COUNTY PENSION COSTS – HARD CHOICES PAYING OFF

ISSUE

What is the status of the County's pension obligations and are appropriate steps being taken to manage these obligations?

SUMMARY

The County of San Mateo provides a defined benefit pension plan to about 5,000 employees. The plan is administered by the San Mateo County Employees' Retirement Association (SamCERA). Previous San Mateo County Civil Grand Juries, in 2011-2012 and 2012-2013, published reports critical of the County pension system. They cited an "unsustainable" increase in Unfunded Liability and a failure, by both the County and SamCERA, to adequately address the issue.

The 2017-2018 San Mateo County Civil Grand Jury finds much has changed. For its part, in 2013 the County Board of Supervisors approved a Memorandum of Understanding (MOU) with SamCERA that provides for the County to make supplemental contributions to SamCERA. These will result in eliminating the County's Unfunded Liability by the end of FY 2022-2023, if actuarial assumptions are met. So far, the County has made supplemental contributions to SamCERA of nearly $139 million. More are planned. The County expects to save over $300 million in interest charges by paying down its Unfunded Liability earlier than by using SamCERA's adopted Amortization Period. After its Unfunded Liability is paid off, the County expects to save up to $100 million per year in principal and interest payments that could be used for other budgetary purposes. The County also adopted reduced benefit plans for new employees. The County has limited salary increases to within pension plan assumptions and has increased the share of pension costs paid by employees. The Grand Jury commends the County for its commitment to eliminate its Unfunded Liability and recommends that it continue on its present course.

SamCERA has also moved in a positive direction by reducing the assumed rate of return on its invested plan assets and by adopting an asset allocation model for its investments that is more diversified and less volatile. It uses a relatively short 15-year Amortization Period to determine the annual contributions needed to pay off the Unfunded Liability. This increases the County's annual payments during the Amortization Period but reduces interest costs in the long run. SamCERA conducts triennial "experience studies" to update its assumptions about various factors, such as the increasing longevity of retirees. Economic assumptions, including assumed Return on Investments, are reviewed annually. One independent report ranks SamCERA the third best pension system in California for "funding assumptions." The Grand Jury commends SamCERA for these actions and recommends that it continue on its present course.

The County's pension plan is not "out of the woods." As of June 30, 2017, SamCERA had an Unfunded Liability of $743 million, of which the County was responsible for $707 million, or 95 percent. SamCERA's "Funded Ratio" of 84.3 percent is comparatively high but still imposes a significant financial burden on the County, and by extension, County taxpayers. Future pension

payments are expected to be funded mostly from earnings on investments. These are uncertain, and the County may not be able to pay off its Unfunded Liability by FY 2022-2023 if investment returns fall short of projections. Once the Unfunded Liability is paid off, the County will still need to be vigilant to prevent new Unfunded Liabilities in future years. The County should take this into account in its future budgetary commitments.

GLOSSARY

- Amortization Cost: payments by the County to SamCERA to pay down the County's Unfunded Liability. It includes payments of (a) principal needed to pay off (amortize) the liability over a period of years, plus (b) interest charged by SamCERA on that liability.
- Amortization Period: the number of years over which an Unfunded Liability is paid off.
- Annual Required Contribution (ARC): the sum of the County's share of Normal Cost and, if any, the Amortization Cost, expressed as a percentage of covered payroll. Each year, the County is legally mandated to pay the ARC to SamCERA in order to fund the County's pension plan. In this Grand Jury report, it is used as equivalent to the term "Statutory Contribution Rate (SCR)" used by SamCERA.
- Comprehensive Annual Financial Report (CAFR): An annual financial report issued by government entities, such as the County of San Mateo and SamCERA.
- California Public Employees Retirement System (CalPERS): CalPERS administers the pension plans for all cities in San Mateo County.
- Discount Rate: the interest rate used in discounted cash flow analyses to determine the present value of future cash flows. Under GASB, the discount rate is usually the same as the pension system's assumed Return on Investment (ROI) that will be earned on plan assets over the long-term.
- Funded Ratio or Funded Percentage: measures the extent to which a pension plan's assets match its projected future pension obligations. It is the ratio that results from dividing Total Plan Assets by Total Plan Liabilities.
- Government Accounting Standards Board (GASB): An independent non-profit entity. Among other things, it sets financial accounting standards for public employee pension plans.
- Members: current and vested former employees, or their beneficiaries, of government entities that participate in SamCERA.
- Normal Cost: payments made by the County and its current employees to cover the actuarially determined, projected lifetime cost of pension benefits that accrue to the employees during the year. It does not include amortization costs.
- Return on Investment (ROI): the annual gain or loss on invested pension plan assets. In public pension plans, this is the same as the discount rate.
- San Mateo County Employees' Retirement Association (SamCERA): an independent government entity that administers the pension system for the County of San Mateo, the San Mateo County Superior Court and the San Mateo County Mosquito Abatement and Vector Control District.
- Total Plan Assets: the dollar value of all assets within a pension plan.
- Total Plan Liabilities: the discounted, present dollar value of total future pension obligations within a plan (accrued liability).

- Unfunded Liability or Unfunded Actuarial Accrued Liability (UAAL): the dollar amount, if any, by which Total Plan Liabilities of a pension plan exceed its Total Plan Assets. In this Grand Jury report, Unfunded Liability is used as a general term that encompasses the term "Unfunded Actuarial Accrued Liability," a specific measure of Unfunded Liability used for funding purposes by SamCERA.[1]

BACKGROUND

In 1944, the County Board of Supervisors created the San Mateo County Employees Retirement Association (SamCERA) to administer retirement, disability and death benefits for its eligible members and "other beneficiaries" (usually spouses of deceased members).[2]

As with nearly all public employers in California, the County provides a "defined benefit" pension plan. A defined benefit plan guarantees that an employee, upon retirement, will receive a pension amount based on certain fixed criteria, such as salary history, age at retirement and years of service. Pension payments are legal obligations and are not discretionary spending. Although SamCERA is responsible for managing the pension plan, the County is ultimately responsible for ensuring that pension benefits are paid.[3] Pursuant to a California Supreme Court ruling known as the "California Rule,"[4] the state constitution prohibits state and local governments from reducing defined pension plan benefits for existing employees and retirees. However, the state and local governments can reduce benefits for *new* hires. The California Rule is currently being challenged before the state Supreme Court.[5] A ruling overturning or modifying the California Rule may provide the County with opportunities to negotiate reduced benefits for existing employees.

---

[1] SamCERA has also used the term "unfunded liability" instead of "UAAL" when communicating with the public. See SamCERA, *2017 Popular Annual Financial Report*, pp. 4, 6, 10. https://www.samcera.org/sites/main/files/file-attachments/2017pafr_final.pdf

[2] SamCERA, 2017 CAFR, p. 11. The SamCERA pension system was created pursuant to the California County Employees' Retirement Act of 1937. https://www.samcera.org/sites/main/files/file-attachments/2017cafr_final.pdf The law is contained in California Government Code Section 31450 et seq., https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawcode=GOV&division=4.8&title=3.&part=3.&chapter=3.&article=1

[3] Sources: Interviews. The County is ultimately responsible for any Unfunded Liability and for the employer share of Normal Costs. County employees are responsible for the remaining share of Normal Costs. See also California Government Code Section 31450 et seq. For a fuller discussion of pension plan obligations see *Soaring City Pension Costs – Time for Hard Choices.*, San Mateo County Civil Grand Jury, 2017-18.

[4] *Allen v. City of Long Beach* 287 P.2d 765, 767 (Cal 1955). < https://scocal.stanford.edu/opinion/allen-v-city-long-beach-26585.>.

[5] See: *Marin Association of Public Employees v. Marin County Employees Retirement Association*, 2 Cal. App. 5th 674 (1st Dist. 2016), https://www.leagle.com/decision/incaco20160817007; *Cal Fire Local 2881 et al., v. California Public Employees' Retirement System et al.*, 7 Cal. App. 5th 115 (1st Dist. 2016) . <https://www.eastbaytimes.com/wp-content/uploads/2017/01/123016-appellate-court-ruling.pdf; and *Alameda County Deputy Sheriff's Association, et al. v. Alameda County Employees' Retirement Assn., et al.*, Case No. A141913, filed January 8, 2018, as modified, <https://www.gmsr.com/wp-content/uploads/2018/04/scw-A141913M.pdf>. Also see: Beyersdorf, Brian, "The Fate of Public Employee Pensions: *Marin's* Revision of the 'California Rule" (2018) *The Circuit* 102 https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1102&context=circuit.>

The County's pension plan is funded by employee payroll contributions, as well as contributions by the County government itself. These are called "Normal Cost" contributions. Money from these two sources is provided to SamCERA, which invests these funds in a portfolio of assets, the largest categories being public equities (public stocks) and fixed income (bonds). Historically, the earnings, or "Return on Investment" (ROI), provided by these assets has been the biggest source of funding for SamCERA's pension benefits, comprising 57 percent of total revenues. By comparison, contributions by the County provided 29 percent and contributions by employees provided 14 percent of total revenues.[6]

Retirement benefits are a long-term commitment. To ensure that money is available to pay pensions when needed, SamCERA estimates the cost of these payments into future years. It takes into account factors such as anticipated salary increases, inflation and the longevity of retirees.[7] If any of these factors grows unexpectedly, SamCERA could end up with a plan that is not adequately funded.

Likewise, SamCERA estimates the ROI it will earn on its portfolio of assets. Over the long term, if the ROI falls short of what is expected, SamCERA could also end up with a plan that is not adequately funded.

In accordance with government standards, if SamCERA determines that the value of plan assets is less than the present value of future retiree benefits, an Unfunded Liability results. In this situation, the County (not the employees) must make additional payments to SamCERA of both principal and interest on the Unfunded Liability. This is referred to as "Amortization Cost."

