Santa Cruz County Civil Grand Jury

2014-2015 Response Packet

Funded for the Future?

Retirement Costs and Obligations in Santa Cruz County

Board of Directors, Soquel Creek Water District

Due date: 90 Days (by Thursday, Sept.10, 2015)

When finished, email the completed response packet as a file attachment to: grandjury@co.santa-cruz.ca.us

Instructions for Respondents

California law PC § 933.05 requires that those responding to a Grand Jury report must provide a response for each individual finding and recommendation within a report, not a generalized response to the entire report. Explanations for disagreements and timeframes for further implementation or analysis must be provided.
Please follow the format below when preparing your response.

Response Format

1. Find the Responses Required table that appears near the end of the report. Look for the row with the name of the entity you represent and then respond to the Findings and/or Recommendations listed in that row using the custom packet provided to you.
2. For Findings, indicate one of the following responses and provide the required additional information:
    a. AGREE with the Finding,
    b. PARTIALLY DISAGREE with the Finding and specify the portion of the Finding that is disputed and include an explanation of the reasons therefor, or
    c. DISAGREE with the Finding and provide an explanation of the reasons therefor.
3. For Recommendations, select one of the following actions and provide the required additional information:
    a. HAS BEEN IMPLEMENTED, with a summary regarding the implemented action,
    b. HAS NOT YET BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE, with a timeframe or expected date for implementation,
    c. REQUIRES FURTHER ANALYSIS, with an explanation and the scope and parameters of an analysis or study, and a timeframe for that analysis or study; this timeframe shall not exceed six months from the date of publication of the grand jury report,
    d. WILL NOT BE IMPLEMENTED because it is not warranted or is not reasonable, with an explanation therefor.

If the respondent is a governing body, please provide the voted response of the body as a whole. Individual responses from members of a governing body will not be published.

If you have questions about the response report please contact the Grand Jury by calling 831-454-2099 or by sending an e-mail to grandjury@co.santa-cruz.ca.us.

How and Where to Respond

1. Please download and fill out the Response Packet provided to you for your responses. Please respond to each finding and recommendation. Be sure to save any changes you make to the packet.
2. Print and send a hard copy of the Response Packet to:

   The Honorable Judge Rebecca Connelly
   Santa Cruz Superior Court
   701 Ocean Street
   Santa Cruz, Ca 95060
3. Email the completed Response Packet, as an attachment, to the Grand Jury at grandjury@co.santa-cruz.ca.us.

Due Dates

Elected officials or administrators are required to respond within 60 days of the Grand Jury report's publication. Responses by the governing body of any public entity are required within 90 days.

Penal Code § 933.05

1. For Purposes of subdivision (b) of § 933, as to each Grand Jury finding, the responding person or entity shall indicate one of the following:
    a. the respondent agrees with the finding,
    b. the respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefor.

2. For purpose of subdivision (b) of § 933, as to each Grand Jury recommendation, the responding person shall report one of the following actions:
    a. the recommendation has been implemented, with a summary regarding the implemented action,
    b. the recommendation has not yet been implemented but will be implemented in the future, with a timeframe for implementation,
    c. the recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a timeframe for the matter to be prepared for discussion by the officer or director of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This timeframe shall not exceed six months from the date of the publication of the Grand Jury report, or
    d. the recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.

3. However, if a finding or recommendation of the Grand Jury addresses budgetary or personnel matters of a County department headed by an elected officer, both the department head and the Board of Supervisors shall respond if requested by the Grand Jury, but the response of the Board of Supervisors shall address only those budgetary or personnel matters over which it has some decision-making authority. The response of the elected department head shall address all aspects of the findings or recommendations affecting his or her department.

4. A Grand Jury may request a subject person or entity to come before the Grand Jury for the purpose of reading and discussing the findings of the Grand Jury report that relates to that person or entity in order to verify the accuracy of the findings prior to their release.

5. During an investigation, the Grand Jury shall meet with the subject of that investigation regarding that investigation unless the court, either on its own determination or upon request of the foreperson of the Grand Jury, determines that such a meeting would be detrimental.

A Grand Jury shall provide to the affected agency a copy of the portion of the Grand Jury report relating to that person or entity two working days prior to its public release and after the approval of the presiding judge. No officer, agency, department or governing body of a public agency shall disclose any contents of the report prior to the public release of the final report.

Findings

Finding 1: Continually rising retirement costs and obligations put funding of jurisdictions' services and projects at risk.

___ **AGREE**
_X_ **PARTIALLY DISAGREE** - explain disputed portion below
___ **DISAGREE** - explain below

Response explanation (required for responses other than "Agree"):

The Soquel Creek Water District's total Unfunded Liability (UL) for pension and OPEB as of June 30, 2013 was $9 million. Required employer contributions are estimated at $682,000 for the 2015/16 fiscal year and projected to rise over four more years before flattening out. If the District pays according to CalPERS amortization schedule, the pension UL costs would total $14.9 million over 30 years.

This is the first year that small employers in the mandated CalPERS risk pools have the ability to effectively manage their pension liabilities. The Fiscal Year 2015/16 Budget adopted by the Board on June 16, 2015 includes funding for accelerated payment of the UL. The smaller liability associated with the Second Tier plan will be paid off and the District intends to pay down the liability for the First Tier plan in ten years instead of thirty in order to achieve significant long term savings.

Retirement costs certainly contribute to the District's financial pressures. However, as noted in the 2015 Ten-Year Finance Plan (Attachment 1), the District faces financial challenges on a number of fronts that combined, put significant upward pressure on future water rates. Future anticipated projects and costs include:

- $80 million (in escalated $) to develop a supplemental water supply project. New and ongoing annual maintenance costs to operate the project once it's placed into service are estimated to be $1.3 million starting in 2022/23.

