Retirement System Sustainability

A SECURE FUTURE FOR CALIFORNIA CITIES

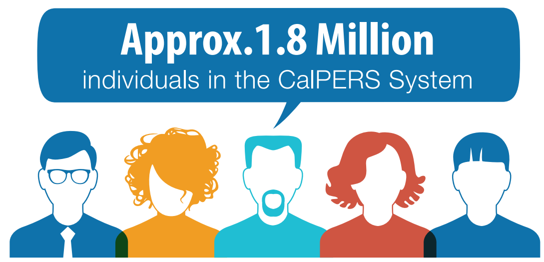
LEAGUE® OF CALIFORNIA CITIES

Why is the pension gap so important to address?

Defined benefit pension plans play a vital role in attracting and retaining quality public employees. Many cities, however, face increasing challenges funding these benefits while maintaining levels of public services their residents expect. Employer contribution rates have increased dramatically in recent years and will continue to do so for years to come. In 2012, the Legislature adopted more reasonable and sustainable benefit tiers for new employees. However, it will take decades for those cost savings to be realized. It is critical that all stakeholders work together to address these challenges head-on in order for local agencies to continue to provide quality services while retaining our valued employees.

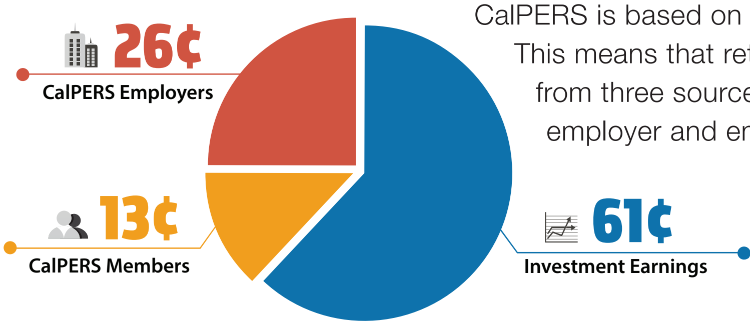
What is CalPERS?

CalPERS, the California Public Employees' Retirement System, is the nation's largest pension fund. Established in 1932, it is a defined benefit system and members include employees of state agencies, schools and other local public agencies. At retirement, an employee who vests in the system, typically five years of service, is entitled to collect a monthly payment for life. Approximately 1.8 million individuals are in the CalPERS system.



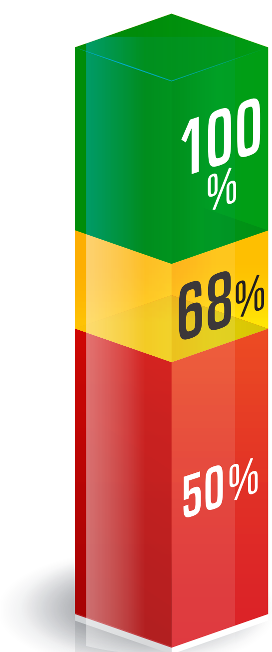
How is CalPERS funded?

CalPERS is based on "shared responsibility." This means that retiree payments come from three sources: investment earnings, employer and employee contributions.



Does CalPERS have enough cash on hand to pay promised benefits?

CalPERS is not fully funded. As of July 2017, CalPERS only had 68% of the funds required to pay estimated retirement benefits. That means there is only 68 cents for every dollar needed to fund retiree benefits. CalPERS' goal is to be 100% funded. Experts warn that the system may no longer be viable should the fund drop below 50-55% funded.



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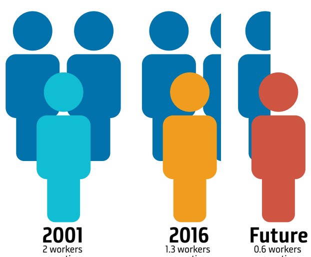
Why are contribution payments increasing?

Several factors are resulting in increased employer and in some case employee contributions. A primary reason for the increase was the economic downturn in 2008 when CalPERS suffered a 27% negative return with a gross impact of a 34.75% loss to the fund.

Other factors include:

- **Enhanced pension benefits** authorized by state law in 2000 for public safety employees and 2001 for all other public employees, which included a retroactivity credit for years of service. Subsequently, these enhanced benefits, negotiated locally, have increased member agency contribution rates and payments to retirees.
- **People are living and drawing pensions longer**. CalPERS has increased rates for member agencies to adjust for longer lifespans.
- **There are fewer active employees for each retiree.** In 2001, there were two active workers for each retiree. By 2016, that dropped to 1.3 and CalPERS projects that in 10–20 years there will be just 0.6 active workers per retiree. Fewer people paying into the system means higher contribution rates from local agencies and their employees.



- **When CalPERS lowers its investment return target, also known as the "discount rate," member agencies must increase contributions to make up the difference.** CalPERS dropped the discount rate from 7.75% to 7.5% in 2014 and then to 7% in 2016. This last adjustment will be phased in over eight years with the member rates rising exponentially each year.

2014 7.5% 2016 7%

What is at stake for cities and their employees?

Growing employer contributions are having a direct impact on city residents and employees. Difficult choices will have to be made at the local level as cities work to maintain critical services for their residents. Each city will need to assess its own liabilities to determine several factors including:

- The overall service model and which public services may need to be reduced;
- Identification of new or additional revenue sources; and
- Revisions to employee benefits and staffing levels.

Collaboration is the key to system sustainability

There are various tools cities can use to address the fiscal challenge created by rising pension costs to provide greater financial and retirement security. Most importantly, cities must approach all impacted stakeholders in a collaborative manner to ensure long-term sustainability of the system. These stakeholders include:

- Local and state employee, employer and retiree organizations, etc.;
- CalPERS Board of Directors and executive leaders;
- The Legislature and Governor's Office; and
- Neighboring municipalities.