The County's share of the Normal Cost and, if there is an Unfunded Liability, the Amortization Cost, together constitute the Annual Required Contribution (ARC) that must be paid out of the County's annual budget. Such payments from the County to SamCERA reduce the amount of money available for the County to pay for public services that it provides.

Two previous San Mateo County Civil Grand Juries have investigated the status of the County's pension plan:

- The 2011-2012 Grand Jury issued the report "Controlling the County's Escalating Retirement Costs."[8] It concluded that pension costs were adding to an already unsustainable budget deficit and that the Board of Supervisors must make some tough decisions to pay for increasing pension costs they approved in the past. The Grand Jury recommended that the County reduce the number of its employees, increase employee contributions, and renegotiate future employee benefits.
- The 2012-2013 Grand Jury published "SamCERA's Unfunded Liability: The Elephant in the Room."[9] The report made 19 recommendations, including that SamCERA adopt a

[6] Source: correspondence from SamCERA official.
[7] SamCERA, 2017 CAFR, p. 35.
[8] 2011-2012 San Mateo County Civil Grand Jury, *Controlling the County's Escalating Retirement Costs*. http://www.sanmateocourt.org/documents/grand_jury/2011/retirement_costs.pdf.
[9] 2012-2013 San Mateo County Civil Grand Jury, *SamCERA's Unfunded Liability: The Elephant in the Room*. http://www.sanmateocourt.org/documents/grand_jury/2012/samcera_liability.pdf.

lower, more realistic assumed ROI; that the Board of Supervisors adopt a Funded Percentage goal of 100 percent; and that the County should make annual contributions beyond what is otherwise required by SamCERA, to achieve that goal by 2023.

In light of these reports, and the ongoing importance of the issue, the 2017-2018 Grand Jury decided to revisit the status of the County's pension plan, as administered by SamCERA. Separately, the 2017-2018 Grand Jury has also investigated the status of pension plans offered by the cities within San Mateo County. These plans are administered by CalPERS, not SamCERA. This second report provides a more detailed analysis of pension plans than is included here. It is entitled *Soaring City Pension Costs – Time for Hard Choices.*[10] The reader is encouraged to read both reports for a more complete review of public pension plans in this county.

DISCUSSION

The SamCERA pension system has nearly 12,000 members, including 5,500 current employees, 5,000 retirees and other beneficiaries (usually spouses of deceased employees), and 1,500 former employees vested with future benefits.[11] While over 90 percent of SamCERA's members are current or former County employees or their beneficiaries, SamCERA also serves employees of the San Mateo County Mosquito and Vector Control District and the San Mateo Superior Court. According to SamCERA's latest CAFR, as of June 30, 2017 the system's Funded Ratio was 84.3 percent. The value of its assets totaled $4 billion, but it had an accrued benefits liability of $4.7 billion. The difference, or Unfunded Liability, came to $743 million.[12] The County of San Mateo, with nearly 5,100 current employee members of SamCERA, accounts for over 95 percent of the Unfunded Liability, or $707.1 million as of June 30, 2017.[13] The remaining 5 percent of the Unfunded Liability is borne by other public entities that participate in the SamCERA retirement system.

The County of San Mateo is not unique. The vast majority of public employee pension plans in California face an Unfunded Liability, and most have an even lower Funded Ratio. For example, the average Funded Ratio for cities in San Mateo County is 70.5 percent.[14] The CalPERS system, which includes most public entities in California, has a Funded Ratio of just 68 percent.[15] Fortunately, the County and SamCERA have acknowledged the problem, identified strategies to fix the problem, and have taken significant steps to implement these strategies.

[10] 2017-2018 San Mateo County Civil Grand Jury, *Soaring City Pension Costs – Time for Hard Choices.*
[11] SamCERA, 2017 CAFR, p. 43.
[12] Ibid., pp. 35-36. Figures include the San Mateo County Mosquito and Vector Control District and San Mateo Superior Court, Ibid., p.74.
[13] County of San Mateo, 2017 CAFR, p. v.
[14] See 2017-2018 San Mateo County Civil Grand Jury, *Soaring City Pension Costs – Time for Hard Choices.* Appendix A
[15] CalPERS, "CalPERS Reports Preliminary 11.2 Percent Investment Return for Fiscal Year 2016-17" July 14, 2017. https://www.calpers.ca.gov/page/newsroom/calpers-news/2017/preliminary-fiscal-year-investment-returns

Actions taken by the County of San Mateo

As detailed below, the County has adopted specific measures to eliminate its Unfunded Liability over 10 years. The County has also taken several steps to reduce its long-term pension obligations.

<u>Supplemental Contributions to Reduce Unfunded Liability</u>

In FY 2011-2012 and FY 2012-2013, the County paid "supplemental contributions" to SamCERA to reduce its Unfunded Liability. These were in addition to its Annual Required Contribution (ARC) payments.[16] However, these supplemental contributions were applied to the entire SamCERA system, not the County alone.[17] Then, in November 2013, SamCERA and the County signed a Memorandum of Understanding (MOU) to formalize a plan to pay supplemental contributions.[18] Under the MOU, the County made two commitments. First, it agreed to pay supplemental contributions in a lump sum of $50 million in the initial fiscal year (FY 2013-2014) and then to pay an additional $10 million in each of the following nine years. Second, the County stated that it intended to maintain a high minimum average employer payroll contribution rate (later determined through negotiations with bargaining units to be 37.4 percent) during the 10-year period.[19] Since the ARC would otherwise decrease each year, as the Unfunded Liability is reduced, maintaining a contribution rate higher than the ARC would provide a second source of supplemental payments. For its part, SamCERA committed to establish a Supplemental Contribution Account to receive these contributions, which would be credited just to the County, rather than all three SamCERA employers. If SamCERA's actuarial assumptions are met, the County's supplemental contributions are expected to eliminate the Unfunded Liability within 10 years (FY 2022-2023).[20]

The MOU includes language stating that the County's supplemental contributions are not legally binding. However, as of June 30, 2017, the MOU had been implemented on schedule. As shown in Table 1, the County's supplemental contributions, including payments made before the MOU, as well as payments made pursuant to the MOU, total nearly $139 million, through June 30, 2017.

[16] SamCERA, 2017 CAFR, p. 49.
[17] Source: Interview with SamCERA official.
[18] Memorandum of Understanding Between the County of San Mateo and the San Mateo County Employees' Retirement Association Funding, November 19, 2013. Document provided by County official.
[19] Source: interview with County official. By comparison, the mean contribution rate for cities in San Mateo County in FY 2016-2017 was just 27.4 percent (see 2017-2018 Civil Grand Jury, *Soaring City Pension…*, Appendix A).
[20] John L. Maltbie, County Manager, memo to Board of Supervisors "Memorandum of Understanding (MOU) with San Mateo County Employees' Retirement Association (SamCERA)," October 24, 2013. Document provided by County official. Also, interview with County official.

Table 1. County Pension Contributions to SamCERA[21]

Fiscal Year	Annual Required Contribution (millions)	Supplemental Contribution (millions)	Total Contribution (millions)
2009-2010	$101.0	0	$101.0
2010-2011	$143.3	0	$143.3
2011-2012	$131.6	$11.5	$143.1
2012-2013	$125.0	$13.0	$138.0
2013-2014	$146.7	$50.0	$196.7
2014-2015	$163.4	$10.9	$174.3
2015-2016	$163.6	$19.6	$183.2
2016-2017	$158.7	$33.9	$192.3

The County's total pension contributions are a huge burden, equaling about 39 percent of its total covered payroll costs and 18 percent of total General Fund spending in FY 2016-2017.[22] Of the ARC, two-thirds consists of payments of Amortization Cost ($108 million); just one-third is for payments of Normal Cost ($51 million).[23]

In theory, without supplemental contributions, the Unfunded Liability would be paid off at the end of the 15-year Amortization Period used by SamCERA. Making supplemental contributions to pay off the Unfunded Liability early reduces the interest payments that are included in the Amortization Cost. The savings are substantial. Prior to adoption of the MOU, the County Manager estimated the cumulative interest savings at approximately $304 million.[24] In 2017 the County Manager reported that the County could expect annual savings approaching $90 million to $100 million in reduced Amortization Costs and supplemental contributions, beginning in FY 2023-2024, assuming the Unfunded Liability has been paid off by that date.[25]

However, in interviews with the Grand Jury, both County and SamCERA officials warned about the risks of the County committing such funds to other purposes in anticipation of these savings, given the uncertainty inherent in predicting required contributions after FY 2022-2023.
It should be noted that the County was fortunate in having a non-recurring gain of approximately $47 million from the 2014 sale of the County-owned Circle Star Plaza, which helped fund its capital plan.[26] The County General Fund benefitted from passage of Measure A in 2012, which

[21]Source: Correspondence from SamCERA official.
[22] County of San Mateo, 2017 CAFR, pp. 27, 90. Covered payroll is based on total compensation for pensionable earnings for permanent employees. Also, source: correspondence from County official.
[23] Source: correspondence from SamCERA official.
[24] John L. Maltbie, County Manager, memo to Board of Supervisors "Additional Contributions –Unfunded Pension Liability," July 29, 2013, p. 3. Document provided by County official. Also, interview with SamCERA official.
[25] John L. Maltbie, Budget Message, County of San Mateo FY 2017-2019 Recommended Budget, pp. A-3, A-4. https://cmo.smcgov.org/sites/cmo.smcgov.org/files/documents/files/FY%202017-19%20Recommended%20Budget.pdf
[26] Source: Interview with County official. Also see Blanca Torres, "San Mateo County cashes in with sale of Circle Star Plaza for $90.1 million," in *The San Francisco Business Times*, May 20, 2014. https://www.bizjournals.com/sanfrancisco/blog/real-estate/2014/05/circle-star-plaza-griffin-capital-san-mateo-county.html

added a half-cent countywide sales tax for 10 years, through April 2023.[27] Although the County did not specifically designate Measure A funds to offset its Unfunded Liability, it did state that "the retirement savings that accrue to the County as a result of this initiative [the MOU] could be used to continue Measure A funded programs in the event that the tax measure is not reauthorized by the voters."[28] In 2016 the County's voters approved Measure K, extending the Measure A sales tax for an additional 20 years through April 2043.[29]

Controlling Employee Retirement Benefits

In recent years, the County has made progress in reducing employee retirement benefits. These reductions apply only to new employees. As noted earlier in this report, the County Board of Supervisors does not have the discretion to apply benefit reductions to existing employees, pursuant to a state Supreme Court decision creating the "California Rule."

