

Public Pension Obligations in San Diego County

SUMMARY REPORT

March 2017

Prepared By:

**San Diego Taxpayers
Educational Foundation**

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Executive Summary

The San Diego Taxpayers Educational Foundation conducts research on issues important to taxpayers, including public pensions. This report is intended to provide a description of the current state of pension funds in the major government entities of San Diego County. The Pension Status Report summarizes the findings of SDTEF's 2017 study into the status of public pension funds and allows taxpayers to compare pension costs across the region and their effect on city budgets.

Overall, SDTEF found that Del Mar, Coronado, National City, San Diego, and Carlsbad had both the highest net pension liabilities per capita and the highest employer pension costs per capita. At the same time, Coronado and Carlsbad both have seen some of the best improvement in their funded ratios over the last five years, indicating marked effort to address the problem of unfunded pension benefits.

Alternatively, Vista, Santee, Imperial Beach, and Lemon Grove consistently had both the lowest per capita net pension liabilities and employer pension costs. However, Imperial Beach, Santee, and Lemon Grove saw decreases or only modest improvements in funded status over the examined five-year period. San Marcos had relatively low per capita net pension liability and employer pension costs, as well as the highest increase in weighted average funded ratio over the period.

Nine cities in San Diego County contract with the San Diego County Sheriff's Department for law enforcement services: Del Mar, Encinitas, Imperial Beach, Lemon Grove, Poway, San Marcos, Santee, Solana Beach, and Vista. The pension benefits of these law enforcement officers are administered by the County through SDCERA, and not through the cities themselves. All of these cities with the exception of Del Mar had the lowest NPL per capita and employer contribution per capita in comparison to the other cities in the county who must provide pension benefits to a police employee group. The absence of a police employee group would naturally save these cities pension costs, especially as safety employees tend to receive the most generous pension benefits offered. While Del Mar consistently had some of the highest costs per capita despite the absence of its own police department, it should be noted that the city has the smallest population of all the cities studied. Each government, regardless of population, needs to employ an appropriate number of employees to provide the services necessary to operate the city. While there is no definition of an "appropriate" number of employees, this is a factor cities should consider when evaluating their pension obligations.

With this in mind, the San Diego Taxpayers Educational Foundation is offering three recommendations to best address the region's growing pension obligations.

Recommendation #1: Offer defined contribution retirement plans. SDTEF believes that offering 401(k)-style defined contribution retirement plans with an employer match to

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new employees would be a further step toward protecting retirement benefits for future employees while reducing the risk to city budgets. Though pension benefits are primarily funded by investment returns, taxpayers still pay the cost of employer contributions to pension funds. Because employers are responsible for keeping benefits funded throughout the life of the recipient even when faced with underperforming investments, taxpayers are then left with the risk of defined benefit plans. In a defined contribution plan, employees bear the risk of investment and retirement benefits are dependent on responsible contributions from both the employee and employer. Cities could still provide a generous match to a defined contribution plan, as in the City of San Diego, to ensure our public servants are set up for a happy and healthy retirement.

Recommendation #2: Elimination of employer-paid member contributions. SDTEF recommends that cities additionally eliminate EPMCs for “classic” members hired before PEPRA took effect. Many cities throughout the County have already taken this step, but several continue to offer this benefit to members in a higher tier of retirement benefits. If cities were to require all employees to pay the full normal member contribution to the retirement fund instead of picking up some of the cost, this could result in significant employer savings over time.

Recommendation #3: Pay off unfunded liability as soon as possible. Cities can save costs by paying off their unfunded pension liabilities as soon as possible. As with any other debt, paying down liability early on will avoid some of the high costs added by interest and result in lower payments over time. Eliminating unfunded liability will help lower yearly contribution rates, helping cities avoid the need for future tax increases and/or cuts to important community services. It is important that governments do all they can to address increasing pension liabilities without letting the burden fall heavily on taxpayers or those who most need important public services.

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2017 SDTEF Pension Status Report

	FY 2015 Unfunded Actuarial Accrued Liability	One Year Change in Unfunded Actuarial Accrued Liability	FY 2015 Net Pension Liability	FY 2015 Net Pension Liability Per Capita	Weighted Average of FY 2015 Funded Ratio	Weighted Average of Five Year* Change in Funded Ratio	Cumulative Cost to Terminate CalPERS @ 3.25%	Cumulative Termination Cost as Percentage of FY 2017 Budget Expenditures	FY 2017 Total Employer Contribution Amount	One Year Change in Pension Cost	FY 2017 Pension Cost Per Capita	FY 2017 Pension Cost as Percentage of Budget Expenditures
San Diego County	\$2,544,743,000	9.84%	\$1,958,456,000	\$595.53	80.50%	-3.80%			\$428,609,000	6.07%	\$154.87	9.50%
Carlsbad	\$147,543,112	16.92%	\$123,568,624	\$1,238.38	74.38%	11.40%	\$857,799,368	342.92%	\$19,878,103	33.17%	\$176.02	7.95%
Chula Vista	\$261,221,387	17.70%	\$219,124,146	\$826.67	69.93%	8.02%	\$1,549,170,789	530.19%	\$26,359,054	9.11%	\$99.44	9.02%
Coronado	\$34,526,073	10.36%	\$31,390,055	\$1,244.16	81.01%	11.74%	\$306,997,608	322.89%	\$4,387,978	7.47%	\$191.78	5.09%
Del Mar	\$8,614,935	28.80%	\$6,762,328	\$1,582.20	79.97%	7.76%	\$68,999,023	344.01%	\$998,855	10.25%	\$233.70	4.98%
El Cajon	\$157,034,830	13.97%	\$135,397,786	\$1,323.06	68.66%	7.89%	\$830,406,305	725.62%	\$13,700,398	10.66%	\$133.88	11.97%
Encinitas	\$37,872,559	25.90%	\$35,820,101	\$578.42	77.84%	10.91%	\$287,437,663	369.21%	\$4,700,807	6.01%	\$75.91	6.04%
Escondido	\$196,854,478	20.55%	\$163,094,494	\$1,081.82	71.20%	9.39%	\$1,192,447,320	646.74%	\$20,378,908	12.19%	\$135.17	11.05%
Imperial Beach	\$8,910,175	30.05%	\$6,194,125	\$225.78	78.73%	-0.16%	\$70,184,218	242.28%	\$1,042,310	12.72%	\$37.99	3.60%
La Mesa	\$70,815,789	17.93%	\$61,432,925	\$1,024.19	72.02%	6.69%	\$434,610,963	670.82%	\$6,936,651	8.99%	\$115.65	10.71%
Lemon Grove	\$7,622,452	16.77%	\$5,993,827	\$225.24	74.71%	1.70%	\$46,257,709	164.53%	\$1,062,068	7.45%	\$39.91	3.78%
National City	\$80,115,224	13.08%	\$74,631,579	\$1,228.14	72.93%	7.51%	\$480,403,762	559.63%	\$8,544,191	14.67%	\$140.60	9.95%
Oceanside	\$186,804,257	17.71%	\$167,983,389	\$954.73	76.38%	10.19%	\$1,393,098,294	359.82%	\$21,918,428	6.69%	\$124.57	5.66%
Poway	\$36,221,685	21.31%	\$36,135,792	\$721.23	75.50%	5.38%	\$251,078,251	302.06%	\$3,603,128	8.91%	\$71.91	4.33%
San Diego	\$2,001,708,564	-1.40%	\$1,535,537,000	\$1,103.37	75.60%	8.50%			\$324,500,000	24.28%	\$233.17	10.94%
San Marcos	\$52,220,156	15.05%	\$48,048,694	\$515.02	68.82%	12.12%	\$295,053,212	425.72%	\$6,528,034	6.30%	\$69.97	9.42%
Santee	\$30,219,159	23.12%	\$23,201,041	\$408.78	77.96%	0.52%	\$220,620,255	511.16%	\$3,380,720	-2.90%	\$59.56	7.83%
Solana Beach	\$10,347,342	25.51%	\$7,592,180	\$562.63	80.19%	-2.86%	\$75,491,892	237.56%	\$1,178,293	11.71%	\$87.32	3.71%
Vista	\$49,834,131	12.00%	\$43,025,603	\$435.06	76.28%	8.98%	\$356,514,441	284.69%	\$5,814,928	1.91%	\$58.80	4.64%

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Background

Annual pension costs across the nation continue to rise, placing a significant burden on local government budgets. In San Diego County, the cumulative unfunded pension liability for the governments examined in this report totaled over \$5.9 billion. The San Diego County Taxpayers Association (SDCTA) has acted at the forefront of regional pension analysis over the last several years, and has made many reform recommendations to achieve cost savings. Because pension costs continue to place pressure on city coffers despite several recent successful reforms being made, SDTEF has elected to review the status of the region's pension funds to foster a new conversation about reform.

