9-3-19 Oversight Committee

Item 4

Having had the opportunity to have read others thorough and thoughtful comments to the Oversight Committee leaves me with mostly non-technical observations from a laymen's point of view.

Why I would put the money into CalPERS?

CalPERS has stated that they expect investment returns to be less than 6% over the next ten years. We should move the current 7% needle down to 6% instead of keeping it artificially high as CalPERS has done that for years. If we "get real" and use 6%, the pension debt is really $83,000,000 and OPEB will be around $14,000,000, for a total employment related debt of $97,000,000!

Interest on the Miscellaneous pension debt in 2017 was nearly $7M. We do not have actual interest charges on Safety, but proportionately, it should have been close to $5,000,000 for total estimated interest charges of $12,000,000 for pension debt. If you then add the OPEB interest charge from 2017, $1,607,000, you'll find that we paid **<u>$13,607,000 interest!</u>**

Interest is money that could have been spent on town improvements, paid salaries, hired police to direct beach traffic, etc.

Interest costs will be increasing if we don't make continual concentrated efforts to reduce the unfunded pension debt each year.

The OPEB funded status has increased from 42.8% to 54.9% in the past two years; up 12.1% points. On the other hand, the unfunded pension liability for Miscellaneous has only gone up 1.4% percentage points from 2016 to 2017 but has fallen from 76% in 2014 to 69% today.

I do not subscribe to the 115 plan as its investments are close to those of CalPERS who is much larger and has a much longer history of investment successes. CalPERS, for all its travails, has survived the two huge downturns; the 2001 the Dotcom bust and the 2008 Great Recession. The current 115 investment fund has not had to suffer any severe setbacks and has only been making investments while investing in the longest bull market in history. With investment fees of just under ½%, the 115 plan starts out at a disadvantage every year.

I also do not subscribe to the state bailing out a town. We have over $70,000,000 in the bank. There is no sound reasoning that the state could make to bail us out with that high of a cash balance.

The best thing we can do to improve the financial position of the town will be to pay directly to CalPERS. We need to eliminate the opportunity of future councils to exercise the fungibility of money, spending pension dollars on personal pet projects rather than paying down pension debt.

Jak VanNada

Los Gatos Community Alliance

From: Phil Koen <pkoen@monteropartners.com>
Sent: Monday, September 02, 2019 10:33 PM
Subject: Agenda item #4 - Pension and OPEB Oversight Committee Meeting - September 3, 2019

Dear Honorable Mayor and Council Members,

Recommendation

There has been a tremendous amount of discussion regarding what the Town should do with the $8.2m which is freely available to this Council. I would strongly encourage the Council to make an $8.2m ADP to CalPERS while directing CalPERS to apply this payment against the longer unfunded bases that Bartels Associates identified on page 19 of his August 12, 2019 report.

By doing this the Town will capture $11.7m in future contribution savings. Based on the analysis provided by Bartels, making this ADP to CalPERS is far superior in both nominal dollar terms and on a present value basis to any other alternative identified on page 3 of the Staff memo, which included making an ADP to PARS or OPEB.

Background

It is important for this Council to fully understand the massive challenge the Town is facing. For this discussion I will only reference the miscellaneous plan, but the same issues also apply to the safety pension plan.

Please look at slide number 3. In 2007, the miscellaneous plan was fully funded, and in fact had a slight excess funding of $3m. By 2017 the plan had materially deteriorated and was now facing an unfunded liability of $30m. While during this period of time assets to fund the plan had increased from $58m to $70m, the pension liability had exploded from $55m to $100m (and that is measured using a 7.25% discount rate).

If you were to measure the pension liability using the 6% discount rate, which CALPERS is on a path to adopt, you can see in slide 1 the miscellaneous plan liability would be $116m with no increase in the asset base. That means the unfunded liability would be $46m. The negative impact of the discount rate cannot be emphasized enough.

If that were not enough, the Town is facing a very challenging demographic profile as shown in slide 2. In 2007 the miscellaneous plan had 119 active employees making contributions with 167 receiving benefits. By 2017 the number of active employees had decreased slightly to 111 but the number of individuals receiving benefits had increased to 228. This trend will only continue to get worse, putting even more strain on the assets that must be used to pay for these benefits. For example in 2017 the Miscellaneous Plan paid benefits totaling $5.1m but collected only $3.1m from employee and employer contributions. That means the plan experienced $2m in negative contributions. This is up from the $1.2m negative contribution the Town experienced in 2012.