The County currently has various benefit plans or "tiers"[30] for its employees, depending on date of hire and whether they are general, safety or probation employees. In 2003 and 2005, the County adopted enhanced benefit pension formulas and applied them retroactively to all employees. As neither the County nor its employees had ever made Normal Cost contributions to pay for the enhanced benefits, the County's Unfunded Liability immediately increased.[31] It should be noted that the new formula adopted by the County for general members, "2% @ 55.5," remained well below the enhanced benefit formula of "2.7% @ 55" adopted at about the same time by many other government entities.[32] Also, in 2005 the County added new employee cost sharing contributions to help pay for the enhanced benefits. In 2011, the County reversed its previous decision and returned to the original benefit formula of "2% @ 61.25" for general members. However, this only applied to new hires. Pursuant to the California Public Employees' Pension Reform Act (PEPRA) of 2012, an additional tier was added for employees hired after January 1, 2013.[33] The PEPRA formula for general members of "2% @ 62" is close to the rate adopted by the County in 2011. However, PEPRA also capped the dollar amount of annual salary that can be used to calculate pensions and limited factors that could be used to increase the salary base used to calculate pensions. The long-term impact of PEPRA will be significant. For instance, a new general plan employee retiring at age 55 with 30 years of public service would be

---

[27] "San Mateo County Sales Tax Increase, Measure A (November 2012) in *Ballotpedia* https://ballotpedia.org/San_Mateo_County_Sales_Tax_Increase,_Measure_A_(November_2012)

[28] Maltbie, staff report "Additional Contributions…" pp. 1-2.

[29] "San Mateo County, California, Sales Tax, Measure K (November 2016)" in *Ballotpedia* https://ballotpedia.org/San_Mateo_County,_California,_Sales_Tax,_Measure_K_(November_2016)

[30] See San Mateo County, 2017 CAFR, pp. 71-72 for description of Benefit Plans.

[31] Source: Interview with SamCERA official.

[32] Terms such as "2% @ 55", " 2% @ 61.5 " and "2% @ 62" refer to pension benefit formula tables. For instance, under the "2%@55" formula, a retiring employee would receive, at age 55, a pension equal to 2 percent times the employee's number of years of service times the employee's base salary. For information on SamCERA's benefit calculations, see SamCERA, Guide to Your Retirement Benefits, https://www.samcera.org/sites/main/files/file-attachments/guidetoyoursamcerabenefits.pdf

[33] CalPERS, "Summary of Public Employees' Pension Reform Act of 2013 and Related Changes to the Public Employees Retirement Law," November 27, 2012. https://www.calpers.ca.gov/docs/forms-publications/summary-pension-act.pdf

entitled to a pension that is 33 percent less than one received by an employee with the same age and years of service hired under the pre-2011 plan.[34]

It will take many years before the reduction in benefit formulas will be fully realized in reduced pension payments. As of June 30, 2017, no retired SamCERA member was in the PEPRA tier. However, among *current* employees, almost 30 percent were subject to PEPRA.[35]

Managing Payroll

The pension formulas discussed above, such as "2% @ 55.5," generate a percentage figure that is then multiplied against the retiring employee's salary base. This determines the amount of his or her pension. Thus, any increase in salaries directly increases the County's pension obligations. SamCERA's calculation of pension obligations includes assumptions about future salary increases including general wage increases (largely due to inflation), plus raises due to merit and length of service.[36] For the 10-year period, 2007-2017, the County increased salaries at an average annual rate of 2.87 percent.[37] Since these increases were below the rates assumed by SamCERA, they actually reduced Unfunded Liability by a cumulative total of $154.7 million. The Grand Jury notes, however, that in the last three years of the period (2014-2017), the trend showed an increase in Unfunded Liabilities due to salary increases. The cumulative reduction in Unfunded Liability would have been $91.5 million greater without the recent increases, which exceeded the rates assumed by SamCERA.[38]

The size of the County's workforce has declined overall over the last seven years. In 2010, the County had 5,327 current employee members of SamCERA. By 2013, this number had declined to 4,650. By 2017 it had risen back up to 5,080.[39] A changing employment count does not impact Unfunded Liabilities but does impact the dollar amount of Normal Cost contributions. The impact on the Normal Cost contribution rate is more complicated, depending on several factors such as whether the laid-off or hired employee falls under PEPRA.[40]

Sharing of Normal Cost Pension Contributions

The 2011-2012 Grand Jury report on pension costs noted that the County not only paid the employer share of Normal Costs, but also paid part of the employee share. This was known as the "employer pickup."[41] In 2014, the County negotiated with bargaining units to eliminate its

[34] Source, SamCERA, Guide to Your Retirement Benefits, pp. 46, 48.
[35] County of San Mateo, 2017 CAFR, p. 73.
https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2017CAFR.pdf
[36] SamCERA, 2017 CAFR p. 60. Also, interview with SamCERA official.
[37] Milliman, *June 30, 2017 Actuarial Valuation, San Mateo County Employees' Retirement Association*, Exhibit 20, p.65. https://www.samcera.org/sites/main/files/file-attachments/2017_valuation_report.pdf
[38] Milliman, *June 30, 2012 Actuarial Valuation, San Mateo County Employees' Retirement Association,* Exhibit 17, p. 51 https://www.samcera.org/sites/main/files/file-attachments/2012valuation_0.pdf and Milliman, *June 30, 2017*, Exhibit 16, p. 61.
[39] Source: correspondence from SamCERA official.
[40] Source: Interview.
[41] 2011-12 San Mateo County Civil Grand Jury, *Controlling the County's Escalating Retirement Costs*, p. 5.

pickup of the employee share for all employees except members of the Board of Supervisors who were in office prior to 2013.[42]

Retired SamCERA members receive an annual Cost of Living Adjustment (COLA) to their pensions. SamCERA includes the cost of this benefit in calculating the County's pension liability. Prior to 2013, the County paid the entire Normal Cost associated with the retiree COLA. That changed under PEPRA after January 1, 2013, which required that all employees hired after that date pay 50 percent of the future cost of this benefit as part of their payroll deduction for Normal Costs. Since 2014, the County has extended this 50 percent cost sharing to non-PEPRA as well as PEPRA employees.[43]

Actions taken by SamCERA

Every three years, SamCERA's actuary conducts a "Triennial Experience Study" to "assess the reasonableness" of the demographic assumptions underlying its plan, including life expectancy.[44] Pursuant to these and other analyses, SamCERA has adopted increasingly conservative actuarial assumptions for estimating future benefit costs. SamCERA also conducts annual reviews of its economic assumptions including the expected return on its investments (ROI), and its asset allocation model. Expectations of ROI have become more conservative in recent years and the asset allocation model has become more diversified, with reduced volatility. The May 2018 Roeder Survey of 37 California public pension plans ranked SamCERA third best for its "funding assumptions."[45]

<u>SamCERA Assumptions: Amortization Schedule, Life Expectancy and Return on Investment</u>

Key assumptions made by SamCERA are:

- <u>Amortization Period</u>. The Amortization Period is the number of years over which the Unfunded Liability will be repaid. As with home loan repayment terms, for example, a longer Amortization Period results in lower monthly payments, but much larger interest costs over the term of the loan. Since FY 2006-2007, SamCERA has used a layered 15-year Amortization Period.[46] State law allows up to a 30-year Amortization Period.[47] CalPERS currently uses a 30-year Amortization Period (though it recently decided to phase-in a 20-year Amortization Period, with CalPERS agencies first being impacted in FY 2021-2022).[48]

---

[42] Source: correspondence from County official.
[43] Ibid.
[44] SamCERA, 2017 CAFR, p. 35.
[45] Rick Roeder, Roeder Financial, "California 2018 Funding Assumption Survey, May 2018. http://roederfinancial.com/rambles/RoederSurvey2018.htm. The only systems ranked higher than SamCERA were CalPERS – Legislative (closed) and CalPERS *Judges System II, 1, 3.*
[46] SamCERA, 2017 CAFR, p. 102. Unfunded Liabilities are amortized over separate closed 15-year layers that are determined annually. Prior to FY 2006-2007, SamCERA employed a 16-year Amortization Period for FY 2005-2006 (SamCERA, 2006 CAFR, p. 42 https://www.samcera.org/sites/main/files/file-attachments/2006_cafr_final.pdf) and an 18-year Amortization Period for FY 2004-2005 (SamCERA, 2005 CAFR, p. 53. https://www.samcera.org/sites/main/files/file-attachments/2005cafr_0.pdf
[47] California Government Code Section 31453 (b)(2).
[48] League of California Cities, *CalPERS Board Reduces Amortization Policy*, February 14, 2018. https://www.cacities.org/Top/News/News-Articles/2018/February/CalPERS-Board-Reduces-Amortization-Policy

- Post-Retirement Mortality Rates. Due to a general trend of increasing life expectancy, retirement systems are advised to periodically update their assumptions. SamCERA mortality rates have been updated as part of the Triennial Experience Study.[49] In 2017, SamCERA adopted revised generational mortality tables that predict how long members are currently living and added a projection that reflects the gradual year-to-year improvement in mortality that is expected to occur in the future. The impact on Normal Cost contributions paid to SamCERA was significant, amounting to an increase equal to 2.19 percent of payroll.[50]
- Return on Investment (ROI). SamCERA's assumed rate of return[51] has been steadily reduced, reflecting a more conservative investment outlook.[52]

FY 2004-2005	8.00 percent
FY 2005-2006	7.75 percent
FY 2011-2012	7.50 percent
FY 2014-2015	7.25 percent
FY 2015-2016	7.00 percent
FY 2016-2017	6.75 percent

By contrast, CalPERS in FY 2016-2017 used an ROI of 7.50 percent. The CalPERS Board has since approved lowering the ROI in steps to 7.0 percent by FY 2020-2021. SamCERA's actual return on its investments has averaged 9.2 percent over the last five years and 5.4 percent over the last 10 years.[53]

Reducing expected revenue from ROI means that required contributions from the County and its employees must increase to make up the difference. The Grand Jury did not determine whether further reductions in ROI are expected in future years. SamCERA and County officials interviewed by the Grand Jury stated that SamCERA always notifies employer clients in advance of making a final decision on ROI assumptions.

