TRUCKEE TAHOE AIRPORT DISTRICT
BOARD OF DIRECTORS AGENDA ITEM SUMMARY

Topic:	Pension Update
Purpose	Information: **X** Guidance: Decision:
Recommendation	None, for informational purposes only.
Last Action	The District passed resolution 2003-10 in August of 2003 which amended the contract with CalPERS from a 2% at 55 formula to a 2.7% at 55 formula.

Discussion

In February 2011 the Little Hoover Commission presented a report on public pensions to the Governor of the State of California and the State Legislature. I have attached the executive summary section of the report (on which I have made some comments in the margins to highlight issues specific to TTAD) for your convenience.

There are three basic lines of discussion we will pursue:

- Funding, including the effect of rates of return/discount rates
- District history and current status
- Need for reform

Funding

Each year the District pays a percentage of payroll into the CalPERs system. The rate is determined by CalPERs based on the valuation of the pension assets and the actuarial liability as of their valuation date. In addition, the employees pay 8% of their eligible compensation into the system as well. The total of the payments is meant to cover the present value of the future benefits that are earned in the current year. The actuaries rely on a great number of assumptions in making their calculations, but the one we will focus on is the discount rate. To determine the present value of the future benefit, they must assume a certain return will be earned by the contributions over time. PERS has used a discount rate of 7.75% since 2003; prior to that the rate was 8.25%. This month the CalPERS board will set the discount rate – it could stay the same, or be reduced to 7.5% or 7.25%. PERS has stated that a decrease to 7.5% will cause employer rates to increase 1.5%-3% and if the rate is taken down to 7.25% the increases could be double that amount. The first valuation that would use the new rates would be the June 30, 2010 valuation – which means the District would see the effect in the rates beginning July 1, 2012.

As you can imagine, actual returns earned fluctuate widely from the discount rate used by the actuaries (see historical rates of return at end of Little Hoover Commission Report).

Each year the District and the employees pay their required contributions, however, the plan is not fully funded. There are a few causes of this:

1. The biggest reason is because actual returns have not equaled what was assumed by the actuaries in past periods. The actual return for the last ten years is 4.5%, for the past twenty years it is 7.9% (before deducting administrative and investment expenses). The variances result in short-falls and additional earnings that are smoothed over a period of years to prohibit the annually required contribution rates from swinging wildly.
2. Additional Retirement Service Credit (also known as airtime) purchases were signed into law by Governor Davis shortly before his recall election in 2003 (AB719). It allows public employees in California to purchase up to five years of PERS service credit – even if they have not worked those years. By design, there was not to be any cost to the employer (or the taxpayers) – the amount the employee paid for the service credit would cover both the employer and employee contributions required. However, the actuary's calculation of the amount an employee had to pay to purchase this additional credit was based on the discount rate of 7.75% - as the returns have not matched that over time, this also contributes to the unfunded liability.
3. There have been changes made to the benefit formula that were retroactively applied. Take for example the employees who were employed by the District when the 2.0% at 55 benefit was in place. The District made contributions for those years of employment based on the actuary's calculations to provide the employees that benefit. When the District approved the 2.7% at 55 formula – it was retroactively applied to the service time the employees had accrued – even though contributions made in the earlier years were calculated at the lower formula. This was not an issue specific to TTAD – California SB 400, passed in 1999 at the height of the dot com bubble, increased pensions retroactively for the State employees – and cities, counties and local agencies followed suit over the next few years.

Troy Anderson's summary from CalWatchDog.com:

The genesis of the problems in California began in 1999 when its pension systems were well funded. Under pressure from public employee unions, state lawmakers passed Senate Bill 400 allowing massive, retroactive and

ongoing pension boosts to state employees. The bill led to the infamous 3 percent at 50 provision for California Highway Patrol officers. At age 50, they are eligible to receive 3 percent of their final years pay times the number of years worked. As a result, a public safety employee who began working at age 20 could retire at age 50 with 90 percent of their final salary. In 2002, lawmakers passed SB 183, expanding the 3 percent at 50 calculation to non-safety workers, including billboard and milk inspectors. The bills sparked a wave of public employee pension increases in cities, counties and other government agencies throughout the state.