When discussing an issue as complex as pensions, it is impossible to avoid technical terms. Several terms will be defined throughout this report to help explain the criteria with which we compared each government entity. It should be noted that it is assumed the reader has a basic understanding of public pensions. For anyone seeking to gain a better understanding of public pensions, labor negotiations, and pension law, SDTEF offers a pension certification course each year to provide background information on these topics.

Retirement Systems

There are 17 cities in San Diego County that contract with the California Public Employees' Retirement System (**CalPERS**), which manages retirement and health benefits for public employees across the state. The City of San Diego and the County of San Diego utilize the San Diego City Employees' Retirement System (**SDCERS**) and the San Diego County Employee Retirement Agency (**SDCERA**), respectively, to manage benefits for retirees and their beneficiaries.

Each of the retirement systems has separate pension benefits for different categories of employees--generally safety and miscellaneous. Safety employees usually include sworn officers such as police officers, as well as firefighters and lifeguards. All other employees are usually included in the miscellaneous employee group. It is now common for cities to have more than one "tier" of pension benefits within an employee group, with lower tiers being reserved for newly hired employees who will receive less generous retirement benefit packages.

Pension Plans

There are two basic types of retirement plans that can be available to public sector employees. A **defined contribution plan** is a pension plan into which employees make annual fixed (dollar or percentage) contributions, where the level of benefits received at retirement is based on contributions and investment returns. In this type of plan, the employee bears the investment risk.

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The most common example would be a 401(k) retirement plan. A **defined benefit plan** is a pension plan into which employees and employers make annual actuarially determined contributions, where the level of benefit received at retirement is defined regardless of investment returns. This means that employers are usually required by law to continue funding benefits through the entire life of the employee. Consequently, the employer bears the risk of investment in a defined benefit plan, and that risk falls on taxpayers when the employer is a government entity. **Almost every city involved in this study only offered defined benefit plans to their employees.**

Pension benefits are generally calculated with a **benefit formula** based on years served, **final compensation**, and a **benefit factor**. For new members, PEPRA placed a cap on the salary that can be used to calculate final compensation, and requires that average final compensation be calculated over a period of at least 36 consecutive months. The benefit factor is a specified percentage of salary for each year of service, which you are promised to receive upon retirement, based on age of retirement. Benefit factors are a percentage, usually between 2% and 3%, earned for years of employment.

Annual Pension Benefits = years of service x final compensation x benefit factor

Table 1: Benefit Factors Currently Outlined in CalPERS Publications^{i ii}

Miscellaneous Employees							
2.0% @ 55	2.0% @ 60	2.0% @ 62	2.5% @ 55	2.7% @ 55	3.0% @ 60		
Safety Employees							
2.0% @ 50	2.0% @ 55	2.0% @ 57	2.5% @ 55	2.5% @ 57	2.7% @ 57	3.0% @ 50	3.0% @ 55

Table 2: Benefit Factors for Police Officers Vested in SDCERS, Hired August 1, 2012 to June 30, 2013ⁱⁱⁱ

Police Safety Members					
2.5% @ 50	2.6% @ 51	2.7% @ 52	2.8% @ 53	2.9% @ 54	3.0% @ 55

Table 3: Benefit Factors for SDCERA Members^{iv v vi}

General Members		
Tier A	Tier B	Tier C
2.0% @ 50	1.7% @ 55	1.3% @ 55

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2.5% @ 55	2.0% @ 57	2.0% @ 62
3.0% @ 60	2.6% @ 62	2.5% @ 67
Safety Members		
Tier A	Tier B	Tier C
3.0% @ 50	2.3% @ 50	2.0% @ 50
	3.0% @ 55	2.7% @ 57

Recent Reforms

In June 2012, voters in San Diego passed a comprehensive pension reform measure titled Proposition B. After its passage, the city’s defined benefit plan was closed to all new employees with the exception of sworn police officers, who could be enrolled by City Council in either a defined benefit or defined contribution plan. New employees are offered a 401(a) defined contribution plan, to which the city contributes a maximum of 9.2% of general member salary and 11% of safety member salary. The City is also required to contribute to defined benefit plans an amount “substantially equal” to the employee contribution for a normal retirement allowance, but no more. Proposition B froze pensionable pay ranges for six years, and capped pensionable compensation for police officers in defined benefit plans. The initiative also eliminated the requirement for a majority vote of employees to approve changes in retirement benefits, and required SDCERS to submit a fiscal impact report to the Mayor and City Council when proposing any increase to compensation or benefits.

The California Public Employees’ Pension Reform Act of 2013 (PEPRA) issued in numerous reforms that will have a positive long-term impact on public pension funds. Due to required compliance with PEPRA, each city in San Diego County with defined benefit retirement plans has created a new tier of retirement benefits for members hired on or after January 1, 2013. This tier of “new members” as defined by PEPRA must receive a lower-cost benefit formula, generally requiring more years of work for the highest benefit factor. New members are required to pay 50 percent of the normal cost of retirement or the contribution rate paid by similar employees hired before PEPRA took effect, whichever rate is greater. PEPRA also placed limits and regulations on the amount and type of salary that can be used to calculate a new member’s final pension benefit, further reducing the cost of pensions for employers. Furthermore, PEPRA eliminated **employer-paid member contributions (EPMCs)** for these new members. Previously, employers could pay all or a portion of the member contribution on behalf of the employee. These EPMCs were often reported as a salary increase to CalPERS, thereby increasing pensionable compensation for the employee and increasing future retirement benefits. Some cities have taken these reforms a step further, such as eliminating EPMC for all employee groups.

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In November 2015, the CalPERS Board of Administration approved a policy that will gradually reduce the discount rate by between 0.05 percent and 0.25 percent each year that investment returns outperform the existing expected rate of return by 4 percent or more. The goal of the policy is to lower the volatility of returns, thereby mitigating funding risk and helping to create stable employer contribution rates to pay down unfunded liability. This policy is a reaction to the continually decreasing ratio of active members to retirees, down from 2:1 to 1.6:1 in just a decade. For the first time in its history, CalPERS was paying out \$5 billion more in retirement benefits than it was receiving in contributions.^{vii} This policy is a step in the right direction, but more still needs to be done to ensure retirement benefits are fully funded in the long run.

ⁱ “Local Miscellaneous Benefits,” *California Public Employees’ Retirement System*, 2017, <https://www.calpers.ca.gov/docs/forms-publications/local-misc-benefits.pdf>.

ⁱⁱ “Local Safety Benefits,” *California Public Employees’ Retirement System*, 2017, <https://www.calpers.ca.gov/docs/forms-publications/local-safety-benefits.pdf>.