- Asset Allocation. SamCERA's investments are managed by independent investment management firms, subject to the guidelines and controls specified by SamCERA. Different types of investment, such as stocks and bonds, have different long-term

49 SamCERA, 2017 CAFR, p. 103.
50 Milliman, "Investigation of Experience, July 1, 2014 – April 30, 2017", (SamCERA) p. 6. https://www.samcera.org/sites/main/files/file-attachments/experienceinvestigation2017.pdf
51 Also referred to as the "Discount Rate." Under GASB, except in unusual circumstance, the Discount Rate and Assumed Return on Investment are identical. https://gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176160220621&acceptedDisclaimer=true
52 SamCERA, 2005 CAFR, p. 32 https://www.samcera.org/sites/main/files/file-attachments/2005cafr_0.pdf; SamCERA, 2006 CAFR, p. 42 https://www.samcera.org/sites/main/files/file-attachments/2006_cafr_final.pdf; SamCERA, 2012 CAFR, p. 63 https://www.samcera.org/sites/main/files/file-attachments/2012cafr_0.pdf; County of San Mateo 2015 CAFR, p. iv, https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2015CAFR_0.pdf; 2016 CAFR, p. iv. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2016CAFR.pdf; 2017 CAFR, p. v. Discount Rate is for funding purposes. Discount Rates for GASB reporting purposes were 7.45% in FY 2014-2015 and FY 2015-2016 and 7.2% for FY 2016-2017.
53 SamCERA *Perspectives that Drive Enterprise Success, Investment Performance Review, Period Ending December 31, 2017*. https://www.samcera.org/sites/main/files/file-attachments/samcera_performance_report_4q17.pdf

historical rates of return. Using a "building-block approach," the proportional allocation of pension assets among the different investment types results in the overall expected portfolio return, which is the assumed ROI discussed above.[54] Investments with the highest ROI over the long term, such as stocks, also tend to be the most volatile. As SamCERA has reduced its assumed ROI, the share of its assets invested in public stocks has declined. As of June 30, 2017, only 43 percent of SamCERA's investments were in public stocks ("equities"), compared with 67 percent in 2005.[55] A SamCERA official interviewed stated that he "never expected that it would get so low." At the same time, the share of assets placed in other investments has increased, which diversifies the overall portfolio. In October 2016, SamCERA adopted a new target asset allocation that reduces the share invested in public equities to 36 percent. It will be implemented gradually.[56] The asset allocation model used by SamCERA provides more diversification and less volatility. However, it could come at the cost of losing the opportunity to reap the historically high long-term returns on investments in public stocks.[57]

As can be seen in the table below, the definition of asset categories has expanded over time, and certain assets have been moved between categories. This makes a detailed comparison difficult and beyond the scope of this Grand Jury report.

Table 2. SamCERA Asset Allocations

Asset Category	% of Portfolio 6/30/2005[58]	% of Portfolio 6/30/2015[59]	% of Portfolio 6/30/2016[60]	% of Portfolio 6/30/2017[61]	2016 Adopted Target %[62]
Equity	67	53	50	43	36
Fixed Income	30	19	17	18	23
Real Estate	4	6	N/A	N/A	N/A
Alternatives	N/A	12	12	12	13
Risk Parity	N/A	8	8	7	8
Inflation Hedge	N/A	N/A	10	14	20
Cash	<1	2	4	5	0
Assumed ROI	8.0	7.25	7.0	6.75	N/A

54 SamCERA, 2017 CAFR, p. 52.
55 SamCERA, 2017 CAFR, p. 88; SamCERA, 2005 CAFR, p. 5.
56 SamCERA, 2017 CAFR, pp. 81, 88.
57 See, for example: Damodaran, Aswath, NYU Stern, "Historical Returns: Stocks, T. Bonds & T. Bills with Premiums" updated January 5, 2018, http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html
58 SamCERA 2005 CAFR, p. 5. https://www.samcera.org/sites/main/files/file-attachments/2005cafr_0.pdf (Last accessed on June 10, 2018).
59 SamCERA 2015 CAFR p. 46.
60 SamCERA 2016 CAFR p. 84.
61 SamCERA 2017 CAFR p. 88.
62 Ibid.

In Table 2, for June 30, 2017:
- Equity Assets include publicly traded stock and funds invested in them, including U.S. Large Cap., U.S. Small Cap., and International.
- Fixed Income includes debt instruments issued by governments and corporations that provide periodic payments to holders.
- Risk Parity includes funds that use risk to determine allocations across various components of an investment portfolio.
- Alternative Assets include private equity (that is, funds that invest in private companies or in buyouts of public companies) and absolute return (that is, funds that have an absolute return orientation and provide a diversifying return stream that is not correlated to the public markets).
- Inflation Hedge assets protect against inflation in four categories - real estate, private real assets, liquid pool and Treasury Inflation-Protected Securities.[63]

Where do things stand now?

As shown in Table 1, between FY 2009-2010 and FY 2016-2017, the County of San Mateo made nearly $139 million in supplemental payments to reduce its Unfunded Liability. Further, during the 10-year period, FY 2007-2017, on average the County increased salaries at rates below those assumed by SamCERA. This resulted in a cumulative reduction in Unfunded Liability of $154.7 million. The County has also acted to reduce the pension promises it makes to new hires. As shown in Table 2, since FY 2004-2005, SamCERA has reduced the expected return on its investments (ROI) to more conservative levels and repositioned its portfolio of assets away from the more volatile stock market. SamCERA has also revised its mortality tables to reflect the extended life spans of its members. Over the ten-year period, FY 2007-2017, SamCERA's changes to assumptions increased the plan's unfunded liability by a total of $398.7 million.[64] The actions taken by both the County and SamCERA appear to contribute to a more financially sustainable pension system. However, their actions work at cross purposes in terms of reducing the Unfunded Liability: as SamCERA reduces expected investment income and assumes that retirees will live longer (resulting in more benefit obligations), contributions from the County and its employees must increase to make up the difference, or the Unfunded Liability will grow. The County has struggled to pay down the Unfunded Liability by FY 2022-2023 at the pace anticipated.

As shown in Table 3, the County's Unfunded Liability actually increased between FY 2014-2015 and FY 2016-2017. The changes to SamCERA's assumptions, detailed above, are the primary reason for this increase. Despite this trend, SamCERA continues to project that the County's Unfunded Liability will be paid off by the end of FY 2022-2023.[65] It should be noted that investment results remain volatile, despite the five-year "smoothing" of investment gains and losses used in calculating the actuarial value of plan assets. Short- and medium-term market fluctuations can have enormous impacts on stated Unfunded Liabilities. For example, during the

---

[63] Source: correspondence from County official.
[64] Milliman, *June 30, 2012 Actuarial Valuation, San Mateo County Employees' Retirement Association*, Exhibit 17, p. 51 https://www.samcera.org/sites/main/files/file-attachments/2012valuation_0.pdf and Milliman, *June 30, 2017*, Exhibit 16, p. 61.
[65] Source: Interview with SamCERA official.

"dot.com" boom, SamCERA's Funded Ratio rose from 65.46 percent on June 30, 1994, to 98.61 percent on June 30, 2001.[66] This volatility creates a challenge for long-term financial planning for both SamCERA and the County.

Table 3. SamCERA's Unfunded Liability and Funded Percentage[67]

Fiscal Year	Unfunded Liability For Funding Purposes (millions)	Funded Ratio (Plan Assets/Plan Liabilities)
2007-2008	587.3	79.1
2008-2009	1,078.0	63.9
2009-2010	919.4	70.3
2010-2011	841.6	74.1
2011-2012	962.3	72.0
2012-2013	954.1	73.3
2013-2014	803.9	78.8
2014-2015	702.2	82.6
2015-2016	737.6	83.1
2016-2017	743.1	84.3

Conclusion

The Grand Jury commends the County Board of Supervisors and the SamCERA Board of Retirement for their foresight and their decisive actions noted in this report. SamCERA is now rated one of the top pension systems in the state, based on their conservative assumptions. The County's most recent Funded Ratio of 84.3 percent leaves room for improvement but is well above the average Funded Ratio for public entities in California. However, given the volatility in financial markets and ongoing demographic changes, the County and SamCERA must continue to monitor the performance of the pension system and act accordingly.

[66] SamCERA 2005 CAFR p. 33.
[67] Milliman, *June 30, 2017 Actuarial Valuation San Mateo County Employees' Retirement Association* Exhibit 13, p. 58. Note that Milliman uses terminology employed by SamCERA. "Unfunded Actuarial Accrued Liabilities (UAAL)" for Unfunded Liability for Funding Purposes and "Actuarial Value of Valuation Assets" and "Actuarial Accrued Liabilities" as the factors comprising the Funded Ratio.

FINDINGS

F1. As of June 30, 2017, SamCERA's Funded Ratio (Total Plan Assets/Total Plan Liabilities) was 84.3 percent. By comparison, the average Funded Ratio of cities in San Mateo County was 70.5 percent and the average of CalPERS agencies statewide was just 68 percent.

F2. As of June 30, 2017, SamCERA had a significant system-wide Unfunded Liability of $743 million, while the County portion constituted a significant Unfunded Liability of $707.1 million.

