Will the Public Suffer Because of Unfunded Pension Liabilities?

2017-2018 Nevada County Grand Jury

Will the Public Suffer Because of Unfunded Pension Liabilities?

Summary

Most of the pensions of California state and local public employees and teachers are funded through the California Public Employees' Retirement System (CalPERS) or the California State Teachers' Retirement System (CalSTRS). These systems lack the necessary reserves to ensure that funds will be available when needed. This situation, referred to as a Net Pension Liability, requires public employers to increase their annual pension payments into CalPERS and CalSTRS to compensate for the shortage of reserves.

Nevada County agencies have a large and growing Net Pension Liability that must be funded. The availability of funding for new county programs and services as well as continued operations may be impacted. Increases in local taxes may also be necessary.

In fact, the County CEO made the following statement in the 2017-2018 Nevada County Adopted Budget: "the second dark cloud is the continuing increase in pension costs. This year alone there was a 9% increase in CalPERS costs. This will impact the County's ability to give pay increases to its workforce in the future and maintain service levels."

The Nevada County Grand Jury has estimated that the Net Pension Liability for 28 of 31 local public agencies in this county, including local special and school districts, is approximately $336.3 million.

The annual expense of funding pensions for current and future retirees has risen sharply over the past decade. While every public agency in Nevada County has non-funded pension obligations, some appear to have adequate resources to meet them but many do not. The Grand Jury's aim is to offer clarity to a complex issue and to encourage public agencies to provide greater transparency to their constituents.

Glossary

CalPERS	California Public Employees' Retirement System
CalSTRS	California State Teachers' Retirement System
County	Nevada County
GASB	Governmental Accounting Standards Board
GASB 68	Governmental Accounting Standards Board Statement #68
Jury	Nevada County Grand Jury
NPL	Net Pension Liability

Background

The California State Teachers' Retirement System (CalSTRS) was established by law in 1913 to provide retirement benefits to public school educators from pre-kindergarten through community college. According to the CalSTRS website, it is the largest educator-only pension fund in the world and the second largest pension fund in the United States. As of February 28, 2018, the market value of the investment portfolio was approximately $224.4 billion.

In 1932 the State of California created what is now called the California Public Employees' Retirement System (CalPERS) to establish defined benefit pension plans for their employees by requiring contributions from employees and employers during the course of employment. These contributions are accumulated and invested by CalPERS to fulfill its obligation of building funds sufficient to meet the promised level of retirement income. In 1939 the California State Legislature voted to allow local public agencies (cities, counties, school districts, etc.) to participate in the CalPERS retirement system. It is the largest defined benefit public pension fund in the United States with a total market value of $326.4 billion and 1.9 million members.

In the late 1990s, CalPERS held assets well in excess of its predicted future pension obligations. In 1999, California Assembly Bill 400 provided retroactive increases to retirement benefits and retirement eligibility at earlier ages for many state employees to utilize this predicted surplus. However, the bursting of the dotcom bubble in the early 2000s and the recession beginning in 2008 caused a dramatic fall in the value of CalPERS assets. Where there had been surplus assets, the state now had a large Net Pension Liability (NPL). The value of the CalPERS investment portfolio peaked at $260 billion in the fall of 2007 then plunged for a year and a half before bottoming out at $160 billion in March 2009. The value has grown since but not at the rate originally predicted.

The retirement programs for most of the public employees and teachers in Nevada County (County) are administered by CalPERS or CalSTRS. Accordingly, a portion of our countywide income, once planned for other local obligations, is being diverted to increased payments to CalPERS and CalSTRS to pay down the NPL.

Approach

The Grand Jury (Jury) reviewed audited financial statements of 28 county agencies and schools for fiscal year 2015-2016 (Appendix A). We focused on NPLs as well as key financial data from the Statements of Net Position (called balance sheets in the private sector) and Statements of Change in Net Position (income statements) for each of the agencies selected. The Jury also interviewed staff and management from the selected agencies and reviewed the current data provided about NPLs by CalPERS and CalSTRS.

The Jury's investigation was to determine only the pension obligations of each agency, not the details of individual pension plans. The Jury did not analyze the mix of pension fund investments nor did we investigate other employee benefits such as deferred compensation or inducements for early retirement.

Financial Data Transparency

The Jury sought the audited financial statements and multiple-year financial forecasts for each agency in the County through each agency's website. However, the availability of current and past financial statements online was limited. Obtaining this information required additional research.

