County Connection

INTER OFFICE MEMO

To: Board of Directors **Date:** January 16, 2020

From: Erick Cheung
Chief Finance Officer

SUBJECT: PERS Actuarial Valuation for June 30, 2018; Rate for FY 2021, Pension Funding Policy

SUMMARY OF ISSUES:

The CalPERS Actuarial Valuation Report (Report) for the period ending June 30, 2018 is used to set the contribution rate for the 2021 fiscal year and provides County Connection's funded status. According to the Report, **the required employer contribution rate for FY 2021 consists of 8.785% of payroll, plus an unfunded liability payment of $537,865.** County Connection's funded status is currently **89.8% funded,** which is down from 91.5% in last year's actuarial report. CalPERS' actual investment rate of return for 2018 was 8.6%, which was greater than the assumed rate of return (or "discount rate") of 7.0% (lowered by CalPERS from 7.5% in phases since 2016).

The attached Pension Funding Policy will establish a process for County Connection to make additional discretionary payments to CalPERS to address its unfunded pension liability, subject to budgeting considerations, and is intended to result in overall savings in pension costs.

The A&F Committee accepted the report on the updated PERS Actuarial Valuation Report. The Committee also recommended approval of the Pension Funding Policy.

<u>CalPERS Assumptions & Projections</u>

The updated projections shown below will be used for the budget and 10 year forecast. The revised unfunded liability payments are slightly lower as CalPERS rate of return was 8.6% for FY 2018. As shown in the table, the payments for unfunded liability payments over the next 6 fiscal years are down slightly by $160,135 (assuming assumptions are met in future years). CalPERS has recently announced the actual investment return was 6.8% in FY 2019, which is less than 7.0% and will bring these rates probably closer to the prior forecast.

Below are the CalPERS current projections compared with the prior projections:

	Current			Prior Forecast			Difference		
	Payroll Rate	+	Unfunded Liability Payment	Payroll Rate	+	Unfunded Liability Payment	Payroll Rate	+	Unfunded Liability Payment
FY 2020 Actual	8.313%		$ 349,903	8.313%		$ 349,903	n/a		n/a
FY 2021	8.785%		$ 537,865	8.900%		$ 548,000	-1.292%		$ (10,135)
FY 2022	8.800%		$ 741,000	8.900%		$ 762,000	-1.124%		$ (21,000)
FY 2023	8.800%		$ 897,000	8.900%		$ 928,000	-1.124%		$ (31,000)
FY 2024	8.800%		$ 937,000	8.900%		$ 980,000	-1.124%		$ (43,000)
FY 2025	8.800%		$ 1,017,000	8.900%		$ 1,072,000	-1.124%		$ (55,000)
FY 2026	8.800%		$ 1,045,000	8.900%		n/a	-1.124%		n/a
Unfunded Liab Payment Total			$ 5,524,768						
Unfunded Liab Payment Total FY 2020-FY2025			$ 4,479,768			$ 4,639,903			$ (160,135)

Estimates of future employer contribution rates are based on the following assumptions used by CalPERS:

- Future investment returns of 7.00%.
- Payroll growth of 2.75%.
- Inflation growth of 2.50%.
- Demographic assumptions including the percentage of terminated, retired and deceased employees in each future year.

Several pages of the actuarial report are attached.

<u>Plan's Funded Status, Based on Market Value of Assets (Page 5 Actuarial Report)</u>

As stated earlier, the current funded status of County Connection's CalPERS pension plan is 89.8% with the unfunded liability totaling $10.2 million. The prior year funded status was 91.5%, with the unfunded liability of $7.8 million. The unfunded accrued liability (UAL) increased by $2.4 million due to CalPERS' updating their financial system and the reduction in the discount rate from 7.25% to 7.00%.

It is CalPERS' policy to use a constant investment return rate for the actuarial report rather than the actual rate of return. This is called *asset smoothing*- the delayed recognition of part of the investment gains or losses mitigates the effect of short-term market value fluctuations in setting employers' rates. Prior to fiscal year 2019, CalPERS amortized all gains and losses over a fixed 30-year period, which was smoothed by ramping up/down the increase or decrease over a 5 year period. This method is referred to as "direct rate smoothing." Beginning this fiscal year, the CalPERS Board approved amortizing gains/losses over a 20-year period based on a level dollar amount. In addition, the new policy removes the 5 year ramping on UAL bases attributable to assumption changes and non-investment gains/losses. Finally, CalPERS uses the market value rather than the actuarial value of assets in determining the pension plan's funded status .