ⁱⁱⁱ “City of San Diego Retirement Plan Summary for Police Safety Members Hired August 1, 2012 to June 30, 2013,” *San Diego City Employees’ Retirement System*, 2014, https://www.sdcers.org/Forms-Publications/Retirement-Plan-Summaries/City-of-San-Diego-Police-Safety-Members/2014-01-29_Police-Hired-August-1,-2013-June-30,-20.aspx.

^{iv} “Retirement Plan: Overview of SDCERA benefits and services for active and deferred, Tier A Members,” *San Diego County Employees Retirement Association*, 2016, http://sdcera.com/PDF/retirement_plan_booklet.pdf.

^v “Retirement Plan: Overview of SDCERA benefits and services for active and deferred, Tier B Members,” *San Diego County Employees Retirement Association*, 2016, http://sdcera.com/PDF/Tier-B_booklet.pdf.

^{vi} “Retirement Plan: Overview of SDCERA benefits and services for active and deferred, Tier C Members,” *San Diego County Employees Retirement Association*, 2016, http://sdcera.com/PDF/retirement_plan_Tier-C_booklet.pdf.

^{vii} Brad W. Pacheco, “CalPERS Adopts Funding risk Mitigation Policy to Rain in Risk and volatility in Pension System,” *California Public Employees Retirement System*, November 18, 2015, <https://www.calpers.ca.gov/page/newsroom/calpers-news/2015/adopts-funding-risk-mitigation-policy>.

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Methodology

SDTEF examined CalPERS annual pension valuation reports for each member city's various employee groups from fiscal years 2014 and 2015--the most recent data available at the time this report was written. These valuations describe each city's required contribution toward employee pension plans, as well as the city's contribution rate as a percentage of payroll. The valuations also contain information regarding each plan's **unfunded actuarial accrued liability (UAAL)**, **funded ratio**, and **hypothetical termination liability**. SDTEF also examined the CalPERS valuation reports for SDCERA and SDCERS.

SDTEF also examined the fiscal year 2015 Comprehensive Annual Financial Reports (CAFRs) and fiscal year 2017 operating budgets of each government entity to gain information about **net pension liability (NPL)** and estimated revenues and expenditures. In the weeks preceding the release of this report, several cities released their Comprehensive Annual Financial Reports for fiscal year 2016. SDTEF chose not to use the net pension liability listed in these reports due to the fact that the CalPERS actuarial valuations containing the fiscal year 2016 unfunded actuarial liabilities had not yet been released. It is important that the reader can compare the UAAL and NPL for the same year because they both describe the city's pension obligation using a different measurement of the city's assets. SDTEF reached out to each city to verify the data before releasing this report.

The 2017 Pension Scorecard uses the following criteria for presenting a description of the pension burdens facing San Diego County:

- FY 2015 Unfunded Actuarial Accrued Liability
- One Year Change in Unfunded Actuarial Accrued Liability
- FY 2015 Net Pension Liability
- FY 2015 Net Pension Liability Per Capita
- Weighted Average of 2015 Funded Ratio
- Weighted Average of Five Year* Change in Funded Ratio
- Cumulative Cost to Terminate CalPERS @ 3.25%
- Cumulative Termination Cost as Percentage of FY 2017 Budget Expenditures
- FY 2017 Total Employer Contribution Amount
- One Year Change in Pension Cost
- FY 2017 Pension Cost Per Capita
- FY 2017 Pension Cost as Percentage of Budget Expenditures

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Results

Pension Liability

In 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 68, which changed financial reporting and accounting standards in ways that affected governments participating in cost-sharing pension plans such as CalPERS. Beginning in fiscal year 2015, all governments in this study were required to begin recognizing deferred outflows and inflows of resources, reporting the balance of pension trust funds—the liability for which the city is responsible even if the city does not own the fund—and reporting a net pension liability in their financial statements for the current period. Consequently, GASB No. 68 oftentimes resulted in increased pension expenses and liabilities from 2014.^{viii}

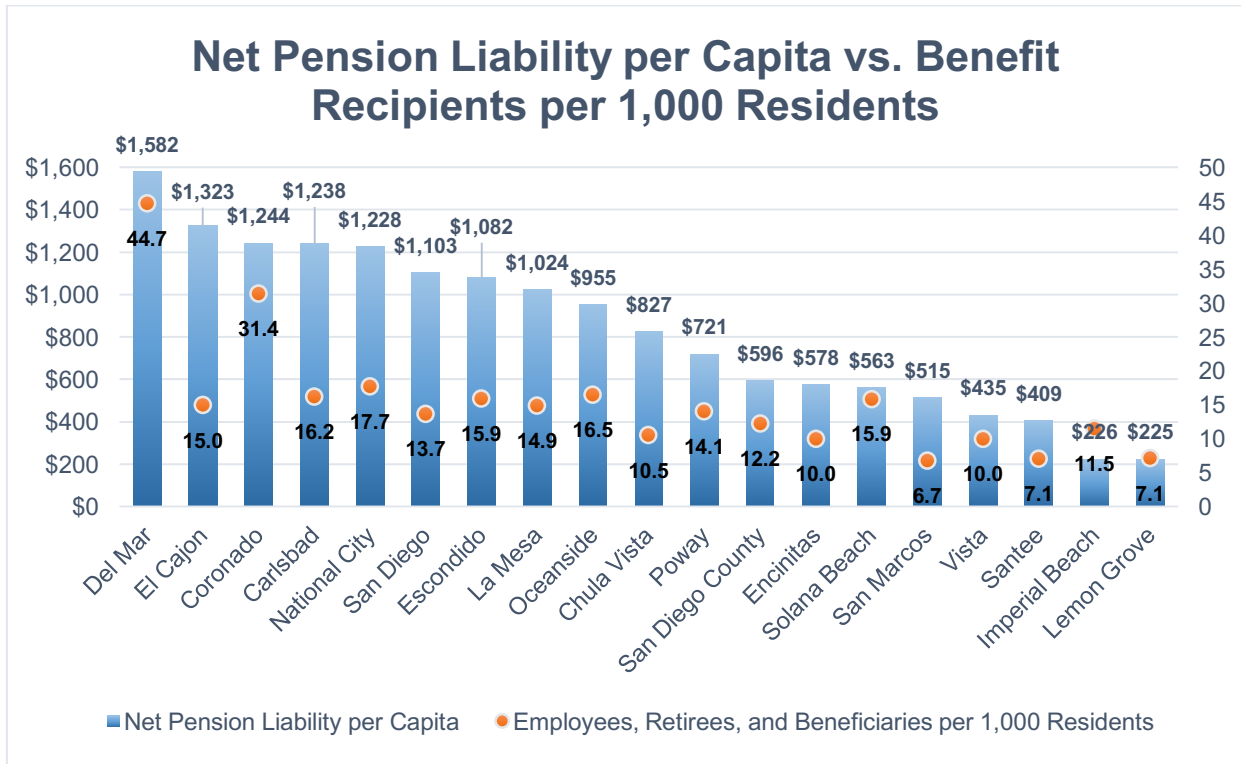
Unfunded actuarial accrued liability is the difference between the value of the plan’s assets and the value of future benefits earned by employees. Unfunded liability is created when there are market losses or lower-than-expected investment returns; demographic changes, such as higher life expectancy of retirees; retroactive benefit increases, as occurred in San Diego County in 2002; or differences between actuarial assumptions and actual experience, such as higher-than-expected salary increases. Cities must pay this off over time, and employer contributions include a payment towards amortization of the UAAL.