This trend in negative contributions is in part driven by increases in service benefits that prior Council had agreed to as part of the employee bargaining process. As shown on slide 2, the average annual benefit provided for miscellaneous plan service retirees in 2007 was $14,300. By 2017 this had grown to

$25,200. This can only be paid if there are sufficient assets in the pension plan to meet these obligations as they come due.

The Town has responded to this challenge by dramatically increasing the contribution rate, thus pumping more dollars into the miscellaneous pension plan. As shown on slide 4, the contribution rate in 2007 was 12.7%. By 2017 it had grown to 27.0% and it is projected to increase to 33.2% in 2020. These rates are the minimum amount charged by Calpers. To date, with the exception of paying off a side car fund in the safety plan, the Town has only paid the minimum required amount into the miscellaneous pension plan.

To be fair, the Town has made payments into a 115 Trust fund, but these payments do not reduce the unfunded pension liability nor have any impact on the required annual Calpers contributions. Putting money into a 115 Trust would be equivalent to putting money into a savings account which could be used in the future to pay your home mortgage.

Despite all of these good efforts, the Town is making no headway in reducing the Miscellaneous Plan unfunded pension liability. This is clearly shown in slide 5. Despite realizing a 11.2% return on the $69.5m in assets in the miscellaneous pension plan in 2017, the unfunded pension liability still increased by $300k. A major reason for this is the $2m negative contribution mentioned above REDUCED the 11.2% return. The $2.4m that is reported as an asset gain is a "net" number. This coupled with adverse change in plan assumptions combined to push the unfunded liability higher.

Let me also quickly address the advisability of making an ADP to the OPEB Trust. If you look at slide # 6 you can see that in 2017 the Town contributed in excess of $2.6m more to the OPEB fund than it paid out in benefits. Additionally, unlike the Miscellaneous Pension Plan, the Town paid more than $800k than was actuarially required.

This "over contributing" has allowed the funded status of the OPEB plan to consistently improve. If you look at slide #7, Bartel has projected that the OPEB Plan will be 77% funded if the Town continues to contribute at roughly the same $2.1m level as 2018. It is because of this, that making an $8.2m ADP to this plan make no sense. The OPEB plan simply doesn't need additional assets compared to the pressing need of the miscellaneous pension plan.

Conclusion

Unfortunately, there is no magic solution to the unfunded miscellaneous pension plan liability. Just like individuals who are retiring only to realize that their 401k has insufficient assets, the Town is facing the same problem with the pension plans. Hoping that miraculous stock market returns will be realized in the future to offset the negative trends discussed above would not be prudent nor in the best interests of the plan beneficiaries.

This leaves only one sensible act, namely put the $8.2m into the Miscellaneous Plan as quickly as possible. As Bartel has computed, the financial benefits are significant and cannot be matched by any of the other alternatives under consideration.

WHERE ARE WE NOW?

①

Valuation Results[1]

June 30, 2017

(Dollar Amounts in Thousands)

Employee Group	Misc	Safety	Total
■ **Participants**			
● Actives	111	36	147
● Transfers[2]	98	17	115
● Terminations[3]	79	1	80
● Retirees & Beneficiaries	228	73	301
● Total	516	127	643
■ **Funded Status**			
● Accrued Liability	$99,903	$84,807	$184,710
● Assets	69,527	62,719	132,246
● Unfunded Liability	30,376	22,089	52,465
● Funded Percent	69.6%	74.0%	71.6%
■ **Projected 2019/20 Payroll**	10,147	5,198	15,345
■ **Employer Contribution 2019/20**[4]			
● Dollar Amount (Estimated)[5]	3,366	2,673	6,039
● Percent of Payroll	33.2%	51.4%	39.4%

[1] Amounts in this report might not add due to rounding.
[2] "Transfers" are former employees working for another agency participating in a CalPERS pension plan.
[3] "Terminations" are former employees not working for an agency participating in a CalPERS pension plan.
[4] CalPERS results do not reflect Employee-Paid Member Contributions and Member Share of Employer Contributions, if any.
[5] CalPERS provides the Normal Cost as a percentage of payroll and the Unfunded Liability amortization payment as a dollar amount. CalPERS' Normal Cost estimate is based on payroll projected from 2016/17 to 2019/20 using the valuation's aggregate payroll increase assumption. The Town's budgeted amount may differ based on its expected 2019/20 payroll.

