



DATE: October 20, 2021

TO: Council Budget and Finance Committee

FROM: Director of Finance

SUBJECT: CalPERS Update

RECOMMENDATION

That the Committee reviews and comments on the CalPERS Update.

SUMMARY

This report provides a review of the June 30, 2020, CalPERS Actuarial Valuation Report, and includes projected future fiscal impacts associated with the changes the CalPERS' Board of Directors is considering related to the assumed discount rate from 7.0 percent potentially to a rate at or between 6.8 percent and 6.375 percent.

BACKGROUND

The City of Hayward offers its employees and retirees a defined pension benefit plan which is managed and administered by the California Pensions Retirement System (CalPERS) a State of California Pension program. For each of the City's plans (Police, Fire & Miscellaneous) CalPERS provides annual actuarial valuation report detailing the latest status of the City of Hayward Pension plans for employees and retirees. These actuarial reports are used to calculate the annual required contribution the pension obligations. In addition, updates on the rate of return, funding status, and changes based on various impacts are detailed in the report.

The information in this report is based on the details included in the June 30, 2020, actuarial valuation for each of the City's three plans.

DISCUSSION

CalPERS provides participating agencies an annual actuarial valuation, an analysis that provides determined pension liability and annual required contribution for the pension plans it manages – each valuation includes an update on the plan's funding status, results of assumptions such as rate of return, the new fiscal year Annual Required Contribution (ARC) and projected future ARC as a percentage of payroll.

Hayward's Funding Status:

The City actively manages its benefit liabilities and completes actuarial valuations for benefit liabilities, including the review of the annual CalPERS Actuarial Valuation report. Table 1 provides an update to the City's most recent CalPERS Actuarial Valuation report as of June 30, 2020.

Table 1: CalPERS Actuarial Valuation as of June 30, 2020

(In millions)	Actuarial Valuation Date	Accrued Liability	Value of Assets	Funded Ratio	Unfunded Liability	Unfunded Ratio
CalPERS Police Safety Plan	6/30/2020	\$ 443.37	\$ 261.53	59.0%	\$ 181.8	41.0%
CalPERS Fire Safety Plan	6/30/2020	\$ 326.37	\$ 197.12	60.4%	\$ 129.3	39.6%
CalPERS Misc. Plan	6/30/2020	\$ 503.64	\$ 323.94	64.3%	\$ 179.7	35.7%
Total CalPERS		\$ 1,273.38	\$ 782.59	61.5%	\$ 490.8	38.5%

As shown in Table 1, the funding ratio and unfunded liabilities vary between the three plans. The overall funded ratio for all plans combined is 61.5%¹, leaving an unfunded liability of \$490.8 (or 38.5%). Table 2 provides a historic overview of funded comparison by plan. The last several CalPERS Actuarial Valuation reports have illustrated varying funding status. As of the June 30, 2019, report, the City saw a slight increase its funding status, yet the most recent valuation report indicate a slight decrease in funding status over the last two valuation reports.

Table 2: CalPERS Three Year Historic Funded Comparison by Plan

CalPERS Plans	As of June 30, 2018	As of June 30, 2019	As of June 30, 2020
Police Safety Plan	\$ 162,429,655	\$ 168,822,326	\$ 181,845,843
Funded Ratio	60.0%	60.1%	59.0%
Fire Safety Plan	\$ 118,918,250	\$ 125,760,794	\$ 129,243,348
Funded Ratio	61.1%	60.6%	60.4%
Miscellaneous Plan	\$ 168,102,086	\$ 172,327,383	\$ 179,702,194
Funded Ratio	64.5%	64.8%	64.3%
Total Unfunded Pension Liability	\$ 449,449,991	\$ 466,910,503	\$ 490,791,385

The City fully met its annual required contribution (ARC) amount in FY 2022, which is expected to improve the City's funding ratio in future Actuarial Valuation reports. Given continued organizational fiscal health, the City is dedicated to meeting the ARC payment each

¹ The funded ratio provided in this table is based on a point in time of the CalPERS Actuarial Valuation report as of 6/30/2020. The funded ratio shown in the presentation varies slightly as the funded ratio reflects actual demographic changes, such as early retirements and higher or lower wage growth rather than the estimate reflected in the CalPERS Actuarial Valuation report.

fiscal year. This effort is expected to have a positive impact on future funding ratios for all three plans.

Potential Change in Discount Rate:

In 2015 the CalPERS Board of Directors adopted a CalPERS Funding Risk Mitigation Policy² to identify key indicators for potential changes in strategy and that may trigger the lowering of the discount rate in times when investment during the fiscal year exceed the current target rate of return by two or more percent. The policy was created specifically in response to the Public Employees' Pension Reform Act which took effect January 1, 2013. When a Funding Risk Mitigation event occurs the discount rate and expected investment return are adjusted.

In July 2021, CalPERS announced that their investment returns for fiscal year 2020-21 was 21.3 percent. This triggered a Funding Risk Mitigation event as included in the above mentioned policy. This is the first time the policy has been triggered. Table 3 provides the thresholds and impacts should a Funding Risk Mitigation Event occur.