The inconsistency of agencies' publishing of audited financial statements is a transparency issue in the County. In general, the Jury found that the County and municipalities are most transparent while school districts are least transparent. The Jury also found that, in some instances, obtaining the financial statements in person or by telephoning was difficult. For public information and transparency, financial statements should be available online. Hard copies that are only available through the mail or in person make it difficult for the public to access. Websites should be organized so that citizens can easily find financial statements. A good user experience online is very important. Hiding financial statements in a deep, dark corner of a website – a place that takes multiple clicks to reach – does not convey transparency. For financial comparison, at least three years of audited financial statements should be available.

Higgins Fire Protection District was not in compliance with Government Code 26909 which requires audited financial statements to be filed with the County Auditor-Controller within 12 months of the end of the fiscal year. Higgins Fire Protection District financial statements were not available for review by the Jury.

The 2015-2016 audited financial statements for the Nevada City School of the Arts were done as a non-profit organization audit instead of as a governmental agency audit. Governmental Accounting Standards Board (GASB) rules therefore did not apply and the NPL was not disclosed.

The 2015-2016 audited financial statements for the Nevada County Superintendent of Schools include five charter schools considered part of the agency's audit. The total NPL shown in the financial statements is not split out to show each charter school's NPL. The five charter schools are:

1. Bitney College Prep High School,
2. Forest Charter School,
3. Sierra Montessori Academy,
4. Twin Ridges Home Study Charter School, and
5. Yuba River Charter School.

See Appendix B for the results of the search for financial statements.

Discussion

Most Nevada County public employees have a defined benefit pension plan administered by CalPERS or CalSTRS as part of their employee compensation package. This benefit assures retired public employees a predictable retirement income protected by California law.

Where there had been surplus assets in the past, the state now has a large unfunded NPL primarily due to the recession starting in 2008 in which the CalPERS and CalSTRS investments lost a large portion of their value. In Nevada County, the Jury's review of 2016 financial statements has calculated the NPL for 26 county agencies to be approximately $336 million.

AGENCIES	NPL
County and Municipalities	$ 167,745,712
Western Nevada County Special Districts	$ 48,203,290
Truckee Special Districts	$ 21,157,099
Western Nevada County School Districts	$ 99,172,619
TOTAL	**$ 336,278,720**

In short, CalPERS and CalSTRS do not have the money required to pay the predicted benefits that are guaranteed to be paid and protected by California Law. Accordingly, the member employers must make up the difference.

The State Controller's office has estimated the pension debt of California's 130 state and local pension plans to be approximately $254 billion. That amount is based on how much money the system assumes it will gain from investments. But actual returns do not follow a straight line. In the past two decades, CalPERS and CalSTRS have hit their target only two out of every three years. As far back as 1994, CalPERS was projecting 8.75 percent growth from investment returns. Today it has lowered projections to 7.0 percent. CalSTRS assumed 8.5 percent returns in 1994 but it is also revising its rate down to 7.0 percent. Some pension advisors believe the projections are still overly optimistic.

The Governmental Accounting Standards Board (GASB) establishes rules that it recommends public agencies follow (and most do) when presenting their financial results. The recent implementation of GASB Statement #68 (GASB 68) requires public agencies to report their NPL as a liability to their net position on their audited financial statements beginning with the fiscal year ended June 30, 2015. Prior to this accounting rule change, agencies only reported required annual contributions to pension plans on their income statements but NPL was not reflected on their Net Position Statements. The net position is one way to evaluate the financial health of an organization. The new method of reporting has provided greater transparency into the future impact of pension promises on current agency financials. The addition of NPL as a liability on the Net Position Statements of government agencies has resulted in dramatic reductions to most agencies' net position.

Agencies are required to make annual contributions to the pension plan administrator (CalPERS and CalSTRS). Portions of the yearly contributions are used to make payments to current retirees and the remainder is invested into a diversified portfolio of stocks, bonds, real estate, and other investments. The NPL is the difference between how much an agency should be saving to cover its future pension obligations and how much it has actually saved. Less than expected returns by many CalPERS and CalSTRS investments have resulted in long-term projections of market value insufficient to meet the plans' obligations.

Growing NPLs and lower investment growth lead to higher required contributions by public agencies to their pension plans. Because these payments are contractually required, they are not a discretionary item in the agencies' budgeting process.

