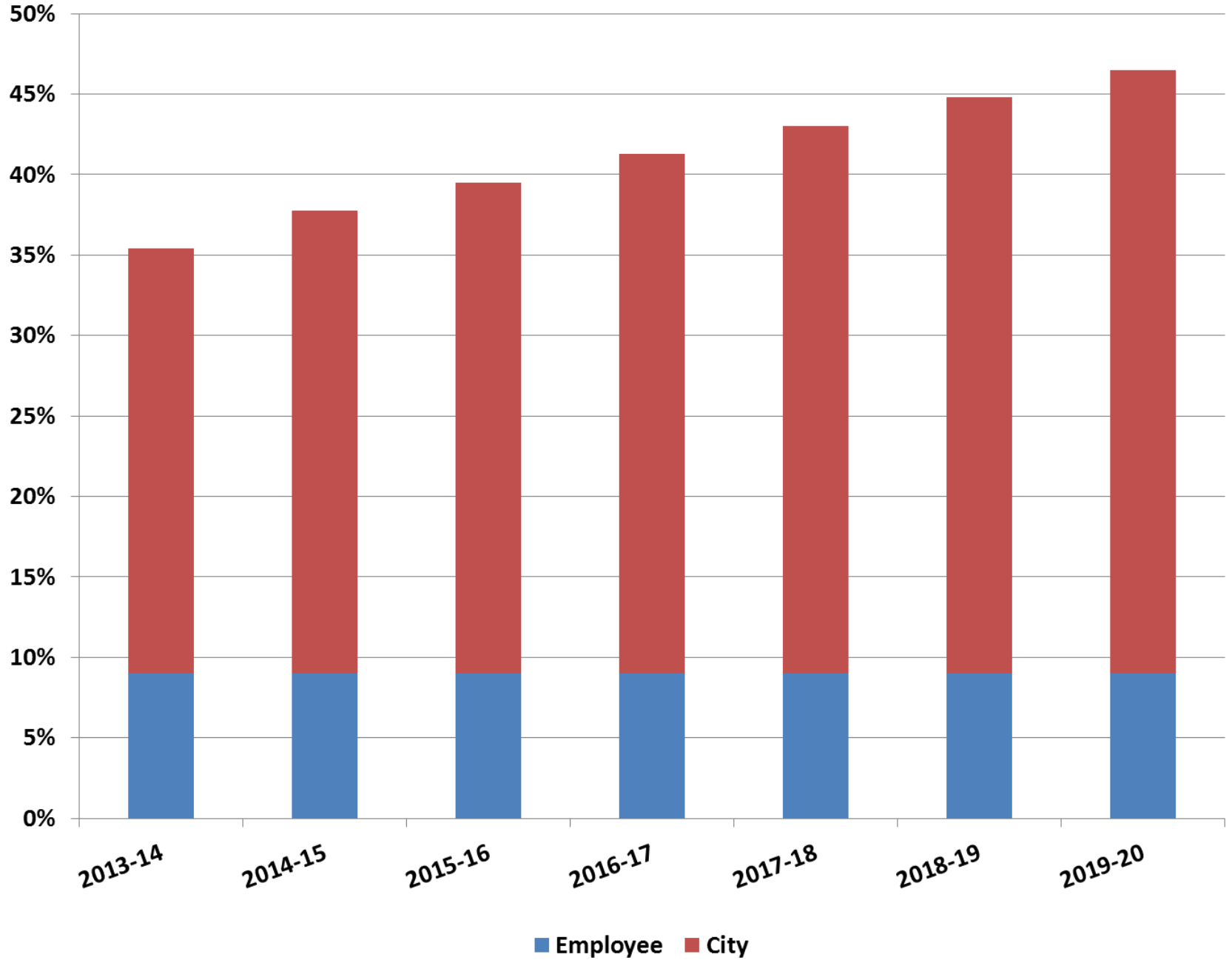


Contribution RATES
by
Employee and Employer

Website: <http://www.costamesaca.gov/index.aspx?page=1603>

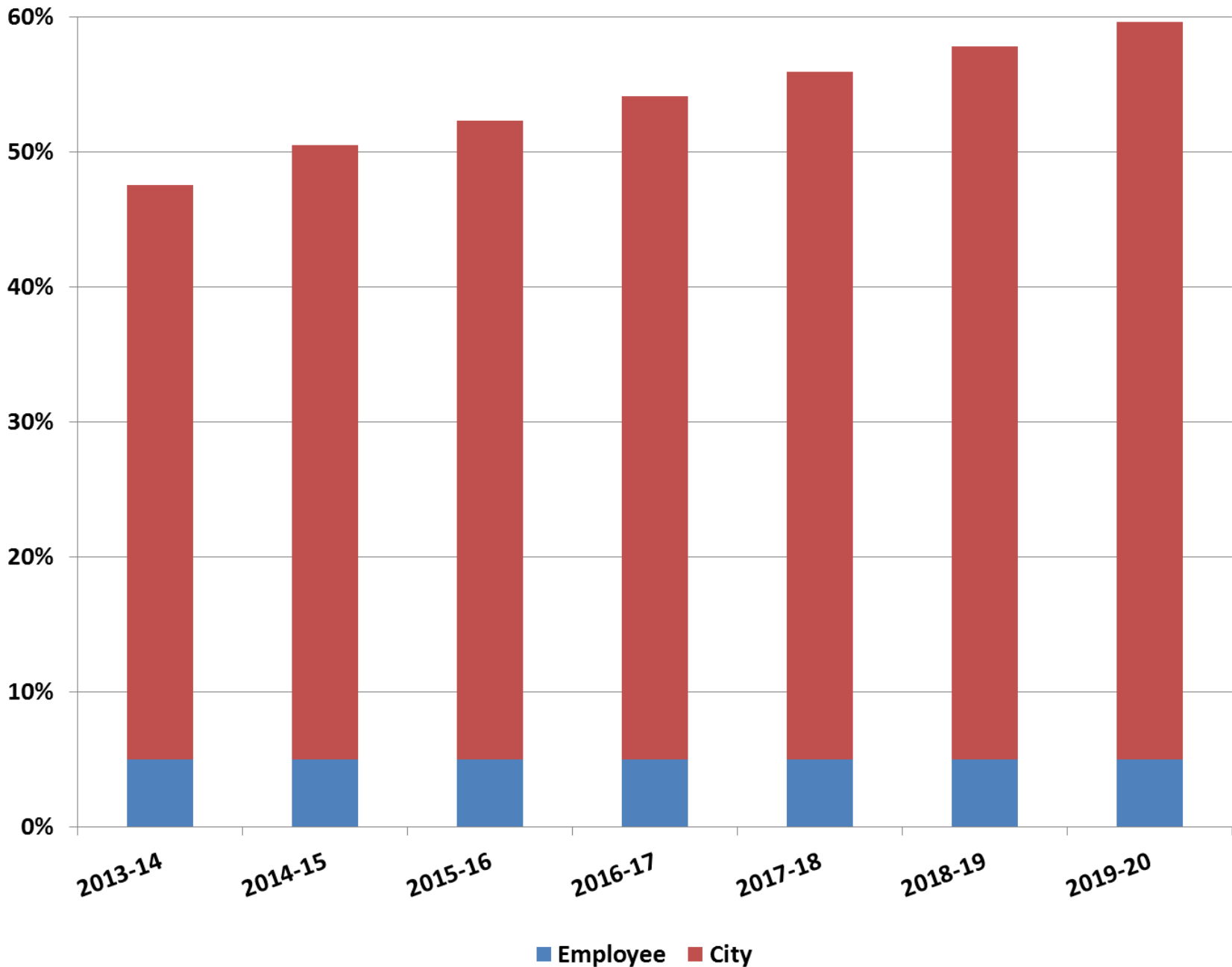
Costa Mesa MISCELLANEOUS - PERS Contribution Rates