F3. In FY 2016-2017, the County's Normal Cost payments to SamCERA were $51 million, while its payments to SamCERA of principal and interest on the Unfunded Liability ("Amortization Cost") came to $108 million. In addition, the County made supplemental payments to SamCERA of nearly $34 million to pay down the Unfunded Liability. The County's total payments of $192 million represented about 18 percent of total General Fund spending and 39 percent of its total covered payroll costs in FY 2016-2017.

F4. The County's payment of Amortization Cost diverts money that could otherwise be used to pay for public services that it provides.

F5. In 2013, the County approved a Memorandum of Understanding (MOU) with SamCERA that would result in the County eliminating its Unfunded Liability by FY 2022-2023, if actuarial assumptions are met. The County's participation is not mandatory, but it has implemented the MOU on schedule. Currently, SamCERA projects that the County will eliminate its Unfunded Liability on schedule.

F6. The MOU provides that the County will make annual supplemental contributions totaling $140 million over the 10-year term of the MOU to pay down its Unfunded Liability. Further, the County will maintain a high payroll contribution rate (later determined to be 37.4 percent), even as Annual Required Contributions (ARC) are expected to fall, as the Unfunded Liability declines. Maintaining a contribution rate that is higher than needed to pay the ARC generates additional supplemental contributions.

F7. The MOU provides that SamCERA will place supplemental contributions from the County into a Supplemental Contributions Account, such that the funds apply to the benefit of the County's plan, rather than the SamCERA system as a whole.

F8. The County anticipates savings of over $304 million in interest expense as a result of paying down its Unfunded Liability ahead of the schedule provided in the Amortization Period. The County further anticipates that, once the Unfunded Liability is paid off, it will save up to $100 million per year in Amortization Costs and supplemental contributions. However, if the County commits these expected savings to other budgetary purposes, it will be more difficult for the County to meet Unfunded Liabilities in future years, if SamCERA's current actuarial assumptions prove to be too optimistic.

F9. In 2003 and 2005, the County adopted enhanced pension benefit formulas that were applied retroactively to all employees. Since neither the County nor its employees had made Normal Cost contributions to pay for the enhanced benefits, the County's Unfunded Liability immediately increased. In 2011, the County reversed its previous action and returned to the original benefit formula. However, this only applied to new hires. In 2013, SamCERA implemented new reduced pension formulas required under the California Public Employees' Pension Reform Act.

F10. Since 2014, the County has eliminated its prior practice of paying a portion of the employees' share of Normal Cost, known as the "employer pickup."

F11. Since 2014, the County has changed its prior practice of paying the entire cost of annual COLA increases for retirees. It now requires that all employees pay 50 percent of the future cost of this benefit as part of their payroll deduction for Normal Costs.

F12. During the FY 2007-2017 period, the County kept salary increases to an average annual rate of 2.87 percent, well below the rates of increase assumed by SamCERA. This resulted in a cumulative reduction in Unfunded Liability of $154.7 million. However, in the most recent years within the period, FY 2014-2017, the trend showed an increase in Unfunded Liability attributable to salary increases that exceeded SamCERA's assumptions.

F13. In 2010, the County had 5,327 current employee members of SamCERA. By 2013, this had declined to 4,650 current members before rising back up to 5,080 in 2017.

F14. SamCERA uses a 15-year layered Amortization Period to determine payments on the Unfunded Liability. That is a shorter period than used by some other pension systems, such as CalPERS. It results in higher employer contributions during the Amortization Period but will ultimately reduce the total interest expense.

F15. SamCERA conducts Triennial Experience Studies to monitor its demographic actuarial assumptions, including member life-expectancy. Economic assumptions, including the assumed Return on Investment of its plan assets are reviewed annually.

F16. Based on its latest Triennial Experience Study in 2017, SamCERA has made a change in the mortality assumption that predicts how long members are currently living and adds a projection scale that reflects the gradual year-to-year improvement in mortality that is expected to occur in the future. The new mortality assumption results in a significant increase of Normal Cost contributions equal to 2.19 percent of payroll.

F17. SamCERA has lowered its assumed Return on Investment (ROI) on plan assets in a series of steps since 2005. The assumed ROI for FY 2017-18 is 6.75 percent. That is more conservative than most other public pension systems, such as CalPERS, which is currently at 7.5 percent. (The CalPERS Board has since approved lowering the ROI in steps to 7.0 percent by FY 2020-2021).

F18. Historically, ROI is the biggest source of funding for SamCERA's pension benefits, comprising approximately 57 percent of total revenues. Contributions by the County provided 29 percent and contributions by employees provided 14 percent of total revenues. As assumed ROI is lowered, Normal Cost increases, so contributions by the County and employees must be increased.

F19. SamCERA has changed its allocation of assets in different types of investments over time. It has gradually reduced the share of investments in public equities (public stocks) to just 43 percent (as of June 30, 2017) and has diversified its portfolio by increasing the share invested in other asset categories.

F20. An independent 2018 analysis by Roeder Financial ranks SamCERA third best among California pension plans, based on "funding assumptions." Since the only plans ranked higher than SamCERA were the CalPERS – *Legislative* (closed) and CalPERS *Judges System II, 1, 3* plans, SamCERA has the highest ranking among its peer public pension plans for public agencies.

F21. ROI can be estimated but not guaranteed. Financial markets have proven to be highly volatile. This makes long-term financial planning difficult.

RECOMMENDATIONS

R1. The Grand Jury recommends that the County Board of Supervisors continue to implement its MOU with SamCERA to eliminate its Unfunded Liability by the end of FY 2022-2023, provided that actuarial assumptions are met.

R2. The Grand Jury recommends that the County Board of Supervisors keep overall salary increases at or below the actuarial rates assumed by SamCERA.

R3. Due to uncertainties regarding future pension liabilities, especially returns on investments, the Grand Jury recommends that the County Board of Supervisors, in budgeting for years beyond FY 2022-2023, ensure that the anticipated savings that accrue from eliminating the need to pay down an Unfunded Liability are not irrevocably committed to other budgetary purposes, such as operational or other ongoing expenses.

R4. The Grand Jury recommends that the SamCERA Board of Retirement continue to conduct Triennial Experience Studies to address potential demographic changes and continue to conduct annual economic analyses to assess its economic assumptions, including Return on Investment.

REQUEST FOR RESPONSES

Pursuant to Penal Code Section 933.05, the Grand Jury requests that each of the following respond to the foregoing Findings and Recommendations referring in each instance to the number thereof:

- County of San Mateo Board of Supervisors for R1, R2 and R3.
- The San Mateo County Employees' Retirement Association (SamCERA) Board of Retirement for R4.

METHODOLOGY

The Grand Jury reviewed each of the documents listed in "BIBLIOGRAPHY" below. The Grand Jury also interviewed officials with the County Manager's office, the County Controller's office, and the San Mateo County Employees' Retirement Association. The Grand Jury also interviewed an expert in the field of pension analyses.

BIBLIOGRAPHY

Comprehensive Annual Financial Reports

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2004. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2399560452004CAFR_web.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2005. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/5585320952005CAFR.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2006. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/809144669CAFR06.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2007. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/11630506422007CAFR.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2008. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/13454926152008cafr.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2009. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2009CAFR.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2010. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2010CAFR.pdf (last Accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2011. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2011CAFR.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2012. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2012CAFR.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2013. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2013CAFR.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2014. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2014_CAFR_Final%20Report_0.pdf (Last accessed on June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2015. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2015CAFR_0.pdf (Last accessed June 10, 2018)

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2016. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2016CAFR.pdf (Last accessed June 10, 2018).

County of San Mateo, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2017. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2017CAFR.pdf (Last accessed, June 10, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2005. https://www.samcera.org/sites/main/files/file-attachments/2005cafr_0.pdf (Last accessed on June 10, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2006. https://www.samcera.org/sites/main/files/file-attachments/2006_cafr_final.pdf (Last accessed on June 10, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2007. https://www.samcera.org/sites/main/files/file-attachments/2007_cafr_final_0.pdf (Last accessed on June 10, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2008. https://www.samcera.org/sites/main/files/file-attachments/2010cafr_0.pdf (Last accessed on June 10, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2009. https://www.samcera.org/sites/main/files/file-attachments/2009cafr_0.pdf (Last accessed on June 10, 2018

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2010. https://www.samcera.org/sites/main/files/file-attachments/2010cafr_0.pdf (Last accessed on June 10, 2018)

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2011. https://www.samcera.org/sites/main/files/file-attachments/2011cafr_0.pdf (Last accessed June 11, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2012. https://www.samcera.org/sites/main/files/file-attachments/2012cafr_0.pdf (Last accessed on June 11, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2013. https://www.samcera.org/sites/main/files/file-attachments/2013cafr_0.pdf (Last accessed on June 11, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2014. https://www.samcera.org/sites/main/files/file-attachments/2014cafr_0.pdf (Last accessed June 11, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2015. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2015CAFR_0.pdf (Last accessed June 11, 2018.)

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2016. https://controller.smcgov.org/sites/controller.smcgov.org/files/documents/files/2016CAFR.pdf (Last accessed June 11, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2017. https://www.samcera.org/sites/main/files/file-attachments/2017cafr_final.pdf (last accessed June 9, 2018).

Other

Alameda County Deputy Sheriff's Association, et al. v. Alameda County Employees' Retirement Assn., et al., Case No. A141913, filed January 8, 2018, as modified February 5, 2018. <https://www.gmsr.com/wp-content/uploads/2018/04/scw-A141913M.pdf>. (Last accessed June 9, 2018).
Allen v. City of Long Beach 287 P.2d 765, 767 (Cal. 1955). < https://scocal.stanford.edu/opinion/allen-v-city-long-beach-26585.> (Last accessed June 5, 2018.)