Until recently, CalPERS had a policy aimed at returning the retirement system to fully-funded status within 30 years. It has now targeted 20 years in which to return it to fully-funded status. The net effect of this change is to increase the annual contributions required by each employer. Consequently, steadily increasing pension payments are competing with and reducing other items in the budgets.

In January 2018 the League of California Cities issued a Retirement System Sustainability Study and Findings which includes three key recommendations (Appendix C):

1. City pension costs will dramatically increase and eventually reach unsustainable levels.
2. Rising pension costs will require cities to nearly double the percentage of their General Fund dollars to pay to CalPERS.
3. Cities have few options to address growing pension liabilities.

The report offered suggestions for cities to address these fiscal challenges. These are:

1. Develop and implement a plan to pay down the city's NPL.
2. Consider local ballot measures to enhance revenues.
3. Create a "Pension Rate Stabilization Program."
4. Change service delivery methods and levels of certain public services.
5. Use transparent collective bargaining to increase employee pension contributions.
6. Issue a pension obligation bond.

The Jury believes these League of California Cities' recommendations should be adopted by all Nevada County agencies.

The NPL of Nevada County's public agencies cannot be made to disappear. It represents benefits earned over several decades by public employees and constitutes a legal and ethical obligation. Some progress has been made to reduce the growing liability but the vast bulk still needs to be paid.

Findings

F1 Nearly every Nevada County agency has a Net Pension Liability.

F2 Many Nevada County agencies, especially schools, lack a sufficient Net Position to successfully comply with the requirement to reduce their Net Pension Liability.

F3 Some Nevada County agencies, especially schools, have a negative Net Position.

F4 Transparency demands that financial statements provided by the office of the Superintendent of Schools identify each charter school's Net Pension Liability.

F5 The strain on Nevada County agency budgets is likely to require cutbacks in services to balance the pension contribution increases.

F6 Many agencies may spend down their reserves to avoid cutbacks in services.

F7 New sources of revenue may be requested by many agencies to avoid cutbacks in services or reduction of reserves.

F8 The public bears most of the risk if CalPERS and CalSTRS investments continue to underperform.

F9 Higgins Fire Protection District is out of compliance with Government Code 26909 by not filing an audited financial statement for 2015-2016.

F10 Nevada City School of the Arts' financial statements should reflect their Net Pension Liability.

Recommendations

The Nevada County Grand Jury makes the following recommendations.

R1 The Nevada County Chief Executive Officer should provide a separate presentation to the Board of Supervisors describing the County's current Net Pension Liability and providing a plan for addressing the problem. The presentation should not be hidden in the annual budget report presentation.

R2 Public agencies and public employee unions should explore how increasing employee pension contributions can reduce non-funded pension liabilities.

R3 For the purposes of transparency and easy access, each agency should provide links to three years of audited financial statements and summary pension data for the same period on the financial page of its public website.

R4 Public agencies should consider implementing the suggestions from the League of California Cities.

R5 Higgins Fire Protection District should comply with Government Code 26909 and file an audited financial statement for 2015-2016.

R6 Nevada County Superintendent of Schools should report the Net Pension Liability for charter schools that are part of its agency's audit.

R7 Nevada City School of the Arts should report its Net Pension Liability in its financial statements.

Request for Responses

Pursuant to Penal Code section 933.05, the Nevada County Grand Jury requests responses from the following:

- Nevada County Board of Supervisors for Recommendations R1, R2, and R4 by 10 August 2018.

- City of Grass Valley for Recommendations R2 and R4 by 10 August 2018.

- City of Nevada City for Recommendations R2, R3, and R4 by 10 August 2018.

- Town of Truckee for Recommendations R2 and R4 by 10 August 2018.

- Nevada Irrigation District for Recommendations R2, R3, and R4 by 9 September 2018.

- Nevada County Consolidated Fire District for Recommendations R2, R3, and R4 by 9 September 2018.

- Nevada Cemetery District for Recommendations R2, R3, and R4 by 9 September 2018.

- Ophir Hill Fire Protection District for Recommendations R2, R3, and R4 by 9 September 2018.

- Peardale Chicago Park Fire Protection District for Recommendations R2, R3, and R4 by 9 September 2018.

- Penn Valley Fire Protection District for Recommendations R2, R3, and R4 by 9 September 2018.

- Nevada County Resource Conservation District for Recommendations R2, R3, and R4 by 9 September 2018.