Both UAAL and NPL demonstrate the present value of the pension obligation for which the government entity is not fully funded. The UAAL is calculated using a “smoothed” value of plan assets. Smoothing assets involves taking the relative average of market values over a short period of time to reduce the volatility of these asset values in years where investments under- or over-performed, and therefore allows actuaries to calculate a contribution rate that will properly fund pension benefits in the long run. Assets can be smoothed by adjusting market values while considering details like time value of money and pension benefits paid out. Alternatively, **net pension liability** is calculated using the fair value of assets, which fully realizes changes in market value, interest, dividends, gains, and losses at the end of each period. This provides a measurement of pension liability that is more reflective of current market conditions and plan status.^{ix x}

Overall, UAAL increased for every government entity evaluated except for the City of San Diego, which saw a decrease in UAAL of 1.4% since fiscal year 2014. Change in NPL since fiscal year 2014 could not be evaluated in this report because fiscal year 2015 was the first year for which NPL was reported.

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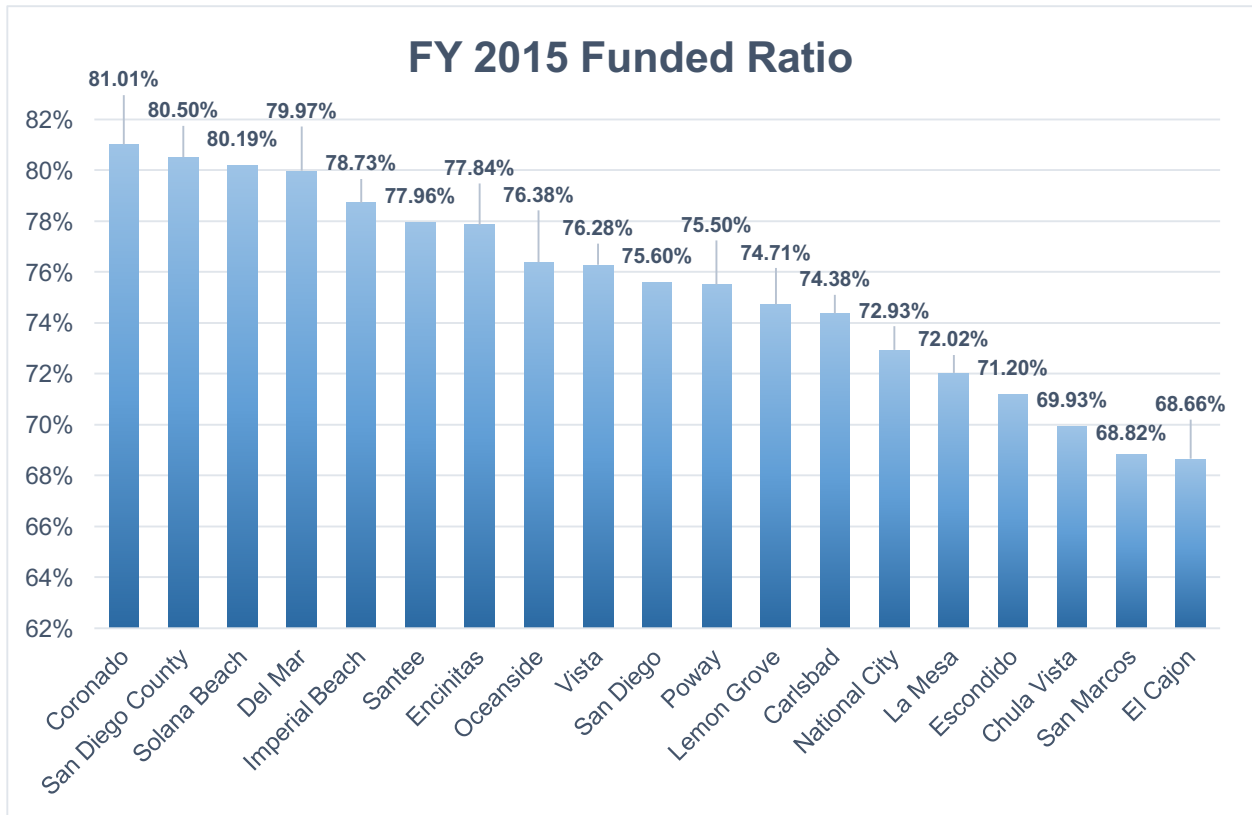
Del Mar, El Cajon, Coronado, Carlsbad, and National City had the highest NPL per capita, each with over \$1,200 per resident. At the same time, Del Mar, Coronado, National City, and Carlsbad each had the highest ratio of active employees, retirees, and beneficiaries per 1,000 residents. Lemon Grove and Santee had the lowest and third-lowest NPL per capita, while also having the second-lowest ratio of active employees, retirees, and beneficiaries per 1,000 residents. SDTEF’s analysis demonstrated a correlation between a high ratio of employees, retirees, and beneficiaries per 1,000 residents and a high NPL per capita.

Funded Status

While UAAL and NPL paint a portrait of numerical value of the current liability that unfunded pension benefits create for public employers, a plan’s **funded ratio** gives a better idea of the status of a pension plan’s funds. The funded ratio compares the value of the plan’s assets to the present value of future benefits owed to employees, retirees, and beneficiaries. A 100% funded ratio is the ideal target funding level for pension plans. However, a plan may not be sustainable at any funded ratio if required contributions are not made, if investments are overly risky, or if the size of the pension liability is disproportionate compared to the financial resources of the plan’s sponsor.^{xi}

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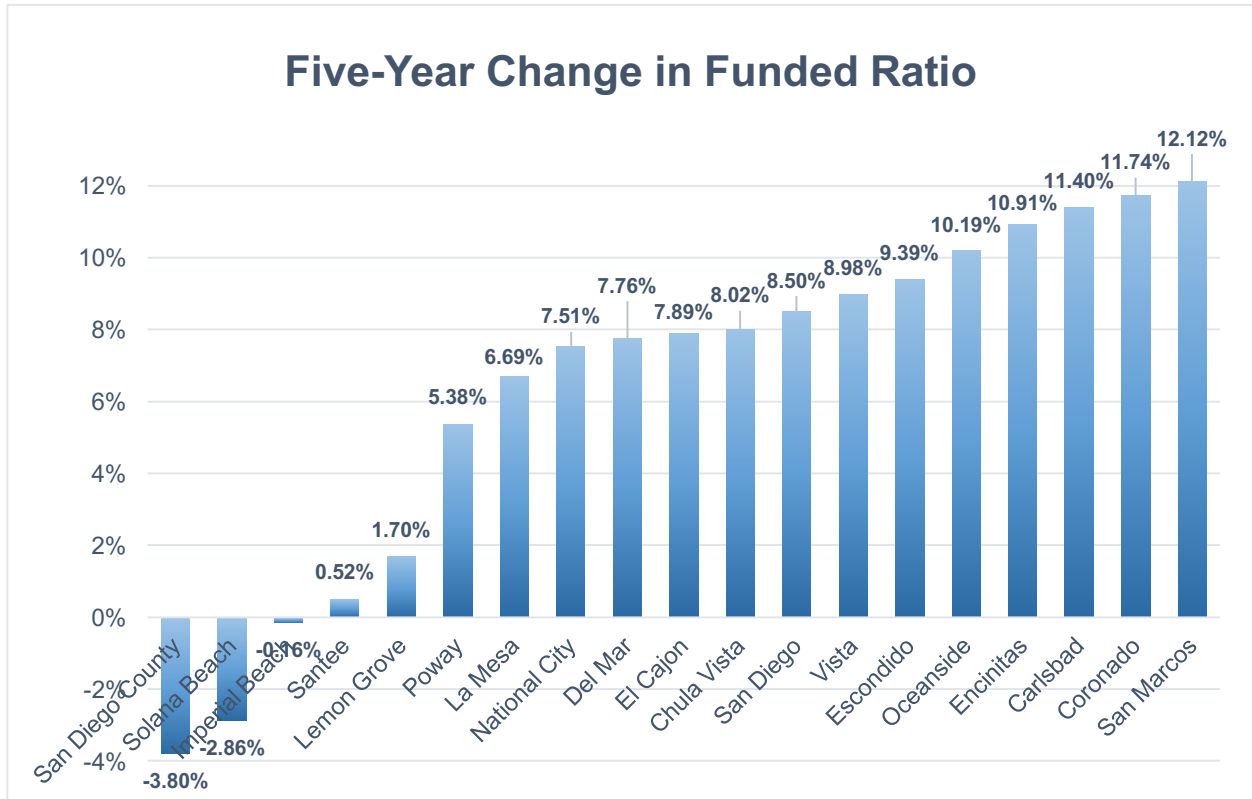
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According to a 2015 study conducted by the California Policy Center, the weighted average funding ratio for all 459 municipalities in California was approximately 75% in 2013.^{xii} Using this as a comparison, 11 of the 19 governments in San Diego had a weighted average funded ratio that was at or above average in FY 2015. SDTEF calculated weighted averages using 2015 levels for employees, retirees, and beneficiaries.

