City of Long Beach
Working Together to Serve

Memorandum

Date: August 7, 2015

To: Patrick H. West, City Manager

From: John Gross, Director of Financial Management

For: Mayor and Members of the City Council

Subject: **Structure and Use of the CalPERS Stabilization Fund**

CalPERS Costs Fluctuate More Than In The Past

Effective with the City's FY 16 CalPERS contribution rates, the California Public Employees' Retirement System (CalPERS) Board of Administration approved changes to the CalPERS' amortization and smoothing policies in order to ensure greater sustainability of the CalPERS pension system. While this change puts the City on a path to eliminate its unfunded liability in an estimated 30 years, the change also results in higher City CalPERS contribution rates and associated higher pension costs. It also means that the City will be exposed to greater up and down swings in pension costs due to CalPERS' investment gains or losses than in the past.[1]

While the City cannot do anything to impact the overall increase in pension costs caused by the CalPERS changes, it can and did take steps to smooth the impact of the potential large swings in costs in order to help provide stability in budget planning. The City established an innovative CalPERS Stabilization Fund (Fund) in FY 14 and the Mayor and City Council funded it with $8.5 million over two years. The Fund is intended to help create stability in budget planning by "locking" in CalPERS employer contribution rates for the General Fund during the three-year period used in the City's budget forecasting.[2] Rates are locked based on CalPERS' assumed rate of return on investments of 7.5 percent.

The CalPERS Stabilization Fund Reduces Cost Fluctuations

During the City's 3-year budget forecast period, actual pension costs may be higher or lower than anticipated as a result of low CalPERS pension earnings (or other unexpected causes). If the City's pension costs are higher than expected, the City will draw from the Stabilization Fund to keep General Fund costs lower and avoid unexpected budget increases. Likewise, if the City's pension costs are lower than expected, the previously

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[1] Previous CalPERS policies required that investment gains or losses were recognized over 15 years and required them to be funded by the City for over a rolling 30-year amortization period. The new methodology recognizes all gains and losses over 5 years and requires them to be funded over a fixed 30-year period. The shorter time period for recognizing gains and losses is a key factor in causing CalPERS rates to swing up or down. The new policy was effective with the June 30, 2013 CalPERS pension plan valuations and first impacts the City's FY 16 CalPERS rates.

[2] Each year, the projected rates for the third year of the City's General Fund budget forecast is "locked" based on an assumed 7.5 percent rate of return on investments. For instance, in the budget forecast done in FY 16, the projected rates for FY 18 was locked. When the budget forecast is done again in FY 17, the rates for FY 19 will be locked.

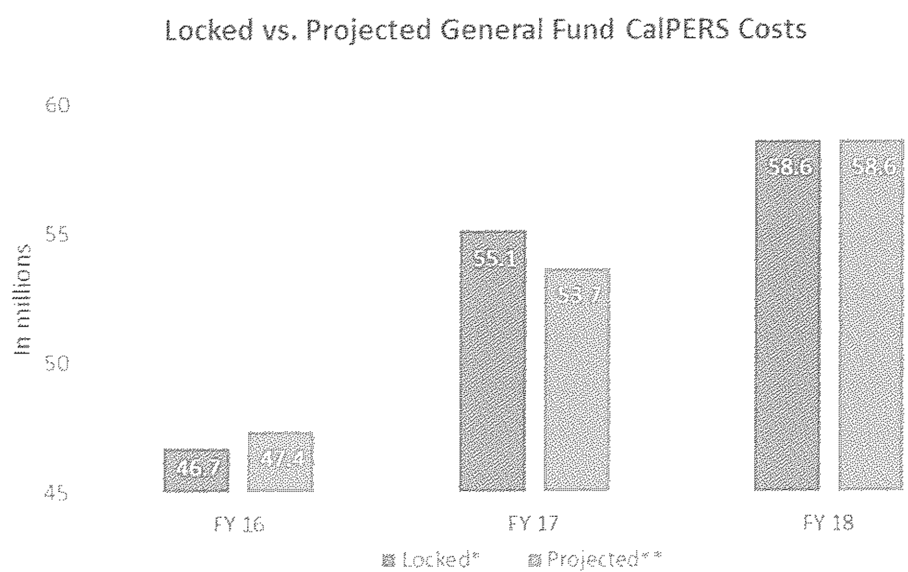
projected higher cost will still be budgeted in the General Fund and the savings will be put into the Stabilization Fund to replenish it for future use. The following table summarizes how the Fund is impacted by CalPERS investment returns (and other unexpected changes impacting pension costs).

Impact on Stabilization Fund by Locking in CalPERS Cost Projections

CalPERS Investment Return[3]	Impact on Stabilization Fund
7.5% investment earnings	No impact
Under 7.5% investment earnings	Monies drawn from Fund
Over 7.5% investment earnings	Monies added to Fund

When money is drawn from the Fund, it is used to partially pay CalPERS costs without having to budget in the General Fund for them. When money is put into the Stabilization Fund, the cost to transfer money into the Fund is included in the General Fund budget as an expense.

As mentioned previously, the locked employer contribution rates are established based on the assumption that CalPERS' investment returns will be 7.5 percent, while the City's actual pension costs are based on the latest available information. The finalized CalPERS employee contribution rate is known for the first year of the City's three-year forecast, while the next two years are projections. The following graph shows the estimated pension costs based on the locked rates as well as the current projected rates (actual for FY 16).



* FY 16 and FY 17 were locked in FY 15. FY 18 is locked as of FY 16
** The projected costs for FY 17 and FY 18 are based on FY 16 Base Budget and will be updated as additional information is obtained

[3] Due to the timing of data being available and the time needed by CalPERS to prepare the required actuarial study and calculate employer contribution rates, there is a three fiscal year delay between actual investment returns and the fiscal year in which the City's costs are impacted. For example, the investment returns that CalPERS have in State FY 16 (year ending 6/30/16) will first impact the City's CalPERS costs in the City's FY 19 budget.

Based on these current locked and projected rates for FY 16 – FY 18, the City is currently projecting the General Fund to use the Stabilization Fund to lower costs in FY 16, and add money to the Stabilization Fund (keep General Fund expenses at the higher projected amount) in FY 17. Previously, the City was projecting FY 16 costs to be $46.7 million, while the estimated costs are now at $47.4 million. This difference of about $0.7 million will be funded by drawing that amount from the Stabilization Fund. The FY 17 and FY 18 rates are not finalized by CalPERS and estimates will be updated as more information is obtained.

Limitations of the Stabilization Fund

The CalPERS Stabilization Fund is projected to be able to lock in CalPERS costs for three years for "normal" variations. However, it does not have unlimited capacity to lock in rates. If investment returns drop and continue dropping or drop too sharply, the Fund will run out of money. In addition, while the Fund is designed to lock in the projected rates, it is not designed to keep the total cost at a level amount (that is not practical to try to accomplish). The current size of the Fund, $8.5 million, is believed to be sufficient for normal variations in investment earnings and no additional seed money for the Fund is recommended at this time.

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