- Higgins Fire Protection District for Recommendations R2, R3, R4, and R5 by 9 September 2018.

- Truckee Cemetery District for Recommendation R3 by 9 September 2018.

- Truckee Donner Public Utilities District for Recommendations R2, R3, and R4 by 9 September 2018.

- Truckee Fire Protection District for Recommendations R2, R3, and R4 by 9 September 2018.

- Tahoe-Truckee Sanitation District for Recommendations R2 and R4 by 9 September 2018.

- Truckee Tahoe Airport District for Recommendations R2 and R4 by 9 September 2018.

- Nevada County Superintendent of Schools for Recommendations R2, R3, R4, and R6 by 10 August 2018.

- Grass Valley School District for Recommendations R2, R3, and R4 by 9 September 2018.

- Chicago Park School District for Recommendations R2, R3, and R4 by 9 September 2018.

- Clear Creek School District for Recommendations R2, R3, and R4 by 9 September 2018.

- John Muir Charter School for Recommendations R2, R3, and R4 by 9 September 2018.

- Nevada City School District for Recommendations R2, R3, and R4 by 9 September 2018.

- Nevada County School of the Arts for Recommendations R2, R3, R4, and R7 by 9 September 2018.

- Nevada Joint Union High School District for Recommendations R2, R3, and R4 by 9 September 2018.

- Penn Valley Union Elementary School District for Recommendations R2, R3, and R4 by 9 September 2018.

- Pleasant Ridge Union School District for Recommendations R2, R3, and R4 by 9 September 2018.

- Twin Ridges Elementary School District for Recommendations R2, R3, and R4 by 9 September 2018.

- Union Hill Elementary School District for Recommendations R2, R3, and R4 by 9 September 2018.

- Bitney College Prep High School for Recommendations R3, R4, and R6 by 9 September 2018.

- Forest Charter School for Recommendations R3, R4, and R6 by 9 September 2018.

- Sierra Montessori Academy for Recommendations R3, R4, and R6 by 9 September 2018.

- Twin Ridges Home Study Charter School for Recommendations R3, R4, and R6 by 9 September 2018.

- Yuba River Charter School for Recommendations R3, R4, and R6 by 9 September 2018.

Appendix A

NEVADA COUNTY PUBLIC AGENCIES
NET POSITION STATEMENT DATA
2016

Agency	Assets	Liabilities	Net Position	Net Pension Liability	NPL % of Net Position	NPL % of Liabilities
COUNTY AND MUNICIPALITIES						
County of Nevada	$452,115,976	$204,630,431	$249,882,965	$143,371,040	57%	70%
City of Grass Valley	$129,240,858	$36,146,111	$93,094,747	$12,879,011	14%	36%
City of Nevada City	$25,853,390	$8,372,137	$12,839,589	$3,204,165	25%	38%
Town of Truckee	$225,870,471	$23,535,597	$204,054,950	$8,291,496	4%	35%
COUNTY AND MUNICIPALITIES TOTALS				**$167,745,712**		
WESTERN NEVADA COUNTY SPECIAL DISTRICTS						
Nevada Irrigation District	$512,525,523	$114,710,733	$397,814,790	$43,525,370	11%	38%
Nevada County Consolidated Fire District	$6,243,759	$4,704,144	$1,481,062	$3,801,425	257%	81%
Nevada Cemetery District	$6,128,775	$426,992	$5,651,220	$192,258	3%	45%
Ophir Hill Fire Protection District	$1,884,505	$233,856	$1,650,606	$131,224	8%	56%
Peardale Chicago Park Fire Protection District	$1,490,278	$147,266	$1,289,753	$89,335	7%	61%
Penn Valley Fire Protection District	$2,496,477	$667,720	$3,090,460	$432,756	14%	65%
Nevada County Resource Conservation District	$617,857	$56,129	$561,728	$30,922	6%	55%