Source: 6/30/12
PERS Valuations



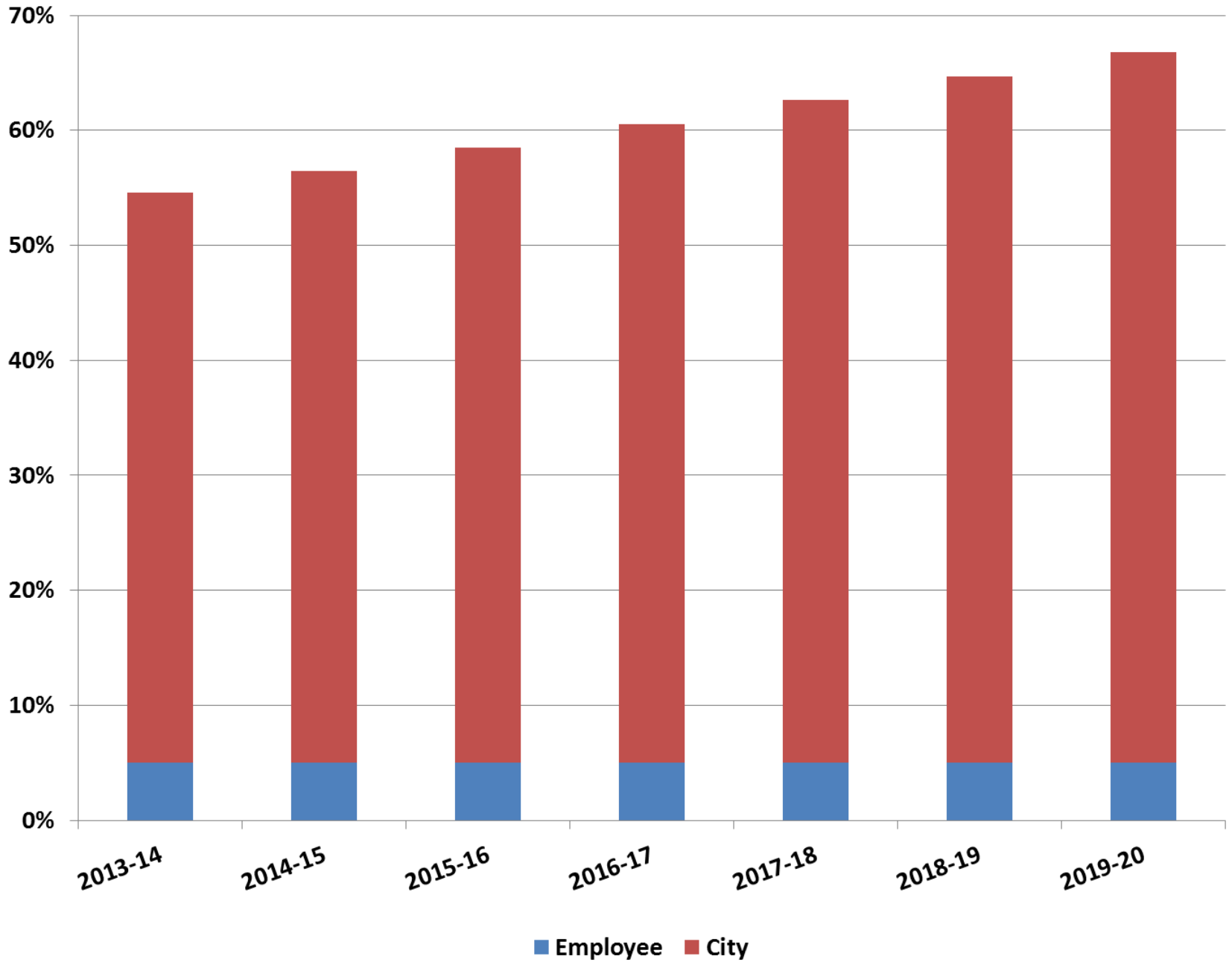
Costa Mesa POLICE - PERS Contribution Rates