The CalPERS history of investment returns is shown on Page 11 of the actuarial report.

Other Plan Information

- There are 197 retirees receiving benefits.
- The average annual benefit is $17,792.
- The average age of retirees is 70.32.
- There are 251 active members.
- The average annual payroll of the active members is $59,089.
- The covered annual payroll is $14,831,366.
- The average age for active members is 51.25.
- Pages C-1 & C-2 include a breakdown of the active members by age and salaries & years of service. As of June 30, 2018, 25% or 63 employees were over 60 years of age.

Options to Reduce Pension Liability

Staff has been considering options to reduce the unfunded pension liability -- including the establishment of an Internal Revenue Code Section 115 Pension Trust to fund additional payments to CalPERS. The Section 115 Pension Trust Fund has been adopted or considered by many agencies throughout California including some of our member agencies. As we discussed last year and more recently in July (PARS update item), the Section 115 Pension Trust is currently not an option for County Connection because we are heavily funded by grants allocated by Metropolitan Transportation Commission (MTC). These funds include Transportation Development Act 4.0 (TDA 4.0 revenue is from sales tax) and State Transit Assistance (STA revenue is from sales tax on diesel) and represent about 60% (based on FY2020 budget) of our total revenue. These revenue sources must be used for current operations and/or capital. If we were to open and deposit funds in the Section 115 Pension Trust, under current accounting rules, we could not expense those contributions as we do for pension costs. This transaction would be similar to a transfer from a checking account to a savings account. Since we are so heavily grant funded, MTC could request and we would be required to spend and/or return these funds, because depositing them in a Section 115 Trust would mean they were not being used for current operations and/or capital expense.

CalPERS provides two options to reduce the liability: 1) amortizing the debt on a shorter basis (i.e. 15 years or 10 years), which it calls a “Fresh Start” (see CalPERS Actuarial Report PP18) and 2) paying one time additional payments. The Fresh Start is similar to refinancing a home mortgage from 30 years to 15 years, but unlike a home mortgage, once you decide to begin a Fresh Start it cannot be undone. If an agency believed they could make the scheduled payments today, but due to financial or economic changes (i.e. CalPERS lowering discount rate) were no longer able to make the Fresh Start payments, CalPERS cannot reverse nor refinance the Fresh Start. Also, County Connection doesn’t have additional funding that it could provide to pay for the Fresh Start amounts other than drawing down on reserves or reducing service. Thus, the Fresh Start option is not viable for County Connection.

The only viable option for County Connection is to directly make additional discretionary payments to CalPERS to reduce the pension liability, on an ad hoc basis. In the past, this option was not available to us because we were over 100% funded through FY 2011. Even as recent as FY 2017, County Connection was 99.9% funded. The CalPERS Board has made changes in the last few years, from updating mortality rates, changing how it amortizes gain/losses, and most importantly lowering the discount rate from 7.5% to 7.0%. Staff informed the A&F Committee of these changes as they occurred and subsequently these changes have reduced our funding level to 89.8% or an unfunded liability of $10.2 million. Therefore, paying CalPERS directly by making additional discretionary payments to lower the unfunded liability is now an option available to County Connection, since we are currently not fully funded.

The respective gains/losses (table below *or see PP16 of PERS Actuarial Report if table is difficult to read*) represent our asset/liability each fiscal year at that point in time and total $10.2 million as of 6/30/18. Each fiscal year has its own bases and will include an addition of future gains or losses and assumption changes.

CalPERS Actuarial Valuation - June 30, 2018
Miscellaneous Plan of the Central Contra Costa Transit Authority
CalPERS ID: 2146548042