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When evaluating the weighted average change in funded ratios for each government, SDTEF aimed to demonstrate a change over five years. If a certain plan had not yet existed for five years, such as PEPPRA tiers which would not have taken effect until at least 2013, we used the change over the greatest number of years for which data was available. San Diego County, Solana Beach, and Imperial Beach each had a decrease in weighted average funded ratio over the period. Overall, San Marcos, Coronado, Carlsbad, Encinitas, and Oceanside had the highest improvements in average funded ratio over the period--all above 10%.

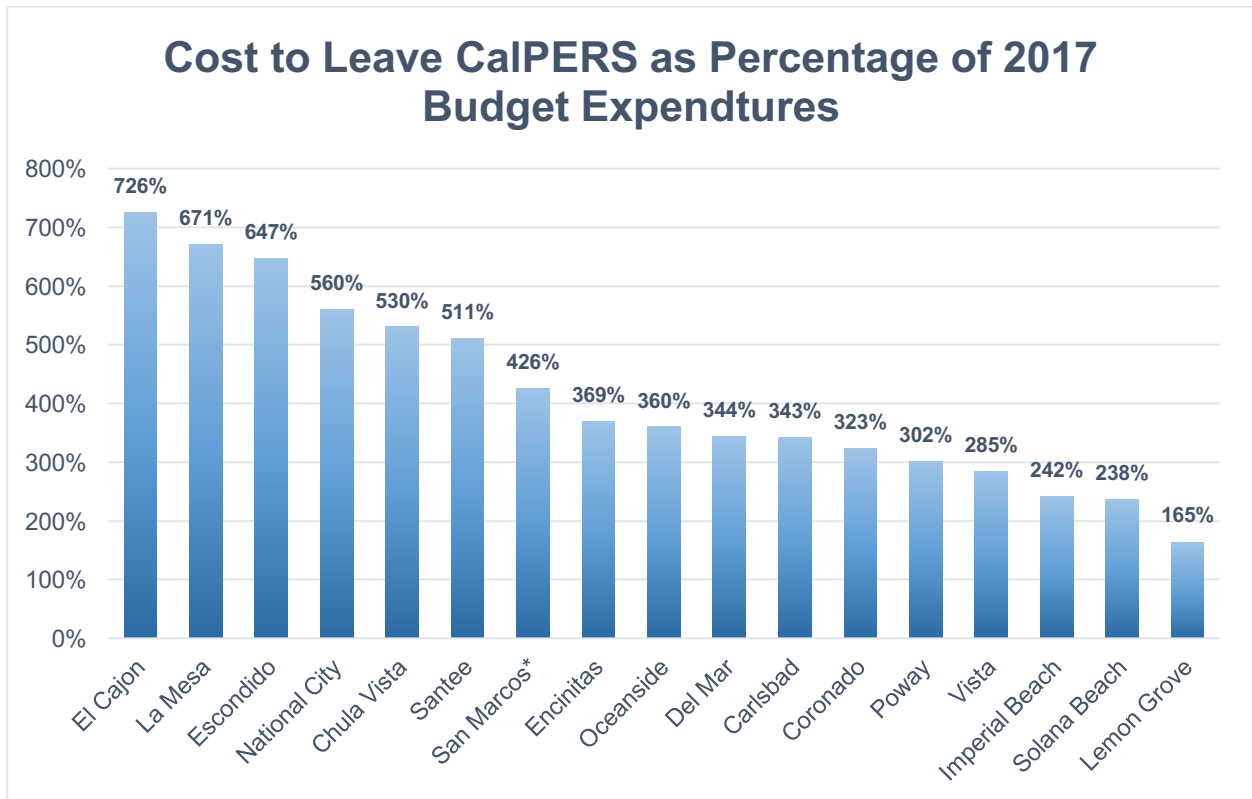
Cost to Terminate CalPERS

The official annual forecast of CalPERS investment returns is currently set at 7.5%. Returns over the past 20 years have averaged 7.76%, and over the last 10 years have averaged 11%. Returns vary widely year-to-year. When CalPERS reports funded status to the public, the pension obligation of an entity that is still part of CalPERS is “discounted” by a rate estimating the amount of investment returns the plan expects to make. However, if a plan is being terminated, there will not be any further employer contributions which can be raised to cover investment losses, so the pension obligation must be calculated more conservatively.

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CalPERS uses a different (lower) **discount rate** to determine the **hypothetical termination liability** of the plan when an entity wishes to leave CalPERS. The hypothetical termination liability is meant to more accurately represent the market and guarantee that the funds be paid even if investment returns are low. The discount rate used depends on the duration of the plan's liabilities and actual market rates of return for risk-free securities on the date of termination, but each plan's CalPERS actuarial report lists two theoretical discount rates. SDTEF has chosen to display hypothetical termination liabilities calculated with a 3.25% discount rate, but the lower listed rate—2.00%—would result in a greater hypothetical termination liability. Though it is unlikely a city would go through the process of leaving CalPERS, SDTEF wanted to highlight the high costs a city would face to fund its future pension benefits and the contrast between the hypothetical termination liability and the value of the unfunded pension liability.



While various cities across the county have very large hypothetical termination liabilities, it is important to consider these amounts relative to the size of each city's budget. El Cajon, La Mesa, and Escondido each have a cumulative hypothetical termination liability over 645% of their adopted budget expenditures for fiscal year 2017. Imperial Beach, Solana Beach, and Lemon Grove were the only governments with costs to terminate CalPERS at less than 250% of adopted budget