Source: 6/30/12
PERS Valuations



Costa Mesa FIRE - PERS Contribution Rates

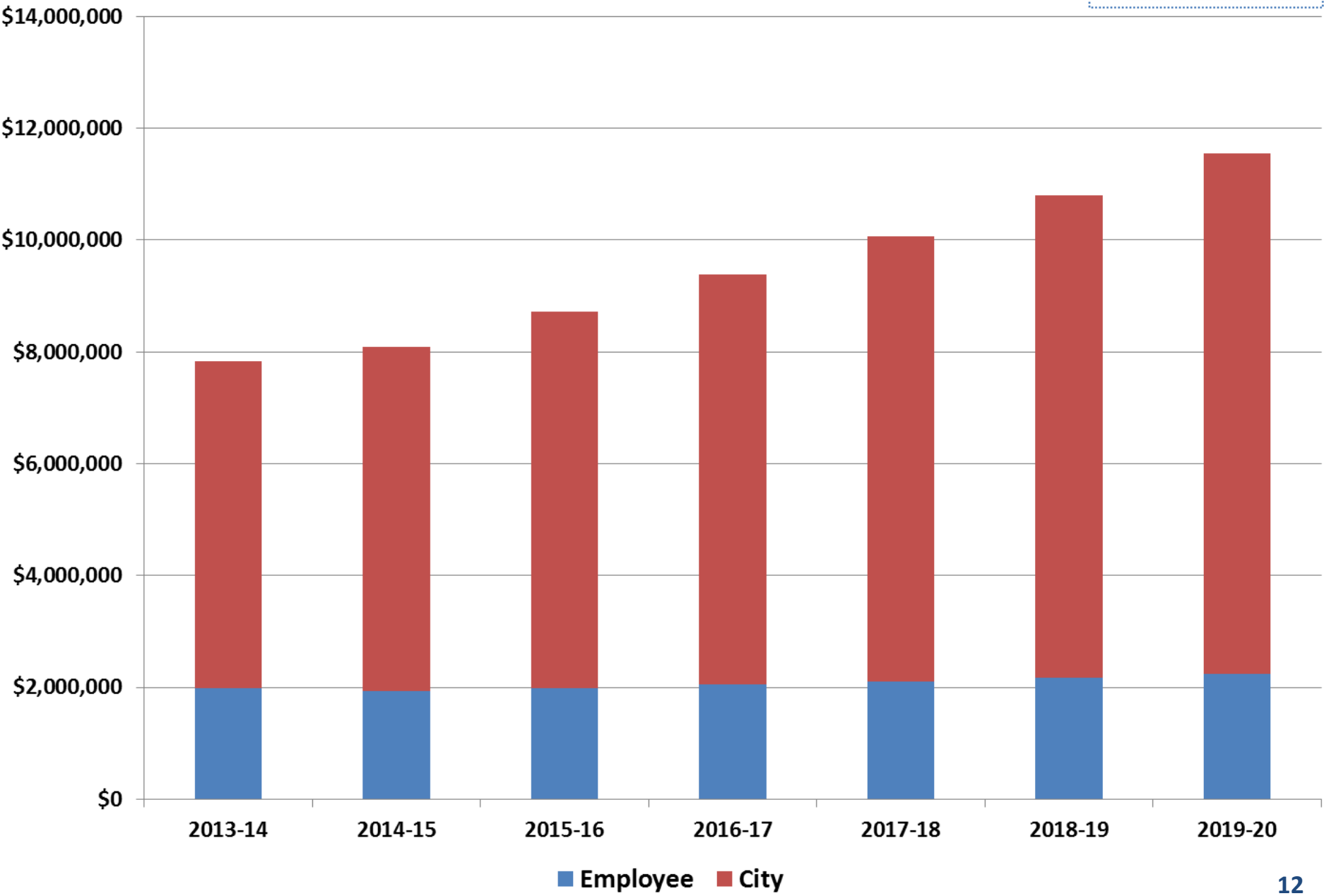
Source: 6/30/12
PERS Valuations



***Contribution DOLLARS
by
Employee and Employer***

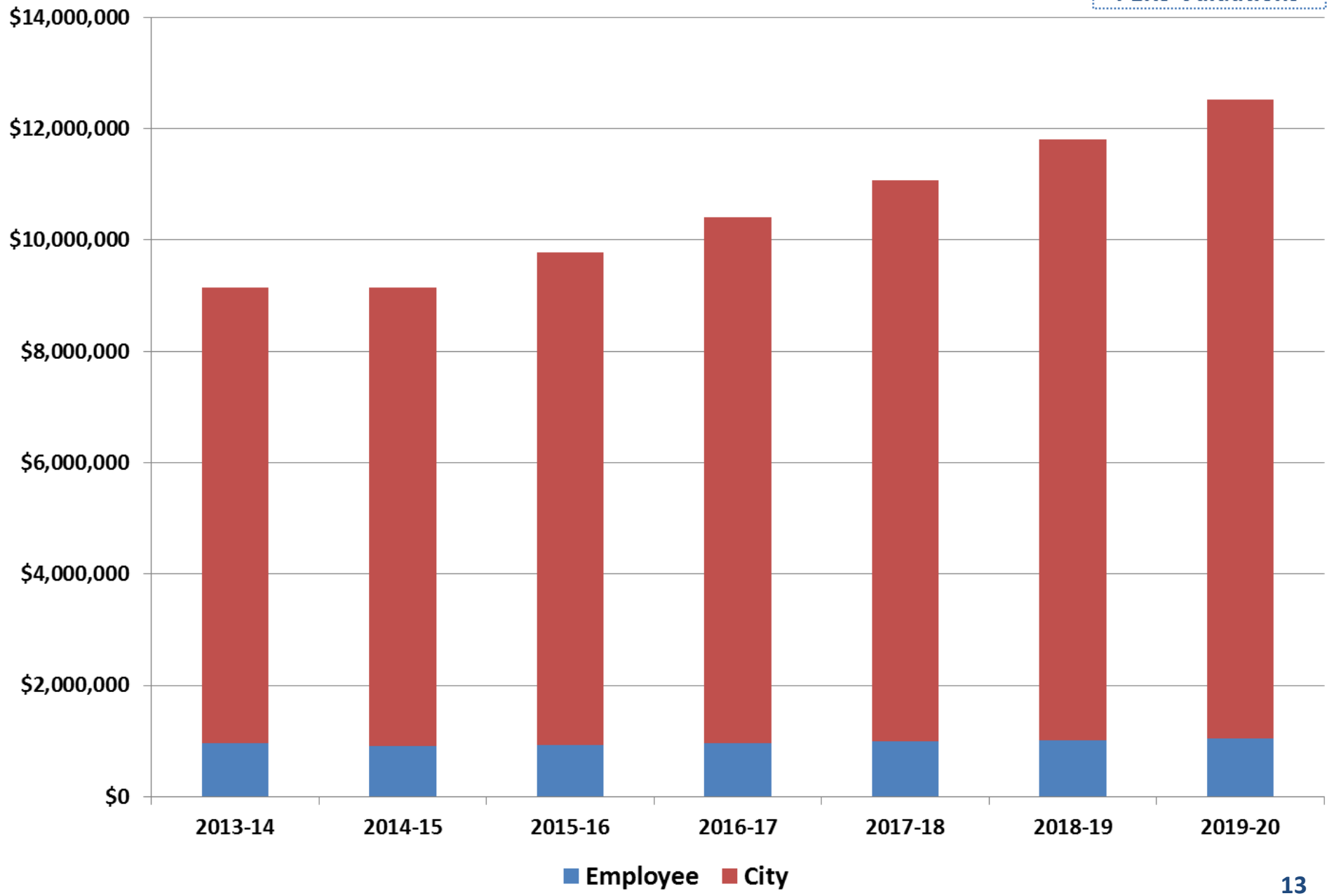
Costa Mesa MISCELLANEOUS - PERS Contributions