Schedule of Amortization Bases

Reason for Base	Date Established	Ramp Up/Down 2020-21	Escalat-ion Rate	Amorti-zation Period	Balance 6/30/18	Expected Payment 2018-19	Balance 6/30/19	Expected Payment 2019-20	Balance 6/30/20	Scheduled Payment for 2020-21
FS SURPLUS TO 30 YEARS	06/30/14	No Ramp	2.750%	26	$(104,746)	$(6,436)	$(105,421)	$(6,612)	$(105,961)	$(6,684)
(GAIN)/LOSS	06/30/15	80% ↗	2.750%	27	$4,009,331	$108,187	$4,178,075	$166,740	$4,298,063	$224,806
ASSUMPTION CHANGE	06/30/16	60% ↗	2.750%	18	$1,637,074	$30,892	$1,719,714	$63,476	$1,774,434	$96,609
(GAIN)/LOSS	06/30/16	60% ↗	2.750%	28	$5,623,125	$78,030	$5,936,029	$160,361	$6,185,672	$243,089
ASSUMPTION CHANGE	06/30/17	40% ↗	2.750%	19	$1,084,552	$(41,412)	$1,203,308	$22,729	$1,264,028	$46,093
(GAIN)/LOSS	06/30/17	40% ↗	2.750%	29	$(3,820,283)	$0	$(4,087,703)	$(56,791)	$(4,315,097)	$(114,702)
METHOD CHANGE	06/30/18	20% ↗	2.750%	20	$488,090	$6,248	$515,793	$6,420	$545,258	$10,166
ASSUMPTION CHANGE	06/30/18	20% ↗	2.750%	20	$2,626,857	$(95,855)	$2,909,890	$(98,491)	$3,215,462	$59,951
(GAIN)/LOSS	06/30/18	20% ↗	2.750%	30	$(1,372,583)	$0	$(1,468,664)	$0	$(1,571,470)	$(21,463)
TOTAL					**$10,171,418**	**$79,654**	**$10,801,021**	**$257,832**	**$11,290,389**	**$537,865**

If County Connection made additional discretionary payments to CalPERS, we would be required to notify CalPERS of the additional payment and direct which amortization bases to reduce by applying the payment. For example, an additional payment of $50 thousand a year over 10 years against the loss in 6/30/2016 would provide savings of $542 thousand in interest payments based on CalPERS amortization tables. Obviously, if County Connection were able to make larger additional discretionary payments to CalPERS, there could be increased savings in interest payments. Staff believes the long-term benefits of making additional discretionary payments to CalPERS, when the budget permits, outweigh the risk of a potential decrease in fare box ratio that could result in any given fiscal year.

Also, staff has discussed with CalPERS staff how the bases amount could be changed by the CalPERS Board as reflected below:

1. If CalPERS discount rates were decreased, this would cause an assumption change and increase the liability for the year of implementation. The bases liability would not change but slightly decrease the payments since the rate for previous bases would be lower. For example, if the CalPERS Board approved lowering the discount rate to 6.75% in FY 2020, this change would cause a FY 2020 Assumption Change liability in the FY 2020 bases. But it would also slightly reduce the previous payments on previous year's unfunded liability bases since the interest rate is now lower.
2. If CalPERS were to decrease the escalation rate (aka salary growth rate) of 2.75% to a lower rate, this would cause a slight gain in year of implementation, but would slightly increase the payments on previous year's unfunded liability bases. CalPERS staff noted that if the escalation rate were lowered, it is likely that the discount rate would be lowered.

Making additional discretionary payments to CalPERS when the budget permits would decrease the overall amount paid to CalPERS over time by improving the funding percentage and avoiding additional liability related to underfunding that accrues over time. It's a reasonable goal to make smaller one time payments (as noted in the example earlier) and achieve interest savings over time. The following is a framework of how those additional payments could be made under the proposed Pension Funding Policy:

1. If the estimate for pension related costs is less than the previously budgeted amount as of the annual budget presentation each May, and making an additional payment to CalPERS would not require a draw on the contingency, nor additional TDA allocations; the Pension Funding Policy allows the General Manager to authorize additional payments to CalPERS up to $100,000.
2. The Pension Funding Policy further provides that additional payment amounts over $100,000 could be recommended by staff and approved by the A&F and Board as part of the May budget review.

3. Under the Policy, any additional payments made by County Connection to CalPERS would be excluded from total pension costs in the Wage Increase determination performed by the auditors each year. Accordingly, the amount of any additional payment to CalPERS will not be included in determining whether there was an increase in total pension costs of $1,000,000 for that fiscal year, and would not affect whether an increase in pension costs triggers a reduction of wage increases.

FINANCIAL IMPLICATIONS: These rates will be used for the Fiscal Year 2021 Budget and Forecast. Staff will notify the Board through the budget process of any additional payments to CalPERS, if the Pension Funding Policy is approved by the Board.

ACTION REQUESTED: A&F Committee recommend approval of the Resolution and Pension Funding Policy to the Board.