Ballotpedia, San Mateo County Sales Tax Increase, Measure A (November 2012) https://ballotpedia.org/San_Mateo_County_Sales_Tax_Increase,_Measure_A_(November_2012) (Last accessed June 9, 2018)

Ballotpedia, San Mateo County, California, Sales Tax, Measure K (November 2016), https://ballotpedia.org/San_Mateo_County,_California,_Sales_Tax,_Measure_K_(November_2016) (Last accessed June 9, 2018).

Beyerdorf, Brian, *The Fate of Public Employee Pensions: Marin's Revision of the 'California Rule'*, California Law Review Online, September 2017, www.californialawreview.org/wp-content/uploads/2017/09/Beyersdorf-02-formatted-62-72.pdf . (Last accessed June 9, 2018).

Cal Fire Local 2881 et al., v. California Public Employees' Retirement System et al., 7 Cal. App. 5th 115 (1st Dist. 2016), <https://www.eastbaytimes.com/wp-content/uploads/2017/01/123016-appellate-court-ruling.pdf>. (Last accessed, June 5, 2018.)

California County Employees' Retirement Act of 1937. California Government Code Section 31450-31485.18. https://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawcode=GOV&division=4.8&title=3.&part=3.&chapter=3.&article=1 (Last accessed on June 10, 2018).

Calpensions.com *How more generous pensions boosted city costs*, March 5, 2018, https://calpensions.com/category/calpers/sb-400/ (Last accessed on June 10, 2018).

California Public Employees Retirement System (CalPERS), *Summary of Public Employees' Pension Reform Act of 2013 and Related Changes to the Public Employees' Retirement Law*, November 27, 2012. https://www.calpers.ca.gov/docs/forms-publications/summary-pension-act.pdf (Last accessed, June 10, 2018).

California Public Employees Retirement System (CalPERS), "CalPERS Reports Preliminary 11.2 Percent Investment Return for Fiscal Year 2016-17" July 14, 2017. https://www.calpers.ca.gov/page/newsroom/calpers-news/2017/preliminary-fiscal-year-investment-returns (Last accessed, June 10, 2018).

County of San Mateo Civil Grand Jury, *Unfunded Pension Liabilities: Early Results Under GASB Standard 68*, June 27, 2017, http://www.sanmateocourt.org/documents/grand_jury/2016/unfunded_pension.pdf.

County of San Mateo Civil Grand Jury. *SamCERA's Unfunded Liability: The Elephant in The Room*, 2012-2013, http://www.sanmateocourt.org/documents/grand_jury/2012/samcera_liability.pdf.

County of San Mateo Civil Grand Jury, *Controlling the County's Escalating Retirement Costs*, 2011-2012, http://www.sanmateocourt.org/documents/grand_jury/2011/retirement_costs.pdf.

County of San Mateo Civil Grand Jury, *Exploding City Pension Costs – Time for Hard Choices*, 2017-2018.

County of San Mateo, *Memorandum of Understanding Between the County of San Mateo and the San Mateo County Employees' Retirement Association Regarding Retirement System Funding*, November 19, 2013.

Damodaran, Aswath, NYU Stern, "Historical Returns: Stocks, T. Bonds & T. Bills with Premiums" updated January 5, 2018, http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html (Last accessed June 10, 2018).

Government Accounting Standards Board (GASB), *Government Accounting Standard Series, Statement No. 68 of the Government Accounting Standards Board*, June 2012. https://gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176160220621&acceptedDisclaimer=true (Last accessed on June 10, 2018).

League of California Cities, *CalPERS Board Reduces Amortization Policy*, February 14, 2018 at https://www.cacities.org/Top/News/News-Articles/2018/February/CalPERS-Board-Reduces-Amortization-Policy. (Last accessed on June 10, 2018).

Maltbie, Jon L. Budget Message, County of San Mateo FY 2017-19 Recommended Budget. https://cmo.smcgov.org/sites/cmo.smcgov.org/files/documents/files/FY%202017-19%20Recommended%20Budget.pdf (Last accessed, June 9, 2018).

Maltbie, John L. County Manager, staff report to Board of Supervisors, *Memorandum of Understanding (MOU) with San Mateo County Employees' Retirement System (SamCERA)*, October 24, 2013.

Maltbie, John L. County Manager, staff report to Board of Supervisors, *Additional Contributions – Unfunded Pension Liability*, July 29, 2013.

Marin Association of Public Employees v. Marin County Employees Retirement Association, 383 P.3d 1105 (Cal. 2016). https://www.leagle.com/decision/incaco20160817007>. (Last accessed, June 5, 2018.)

Milliman, *June 30, 2012 Actuarial Valuation*, San Mateo County Employees' Retirement Association. https://www.samcera.org/sites/main/files/file-attachments/2012valuation_0.pdf (Last accessed, June 10, 2018).

Milliman, *Investigation of Experience, July 1, 2014 – April 30, 2017*, San Mateo County Employees' Retirement Association. https://www.samcera.org/sites/main/files/file-attachments/experienceinvestigation2017.pdf (Last accessed June 10, 2018).

Milliman, *June 30, 2017 Actuarial Valuation, San Mateo County Employees' Retirement Association*. https://www.samcera.org/sites/main/files/file-attachments/2017_valuation_report.pdf (Last accessed, June 10, 2018).

Roeder, Rick, Roeder Financial, "California 2018 Funding Assumption Survey, May 2018. http://roederfinancial.com/rambles/RoederSurvey2018.htm. (Last accessed June 10, 2018).

San Mateo County Employees' Retirement Association (SamCERA) "Perspectives that Drive Enterprise Success, Investment Performance Review, Period Ending December 31, 2017." https://www.samcera.org/sites/main/files/file-attachments/samcera_performance_report_4q17.pdf (Last accessed June 10, 2018).

San Mateo County Employees' Retirement Association (SamCERA), Guide to Retirement Benefits, at http://www.samcera.org/sistes/...guidetoyourretirementbenefits.pdf. (viewed June 10, 2018).

San Mateo County Employees' Retirement Association (SamCERA), *2017 Popular Annual Financial Report*. https://www.samcera.org/sites/main/files/file-attachments/2017pafr_final.pdf (Last accessed June 9, 2018.)

Torres, Blanca, "San Mateo County cashes in with sale of Circle Star Plaza for $90.1 million" in *The San Francisco Business Times*, May 20, 2014. https://www.bizjournals.com/sanfrancisco/blog/real-estate/2014/05/circle-star-plaza-griffin-capital-san-mateo-county.html (Last accessed June 9, 2018).

Issued: July 17, 2018

County of San Mateo

Inter-Departmental Correspondence

Department: COUNTY MANAGER
File #: 18-958 Board Meeting Date: 10/23/2018

Special Notice / Hearing: None
Vote Required: Majority

To: Honorable Board of Supervisors

From: John L. Maltbie, County Manager

Subject: Board of Supervisors' Response to the 2017-2018 Civil Grand Jury Report, "County Pension Costs - Hard Choices Paying Off"

RECOMMENDATION:
Approve the Board of Supervisors' response to the 2017-2018 Grand Jury Report, "County Pension Costs - Hard Choices Paying Off."

BACKGROUND:
On July 17, 2018, the 2017-2018 San Mateo County Civil Grand Jury issued a report titled "County Pension Costs - Hard Choices Paying Off." The Board of Supervisors is required to submit comments on the findings and recommendations pertaining to the matters over which it has some decision making authority within 90 days. The Board's response to the report is due to the Honorable V. Raymond Swope no later than October 16, 2018.

DISCUSSION:
The Grand Jury made twenty-one findings and four recommendations in its report. The Board responses follow each finding and the four recommendations that the Grand Jury requested that the Board respond to within 90 days.

FINDINGS

Finding 1:
As of June 30, 2017, SamCERA's Funded Ratio (Total Plan Assets/Total Plan Liabilities) was 84.3 percent. By comparison, the average Funded Ratio of cities in San Mateo County was 70.5 percent and the average of CalPERS agencies statewide was just 68 percent.

Response:
Agree that the Total Plan Assets/Total Plan Liabilities for the SamCERA Retirement Fund was 84.3 percent. The remainder of this finding contains facts of which the Board of Retirement does not have direct knowledge to independently verify and as such the

Board of Retirement submits no response to the remainder of finding.

Finding 2:
As of June 30, 2017, SamCERA had a significant system-wide Unfunded Liability of $743 million, while the County portion constituted a significant Unfunded Liability of $707.1 million.

Response:
Agree to the fact in this finding that as of June 30, 2017, the Unfunded Liability of the Retirement Fund was $743 million, however the term “significant” is subjective and as such the Board of Retirement submits no response to that portion of the finding. As for the $707.1 million, the Board of Retirement does not have direct knowledge of this fact to independently verify and as such the Board of Retirement submits no response to that portion of the finding.

Finding 3:
In FY 2016-2017, the County’s Normal Cost payments to SamCERA were $51 million, while its payments to SamCERA of principal and interest on the Unfunded Liability (“Amortization Cost”) came to $108 million. In addition, the County made supplemental payments to SamCERA of nearly $34 million to pay down the Unfunded Liability. The County’s total payments of $192 million represented about 18 percent of total General Fund spending and 39 percent of its total covered payroll costs in FY 2016-2017.

Response:
Agree that in FY 2016-2017, the County’s Normal Cost payments to SamCERA were $51 million, its payments to SamCERA of principal and interest on the Unfunded Liability (“Amortization Cost”) came to $108 million and that it made supplemental payments to SamCERA of nearly $34 million to pay down the Unfunded Liability. The remainder of this finding is directed toward the County of San Mateo and as such the Board of Retirement submits no response to the remainder of finding.

Finding 4:
The County’s payment of Amortization Cost diverts money that could otherwise be used to pay for public services that it provides.

Response:
This finding is not directed to the Board of Retirement, and as such the Board of Retirement submits no response to this finding.

Finding 5:
In 2013, the County approved a Memorandum of Understanding (MOU) with SamCERA that would result in the County eliminating its Unfunded Liability by FY 2022-2023, if actuarial assumptions are met. The County’s participation is not mandatory, but it has implemented the MOU on schedule. Currently, SamCERA projects that the County will eliminate its Unfunded Liability on schedule.