From the *San Diego Union-Tribune, May 29, 2007*

That year (1999), the Legislature passed and Gov. Gray Davis signed SB 400. The bill by Democratic Sen. Deborah Ortiz imposed a far more generous formula for calculating the pensions of state employees.

Even in a state capital dominated by public employee unions, passage of such a massive pension spike would have been impossible had CalPERS put an honest price tag on its cost. Instead, the agency's evaluation of how much of the spike would be borne by taxpayers assumed that CalPERS would enjoy record stock market returns forever and ever. Lawmakers were told the annual tab *(for the State workers)* would range from $379 million to $466 million over the next decade. Not even close. The stock market came back to earth, and the taxpayer tab skyrocketed.

That final reference to the “taxpayer tab” is because the employees continue to pay 8% of their eligible compensation, so the difference must be made up on the employer (agency) side of the equation.

Take away – The investment returns earned by CalPERS have a direct effect on the District’s funded status and its required contribution rate. Also, the discount rate set by CalPERs this month will have a significant effect on the District’s contribution rate going forward.

District History and Current Status

The actuarial valuation of the District’s pension plan dated 6/30/2002 showed that the District plan was OVERfunded (115% of requirement). In fact, the funded ratio had been 172%, 162% and 154% in years ended June 30, 1999, 2000 and 2001, respectively.

Due to the overfunded status, there was no required employer contribution, however the 7% contribution required of employees was being paid by the District. The formula in use at the time was 2% at 55. In May of 2003, the District began working toward an increase in the benefit formula to 2.7% at 55. The information received from the PERS actuary showed that after making the change in the benefit formula, the plan would still be in an overfunded position, (the information presented by the actuary used the 6/30/02 valuation and it showed the funding ratio of 154% for the old plan versus 135.5% under the new plan). The contribution rates changed as follows:

	"Old plan" 2% at 55 7/1/03 – 9/6/03	"New Plan" 2.7% at 55 9/7/03 – 6/30/04
Employer Contribution Rate	0%	5.373% Paid by employees
Employee Contribution Rate	7% Paid by employer	8% Paid by employer

The board approved the resolution increasing the benefit in August of 2003. The way the policy is written, if the employer contribution rate is less than 8%, the employees receive the benefit of the lower rate – essentially the District's rate would have a floor of 8%. By converting to the new plan, the District's contribution rate increased 1% (from 7% to 8%) and the employees began participating in the funding of the plan by paying 5.373%.

The following year the employer rate went to 10.56% and the employee contribution became 8% (which it still is today).

At the same time, PERS mandated that all plans with fewer than 100 active members as of 6/30/2003 had to participate in a risk pool, meaning they would no longer have "stand alone" plans. The District had 17 active members at the time, so with the change in the benefit formula taking effect, we became members of the 2.7% at 55 Risk Pool – which contained 2,410 active members in 76 plans. Risk pooling is the process of combining assets and liabilities across employers to produce large risk sharing pools. Such risk sharing pools dramatically reduce or eliminate the large fluctuations in an employer's retirement contribution rate caused by unexpected demographic events – which can be magnified in a very small pool.

So now the District does not have information on the funded status of the pension assets related to the District's contributions for our specific employees, but rather has information on the funded status of the entire pool. The funded ratio of the plan (based on market value at date of valuation) has fluctuated over the years:

Valuation Date	Funded Ratio (Market Value/Accrued Liability)
6/30/03	80.4%
6/30/04	84.1%
6/30/05	86.2%
6/30/06	88.5%
6/30/07	96.5%
6/30/08	85.0%
6/30/09*	57.2%