ATTACHMENTS:

A. Selected pages of the PERS valuation report.
B. Resolution for adopting Pension Funding Policy
C. Pension Funding Policy

RESOLUTION NO. 2020-014

BOARD OF DIRECTORS CENTRAL CONTRA COSTA TRANSIT AUTHORITY
STATE OF CALIFORNIA

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ADOPTING THE CCCTA PENSION FUNDING POLICY

WHEREAS, the County of Contra Costa and the Cities of Clayton, Concord, the Town of Danville, Lafayette, Martinez, the Town of Moraga, Orinda, Pleasant Hill, San Ramon and Walnut Creek (hereinafter "Member Jurisdictions") have formed the Central Contra Costa Transit Authority ("County Connection"), a joint exercise of powers agency created under California Government Code Section 6500 *et seq*., for the joint exercise of certain powers to provide coordinated and integrated public transportation services within the area of its Member Jurisdictions;

WHEREAS, County Connection is contracted with CalPERS to provide a defined benefit pension plan;

WHEREAS, CalPERS issues an actuarial report ("Report") each year to inform County Connection of the funded status of the defined benefit pension plan, and if County Connection is underfunded, CalPERS provides an unfunded liability amount, which must be paid separately from the rates required to be paid by County Connection the following fiscal year;

WHEREAS, County Connection has paid the required contributions reflected in the Report, however, staff also wants to set up a process to make additional payments to provide interest savings under certain circumstances if County Connection is not fully funded;

WHEREAS, the Chief Financial Officer ("CFO") prepared a CalPERS pension funding policy ("Pension Funding Policy"), under which County Connection may directly make additional annual payments, to CalPERS to reduce County Connection's unfunded liability; and

WHEREAS, the Administration & Finance Committee and the CFO recommend that the Board of Directors adopt the attached Pension Funding Policy.

NOW, THEREFORE, BE IT RESOLVED that the Board of Directors of the Central Contra Costa Transit Authority hereby adopts the Pension Funding Policy, attached hereto, and authorizes the General Manager to take such actions as are reasonable and appropriate to implement the procedures necessary to enforce the policy.

Regularly passed and adopted this ___ day of January 2020, by the following vote.

AYES:

NOES:

ABSTENTIONS:

ABSENT:

____
Candace Andersen, Chair, Board of Directors

ATTEST:

____
Lathina Hill, Clerk to the Board

Central Contra Costa Transit Authority

PENSION FUNDING POLICY

1. Purpose

The purpose of this Central Contra Costa Transit Authority (County Connection) Pension Funding Policy (Policy) is to establish a procedure to fund County Connection's pension and make additional payments based on certain criteria assuming there is an unfunded liability.

2. CalPERS Pension Plan

County Connection is contracted with CalPERS to provide a defined benefit pension plan to eligible employees. CalPERS acts as the common investment and administrative agent for members participating in the plan. Benefit provisions under the defined benefit pension plan are established by State statue and County Connection Resolution, and as set forth in County Connection's contract with CalPERS.

3. Funding

CalPERS issues an actuarial report (Report) each year to notify County Connection of the funded status of the defined benefit pension plan and the contribution rates that are required to be paid by the Employer and Employee for the following fiscal year based on the plan's funded status. Also, if County Connection is underfunded based on the Report, CalPERS provides an unfunded liability amount that is owed to CalPERS, which must be paid separately from the rates. County Connection pays the required payroll contributions and unfunded liability payments reflected in the Report each year. By adopting this Policy, County Connection establishes a process to make additional discretionary payments to CalPERS to provide interest savings under certain circumstances, in the event the County Connection pension plan is not fully funded for any fiscal year.

4. Procedure for additional unfunded liability payments

The CFO shall recommend annually to the General Manager additional payments to CalPERS in the event the County Connection CalPERS pension plan is not fully funded and the payments will provide overall savings to County Connection.

The amount of the additional payment will be based on the following:

a. If the estimate for pension related costs is less than the previously budgeted amount as of the annual budget presentation each May, and making an additional payment to CalPERS would not require a draw on the contingency fund, nor additional TDA allocations, the General Manager may authorize additional payments to CalPERS up to $100,000.
b. Additional payment amounts over $100,000 may be recommended by staff and approved by the A&F Committee and Board as part of the annual budget review each May.

The amount of any additional payments made by County Connection to CalPERS would be excluded for purposes of the Wage Increase determination performed by the auditors each year. The Wage Increase provision is included in the Memorandum of Understanding with County Connection's bargaining groups and provides that wage increases can be reduced to zero if certain conditions occur. One of those conditions is that the dollar amount County Connection paid to CalPERS for non-healthcare retirement benefits in the most recent closed fiscal year increased by $1,000,000 when compared to the dollar amount County Connection paid to CalPERS for non-healthcare retirement benefits in the previously closed fiscal year. County Connection's auditors prepare an Agreed Upon Procedures report each year to determine whether this condition has been met. The amount of any additional payment to CalPERS made in a fiscal year would not be included in total pension costs for purposes of making this determination.