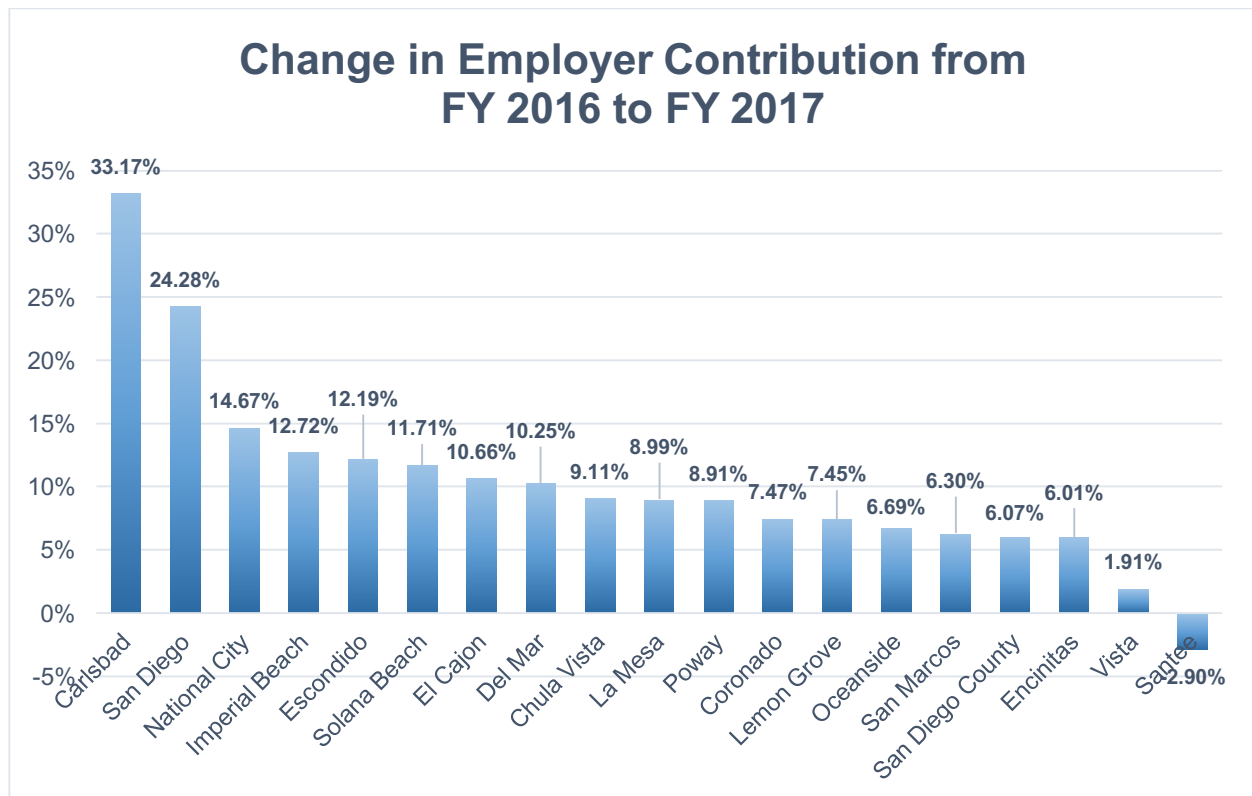
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expenditures. It should be noted that SDTEF used only the fiscal year 2017 General Fund expenditures to calculate this figure for San Marcos.

Annual Pension Costs

Pensions are funded by employer and employee monetary contributions and returns on investment. The **normal cost** of a pension plan is the annual cost of funding future retirement benefits earned by a plan’s members in a particular year, including both employee contributions and employer costs. Yearly employer pension costs include both the employer portion of the normal cost and a contribution towards the amortization of the UAAL. SDTEF gathered information for the total fiscal year 2017 employer contributions listed on CalPERS valuation reports and city budgets, and calculated the cost as a percentage of adopted budget expenditures.

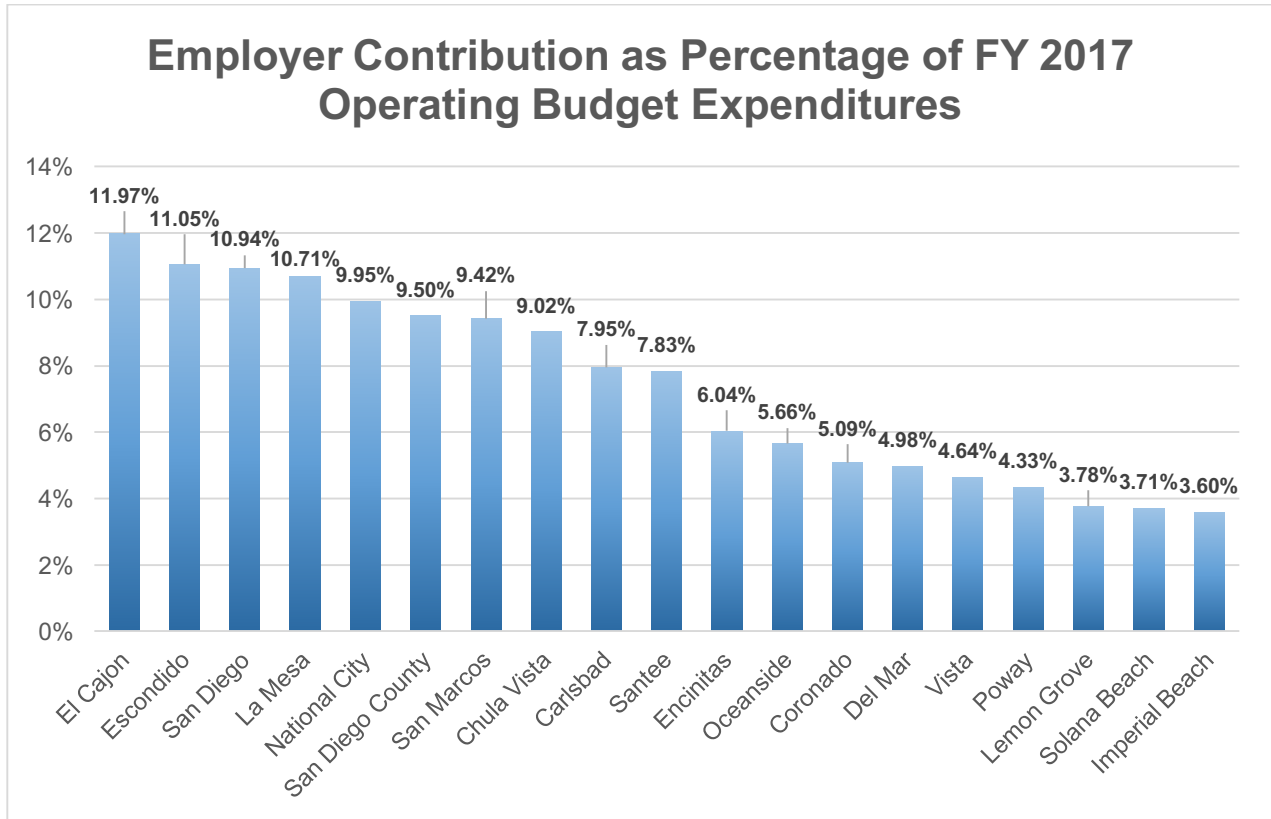


Each city’s employer pension costs have increased since the previous year by between 6.01% and 14.67%, with some exceptions. Carlsbad and the City of San Diego saw 33.17% and 24.28% increases in employer contributions, respectively. Some of these changes can be accounted for by differences in high expected or budgeted contributions and lower actual contribution values at the end of the fiscal year. San Diego saw a large increase in employer contributions due to changes in

