Midpeninsula Regional
Open Space District

R-16-78
Meeting 16-14
June 22, 2016

AGENDA ITEM 7

AGENDA ITEM

Authorization to Reduce the District's Unfunded Pension Liability by Making a $3 Million Pre-Payment to the California Public Employees Retirement System (CalPERS)

CONTROLLER'S RECOMMENDATION

Authorize the General Manager to deposit $3 Million into the Midpeninsula Regional Open Space District's (District) CalPERS account, in order to reduce the District's unfunded pension liability.

SUMMARY

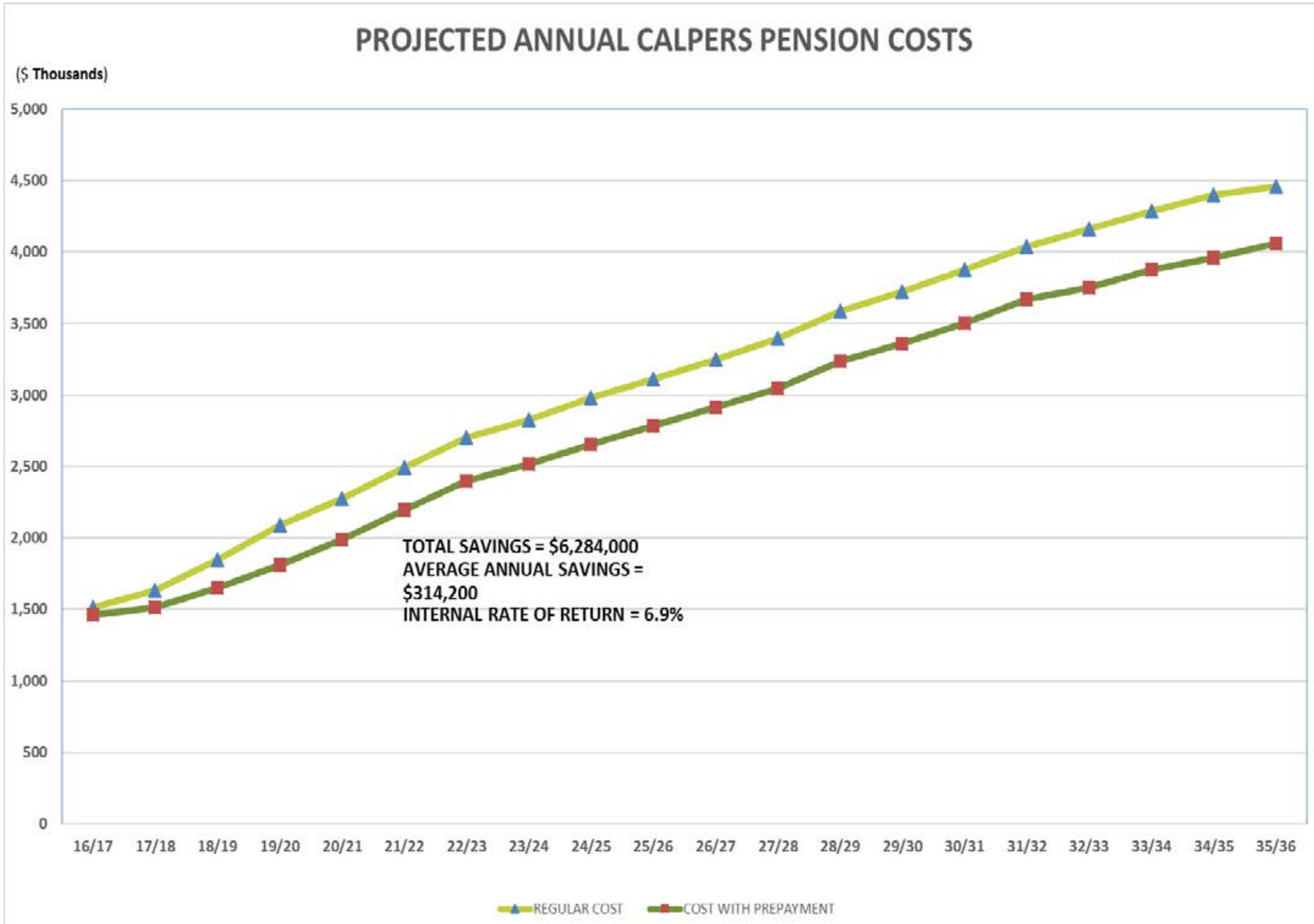
After receiving our June 30, 2014 Annual Valuation Report from CalPERS in January 2016, the District contracted with our actuary, Bartel Associates, to analyze the potential benefits of making a $2 to $3 Million pre-payment to reduce the unfunded liability. Bartel's report confirmed that the projected future savings are significant -- estimated savings of $6.3 Million over twenty years on a $3 Million pre-payment ($3.3 Million net savings).

DISCUSSION

In January 2016, the District received its CalPERS Annual Valuation Report as of June 30, 2014. As of June 2014, the District' CalPERS account had an actuarial liability of $47.5 Million and held assets with a market value of $38.6 Million. Hence, the District's unfunded liability was $8.9 Million, or a funded ratio of 81.3%. This was well above average, as the average CalPERS funded ratio was 73.3%.

CalPERS investment returns have contracted since June 2014, reporting only a 2.4% return in the year ending June 2015 and very likely earning well under the 7.5% target this fiscal year. We estimate that our unfunded pension liability will have increased to at least $14 Million by June 2016, probably reducing the District's funded ratio to around 75%. Importantly, these calculations assume future CalPERS investment returns of 7.5% per year. However, in November 2015, CalPERS announced a new de-risking policy, under which it will shift its asset allocation to less volatile investments and gradually reduce the assumed rate of return to 6.5% over twenty years. Depending on how fast this transition occurs, the District's current adjusted funded ratio is probably under 70%. The consequence of this policy change and inadequate recent investment returns will be rapidly escalating CalPERS charges. Our actuary projects District CalPERS charges, for our current payroll level escalated 3% per year, will increase approximately 6% per year for the next twenty years. Put another way, CalPERS charges as a percent of payroll are projected to increase from 14.7% in FY2015-16 to 26.4% in FY2031-32.

One way to mitigate the scale of these projected pension expense increases is to pay down the unfunded liability with pre-payments. CalPERS is actively encouraging its clients to consider such pre-payments. Bartel's analysis of a $3 Million pre-payment, illustrated in the chart below, projects savings of $6.3 Million over the next twenty years, generating a 6.9% annual return on investment. This return is clearly higher than the District could otherwise earn on its general fund cash. By comparison, the Santa Clara County Pooled Investment Fund has earned a compounded return of 3.2% over the last twenty years (2.0% over the last ten years). A $3 Million pre-payment would also increase the District's funded ratio by some five percentage points—a clear benefit to the employees.



During FY2016-17, we intend to investigate additional advance retirement plan funding, potentially utilizing other trust programs, i.e. non-CalPERS, that are being introduced. However, we recommend that the District move forward now with an initial $3 Million pre-payment, directly to CalPERS, for reduction of its unfunded pension liability.

BOARD COMMITTEE REVIEW

This item was not reviewed by any Committee.

FISCAL IMPACT

The District actuary estimates net savings in retirement plan payments of $56,000 in FY2016-17 and $3.3 Million over the next twenty years.

PUBLIC NOTICE

Public notice was provided pursuant to the Brown Act. No additional notice is required.

CEQA COMPLIANCE

The recommended action is not a project for purposes of the California Environmental Quality Act.

NEXT STEPS

None.

Prepared by:
Mike Foster, Controller