Agency	Assets	Liabilities	Net Position	Net Pension Liability	NPL % of Net Position	NPL % of Liabilities
WESTERN NEVADA COUNTY SPECIAL DISTRICTS continued						
Higgins Fire Protection District	Financial statement in process					
WESTERN NEVADA COUNTY SPECIAL DISTRICTS TOTALS				**$48,203,290**		
TRUCKEE SPECIAL DISTRICTS						
Truckee Donner Public Utilities District	$163,775,304	$48,948,240	$113,229,938	$10,250,329	9%	21%
Truckee Fire Protection District	$16,099,866	$5,961,082	$10,176,878	$4,680,993	46%	79%
Tahoe-Truckee Sanitation District	$67,735,788	$6,884,123	$60,851,665	$4,519,215	7%	66%
Truckee Tahoe Airport District	$58,129,058	$4,928,194	$53,504,307	$1,706,562	3%	35%
TRUCKEE SPECIAL DISTRICT TOTALS				**$21,157,099**		
WESTERN NEVADA COUNTY SCHOOL DISTRICTS						
Nevada County Superintendent of Schools**	$24,900,379	$22,191,071	$3,442,545	$17,704,242	514%	80%
** Consolidated financial statement includes 5 charter schools						
CalPERS				$6,988,507		
CalSTRS				$10,715,735		
Grass Valley School District	$11,492,877	$16,755,881	($4,934,052)	$15,469,370	-314%	92%
CalPERS				$4,953,665		
CalSTRS				$10,515,705		
Chicago Park School District	$4,137,882	$1,296,919	$3,053,768	$1,138,960	37%	88%
CalPERS				$256,726		
CalSTRS				$882,234		
Clear Creek School District	$2,780,976	$1,265,287	$1,671,654	$1,224,545	73%	97%
CalPERS				$390,366		
CalSTRS				$834,179		

Agency	Assets	Liabilities	Net Position	Net Pension Liability	NPL % of Net Position	NPL % of Liabilities
WESTERN NEVADA COUNTY SCHOOL DISTRICTS continued						
John Muir Charter School	$463,500	$15,086,678	($9,421,710)	$11,542,000	-123%	77%
CalPERS				$2,654,000		
CalSTRS				$8,888,000		
Nevada City School District	$17,068,160	$7,165,097	$9,933,780	$6,194,916	62%	86%
CalPERS				$1,452,992		
CalSTRS				$4,741,924		
Nevada County School of the Arts	$1,036,970	$32,708	$1,004,262	not shown in FS		
Nevada Joint Union High School District	$52,346,135	$42,259,563	$9,158,904	$24,130,158	263%	57%
CalPERS				$5,880,128		
CalSTRS				$18,250,030		
Penn Valley Union Elementary School District	$9,468,445	$5,935,083	$3,299,824	$5,411,865	164%	91%
CalPERS				$1,533,651		
CalSTRS				$3,878,213		
Pleasant Ridge Union School District	$10,646,912	$9,893,862	$327,021	$9,274,654	2836%	94%
CalPERS				$1,534,284		
CalSTRS				$7,740,370		
Twin Ridges Elementary School District	$6,997,773	$1,332,100	$5,684,555	$1,149,645	20%	86%
CalPERS				$433,744		
CalSTRS				$715,901		
Union Hill Elementary School District	$9,116,618	$6,341,807	$3,157,586	$5,932,264	188%	94%
CalPERS				$1,446,217		
CalSTRS				$4,486,047		
WESTERN NEVADA COUNTY SCHOOL DISTRICTS TOTALS				**$99,172,619**		
NEVADA COUNTY TOTALS				**$336,278,720**		

Appendix B

NEVADA COUNTY PUBLIC AGENCIES
FINANCIAL DATA TRANSPARENCY
23 April 2018

AGENCY	WEBSITE	Ease of Transparency	Last Financial Stmt	# of Years Posted
COUNTY AND MUNICIPALITIES				
County of Nevada	mynevadacounty.com	Transparent	2017	11
City of Grass Valley	cityofgrassvalley.com	Transparent	2017	9
City of Nevada City	nevadacityca.gov	Transparent	2015	5
Town of Truckee	townoftruckee.com	Transparent	2017	11
WESTERN NEVADA COUNTY SPECIAL DISTRICTS				
Nevada Irrigation District	nidwater.com	Transparent	2016	3
Nevada County Consolidated Fire District	nccfire.com	Not Transparent		0
Nevada Cemetery District	nevadacemeterydistrict.com	About us – Budget	2015	2
Ophir Hill Fire Protection District	ophirhillfire.org	Not Transparent		0
Peardale Chicago Park Fire Protection District	pcpfire.com	Not Transparent		0
Penn Valley Fire Protection District	pennvalleyfire.com	Transparent	2016	1
Nevada County Resource Conservation District	ncrcd.org	Not Transparent		0
Higgins Fire Protection District	higginsfire.org	Not Transparent		0

