Executive Summary

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[1,2]

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

1 A more detailed summary of methodology can be found at the conclusion of this report.

2 Bartel Associates used the existing CalPERS' discount rate and projections for local revenue growth. To the extent CalPERS market return performance and local revenue growth do not achieve those estimates, impacts to local agencies will increase. Additionally, the data does not take into account action pending before the CalPERS Board of Administration (Board) to prospectively reduce the employer amortization schedule from its current 30 year term to a 20 year term. Should the Board adopt staff's recommendation, employer contributions are likely to increase.

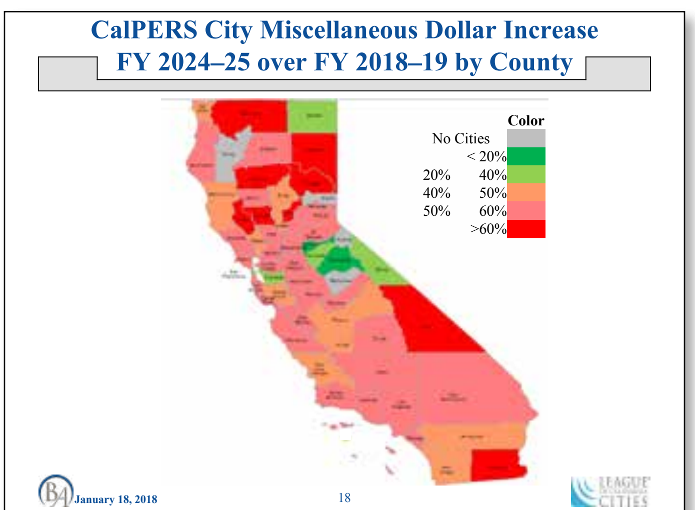
reform enacted by the Legislature in the Public Employees' Pension Reform Act (PEPRA) [applying to employees hired after January 1, 2013] materialize. However, tangible savings resulting from PEPRA will not have a substantial effect on city budgets for decades.

The League has created an online resource (www.cacities.org/pensions) to provide additional background and information for cities on this issue. Consistent with it's 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.

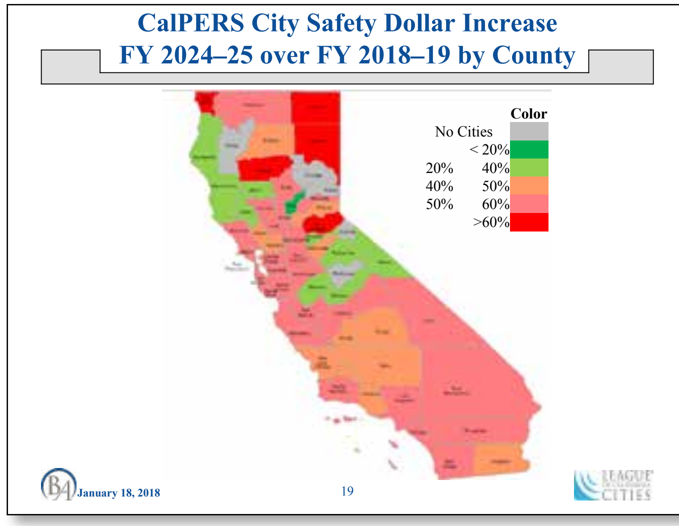
Key Findings[3]

1. 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.



In figures 9, 17, 18, and 19 the grey color representing "No Cities" displays that there are no cities in that specific county with CalPERS as their public retirement system.



FY 2024–25 Contribution Rates[1]

	Cities/Towns	
Percentile	Miscellaneous	Safety
90th	18.8%	35.2%
75th	25.2	44.8
50th	30.8	54.0
25th	37.7	63.8
10th	43.0	76.0

1 CalPERS projected rates adjusted for June 30, 2017 actual investment return and PEPRA.

Percentile means x% of cities have results that are higher than shown

January 18, 2018 20

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.

3 Complete findings can be found at the conclusion of this summary.

Primary Factors Contributing to CalPERS Funded Status

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CalPERS Several factors have contributed to unsustainability of the CalPERS system. While such factors should be acknowledged, it remains far more important that all stakeholders work collaboratively to craft a path forward to ensure a sustainable public pension system that also recognizes the public's need for reliable and adequate services. Based on the League of California Cities® Retirement Sustainability Study Findings, anecdotal evidence, and in consulatation with Bartel Associates, the League has identified five primary factors.

1. **Enhanced Benefits:** The most prominent source of the pension system's cost escalation began with enhanced pension benefits granted by state and local government employers following the passage of SB 400 and AB 616 in 1999 and 2000. Cities throughout California followed the state's lead in providing enhanced benefits and, when negotiated, statute required those enhanced benefits apply to both prior and future service. These enhanced benefits have caused a ripple effect that have fundamentally altered the way in which local agencies can retain employees and provide basic and critical services to the public.
2. **Investment Losses:** Fallout from the Great Recession played a pivotal role in CalPERS' lackluster investment returns. In 2008, CalPERS suffered a negative 27 percent return on investment — factoring in the 2008 discount rate (7.75 percent) results in a gross 34.75 percent impact to the fund. Moreover, CalPERS' outside investment advisors expect returns over the next decade will also be below anticipated returns. CalPERS projects that the projected market rate assumptions will yield a 6.1 percent return for the fund over the next decade. While it is widely known that CalPERS determines its discount rate, using a 60-year blended return to calculate its discount rate — 6.1 percent is well below the 7 percent assumption. Under the current statutory paradigm, public employers will assume the liability associated with this shortfall.
3. **Cost of Living Adjustments:** Automatic Cost of living adjustments (COLA) have continued to hamper CalPERS' ability to compound investment earnings, hampering growth. ***A Sept. 27, 2017 Sacramento Bee article*** states "CalPERS in the past has looked at how suspending COLA's would affect the pension fund. Freezing them would improve pension plans for public safety employees by up to 18 percent and for other employees by up to 15 percent, according to CalPERS." This potentially significant gain in funded status should not be overlooked.
4. **CalPERS Contribution Policy:** CalPERS contribution policy, most notably after the Great Recession, did not require agencies pay interest on accrued unfunded liability. While this shift in policy was an attempt to ease the burden on employers, the policy resulted in pushing unfunded liability payments to future taxpayers.
5. **Demographics:** The liability for retirees at most cities significantly exceeds that of actives. This creates more volatility and led to having a much bigger impact funded status (and ultimately contributions) than any prior downturn.