City of Long Beach
Memorandum
Working Together to Serve

Date: February 3, 2017

To: Patrick H. West, City Manager

From: John Gross, Director of Financial Management

For: Mayor and Members of the City Council

Subject: **Impact of CalPERS Board Actions to Reduce the Discount Rate**

Just a few years ago, the City implemented major pension reform agreed to by all the City's employees. The City was expected to save about $250 million over ten years with that reform. Shortly thereafter, the State's pension reform (PEPRA) and higher California Public Employees' Retirement System (CalPERS) contribution rates were intended to completely resolve all CalPERS unfunded liability (including Long Beach's) over about 30 years. While these City and State reforms have been important – putting the City on track to save the $250 million and experience significant reduction to unfunded liability over time – problems have again shown up.

The main issue is CalPERS' recognition that the world's investment markets are not likely to support the higher returns of the past. In addition, CalPERS considers the current investment strategy as too volatile (higher high returns and lower low returns). The volatility results in too much risk of even higher contribution rates if there is an extended period of poor investment returns. As a result, CalPERS has determined that additional changes and cost increases to employer contributions are needed. Unfortunately, they will have a substantial long-term fiscal impact beginning a few years after a phase-in period.

The most recent change by CalPERS occurred on December 21, 2016, when CalPERS voted to lower the discount rate (actuarially assumed investment rate) from the current 7.5 percent to 7.0 percent over the next three actuarial valuation years. This was done to reflect the expectation of the lower rate of returns predicted by CalPERS' investment advisors. Preliminary information released by CalPERS indicates that this action will increase most cities' "normal" cost by 1 to 3 percent of payroll for Miscellaneous employee plans and 2 to 5 percent of payroll for Safety employee plans. "Normal" cost is the basic underlying and ongoing cost of the pension plan. However, Long Beach, as well as all other agencies in CalPERS, also has unfunded costs from the past. CalPERS indicates the decision to lower the discount rates will also result in a cost increase for unfunded liabilities of approximately 30 to 40 percent. Because the impacts will be phased in over seven years beginning in FY 19, there is no expected fiscal impact in FY 18 and likely only a small impact in FY 19.

Prior to the change in the discount rate in December 2016, there were other changes that CalPERS made that have not yet been fully factored into the City's budget projections. The key factor yet to be included is the expected move to a less risky (lower investment returns) investment strategy. This action was previously approved by CalPERS, but has been temporarily put on hold and is not expected to impact the City until FY 20, at the earliest.

This change seems likely to reduce the discount rate over a projected 20 years from 7 percent to approximately 6 percent and will also increase long-term costs.

The information provided on the December discount rate change is an estimate provided by CalPERS. Staff is working with the City's independent actuary, Bartel Associates, to analyze the impact of the CalPERS board actions, and staff expects to have the budget impact analysis completed by the FY 18 budget kick-off in March.

If you have any questions, please contact Assistant Finance Director Lea Eriksen at (562) 570-6533.

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