AGENCY	WEBSITE	Ease of Transparency	Last Financial Stmt	# of Years Posted
TRUCKEE SPECIAL DISTRICTS				
Truckee Cemetery District	truckeecemeterydistrict.com	Not Transparent		0
Truckee Donner Public Utility District	tdpud.org	Transparent	2016	3
Truckee Fire Protection District	truckeefire.org	Transparent	2017	1
Tahoe-Truckee Sanitation District	truckeesan.org	Transparent	2017	9
Truckee Tahoe Airport District	truckeetahoeairport.com	Transparent	2016	7
WESTERN NEVADA COUNTY SCHOOL DISTRICTS				
Chicago Park School District	chicagoparkschool.org	Not Easily	2017	
Clear Creek School District	clearcreekschool.com	Transparent	2017	
Grass Valley School District	gvsd.us	Not Transparent	NA	
Nevada City School District	ncsd.school	Transparent	2016	2
Nevada Joint Union High School District	njuhsd.com	Board Agenda Packet	2016	
Penn Valley Union Elementary School District	pennvalleyschools.k12.ca.us	Board Agenda Packet	2017	
Pleasant Ridge Union School District	prsd.us	Board Agenda Packet *		
Twin Ridges Elementary School District	twinridgeselementary.com	Not Transparent		
Union Hill Elementary School District	district.uhsd.k12.ca.us	Not Transparent		
Nevada County Superintendent of Schools	nevco.org	Not Transparent		
Bitney College Prep High School	bitneyprep.net	Not Transparent		

AGENCY	WEBSITE	Ease of Transparency	Last Financial Stmt	# of Years Posted
WESTERN NEVADA COUNTY SCHOOL DISTRICTS continued				
Forest Charter School	forestcharter.com	Not Transparent **		
John Muir Charter School	johnmuircs.com	Transparent	2017	
Nevada City School of the Arts	ncsota.org	Not Transparent		
Sierra Montessori Academy	sierramontessori.org	Not Transparent		
Twin Ridges Home Study Charter School	twinridgeshomestudy.org	Not Transparent ***		
Yuba River Charter School	yubariversschool.org	Not Transparent		

* Agendized for 12-13-16 not included in packet.
** Agendized for 1-17-17 no packet available online.
*** Agendized for 1-11-17 no packet available – link from agenda does not work.

Appendix C

League of California Cities®
Retirement System Sustainability Study and Findings
January 2018

The League of California Cities® supports and continues to advocate for secure defined benefit pension plans and the reforms that will allow them to flourish through the next century of public service. Defined benefit plans have proven to be an effective vehicle to provide pension benefits to employees and support California's public servants throughout their lifetimes. Local governments wish to continue to use these pension plans to attract and retain a highly skilled workforce.

The California Public Employee Retirement System (CalPERS), however, is underfunded. As of January 2018, CalPERS had only 68 percent of the funds required to pay estimated retirement benefits – in other words, only 68 cents for every dollar needed to fund retiree pension commitments. Several factors have contributed to unsustainability of the CalPERS system – and as a result, the contributions paid by all public employers to CalPERS are dramatically increasing. California cities are feeling the effects of growing budgetary pressure more than other public employers.

To better understand the cost drivers behind increasing local employer contribution rates and impacts on cities, the League commissioned Bartel Associates, LLC, a leading California actuarial firm serving only public sector agencies to:

- Analyze anticipated pension contribution rates for cities as a percentage of payroll; and
- Determine how those future contribution rates would impact cities' General Funds.

This study was limited only to pension liability. It does not reflect costs to cities associated with active or other post-employment benefits such as health care. Bartel Associates based its analysis on CalPERS' June 30, 2016, public agency actuarial valuation data and results of the League's October 18, 2017, City Survey.

The findings of this study reveal the following:

1. Rising pension costs will require cities over the next seven years to nearly double the percentage of their General Fund dollars they pay to CalPERS;
2. For many cities, pension costs will dramatically increase to unsustainable levels; and
3. The impacts of increasing pension costs as a percentage of General Fund spending will affect cities even more than the state. Employee costs, including police, fire and other municipal services, are a larger proportion of spending for cities.