WHERE ARE WE NOW?

Valuation Results

Discount Rate Sensitivity - June 30, 2017 Valuation

(Dollar Amounts in Thousands)

Funded Percent	Ongoing Plan Discount Rate[6]		
	7.25%	7.00%	6.00%
■ **Miscellaneous**			
● Accrued Liability	$99,903	$102,599	$115,979
● Assets	69,527	69,527	69,527
● Unfunded Liability	30,376	33,073	46,452
● Funded Percent	69.6%	67.8%	59.9%
■ **Safety**			
● Accrued Liability	$84,807	$87,274	$99,376
● Assets	62,719	62,719	62,719
● Unfunded Liability	22,089	24,555	36,657
● Funded Percent	74.0%	71.9%	3.1%
■ **Total**			
● Accrued Liability	$184,710	$189,873	$215,354
● Assets	132,246	132,246	132,246
● Unfunded Liability	52,465	57,628	83,109
● Funded Percent	71.6%	69.6%	61.4%

If 6%, liability is $83M

[6] At its 2017 Asset Liability Management Workshop, CalPERS stated it expected returns to average 6.1% annually for 10 years and 8.3% annually after 10 years, resulting in a blended expected return of 7.0%. It phased in a discount rate reduction over 3 rs from 7.50% for the 6/30/15 valuation to 7.00% for the 6/30/18 valuation. The discount rate is ultimately expected to rease to about 6.00% as a result of CalPERS' risk mitigation policy.

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SUMMARY OF DEMOGRAPHIC INFORMATION - MISCELLANEOUS

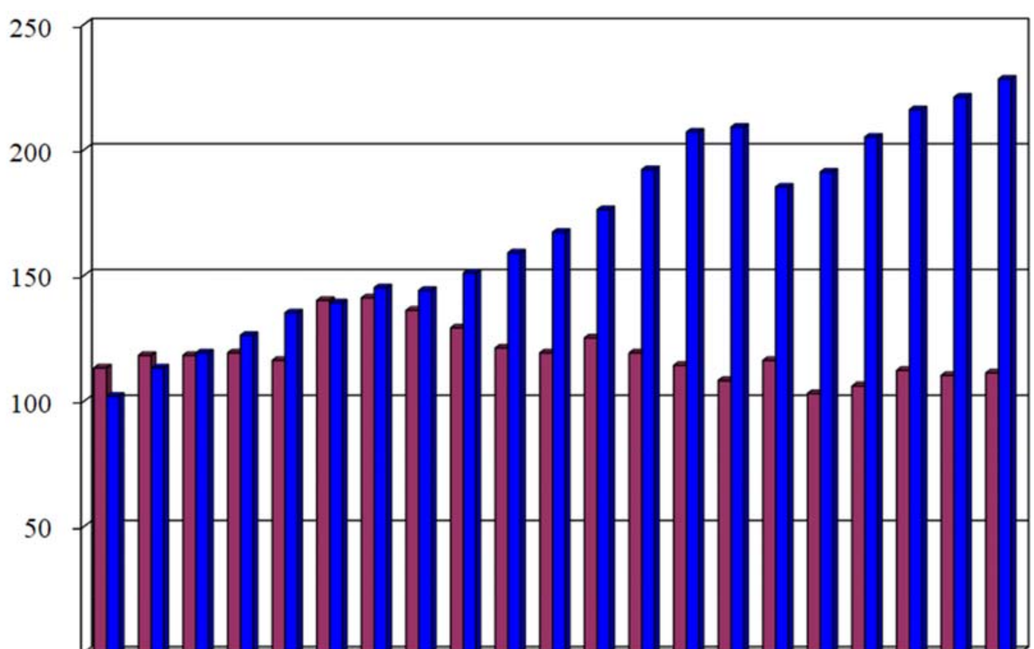
	1997	2007	2016	2017
Actives				
■ Counts	113	119	110	111
■ Average				
• Age	44	48	45	44
• Town Service	9	10	8	8
• PERSable Wages	$ 43,000	$ 73,400	$ 79,700	$ 84,000
■ Total PERSable Wages	4,900,000	8,700,000	8,800,000	9,300,000
Inactive Members				
■ Counts				
• Transferred	59	80	96	98
• Separated	52	77	81	79
• Retired				
□ Service		140	190	197
□ Disability		11	11	12
□ Beneficiaries		16	20	19
□ Total	102	167	221	228
■ Average Annual Town Provided Benefit for Service Retirees[1]	N/A	$ 14,300	$ 24,100	$ 25,200

ratio will only get worse!

what prior Councils agreed to

[1] Average Town-provided pensions are based on Town service & Town benefit formula, and are not representative of benefits for long-service employees.