Source: 6/30/12
PERS Valuations



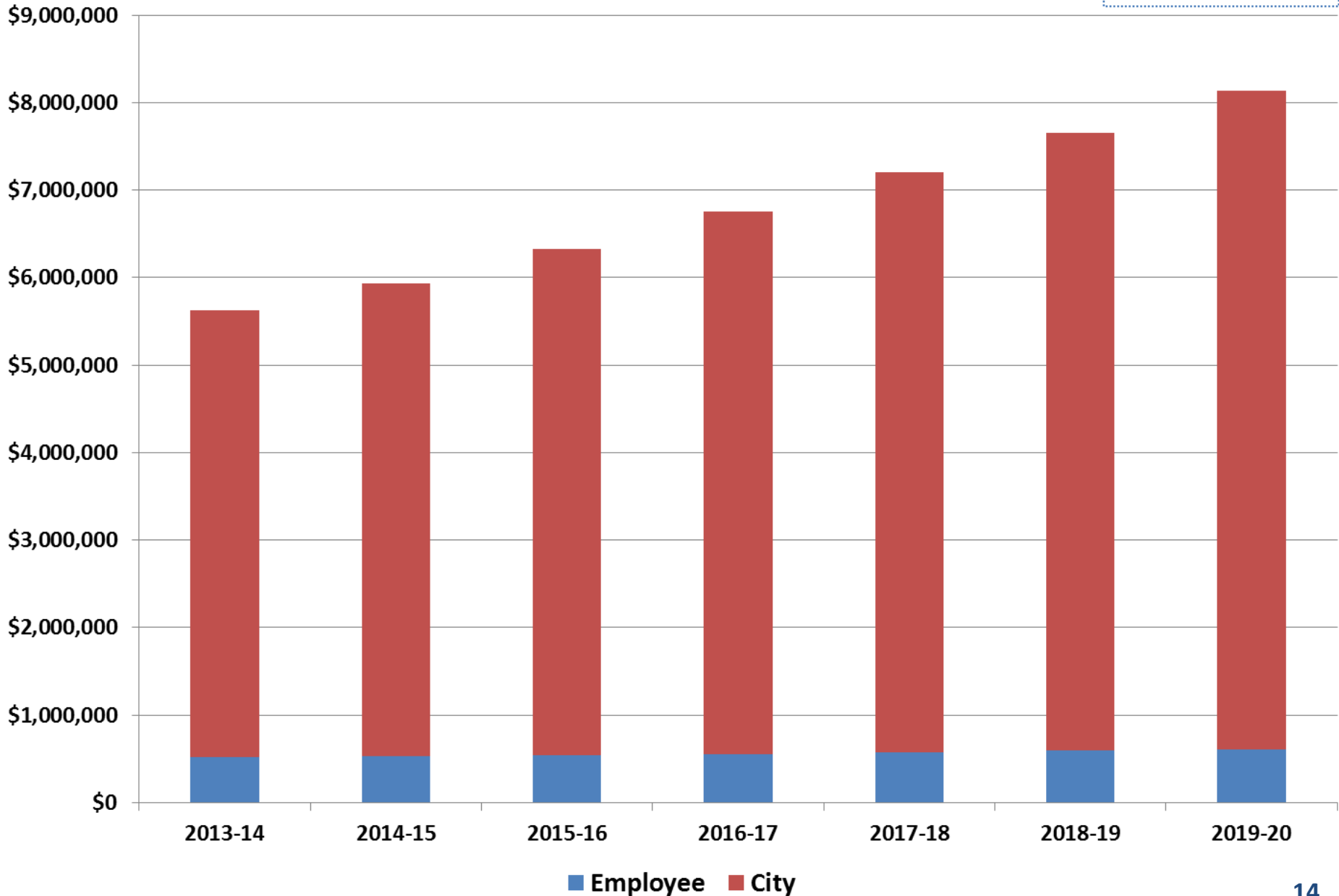
Costa Mesa POLICE - PERS Contributions

Source: 6/30/12
PERS Valuations



Costa Mesa FIRE - PERS Contributions

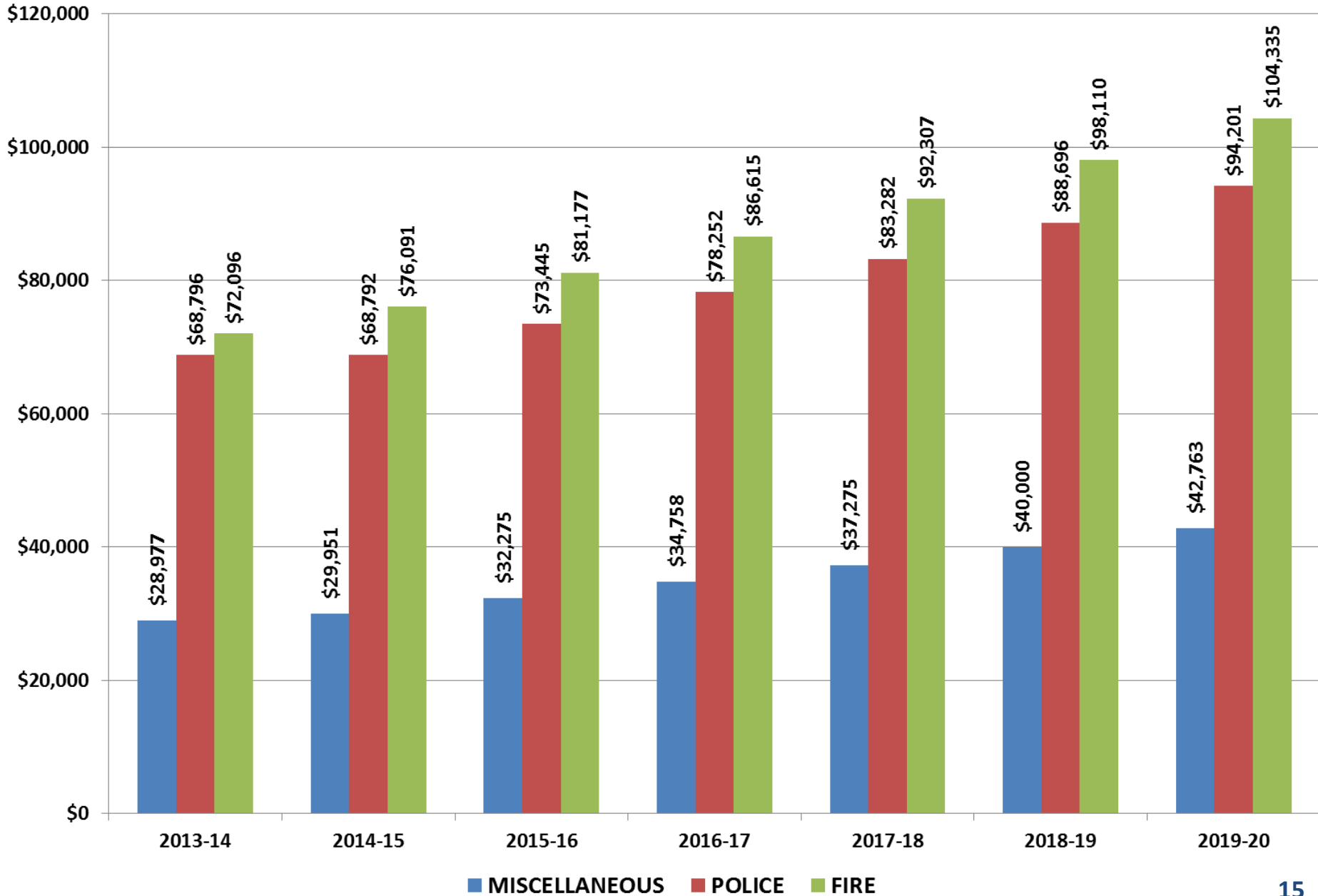