Table 3: Funding Risk Mitigation Event Thresholds and Impacts

Excess Investment Return	Reduction in Discount Rate	Reduction in Expected Investment Return
<i>If the actual investment returns exceed the discount rate by:</i>	<i>Then the discount rate will be reduced by:</i>	<i>And the expected investment return will be reduced by:</i>
2.00%	0.05%	0.05%
7.00%	0.10%	0.10%
10.00%	0.15%	0.15%
13.00%	0.20%	0.20%
17.00%	0.25%	0.25%

In early September, the CalPERS Board of Directors (Board) met to discuss the potential change to the discount rate, and the long-term interest rate used to fund future pension benefits. At the September Board meeting, the proposed 6.25 percent discount rate was denied, with the Board directing staff to return with a 6.5 percent option for consideration. In November, the Board is scheduled to meet to discuss the change in discount rate, which ranges between 6.8 percent and 6.375 percent. At the time of this report no adjustment has been made official.

Long-Range Financial Impacts of Discount Rate Change:

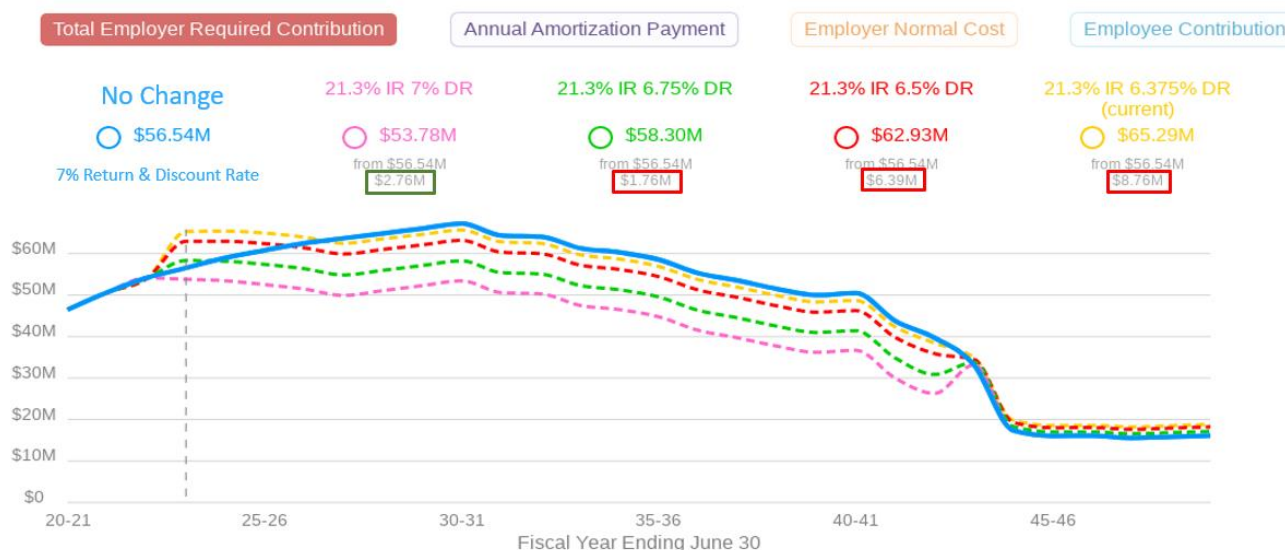
In early 2021, the City entered into a partnership with GovInvest, who developed a pension forecasting model. The forecasting model is an interactive tool that allows the City to run fiscal impact scenarios using the City's current pension plans. The tool allows the City to run scenarios related to a change in discount rate, one-time payments, and potential change to

² CalPERS Funding Risk Mitigation Policy - <https://www.calpers.ca.gov/docs/funding-risk-mitigation-policy.pdf>

employee contribution, illustrating the fiscal impacts to the City's total annual required contribution.

With the potential change in discount rate, the City worked with GovInvest to run several scenarios to illustrate the fiscal impacts to the total annual required employer contribution at discount rates ranging from 7 percent to 6.375 percent. The scenarios shown in Graph 1, illustrate the fiscal impacts of discount rates at 7 percent, 6.75 percent, 6.5 percent and 6.375 percent compared to status quo (or no change).

Graph 1: Potential Impact to Total Required Employer Contribution



As shown in the graph above, as a result of a potential change in discount rate, the fiscal impact to the total annual required employer contribution ranges from \$1.76 million (at 6.75%) to \$8.76 million (at 6.375%).

While the CalPERS Board of Directors met on September 12, 2021 to discuss the potential change in discount rate, the Board ultimately declined the proposed discount rate of 6.25 percent. Rather, the Board directed staff to return in November to discuss the option and fiscal impacts of changing the discount rate to 6.5 percent.

While it is still unclear on the Board's final decision, it is widely believed that the discount range may change to 6.8 percent. Should Board finalize the discount rate at 6.8 percent, the City would realize an increase of approximately \$1.76 million in its total annual required contribution.

ECONOMIC IMPACT

This is an informational item and has no direct economic impact.

FISCAL IMPACT

While the rising costs of funding associated with the City's pension plans is a challenging piece of the operating budget, the conveyance of the information included in this report has no fiscal impact.

NEXT STEPS

Staff will continue to monitor any decisions made by the CalPERS Board and provide an update to the Committee upon final directive from the Board.

City Council may choose to advocate on behalf of the City of Hayward by submitting a letter to the Board of Agenda or Non-Agenda, in which the entire Board will receive comments from their direct support staff for review and consideration in advance of the November CalPERS Board of Directors meeting.

Prepared by: Nicole Gonzales, Deputy Director of Finance

Reviewed by: Dustin Claussen, Director of Finance

Approved by:

A handwritten signature in black ink, appearing to read 'K. McAdoo', is positioned above a horizontal line.

Kelly McAdoo, City Manager