Response:
Agree with the finding, with exception to the phrase that the MOU would result in the County “eliminating its Unfunded Liability.” It should instead read “reduce its Unfunded Liability.” In 2012, the County approved an MOU with SamCERA that provides for the County to make supplemental contributions to “reduce the County’s long-term costs of contribution to the System by <u>accelerating the reduction</u> of the UAAL.” The MOU further provides that the County understands that “the cumulative effect of depositing supplement funding amounts above the

County's Statutory Contribution Rate (SCR), in accordance with this MOU will accelerate the reduction of the County's SCR over what the County's SCR would have been had the County not deposited such supplemental funding."

Finding 6:
The MOU provides that the County will make annual supplemental contributions totaling $140 million over the 10-year term of the MOU to pay down its Unfunded Liability. Further, the County will maintain a high payroll contribution rate (later determined to be 37.4 percent), even as Annual Required Contributions (ARC) are expected to fall, as the Unfunded Liability declines. Maintaining a contribution rate that is higher than needed to pay the ARC generates additional supplemental contributions.

Response:
Agree.

Finding 7:
The MOU provides that SamCERA will place supplemental contributions from the County into a Supplemental Contributions Account, such that the funds apply to the benefit of the County's plan, rather than the SamCERA system as a whole.

Response:
Agree.

Finding 8:
The County anticipates savings of over $304 million in interest expense as a result of paying down its Unfunded Liability ahead of the schedule provided in the Amortization Period. The County further anticipates that, once the Unfunded Liability is paid off, it will save up to $100 million per year in Amortization Costs and supplemental contributions. However, if the County commits these expected savings to other budgetary purposes, it will be more difficult for the County to meet Unfunded Liabilities in future years, if SamCERA's current actuarial assumptions prove to be too optimistic.

Response:
Agree with the finding. Under any circumstances it would be to meet any change in the future that may put unecpected pressure on the county.

Finding 9:
In 2003 and 2005, the County adopted enhanced pension benefit formulas that were applied retroactively to all employees. Since neither the County nor its employees had made Normal Cost contributions to pay for the enhanced benefits, the County's Unfunded Liability immediately increased. In 2011, the County reversed its previous action and returned to the original benefit formula. However, this only applied to new hires. In 2013, SamCERA implemented new reduced pension formulas required under the California Public Employees' Pension Reform Act.

Response:
Agree.

Finding 10:
Since 2014, the County has eliminated its prior practice of paying a portion of the employees' share of Normal Cost, known as the "employer pickup."

Response:
Agree with the finding that the County has eliminated its prior practice of paying a portion of the employees' share of Normal Cost, known as the "employer pickup;" however, the date is incorrect. The elimination of "pick-ups" occurred through labor negotiations with the various unions. The County commenced the elimination in November 2014 and completed it in July 2016, with a few County members receiving pick-ups until July 2018.

Finding 11:
Since 2014, the County has changed its prior practice of paying the entire cost of annual COLA increases for retirees. It now requires that all employees pay 50 percent of the future cost of this benefit as part of their payroll deduction for Normal Costs.

Response:
Agree, except the finding should read "Since 2015" instead of "Since 2014."

Finding 12:
During the FY 2007-2017 period, the County kept salary increases to an average annual rate of 2.87 percent, well below the rates of increase assumed by SamCERA. This resulted in a cumulative reduction in Unfunded Liability of $154.7 million. However, in the most recent years within the period, FY 2014-2017, the trend showed an increase in Unfunded Liability attributable to salary increases that exceeded SamCERA's assumptions.

Response:
Agree.

Finding 13:
In 2010, the County had 5,327 current employee members of SamCERA. By 2013, this had declined to 4,650 current members before rising back up to 5,080 in 2017.

Response:
Agree.

Finding 14:
SamCERA uses a 15-year layered Amortization Period to determine payments on the Unfunded Liability. That is a shorter period than used by some other pension systems, such as CalPERS. It results in higher employer contributions during the Amortization Period but will ultimately reduce the total interest expense.

Response:
Agree.

Finding 15:
SamCERA conducts Triennial Experience Studies to monitor its demographic actuarial assumptions, including member life-expectancy. Economic assumptions, including the assumed Return on Investment of its plan assets are reviewed annually.

Response:
Agree.

Finding 16:

Based on its latest Triennial Experience Study in 2017, SamCERA has made a change in the mortality assumption that predicts how long members are currently living and adds a projection scale that reflects the gradual year-to-year improvement in mortality that is expected to occur in the future. The new mortality assumption results in a significant increase of Normal Cost contributions equal to 2.19 percent of payroll.

Response:
Agree that the Board of Retirement adopted a new methodology for setting its mortality assumption and this resulted in an increase to the Normal Cost contributions of 2.19 percent of payroll. However, the term "significant" is subjective and as such the Board of Retirement submits no response to that portion of the finding.

Finding 17:
SamCERA has lowered its assumed Return on Investment (ROI) on plan assets in a series of steps since 2005. The assumed ROI for FY 2017-18 is 6.75 percent. That is more conservative than most other public pension systems, such as CalPERS, which is currently at 7.5 percent. (The CalPERS Board has since approved lowering the ROI in steps to 7.0 percent by FY 2020-2021).

Response:
Agree.

Finding 18:
Historically, ROI is the biggest source of funding for SamCERA's pension benefits, comprising approximately 57 percent of total revenues. Contributions by the County provided 29 percent and contributions by employees provided 14 percent of total revenues. As assumed ROI is lowered, Normal Cost increases, so contributions by the County and employees must be increased.

Response:
Agree.

Finding 19:
SamCERA has changed its allocation of assets in different types of investments over time. It has gradually reduced the share of investments in public equities (public stocks) to just 43 percent (as of June 30, 2017) and has diversified its portfolio by increasing the share invested in other asset categories.

Response:
Agree.

Finding 20:
An independent 2018 analysis by Roeder Financial ranks SamCERA third best among California pension plans, based on "funding assumptions." Since the only plans ranked higher than SamCERA were the CalPERS - Legislative (closed) and CalPERS Judges System II, 1, 3 plans, SamCERA has the highest ranking among its peer public pension plans for public agencies.

Response:
Agree.

Finding 21:
ROI can be estimated but not guaranteed. Financial markets have proven to be highly volatile. This

makes long-term financial planning difficult.

Response:
Agree.

RECOMMENDATIONS

Recommendation 1:
The Grand Jury recommends that the County Board of Supervisors continue to implement its MOU with SamCERA to eliminate its Unfunded Liability by the end of FY 2022-2023, provided that actuarial assumptions are met.

Response:
Agree.

Recommendation 2:
The Grand Jury recommends that the County Board of Supervisors keep overall salary increases at or below the actuarial rates assumed by SamCERA.

Response:
Disagree. Meyers-Milias-Brown Act states in law that we must negotiate terms and conditions. Prudent negotiations would factor competitive salary and benefits of other local government agencies and private industry to ensure a stable and effective workforce.

Recommendation 3:
Due to uncertainties regarding future pension liabilities, especially returns on investments, the Grand Jury recommends that the County Board of Supervisors, in budgeting for years beyond FY 2022-2023, ensure that the anticipated savings that accrue from eliminating the need to pay down an Unfunded Liability are not irrevocably committed to other budgetary purposes, such as operational or other ongoing expenses.

Response:
Disagree. Although the Board of Supervisors agrees in principle that it is prudent to not commit to increases in ongoing operational costs within the county's control, it is difficult to anticipate where future costs or needs may arise.

Recommendation 4:
The Grand Jury recommends that the SamCERA Board of Retirement continue to conduct Triennial Experience Studies to address potential demographic changes and continue to conduct annual economic analyses to assess its economic assumptions, including Return on Investment.

Response:
The recommendation will be implemented. SamCERA will continue to have its actuary perform its Triennial Experience Study, in accordance with Government Code section Government Code 31453, which provides, in part:

> "An actuarial valuation shall be made within one year after the date on which any system established under this chapter becomes effective, and therefore at intervals not to exceed three years. The valuation shall be conducted under the supervision of an actuary and shall cover the mortality, service, and compensation experience of the

members and beneficiaries, and shall evaluate the assets and liabilities of the retirement fund…."

Acceptance of the report contributes to the Shared Vision 2025 outcome of a Collaborative Community by ensuring that all Grand Jury findings and recommendations are thoroughly reviewed by the appropriate County departments and that, when appropriate, process improvements are made to improve the quality and efficiency of services provided to the public and other agencies.

FISCAL IMPACT:
There is no Net County Cost associated with accepting this report.

SamCERA
SAN MATEO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

Address: 100 Marine Parkway | Suite 125
Redwood City, CA 94065
Phone: (650) 599-1234
Toll-Free: (800) 339-0761
Fax: (650) 591-1488
PONY: RET 141
Web: www.samcera.org
Email: samcera@samcera.org

September 5, 2018

Hon. V. Raymond Swope
Judge of the Superior Court
c/o Charlene Kresevich
Hall of Justice
400 County Center , 2nd Floor
Redwood City, CA 94063-1655

Re: Response of the Board of Retirement to the San Mateo County 2017-18 Grand Jury Report entitled "County Pension Costs-Hard Choices Paying Off."

Hon. Judge Swope:

The following response was approved by the San Mateo County Employees' Retirement Association Board of Retirement at its public meeting on August 28, 2018.

The Board commends the Grand Jury on its through and accurate report on the status of the County of San Mateo's pension obligations and whether appropriate steps are being taken to manage them.

FINDINGS

F1. As of June 30, 2017, SamCERA's Funded Ratio (Total Plan Assets/Total Plan Liabilities) was 84.3 percent. By comparison, the average Funded Ratio of cities in San Mateo County was 70.5 percent and the average of CalPERS agencies statewide was just 68 percent.