Source: 6/30/12
PERS Valuations



Average Contribution
DOLLARS
per
Active Employee

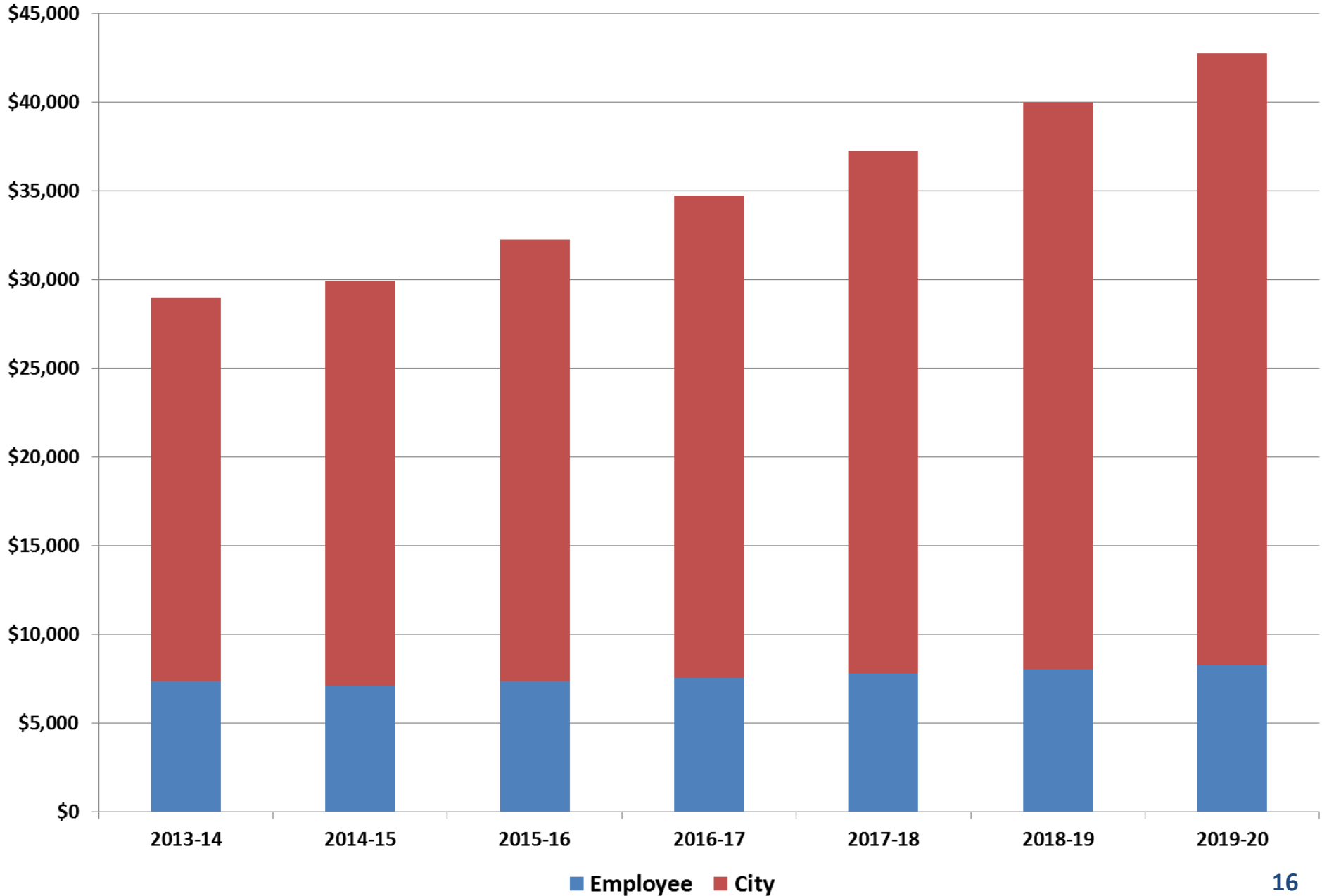
Costa Mesa - Total Annual PERS Contributions per Active Employee