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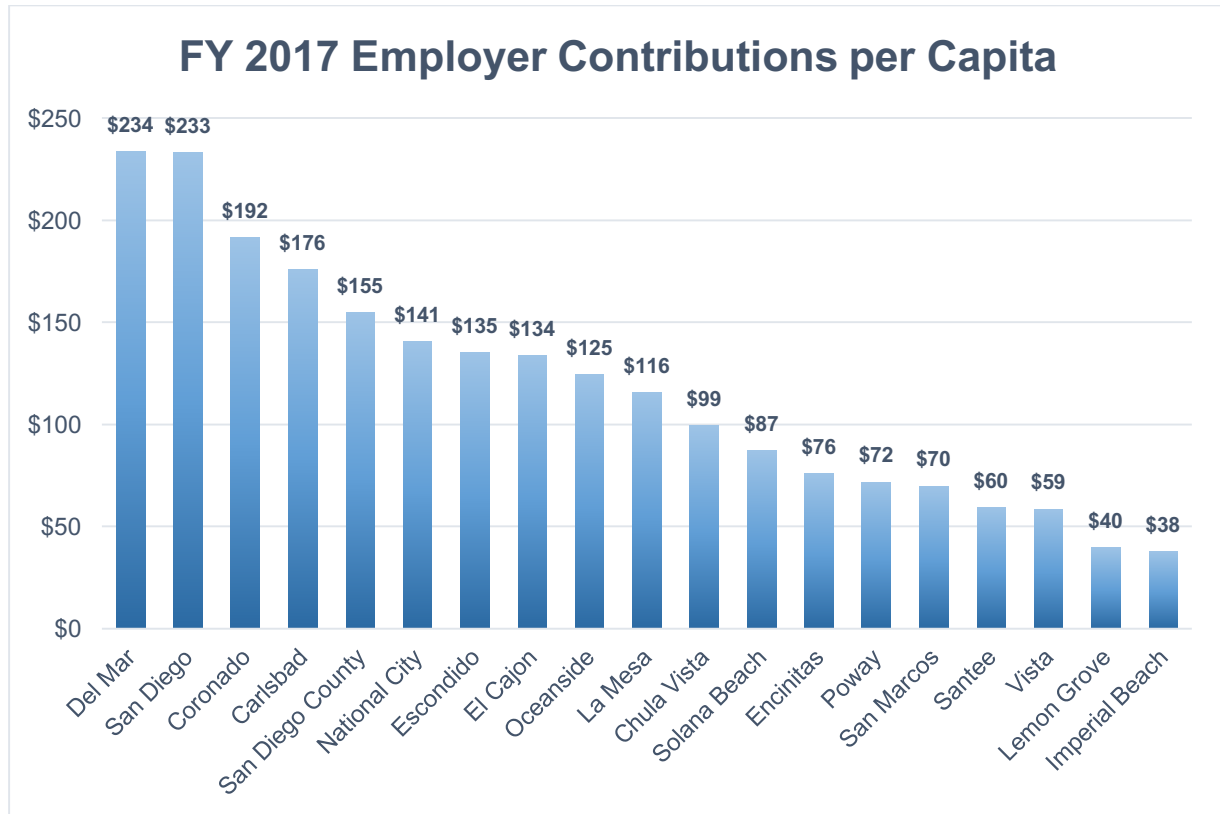
actuarial assumptions of employee life expectancy requiring greater city contributions to fund benefits. Vista saw a modest 1.91% increase, and Santee saw a decrease of 2.90%.



El Cajon, Escondido, San Diego, and La Mesa had the highest pension costs as a percentage of their budget, with employer contributions totaling nearly 11-12% of budgeted expenditures. Lemon Grove, Solana Beach, and Imperial Beach each had the lowest relative pension costs, each more modestly under 4% of budgeted expenditures.

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Alternatively, Del Mar, San Diego, and Coronado had the highest total employer contribution per capita, each with over \$190 in fiscal year 2017 pension costs per capita. Lemon Grove and Imperial Beach each had the lowest employer costs per capita, with \$40 or less per resident.

Summary

Through its analysis, SDTEF found that Del Mar, Coronado, National City, San Diego, and Carlsbad had both the highest net pension liabilities per capita and the highest employer pension costs per capita. At the same time, Coronado and Carlsbad both have seen some of the best improvement in their funded ratios over the last five years, indicating marked effort to address the problem of unfunded pension benefits. Alternatively, Vista, Santee, Imperial Beach, and Lemon Grove consistently had both the lowest per capita net pension liabilities and employer pension costs. However, Imperial Beach, Santee, and Lemon Grove saw decreases or only modest improvements in funded status over the examined five-year period. San Marcos had relatively low per capita net pension liability and employer pension costs, as well as the highest increase in weighted average funded ratio over the period.

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Nine cities in San Diego County contract with the San Diego County Sheriff's Department for law enforcement services: Del Mar, Encinitas, Imperial Beach, Lemon Grove, Poway, San Marcos, Santee, Solana Beach, and Vista. The pension benefits of these law enforcement officers are administered by the County through SDCERA, and not through the cities themselves. All of these cities with the exception of Del Mar had the lowest NPL per capita and employer contribution per capita in comparison to the other cities in the county who must provide pension benefits to a police employee group. The absence of a police employee group would naturally save these cities pension costs, especially as safety employees tend to receive the most generous pension benefits offered. While Del Mar consistently had some of the highest costs per capita despite the absence of its own police department, it should be noted that the city has the smallest population of all the cities studied. Each government, regardless of population, needs to employ an appropriate number of employees to provide the services necessary to operate the city. While there is no definition of an "appropriate" number of employees, this is a factor cities should consider when evaluating their pension obligations.

All the cities examined in this study offer one or more 457 deferred compensation plans through ICMA-RC or another financial services corporation to employees wishing to participate. A 457 plan allows employees to supplement their pension through contributions to an account, the value of which depends on contributions and investment returns as in a defined contribution plan. Of all the cities in San Diego County, only the City of San Diego offers employees a defined contribution basic retirement plan.

^{viii} Connie Spinelli, "GASB's New Pension Standards," *BKD, LLP*, 2013, <http://www.bkd.com/docs/pdf/GASB-67-and-68.pdf>.

^{ix} M. Iqbal Odawally and Steven Haberman, "Pension Plan Asset Valuation Methods," *Pension Forum*, 13, 1 (2001): 51-60, <http://openaccess.city.ac.uk/14284/9/Owadally%20Pension%20plan%20asset%20valuation.pdf>.

^x David Harper, "Financial Statements: Pension Plans," *Investopedia*, <http://www.investopedia.com/university/financialstatements/financialstatements9.asp>.

^{xi} "The 80% Pension Funding Standard Myth," *The American Academy of Actuaries*, July 2012, https://www.actuary.org/files/80_Percent_Funding_IB_071912.pdf.

^{xii} Marc Joffe, "California City Pension Burdens," *California Policy Center*, February 17, 2015, <http://californiapolicycenter.org/california-city-pension-burdens>.

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Conclusion

Every city throughout the County has implemented reforms to their pension programs that have resulted in positive improvements to long-term fund stability. It is important that our public employers work to address increasing pension liabilities head-on to reduce pressure on their budgets in the long-run. With this in mind, the San Diego Taxpayers Educational Foundation is offering three recommendations to best address the region's growing pension obligations.

Recommendation #1: Offer Defined Contribution Retirement Plans

SDTEF believes that offering 401(k)-style defined contribution retirement plans with an employer match to new employees would be a further step toward protecting retirement benefits for future employees while reducing the risk to city budgets. Though pension benefits are primarily funded by investment returns, taxpayers still pay the cost of employer contributions to pension funds. Because employers are responsible for keeping benefits funded throughout the life of the recipient even when faced with underperforming investments, taxpayers are then left with the risk of defined benefit plans. In a defined contribution plan, employees bear the risk of investment and retirement benefits are dependent on responsible contributions from both the employee and employer. Cities could still provide a generous match to a defined contribution plan, as in the City of San Diego, to ensure our public servants are set up for a happy and healthy retirement.

Recommendation #2: Elimination of Employer-Paid Member Contributions

As previously discussed, PEPRA eliminated the payment of EPMCs for "new" members hired on or after January 1, 2013. SDTEF recommends that cities additionally eliminate EPMCs for "classic" members hired before this date. Many cities throughout the County have already taken this step, but several continue to offer this benefit to members in a higher tier of retirement benefits. If cities were to require all employees to pay the full normal member contribution to the retirement fund instead of picking up some of the cost, this could result in significant employer savings over time.

Recommendation #3: Pay Off Unfunded Liability as Soon as Possible

Cities can save costs by paying off their unfunded pension liabilities as soon as possible. As with any other debt, paying down liability early on will avoid some of the high costs added by interest and result in lower payments over time. Eliminating unfunded liability will help lower yearly contribution rates, helping cities avoid the need for future tax increases and/or cuts to important community services. It is important that governments do all they can to address increasing pension liabilities without letting the burden fall heavily on taxpayers or those who most need important public services.

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Description of Criteria

Unfunded Actuarial Accrued Liability (UAAL): The difference between the actuarial value of assets and the actuarial accrued liability.