The results of this study provide additional evidence that pension costs for cities are approaching unsustainable levels. While the state budget has recovered significantly since the Great Recession with the assistance of substantial voter-approved tax increases, some cities have yet to recover. With local pension costs outstripping revenue growth, many cites face difficult choices that will be compounded in the next recession. Under current law, cities have two choices – attempt to increase revenue or reduce services. Given that police and fire services comprise a large percentage of city General Fund budgets, public safety, including response time, will likely be impacted.

Cities are looking for sustainable solutions that provide near-term relief while broader impacts from pension reform enacted by the Legislature in the Public Employees' Pension Reform Act (PEPRA) [applying to employees hired after January 1, 2013] materialize. However, tangible savings resulting from PEPRA will not have a substantial effect on city budgets for decades.

The League has created an online resource (www.cacities.org/pensions) to provide additional background and information for cities on this issue. Consistent with its adopted Pension Sustainability Principles, the League looks forward to working with employees, CalPERS, the Legislature and the Governor to achieve meaningful options for cities to address growing unfunded pension liabilities that will ensure cities remain solvent and able to provide services to residents while continuing to offer employees sustainable pension and health benefits.

Key Findings

City pension costs will dramatically increase to unsustainable levels.

Between FY 2018–19 and FY 2024–25, cities' dollar contributions will increase by more than 50 percent. For example, if a city is required to pay $5 million in FY 2018–19, the League expects that it will pay more than $7.5 million in FY 2024–25.

Miscellaneous Employees: In FY 2024–25, half of cities are anticipated to pay over 30.8 percent of their payroll towards miscellaneous employee pension costs, with 25 percent of cities anticipated to pay over 37.7 percent of payroll. This means that for every $100 in pensionable wages (generally base salary), the majority of cities would pay an additional $31 or more to CalPERS for pensions alone. This amount does not include active or retiree healthcare.

For "mature cities" with larger numbers of retirees, the percentages are even higher. Half of those cities are anticipated to pay 37.9 percent or more of payroll and 25 percent are anticipated to pay 42.9 percent or more of payroll. These findings are not specific to one region of the state. The data shows that cities throughout California are dealing with these challenges.

Public Safety Employees: Contributions are projected to be much higher for cities that employ safety personnel (police officers and firefighters). By FY 2024–25, a majority of these cities are anticipated to pay 54 percent or more of payroll, with 25 percent of cities anticipated to pay over 63.8 percent of payroll. In other words, for every $100 in salary, the majority of cities would pay an additional $54 or more to CalPERS for pensions alone. As with miscellaneous employees, for cities with a large number of retirees, these percentages are even higher. The cities paying the highest percentages of payroll are spread throughout the state.

Unsustainable Costs: For FY 2024–25, the average projected contribution rate as a percentage of payroll is 34.6 percent for miscellaneous employees and 60.2 percent for safety employees. For cities with a large percentage of retirees, the averages are 39.4 percent and 67.5 percent. **Rising pension costs will require cities to nearly double the percentage of their General Fund dollars they pay to CalPERS.**

The League surveyed its members regarding the proportion of their General Fund budget devoted to paying pension costs to CalPERS. These percentages are for CalPERS costs only, over and above the cost of salaries and do not include the cost of active and retiree health care.

On average, from FY 2006–07 to FY 2024–25, cities will nearly double the percentage of the General Fund dollars that goes to CalPERS. In FY 2006–07, the average city spent 8.3 percent of its General Fund budget on CalPERS pension costs. That average increased to 11.2 percent in FY 2017–18 and it is anticipated to increase to 15.8 percent in FY 2024–25. In FY 2024–25, 25 percent of cities are anticipated to spend more than 18 percent of their General Fund on CalPERS pension costs with 10 percent anticipated to spend 21.5 percent or more. These cities are located throughout the state.

The state also faces increasing pension costs. According to Governor Brown's proposed FY 2018–19 budget introduced in January, \$3.2 billion of the state's General Fund will be allocated to pay down CalPERS pension liabilities. This is approximately 2.75 percent of the total \$131 billion proposed General Fund budget. Furthermore, when all state-related retiree costs, including teachers in CalSTRS and state contributions for retiree health care are taken into account, that number increases to 8 percent of the state's General Fund. While these amounts are significant and affect the state's ability to fund other priorities, cities' pension cost impacts alone – without considering any obligations for active and retiree health care – are significantly higher as a percentage of cities' General Funds.

Cities have few options to address growing pension liabilities.