Source: 6/30/12
PERS Valuations



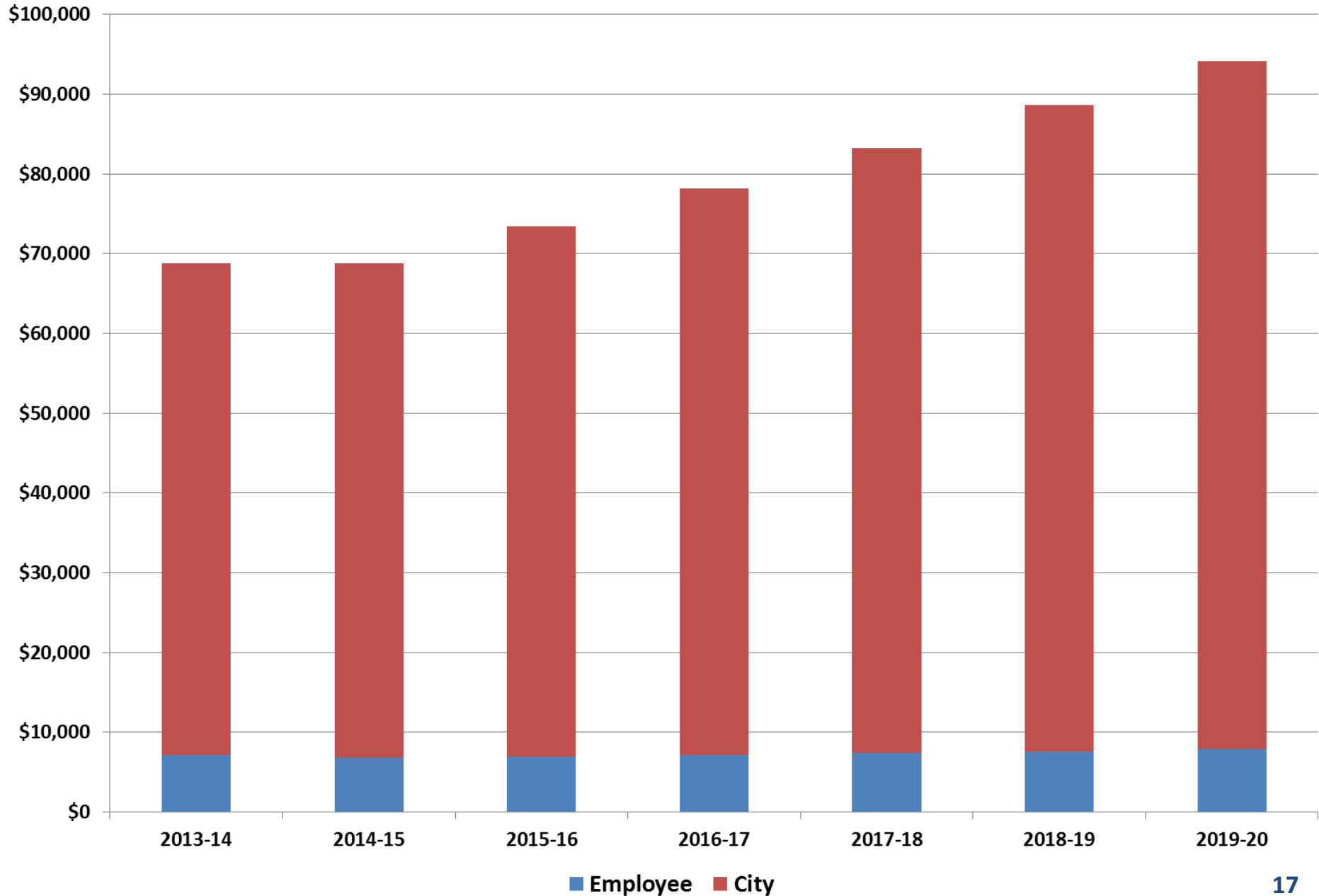
Costa Mesa - Annual PERS Contributions per MISCELLANEOUS Active Employee

Source: 6/30/12
PERS Valuations



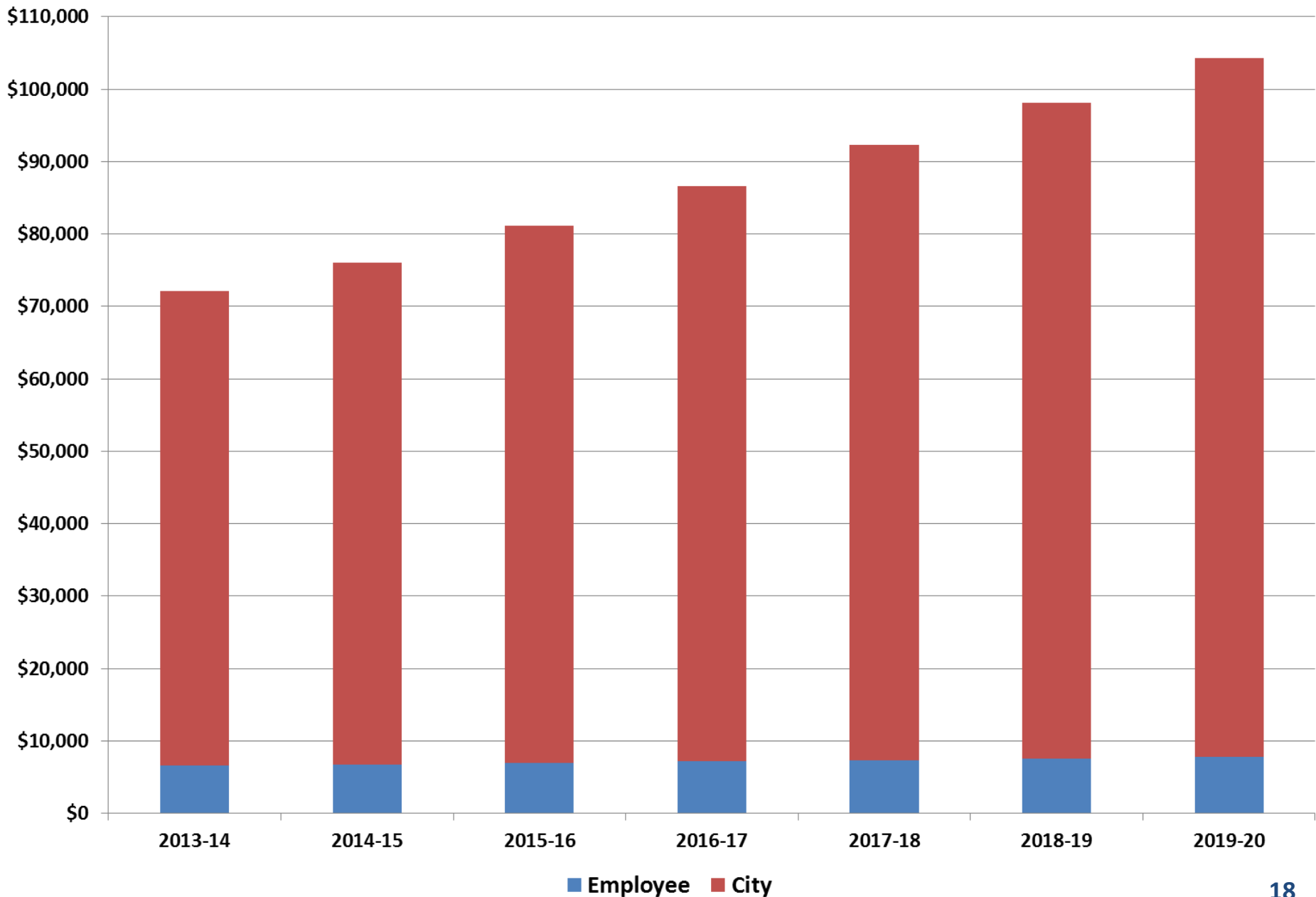
Costa Mesa - Annual PERS Contributions per POLICE Active Employee

