CalPERS UNFUNDED PENSION LIABILITY STUDY

What is unfunded pension liability?

Unfunded pension liability is the gap between the amount of future benefits a pension fund is expected to pay out and the assets presently in the pension fund.

Why hasn't the Town fully funded its pension liability?

Although the Town has an unfunded pension liability, the Town is on relatively solid ground because it has made all pension contributions required by CalPERS (California Public Employees' Retirement System). The unfunded pension liability is a result of policy decisions made by CalPERS. At the end of the 1990s, the stock market was at an all-time high and optimism reigned among investors. At that time, CalPERS assumed future investment returns (that in retrospect were too high) and reduced the amount of payments it demanded from member cities. As a result, during those years, insufficient annual contributions were demanded and collected. Additionally, the volatility of CalPERS investment returns over the years, as well as increased life expectancies, have resulted in changes to CalPERS actuarial assumptions which have resulted in additional unfunded pension liability. CalPERS estimates the Town's unfunded pension liability as of June 30, 2018 to be $7.3 million.

How does the unfunded liability impact the Town?

CalPERS updates its five-year schedule of future unfunded liability payments annually. As a result of ongoing changes to CalPERS' assumptions, the performance of their portfolio, and their policy decision to ramp up payments to pay off the unfunded pension liability that has accrued, the payment amounts are projected to increase over the next five years. As of July 2019, CalPERS projects the Town's future annual contributions as follows:

FY 19/20	FY 20/21	FY 21/22	FY 22/23	FY 23/24	FY 24/25
$472,000	$554,000	$621,000	$664,000	$708,000	$728,000

Why did the Town contract for a CalPERS Actuarial Analysis?

The Council was concerned about the projected 54% increase in the annual unfunded pension liability payments scheduled to occur between this year and fiscal year (FY) 2024/25, and CalPERS' assumption of a 7% rate of return on investment (which may be unrealistic). The Town retained the services of Bartel Associates, Inc. to perform an actuarial analysis that assumes a more conservative (6.5%) rate of return, and to provide the Town with three potential scenarios for managing long term costs and volatility.

What did we learn from Bartel's CalPERS Actuarial Analysis?

Bartel used a 6.5% rate of return to calculate the Town's unfunded liability at $9.3 million, compared to CalPERS' calculation of $7.3 million, causing additional concern about the volatility of this liability. Bartel recommended the Town consider making additional contributions to a supplemental trust to level out annual contributions and mitigate year-to-year volatility. The three scenarios developed assume contributions over the next ten years to stabilize future payments as follows:

Scenario 1 – The Town would make a $1 million one-time contribution in FY 2020/21 to a supplemental trust. The trust would be used starting in FY 2026/27 to offset the increase in the annual payment, eliminating the additional impact on the budget between FY 2026/27 and FY 2036/37.

Scenario 2 – The Town would contribute an additional $250,000 annually towards unfunded pension liability. A portion of this amount would be used starting in FY 2021/22 to help cover the annual increases in the unfunded liability payments. The rest of this amount would be placed in a supplemental trust for use between FY 2026/27 and FY 2036/37 to provide additional relief from the increasing unfunded liability payments.

Scenario 3 – The Town would make a $100,000 annual contribution to a supplemental trust, to be used starting in FY 2030/31 to reduce the projected increase in liability payments.

What is being done by CalPERS to reduce pension costs?

Effective January 1, 2013, CalPERS implemented the Public Employees' Pension Reform Act (PEPRA), which added a second tier of lower benefits for new hires. PEPRA limits the total compensation included in the benefit formula and extends the retirement age to 62 for most employees (57 for public safety employees). PEPRA is being phased in as the workforce ages and new members join CalPERS. Approximately 40% of current Town staff are in the PEPRA plan, which has resulted in cost savings. It is expected to take 20 years for the full impact of this reduced benefit package to be realized.

What actions has the Town taken to manage its future pension obligations?

The Town offers one of the lowest pension benefit formulas in the State. The Town also uses a 3-year average to determine the salary upon which an employee's pension is calculated (as compared to other agencies which use the highest annual salary). The Town also negotiated with the employee bargaining groups for employees to pay a portion of the Town's pension obligation. This has resulted in significant savings, as the Town's pension contribution for most employees as a percent of salary is 6.5%, as compared to the 11.0% employee portion. For public safety employees, the Town contributes a maximum of 14.2% (comparable cities contribute 19.2%, on average) and police officers contribute 13.0%. Fortunately, the Town does not have any additional post-employment benefits, unlike many other public agencies.

Can the Town leave CalPERS and stop offering employees a defined benefit pension?

The Town could exit CalPERS. However, it would have to fully fund its pension obligations at an estimated cost of more than $50 million.

Questions or comments
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