SUMMARY OF DEMOGRAPHIC INFORMATION - MISCELLANEOUS

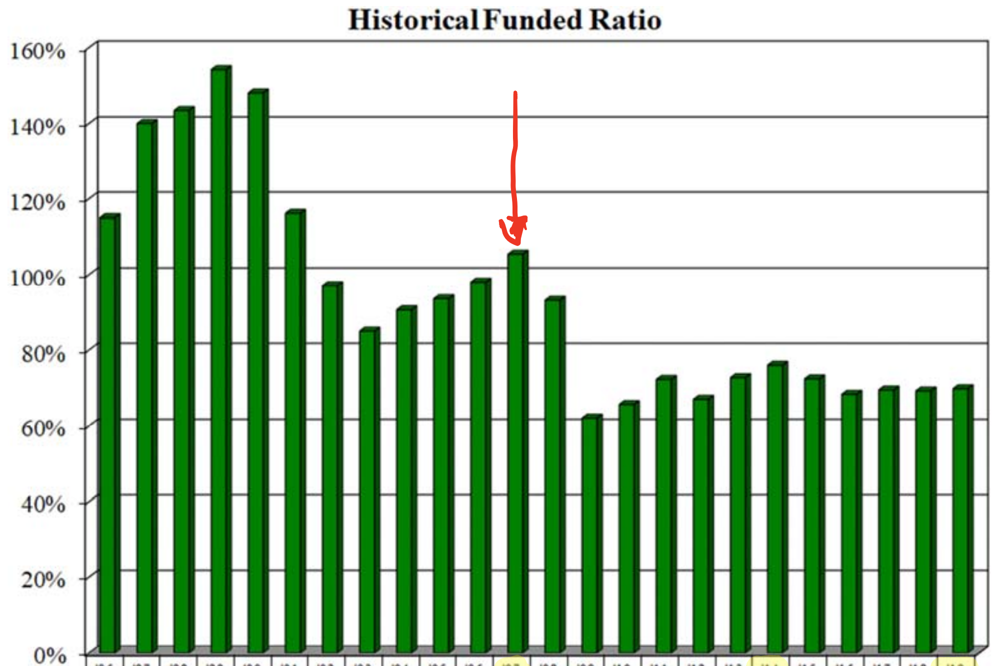


	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17
Active	113	118	118	119	116	140	141	136	129	121	119	125	119	114	108	116	103	106	112	110	111
Receiving Payments	102	113	119	126	135	139	145	144	151	159	167	176	192	207	209	185	191	205	216	221	228