- *Desired Taxpayer Takeaway:* This metric demonstrates the amount in dollars of unfunded retirement benefits promised to the retirees/beneficiaries of each entity. This measure uses a valuation of assets where gains and losses are smoothed over time. It is important to consider the UAL relative to the size of the government and budget.

One Year Change in Unfunded Actuarial Accrued Liability (UAAL): The change from fiscal year 2014 to fiscal year 2015 of each plan's unfunded actuarial liability).

- *Desired Taxpayer Takeaway:* This metric demonstrates whether trends show that the city's unfunded benefit levels have improved or worsened.

Net Pension Liability (NPL): The difference between the employer's total pension liability and the pension plan's net position measured at fair value.

- *Desired Taxpayer Takeaway:* This metric demonstrates the amount in dollars of unfunded retirement benefits promised to the retirees/beneficiaries of each entity. This measure uses a valuation of assets where gains and losses realized in each fiscal year. It is important to consider the NPL relative to the size of the government and budget.

Net Pension Liability (NPL) Per Capita: NPL per capita was taken by dividing the entity's NPL by the total population of the city/county.

- *Desired Taxpayer Takeaway:* This metric demonstrates the total pension liability per person for which each entity is responsible. This can help taxpayers compare different-sized governments and view pension costs as they relate to individuals.

Weighted Average of Funded Ratio: The weighted average of the ratio of the Actuarial Valuation of Assets to the Actuarial Accrued Liability. The weighted average was taken by multiplying each plan's FR by the proportional size of that plan (in relation to the total number 2015 active employees, retirees, and beneficiaries) and finding the sum.

- *Desired Taxpayer Takeaway:* This metric demonstrates the ratio of funded retirement benefits promised to the retirees/beneficiaries of each entity. This makes it easy to compare the status of pension plans regardless of size.

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Weighted Average of Five-Year Change in Funded Ratio: The weighted average of the five-year change (or change across the greatest number of years under five for which data is available) of each plan's funded ratio. The weighted average was taken by multiplying each plan's change in funded ratio by the proportional size of that plan (in relation to the total number 2015 active employees, retirees, and beneficiaries) and finding the sum.

- *Desired Taxpayer Takeaway:* This metric demonstrates whether the ratio of funded retirement benefits promised to the retirees/beneficiaries of each entity is improving or worsening over time.

Cumulative Cost to Terminate CalPERS @ 3.25%: The cumulative total hypothetical termination liability for each of the entity's plans, estimated with a discount rate of 3.25%.

- *Desired Taxpayer Takeaway:* This metric demonstrates the total amount that an entity must pay to remove all employee groups from CalPERS.

Cumulative Termination Cost as a Percentage of Budget Expenditures: The cumulative hypothetical termination liability for each of the entity's plans as a percentage of the entity's estimated budget expenditures for FY 2017.

- *Desired Taxpayer Takeaway:* This metric demonstrates the total amount per person that an entity must pay to remove all employee groups from CalPERS. This can help taxpayers compare the cost over different sized governments.

Total Employer Contribution Amount: The cumulative total of the amount the entity must pay as the employer contribution toward employee retirement benefits for each plan in fiscal year 2017. This amount was estimated by CalPERS, SDCERA, or SDCERS as a percentage of projected payroll and includes both employer normal cost and contributions to pay off unfunded liability.

- *Desired Taxpayer Takeaway:* This metric demonstrates the total amount each entity is required to contribute to retirement benefits for FY 2017.

One Year Change in Pension Cost: The change in the cumulative total amount the entity had to pay as an employer contribution toward employee retirement benefits between fiscal years 2016 and 2017.

- *Desired Taxpayer Takeaway:* The metric demonstrates whether short-term trends show that the city's pension cost is increasing or decreasing.

Pension Cost Per Capita: Pension cost per capita was taken by dividing the entity's total employer contribution amount by the total population of the city/county.

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- *Desired Taxpayer Takeaway:* This metric demonstrates the total city pension contribution per person. This can help taxpayers compare different-sized governments and view pension costs as they relate to individuals.

Pension Cost as a Percentage of Budget Expenditures: The ratio of the total employer contribution amount to the total estimated revenue for fiscal year 2017.

- *Desired Taxpayer Takeaway:* This metric demonstrates the amount each entity is required to contribute to pension benefits as a percentage of total revenue. This helps taxpayers compare different-sized governments.

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Glossary of Terms

Actuarial Value of Assets (AVA): Amount of the plan's assets, which incorporates investment gains and losses using a designated asset valuation method. This allows short-term volatility of the market value of assets to be smoothed by adding the full value of gains/losses to the actuarial value over a defined period (generally 3-5 years). This contrasts to the fair value, where the full amount of investment gains and losses is recognized in the value of assets at the end of the fiscal year.

Actuarial Accrued Liability (AAL): The present value of future benefits earned to date by employees.

Benefit Factor: A percentage of final compensation earned for each year of service, usually between 2% and 3%.

Benefit Formula: The formula which calculates the amount of retirement benefits that an employee will receive based on based on years served, final compensation, and a benefit factor.

CALPERS: The California Public Employees' Retirement System is a California government agency established in 1931 that manages the defined benefit pension plans of over 1.7 million public employees, retirees, and beneficiaries. The current market value of total CalPERS funds is approximately \$295 billion.

Defined Benefit Plan: A pension plan into which employees and employers make annual actuarially determined contributions, where the level of benefit received at retirement is defined regardless of investment returns. The employer bears the risk of investment.

Defined Contribution Plan: A pension plan into which employees make annual fixed (dollar or percentage) contributions, where the level of benefits received at retirement is based on contributions and investment returns. The employee bears the risk of investment.

Discount Rate: Calculated based on the fund's expected long-term investment returns. The discount rate is used to calculate pension obligations and annual plan contributions.

Employer-Paid Member Contribution: Members who participate in their employer's pension plan must contribute a percentage of their salary toward their pension. Previously, employers were able to pay all or a portion of the member contribution on behalf of the employee. These EPMCs were often reported as a salary increase to CalPERS, thereby increasing pensionable compensation for the employee and increasing future retirement benefits.

Fair Value of Assets (Market Value): The full amount of investment gains and losses is recognized in the value of assets at the end of the fiscal year. This contrasts with actuarial value, where short-term volatility of the market value of assets is smoothed by being added to the actuarial

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value over a defined period (generally 3-5 years). Plans appear stronger during times of growth and weaker during times of loss with fair valuation.

Final Compensation: Generally either the average highest consecutive 12 or 36 months of salary, used in the benefit formula to determine retirement benefits. PEPRA requires that all new members' final compensation be calculated for a period of at least 36 consecutive months.

Funded Ratio: The ratio of the value of the plan's assets to the present value of future benefits owed to employees, retirees, and beneficiaries.

Hypothetical Termination Liability: The hypothetical pension obligation that an employer would have to pay upfront if it chose to terminate its CalPERS membership. This value is calculated with a lower discount rate than NPL in order to more accurately represent market conditions and guarantee that the funds be paid even if investment returns are low. The discount rate used to calculate hypothetical termination liability depends on the duration of the plan's liabilities and actual market rates of return on the date of termination.

Net Pension Liability (NPL): The difference between the employer's total pension liability and the pension plan's net position measured at fair value.

Normal Cost: The annual cost of funding future retirement benefits earned by members in a particular year.

Pension Plan Net Position: Assets set aside in a trust to pay pension benefits to employees, retirees, and beneficiaries

SDCERA: The San Diego County Employees Retirement Association, established in 1937, administers defined benefit pension plans for County employees and other participating members.

SDCERS: The San Diego City Employees' Retirement System, established in 1927, administers defined benefit pension plans for City employees.

Total Pension Liability: Present value of future benefits already earned by plan participants

Unfunded Actuarial Accrued Liability (UAAL): The difference between the actuarial value of assets and the actuarial accrued liability.

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