* Note that this is the most recent valuation/received 12/3/10

The lag between the valuation date and when the reports are completed is significant. The most recent valuation (6/30/09), is the data that his used to calculate the rate that the District pays for the period from 7/1/11 – 6/30/12. So the District's contribution percentage will increase from the current rate of 11.83% to 14.762% on July 1, 2011 – that is the effect of the 2009 downturn in the economy/investment market on the plan's assets at 6/30/09 just now flowing through to the District's contribution rate. But the 24% loss on investments that CalPERS incurred in the year ended 6/30/09 is not all reflected in that rate increase. The actuaries have ways of smoothing the investment gains and losses by spreading them out over a period of years – so the District will feel the effect of the disastrous 6/30/09 investment returns over a period of years in the future.

Unfunded pension liabilities have not been required to be reported on financial statements – all that is reported is the annual contribution and whether that contribution equaled the amount required by the plan. The Government Accounting Standards Board is currently formulating a statement that will require entities to record their net pension liability (the statement will perhaps to be issued in 2012 – effective 2014). That is complicated in our case, as we are a part of a pool, but the portion of the total pool's unfunded liability related to the District (based on current thinking of how that split is made) is approximately $2.5 million. When the designation of net assets is next reviewed by the board, I will recommend that an amount equal to the District's estimated unfunded liability be designated for that purpose – as a first step towards the recording of the liability that will be mandated.

When reading the Little Hoover report, you will note that they make reference (on page iii) to the possibility of some cities paying one third of their operating budgets on retirement costs in coming years. This would refer to agencies that have a "safety class" (police and fire – which typically have more generous retirement plans and earlier retirement ages), offer post-retirement medical benefits, in many cases pick up the employees' portion of the pension contribution, and participate in Social Security (which the District does not). The District's immediate forecast is not so dire. Although the employer contribution rate will increase to make up the losses in the market and to reflect the new discount rate (if adopted), the District has made some sound decisions in the past that put it in a better position than many other agencies.

Take away –The District has made their required annual pension contributions, but the risk pool we belong to has an unfunded pension liability as of 6/30/09. The District will eventually have to record their net pension liability on the financial statements and the current estimate of that amount is $2.5 million based on the 6/30/09 valuation.

Pension Reform

The Little Hoover Commission report contains four recommendations for pension reform. For the most part they are directed to the State Legislature, since there are changes that need to occur through legislation in order for individual agencies make changes that will result in significant savings. The long term fix is the type of hybrid model mentioned in the chairman of the Little Hoover Commission's cover letter. There is a great deal of legislation that must be passed first – which will no doubt lead to a few court cases. It will be some time before the entire system is reformed.

As mentioned above, the District is not is as desperate a position as some other agencies. The fact that the employees pay their share is monumental; many other agencies will fight for years to get to that point. In addition, the District does not have a "side fund" which is contributing to its contribution rates. (A side fund represents the difference between the funded status of our stand alone plan and the funded status of the risk pool at the time we entered the risk pool. Some entities have significant portion of their required contribution rate related to the amortization of this difference.)

The District could implement a second tier for new employees after a certain date. However, the payback on the setup and accounting for a second plan could be a pretty long period – especially at our

	low rate of hiring. It is maybe not advisable to go down this path until more is known about the reforms required at the State level and the possibilities of developing a hybrid model. Financial markets are cyclical – the 2008-09 downturn is resulting in high pension costs now, but at some point the returns will recover. What happens then is important – agencies, including the District must make decisions at that time with full knowledge of what the costs are to the District (and taxpayers). *Take away* – The District should carefully manage payroll costs.
Fiscal Impact	For information only. When Policy Instruction 213.0 “Unrestricted Net Asset Designations” is next reviewed, a designation will be established for the District’s net pension liability.
Communication Strategy	This informational update will be reviewed with District staff at the next staff meeting (April). The General Manager has stated that this topic is discussed among the executives of the area governmental agencies at their monthly meetings.
Attachments	Little Hoover Commission Report – Executive Summary CalPERS – Facts at a Glance – Historical Rate of Returns