Board of Retirement Response to F1:
Agree that the Total Plan Assets/Total Plan Liabilities for the SamCERA Retirement Fund was 84.3 percent. The remainder of this finding contains facts of which the Board of Retirement does not have direct knowledge to independently verify and as such the Board of Retirement submits no response to the remainder of finding.

F2. As of June 30, 2017, SamCERA had a significant system-wide Unfunded Liability of $743 million, while the County portion constituted a significant Unfunded Liability of $707.1 million.

Board of Retirement Response to F2:
Agree to the fact in this finding that as of June 30, 2017, the Unfunded Liability of the Retirement Fund was $743 million, however the term "significant" is subjective and as such the Board of Retirement submits no response to that portion of the finding. As for the $707.1 million, the Board of Retirement

does not have direct knowledge of this fact to independently verify and as such the Board of Retirement submits no response to that portion of the finding.

F3. In FY 2016-2017, the County's Normal Cost payments to SamCERA were $51 million, while its payments to SamCERA of principal and interest on the Unfunded Liability ("Amortization Cost") came to $108 million. In addition, the County made supplemental payments to SamCERA of nearly $34 million to pay down the Unfunded Liability. The County's total payments of $192 million represented about 18 percent of total General Fund spending and 39 percent of its total covered payroll costs in FY 2016-2017.

Board of Retirement Response to F3:
Agree that in FY 2016-2017, the County's Normal Cost payments to SamCERA were $51 million, its payments to SamCERA of principal and interest on the Unfunded Liability ("Amortization Cost") came to $108 million and that it made supplemental payments to SamCERA of nearly $34 million to pay down the Unfunded Liability. The remainder of this finding is directed toward the County of San Mateo and as such the Board of Retirement submits no response to the remainder of finding.

F4. The County's payment of Amortization Cost diverts money that could otherwise be used to pay for public services that it provides.

Board of Retirement Response to F4:
This finding is not directed to the Board of Retirement, and as such the Board of Retirement submits no response to this finding.

F5. In 2013, the County approved a Memorandum of Understanding (MOU) with SamCERA that would result in the County eliminating its Unfunded Liability by FY 2022-2023, if actuarial assumptions are met. The County's participation is not mandatory, but it has implemented the MOU on schedule. Currently, SamCERA projects that the County will eliminate its Unfunded Liability on schedule.

Board of Retirement Response to F5:
Agree with the finding, with exception to the phrase that the MOU would result in the County "eliminating its Unfunded Liability." It should instead read "reduce its Unfunded Liability." In 2012, the County approved an MOU with SamCERA that provides for the County to make supplemental contributions to "reduce the County's long-term costs of contribution to the System by <u>accelerating the reduction</u> of the UAAL." The MOU further provides that the County understands that "the cumulative effect of depositing supplement funding amounts above the County's Statutory Contribution Rate (SCR), in accordance with this MOU will <u>accelerate the reduction</u> of the County's SCR over what the County's SCR would have been had the County not deposited such supplemental funding."

F6. The MOU provides that the County will make annual supplemental contributions totaling $140 million over the 10-year term of the MOU to pay down its Unfunded Liability. Further, the County will maintain a high payroll contribution rate (later determined to be 37.4 percent), even as Annual Required Contributions (ARC) are expected to fall, as the Unfunded Liability declines. Maintaining a contribution rate that is higher than needed to pay the ARC generates additional supplemental contributions.

Board of Retirement Response to F6:
Agree.

F7. The MOU provides that SamCERA will place supplemental contributions from the County into a Supplemental Contributions Account, such that the funds apply to the benefit of the County's plan, rather than the SamCERA system as a whole.

Board of Retirement Response to F7:
Agree.

F8. The County anticipates savings of over $304 million in interest expense as a result of paying down its Unfunded Liability ahead of the schedule provided in the Amortization Period. The County further anticipates that, once the Unfunded Liability is paid off, it will save up to $100 million per year in Amortization Costs and supplemental contributions. However, if the County commits these expected savings to other budgetary purposes, it will be more difficult for the County to meet Unfunded Liabilities in future years, if SamCERA's current actuarial assumptions prove to be too optimistic.

Board of Retirement Response to F8:
This finding is not directed to the Board of Retirement, and as such the Board of Retirement submits no response to this finding.

F9. In 2003 and 2005, the County adopted enhanced pension benefit formulas that were applied retroactively to all employees. Since neither the County nor its employees had made Normal Cost contributions to pay for the enhanced benefits, the County's Unfunded Liability immediately increased. In 2011, the County reversed its previous action and returned to the original benefit formula. However, this only applied to new hires. In 2013, SamCERA implemented new reduced pension formulas required under the California Public Employees' Pension Reform Act.

Board of Retirement Response to F9:
Agree.

F10. Since 2014, the County has eliminated its prior practice of paying a portion of the employees' share of Normal Cost, known as the "employer pickup."

Board of Retirement Response to F10:
Agree with the finding that the County has eliminated its prior practice of paying a portion of the employees' share of Normal Cost, known as the "employer pickup;" however, the date is incorrect. The elimination of "pick-ups" occurred through labor negotiations with the various unions. The County commenced the elimination in November 2014 and completed it in July 2016, with a few County members receiving pick-ups until July 2018.

F11. Since 2014, the County has changed its prior practice of paying the entire cost of annual COLA increases for retirees. It now requires that all employees pay 50 percent of the future cost of this benefit as part of their payroll deduction for Normal Costs.

Board of Retirement Response to F11:
Agree, except the finding should read "Since 2015" instead of "Since 2014."

F12. During the FY 2007-2017 period, the County kept salary increases to an average annual rate of 2.87 percent, well below the rates of increase assumed by SamCERA. This resulted in a cumulative

reduction in Unfunded Liability of $154.7 million. However, in the most recent years within the period, FY 2014-2017, the trend showed an increase in Unfunded Liability attributable to salary increases that exceeded SamCERA's assumptions.

Board of Retirement Response to F12:
Agree.

F13. In 2010, the County had 5,327 current employee members of SamCERA. By 2013, this had declined to 4,650 current members before rising back up to 5,080 in 2017.

Board of Retirement Response to F13:
Agree.

F14. SamCERA uses a 15-year layered Amortization Period to determine payments on the Unfunded Liability. That is a shorter period than used by some other pension systems, such as CalPERS. It results in higher employer contributions during the Amortization Period but will ultimately reduce the total interest expense.

Board of Retirement Response to F14:
Agree.

F15. SamCERA conducts Triennial Experience Studies to monitor its demographic actuarial assumptions, including member life-expectancy. Economic assumptions, including the assumed Return on Investment of its plan assets are reviewed annually.

Board of Retirement Response to F15:
Agree.

F16. Based on its latest Triennial Experience Study in 2017, SamCERA has made a change in the mortality assumption that predicts how long members are currently living and adds a projection scale that reflects the gradual year-to-year improvement in mortality that is expected to occur in the future. The new mortality assumption results in a significant increase of Normal Cost contributions equal to 2.19 percent of payroll.

Board of Retirement Response to F16:
Agree that the Board of Retirement adopted a new methodology for setting its mortality assumption and this resulted in an increase to the Normal Cost contributions of 2.19 percent of payroll. However, the term "significant" is subjective and as such the Board of Retirement submits no response to that portion of the finding.

F17. SamCERA has lowered its assumed Return on Investment (ROI) on plan assets in a series of steps since 2005. The assumed ROI for FY 2017-18 is 6.75 percent. That is more conservative than most other public pension systems, such as CalPERS, which is currently at 7.5 percent. (The CalPERS Board has since approved lowering the ROI in steps to 7.0 percent by FY 2020-2021).

Board of Retirement Response to F17:
Agree.

F18. Historically, ROI is the biggest source of funding for SamCERA's pension benefits, comprising approximately 57 percent of total revenues. Contributions by the County provided 29 percent and contributions by employees provided 14 percent of total revenues. As assumed ROI is lowered, Normal Cost increases, so contributions by the County and employees must be increased.

Board of Retirement Response to F18:
Agree.

F19. SamCERA has changed its allocation of assets in different types of investments over time. It has gradually reduced the share of investments in public equities (public stocks) to just 43 percent (as of June 30, 2017) and has diversified its portfolio by increasing the share invested in other asset categories.

Board of Retirement Response to F19:
Agree.

F20. An independent 2018 analysis by Roeder Financial ranks SamCERA third best among California pension plans, based on "funding assumptions." Since the only plans ranked higher than SamCERA were the CalPERS – Legislative (closed) and CalPERS Judges System II, 1, 3 plans, SamCERA has the highest ranking among its peer public pension plans for public agencies.

Board of Retirement Response to F20:
Agree.

F21. ROI can be estimated but not guaranteed. Financial markets have proven to be highly volatile. This makes long-term financial planning difficult.

Board of Retirement Response to F21:
Agree.

RECOMMENDATIONS

R4. The Grand Jury recommends that the SamCERA Board of Retirement continue to conduct Triennial Experience Studies to address potential demographic changes and continue to conduct annual economic analyses to assess its economic assumptions, including Return on Investment.

Board of Retirement Response to R4:
The recommendation will be implemented. SamCERA will continue to have its actuary perform its Triennial Experience Study, in accordance with Government Code section Government Code 31453, which provides, in part:

> "An actuarial valuation shall be made within one year after the date on which any system established under this chapter becomes effective, and thereafter at intervals not to exceed three years. The valuation shall be conducted under the supervision of an actuary and shall cover the mortality, service, and compensation experience of the members and beneficiaries, and shall evaluate the assets and liabilities of the retirement fund...."

SamCERA will also continue to have an actuarial audit performed by its auditing actuary to ensure completeness and soundness of the recommended assumptions and findings contained in the Triennial Experience Study. Additionally, SamCERA will continue to have an annual valuation performed by its actuary to determine if adjustments are needed prior to the Triennial Experience Study.

Respectfully submitted,

Scott Hood
Chief Executive Officer