2014 is this Councils base year

3

FUNDED RATIO - MISCELLANEOUS

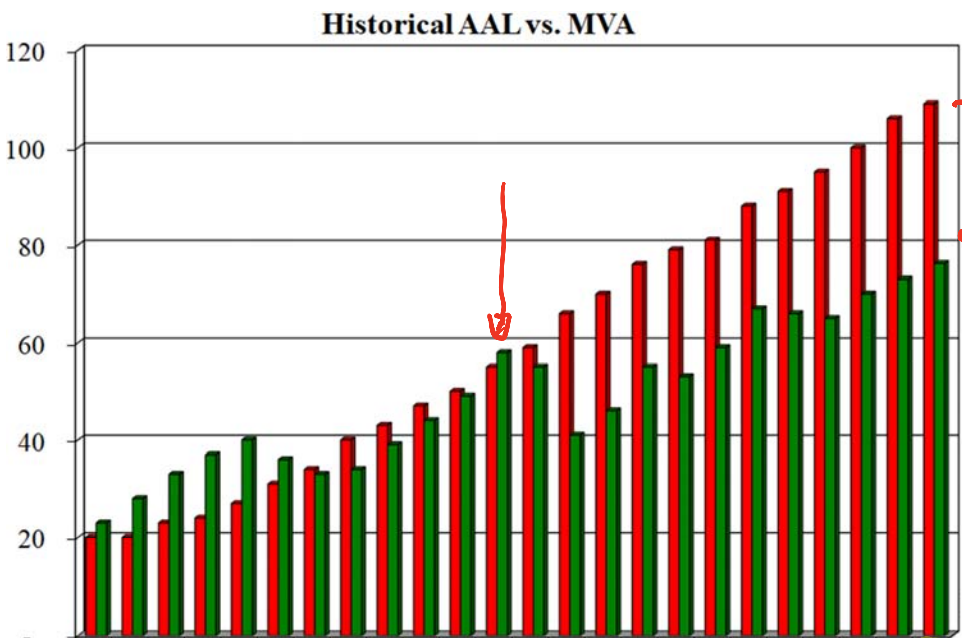


	'96	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19
MVA	115%	140%	143%	154%	148%	116%	97%	85%	91%	94%	98%	105%	93%	62%	66%	72%	67%	73%	76%	73%	68%	70%	69%	70%

6/30/18 & 6/30/19 funded status estimated

Declined !

FUNDED STATUS (MILLIONS) - MISCELLANEOUS



$33m

	'96	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19
AAL	20	20	23	24	27	31	34	40	43	47	50	55	59	66	70	76	79	81	88	91	95	100	106	109
Assets	23	28	33	37	40	36	33	34	39	44	49	58	55	41	46	55	53	59	67	66	65	70	73	76

6/30/18 & 6/30/19 funded status estimated

Unfunded $21m $33m

Assets increased only $9m

4

CONTRIBUTION RATES - MISCELLANEOUS

Historical Employer Contribution Rates (Percent of Payroll)

	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 19	FY 20
Normal Cost	9.4	8.0	7.9	8.0	8.2	8.8	9.0	9.4	9.5	9.5	9.5	10.3	10.4	10.7	10.4	11.0	10.7	10.5	10.4	9.9	10.0	10.2
Total Rate	7.0	0.0	0.0	0.0	0.0	0.0	8.0	13.8	12.7	13.0	12.6	14.6	14.4	18.5	19.6	21.9	22.4	25.4	27.0	27.4	30.9	33.2

Contribution rates soaring because of unfunded liability

CONTRIBUTION RATES - MISCELLANEOUS

	6/30/16 2018/2019	6/30/17 2019/2020
■ Total Normal Cost	17.4%	17.6%
■ Employee Normal Cost	7.4%	7.4%
■ Employer Normal Cost	10.0%	10.2%
■ Amortization Payments	20.9%	22.9%
■ Total Employer Contribution Rate	30.9%	33.2%

■ 2018/19 Employer Contribution Rate	30.9%
● Payroll > Expected	(0.6%)
● Asset Method Change (5th Year)	1.5%
● 6/30/14 Assumption Change (4th Year)	0.9%
● 6/30/16 Discount Rate Change (2nd Year)	0.3%
● 6/30/17 Discount Rate & Inflation (1st Year)	0.8%
● Other (Gains)/Losses	(0.6%)
■ 2019/20 Employer Contribution Rate	33.2%

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PLAN FUNDED STATUS - MISCELLANEOUS

Discount Rate Sensitivity

June 30, 2017

	Discount Rate		
	7.25%	**7.00%**	**6.00%**
AAL	$99,900,000	$102,600,000	$116,000,000
Assets	69,500,000	69,500,000	69,500,000
Unfunded Liability	30,400,000	33,100,000	46,500,000
Funded Ratio	69.6%	67.8%	59.9%

PLAN FUNDED STATUS - MISCELLANEOUS

Unfunded Accrued Liability Changes

■ **Unfunded Accrued Liability on 6/30/16**		$30,100,000
■ **Expected Unfunded Accrued Liability on 6/30/17**		30,700,000
■ **Other Changes**		
• Asset Loss (Gain) (11.2% return for FY 2017)	(2,400,000)	
• Assumption Change	1,200,000	
• Contribution & Experience Loss (Gain)	900,000	
• Total		(300,000)
■ **Unfunded Accrued Liability on 6/30/17**		30,400,000

- this is a "net" number

- Even with a 11.2% return, the UAL increased $300K!

- The plan does not have sufficient assets to earn a sufficient return.