Source: 6/30/12
PERS Valuations



Costa Mesa - Annual PERS Contributions per FIRE Active Employee

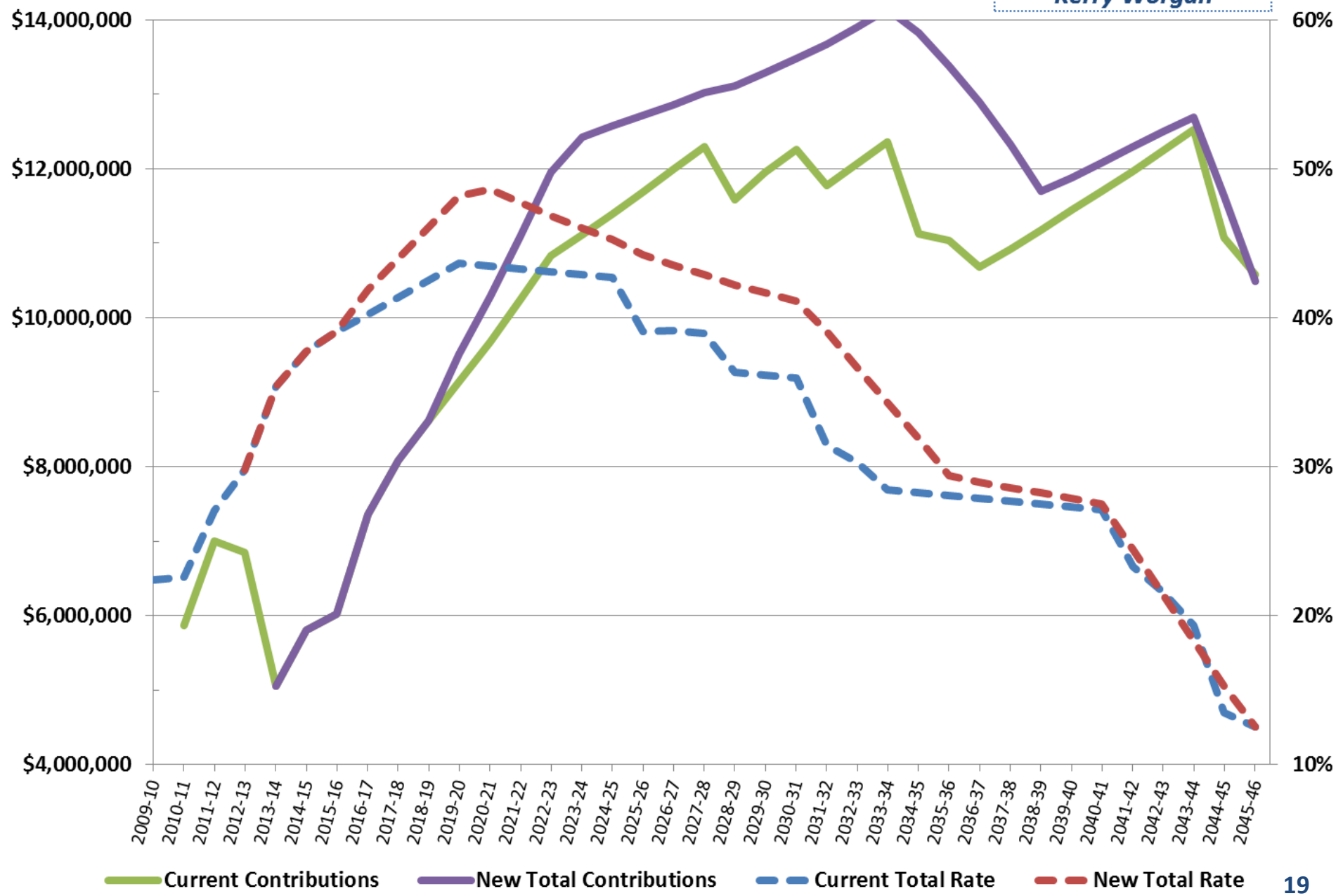
Source: 6/30/12
PERS Valuations



Kerry Worgan, PERS Actuary
Current Assumptions
Versus
New Actuarial Assumptions

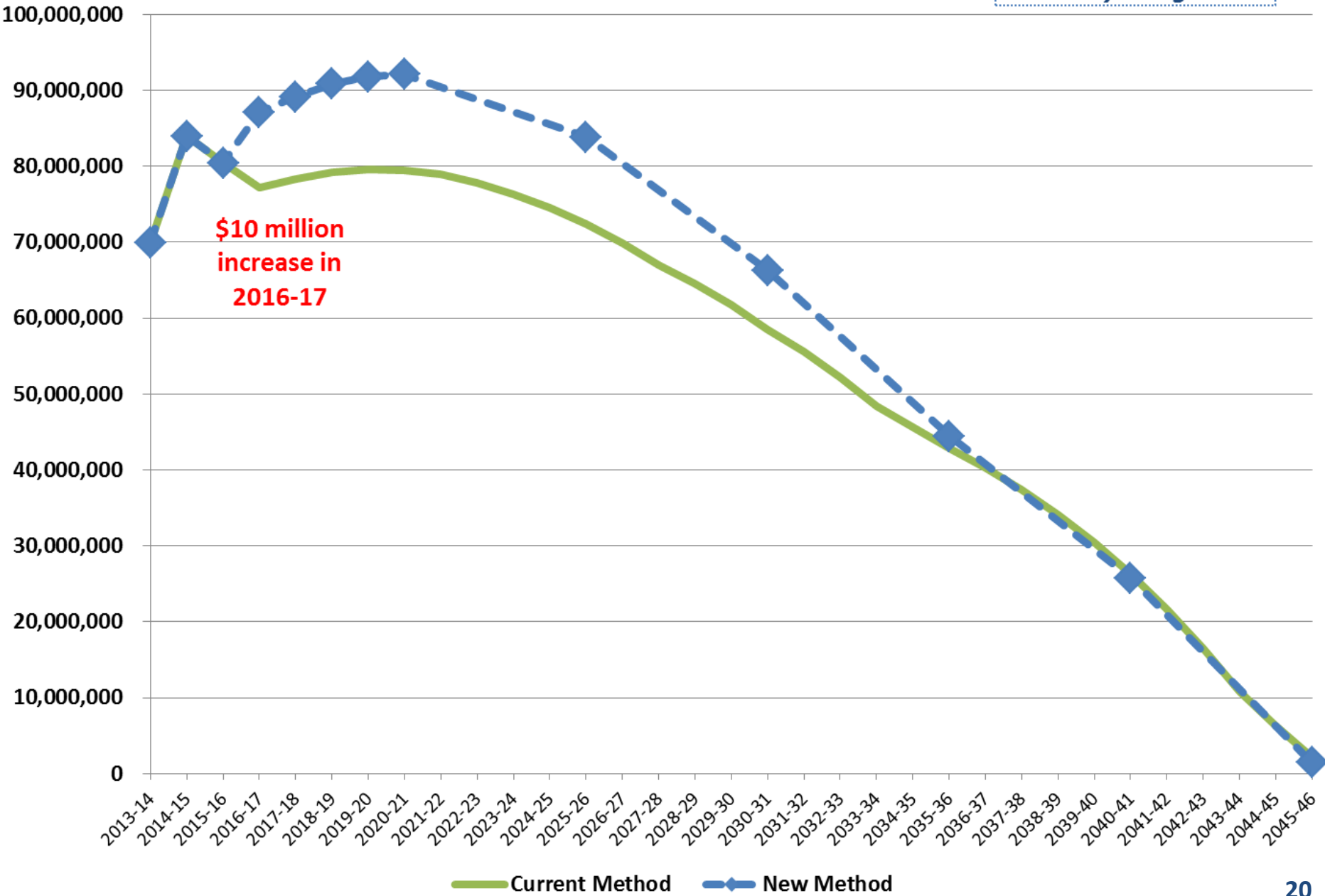