Under the California Constitution, a city's options for revenue raising are strictly limited. Any increase in local taxes requires voter approval and voter tolerance for tax increases is waning. Much of a city's budget is dedicated to employee salaries and benefits to provide fire protection, law enforcement, parks services and other municipal services. If new revenues are unavailable, as contributions rise, local agencies are forced to significantly reduce or eliminate critical programs.

Despite the significant changes made through PEPRA, local governments will continue to face the financial conundrum of meeting their pension obligations. PEPRA, with all of its positive changes, does little to address the more immediate and near-term pension funding problems facing local governments. The anticipated benefits of PEPRA reforms are applicable only to new CalPERS employee members, and therefore it will take decades for these savings to be reflected in city budgets.

Under current law, there are only two sources to address the growing unfunded liability at CalPERS that cities face: higher than expected investment returns or increased employer contributions. Although CalPERS recently reduced its discount rate to 7 percent, the Fund projects a 6.1 percent return over the next 10 years. It is highly probable that public agencies will be expected to pay more to make up the difference – this is unsustainable.

What Cities Can Do Today

Many cities have already exercised their limited options under current law to address the fiscal challenges attributed to growing pension liabilities, which include:

7. Develop and implement a plan to pay down the city's Unfunded Actuarial Liability (UAL):
    a. Possible methods include shorter amortization periods and pre-payment of cities UAL. This option may only work for cities in a better financial condition.
8. Consider local ballot measures to enhance revenues:
    a. Some cities have been successful in passing a measure to increase revenues. Others have been unsuccessful. Given that these are voter approved measures, success varies depending on location.
9. Create a Pension Rate Stabilization Program (PRSP):
    a. Establishing and funding a local Section 115 Trust Fund can help offset unanticipated spikes in employer contributions. Initial funds still must be identified. Again, this is an option that may work for cities that are in a better financial condition.
10. Change service delivery methods and levels of certain public services:
    a. Many cities have already consolidated and cut local services during the Great Recession and have not been able to restore those service levels. Often, revenue growth from the improved economy has been absorbed by pension costs. The next round of service cuts will be even harder.
11. Use procedures and transparent bargaining to increase employee pension contributions:
    a. Many local agencies and their employee organizations have already entered into such agreements.
12. Issue a pension obligation bond (POB):
    a. However, financial experts including the Government Finance Officers Association (GFOA) strongly discourage local agencies from issuing POBs. Moreover, this approach only delays and compounds the inevitable financial impacts.

Bibliography

Where else can I learn more?

from CALmatters, 21 February 2018

Retirement Debt: What's the problem and how does it affect you?

https://calmatters.org/articles/california-retirement-pension-debt-explainer/

Wanting more? Here are other helpful resources on California's retirement debt:

- State government
    - California State Controller's Office: Retirement Systems Financial Data, Public Pay
    - California Finance Department: Long-term liabilities
    - Legislative Analyst's Office
    - Little Hoover Commission: 2011 pension study
- Local Government Organizations
    - League of California Cities
- Major Public Retirement Systems
    - California Public Employees' Retirement System
    - California State Teachers' Retirement System
    - University of California
    - Los Angeles City Employees' Retirement System
    - Los Angeles County Employees Retirement System
    - San Francisco Employees' Retirement System
    - Orange County Employees Retirement System
    - San Diego City Employees' Retirement System
- Labor:
    - Californians for Retirement Security: A coalition of public employee unions representing 1.6 million workers and retirees
    - California Teachers Association
    - California Professional Firefighters
    - SEIU 1000: The largest state government worker union
    - Retired Public Employees' Association
- Pension reform groups
    - California Policy Center: A nonprofit group that advocates for pension cutbacks
    - PensionTsunami.com: A website focused on California pensions edited by Jack Dean
    - TransparentCalifornia.com: A searchable database of pensions by a Nevada-based free-market organization called Nevada Policy Research Institute.
    - Pensiontracker.org: A site tracking financial information about the California Public Employees' Retirement System by Stanford University public policy professor Joe Nation.
    - Retirement Security Initiative: A bipartisan group pushing for fair and sustainable pension systems led by former San Jose Mayor Chuck Reed.

    - CaliforniaPensionReform.com: A group dedicated to putting a pension initiative on the statewide ballot led by Dan Pellissier, who served as an advisor to Gov. Arnold Schwarzenegger.
- Blogs
    - Calpensions.com: A blog by former San Diego Union-Tribune reporter Ed Mendel.