6

Schedule of Changes in Net OPEB Liability and Related Ratios

Measurement Date	**6/30/2017**
Changes in Total OPEB Liablity	
Service Cost	$ 1,134,000
Interest on net liability	1,607,000
Difference between expected and actual	-
experience	-
Changes in assumptions	-
Changes in benefits	-
Benefit payments	(1,269,000)
Net change in total OPEB liability	1,472,000
Total OPEB liability - beginning	23,301,000
Total OPEB liability - ending (a)	$ 24,773,000
Changes in plan fiduciary net position	
Contributionss - employer	3,878,000
Contributionss - employee	-
Net Investment Income	1,049,000
Benefit payments	(1,269,000)
Administrative Expenses	(14,000)
Net change in plan fiduciary net position	3,644,000
Plan fiduciary net position - beginning	9,964,000
Plan fiduciary net position - ending (b)	$ 13,608,000
Net OPEB liability - ending (a) - (b)	$ 11,165,000
Plan fiduciary net position as a percentage of the total OPEB liability	54.9%
Covered payroll	14,985,716
Net pension liability as a percentage of covered payroll	74.50%

$2,609 Excess contribution is increasing Assets

Schedule of Employer Contributions

Fiscal Year	**2018**
Actuarially Determined Contribution (ADC)	$ 2,129,000
Actual Contributions	2,935,000
Contribution deficiency/(excess)	(806,000)
Covered employee payroll	14,985,716
Contributions as a percentage of covered payroll	19.6%

Town paid more than required Payment

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Funded Status Projection - Full ADC Funding

(Amounts in 000's)

Fiscal Year End	Actuarial Value of Assets[15]						Funded Status		
	BOY AVA	Trust Funding	CS Payments	IS Payments	Expected Earnings	EOY AVA	BOY AAL	BOY UAAL[16]	BOY Fund%
2018	$13,605	$2,129	($1,076)	($188)	$879	$15,349	$24,773	$11,168	55%
2019	15,349	2,108	(1,159)	(195)	981	17,084	26,390	11,041	58%
2020	17,084	2,172	(1,242)	(201)	1,094	18,907	28,061	10,977	61%
2021	18,907	2,238	(1,319)	(185)	1,216	20,857	29,791	10,884	63%
2022	20,857	2,307	(1,423)	(197)	1,341	22,885	31,616	10,759	66%
2023	22,885	2,377	(1,510)	(197)	1,473	25,028	33,484	10,600	68%
2024	25,028	2,449	(1,617)	(208)	1,614	27,266	35,432	10,403	71%
2025	27,266	2,524	(1,719)	(210)	1,760	29,621	37,433	10,166	73%
2026	29,621	2,601	(1,830)	(223)	1,914	32,083	39,506	9,885	75%
2027	32,083	2,680	(1,958)	(247)	2,073	34,631	41,638	9,555	77%

[15] Projection assumes Town requests benefit payments, including PEMHCA administrative fees, from the OPEB trust. Expected earnings is shown net of investment and CERBT administrative expenses.
[16] UAAL is amortized over 20 years for 2018/19 and is projected to be fully funded on 6/30/38.

This report presents the Town of Los Gatos Retiree Healthcare Plan ("Plan") June 30, 2017 actuarial valuation. The purpose of this valuation is to calculate the June 30, 2017 funded status and the 2018/19 and 2019/20 Actuarially Determined Contributions.

This report provides recommended contribution information for Plan funding and may not be appropriate for other purposes. Future valuations may differ significantly if the Plan's experience differs from the assumptions or if there are changes in Plan design, actuarial methods, or actuarial assumptions. The scope of the valuation did not include an analysis of this potential variation.

The valuation is based on Plan provisions, participant data, and asset information provided by the Town as summarized in this report, which we relied on but did not audit. We reviewed the participant data for reasonableness.

To the best of our knowledge, this report is complete and accurate and has been completed using generally accepted actuarial principles and practices. As members of the American Academy of Actuaries meeting the Academy's Qualification Standards, we certify the actuarial results and opinions herein.

Respectfully submitted,

Joseph D'Onofrio

Joseph R. D'Onofrio, FSA, EA, MAAA, FCA
Assistant Vice President
Bartel Associates, LLC
May 14, 2018

Katherine Moore

Katherine Moore, ASA, MAAA
Associate Actuary
Bartel Associates, LLC
May 14, 2018