PERS Contributions - Miscellaneous

Source: PERS Actuary
Kerry Worgan



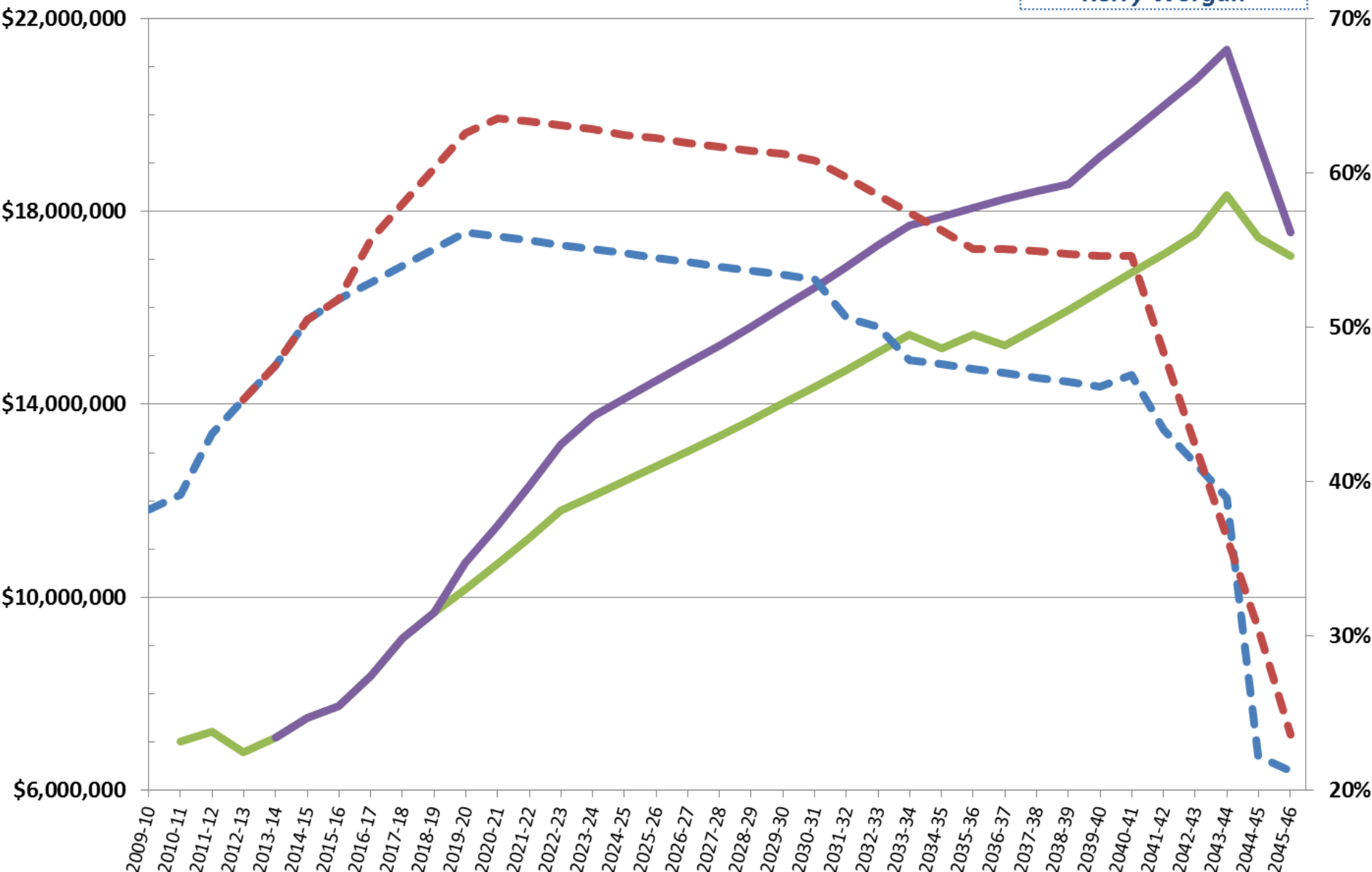
Miscellaneous - Unfunded PERS Liabilities

Source: PERS Actuary
Kerry Worgan



PERS Contributions - Police

Source: PERS Actuary
Kerry Worgan



Police - Unfunded PERS Liabilities