- $70 million (in escalated $) of water system capital needs in the current and next ten years, along with $1 million to $2 million each year for capital outlay, studies, and planning efforts.

- The District will be required to issue additional debt, which will increase debt service payments, in order to fund the supplemental supply project.

- $875,000 for Conservation Program expenses in 2015/16 increasing annually to $1.3 Million in 2024/25 depending upon the degree of implementation.

- $350,000 starting in 2017/18 in ongoing annual operational costs for hexavalent chromium treatment.

The District is currently operating in an environment of declining water sales and will need to raise rates to meet its financial obligations and ensure long term financial stability. Retirement costs must be acknowledged and properly managed but are not the District's sole source of financial pressure. To state that these costs alone put services and projects at risk is not a fair and accurate assessment of the District's overall financial outlook.

Finding 2: A clear and complete statement of the total retirement costs and obligations has not been provided in the budget narrative for either the public or elected officials.

__ **AGREE**
_X_ **PARTIALLY DISAGREE** - explain disputed portion below
__ **DISAGREE** - explain below

Response explanation (required for responses other than "Agree"):

At the April 21, 2015 regular meeting of the Board of Directors, Staff presented an informational report on California Public Employees' Retirement System (CalPERS) Risk Pool Changes (Attachment 2). The report provided an overview of the District's retirement benefits under its contract with CalPERS and information regarding revisions to the risk pool that affect benefits costs. A clear and complete statement of pension retirement costs and obligations was presented. The report was intended to serve as a resource for the discussion and development of funding strategies during May's budget discussions. Staff released the information ahead of the budget discussions to allow time for the Board (and public) to digest the information and formulate questions.

The 2015-16 Budget contains information regarding OPEB expenses but does not address the unfunded liability.

More complete information regarding retirement costs and obligations (pensions and retiree health or OPEB) is appropriately located in the District's annual audited financial statements.

Recommendations

Recommendation 1: To prevent reductions in public services, each of the six public agencies studied in this report should increase, and make public, their efforts to manage and reduce retirement costs and obligations.

__X__ HAS BEEN IMPLEMENTED
__ HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - indicate timeframe below
__ REQUIRES FURTHER ANALYSIS - explain scope and timeframe below (not to exceed six months)
__ WILL NOT BE IMPLEMENTED - explain below

Response summary, timeframe or explanation:

The Soquel Creek Water District has a history of proactively managing, to the extent possible, its retirement costs and obligations. Actions taken to date include:

Retirement

- 2005: Negotiated a contract change to discontinue certain benefits to newly hired employees
- 2011: Paid off, eight years ahead of schedule, the CalPERS side fund which was accruing interest at 7.75%
- 2013: Negotiated a contract change to discontinue the Employer Payment of Member Contributions (EPMC)
- 2015: Adopted the Fiscal Year 2015-16 Budget which includes funding to pay off the unfunded liability for the Second Tier plan and to make a payment in excess of what is owed on the First Tier plan with the intention of paying down the unfunded liability in ten years instead of thirty years in order to achieve significant long term savings

Other Post Retirement Benefits (OPEB)

- 2011: Enrolled in the CalPERS Employers Retiree Benefit Trust Fund (CERBT) and began pre-funding retiree health benefits
- 2013: Negotiated a contract change whereby certain eligible retirees pay 10% of the health premium until they are eligible for Medicare. The District pays 100% of the Supplemental Medicare Premium
- 2013: Negotiated a contract change lengthening the number of years of District service AND the age requirement necessary to earn full retirement health benefits

District staff will continue to monitor retirement costs and obligations on an on-going basis and seek ways in which to achieve savings and minimize the impact on District finances.

Recommendation 2: Each of the six public agencies studied in this report should provide, in language understandable to the public, the totality of retirement obligations in their annual budget narratives beginning with the fiscal year 2015/16 budget.

__ HAS BEEN IMPLEMENTED
_X__ HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - indicate timeframe below
__ REQUIRES FURTHER ANALYSIS - explain scope and timeframe below (not to exceed six months)
__ WILL NOT BE IMPLEMENTED - explain below

Response summary, timeframe or explanation:

The District will include expanded language regarding retirement obligations in the annual budget narratives beginning with the Fiscal Year 2016-17 Budget. Additionally, the April 21, 2015 financial report on pensions (referenced above in Finding 2) will be posted as a supplementary budget document to the District's website in the Transparency Center under Finance and Budgets. Staff will add information regarding the funded status of the plans to the report and make the document available on the website no later than July 30, 2015. The report will be updated annually.

As noted in the Grand Jury report, the District pre-funds Other Post-Employment Benefits (OPEB) through the California Employers' Retiree Benefit Trust Program (CERBT). All plan participants are required to perform an actuarial valuation every two years. The District's last actuarial report is as of June 30, 2013 and Staff has arranged for actuarial work to begin this summer. Once the study is complete; sometime in October, the results will be presented to the Board at a regularly scheduled public meeting. Staff will utilize the information in the 2015 actuarial report to develop a comprehensive OPEB report similar to the one on pensions that will also be updated annually and posted to the District's website as a supplementary Budget document.

Table 3B - Soquel Creek Water District - Cash Flow Projections: 100% Recycled Water Project & $4 Million Target Annual Pay-Go CIP

		2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
1	Projected Rate Increases (Effective Jan-1)		12%	12%	12%	8%	5%	5%	5%	5%	9%	9%
2	*Cumulative Increases Starting 2015/16*		*12%*	*25%*	*40%*	*52%*	*59%*	*67%*	*76%*	*84%*	*101%*	*119%*
3	Projected Growth (5/8" meter equivs)	10	0	0	0	0	0	0	0	0	0	0
4	Total Fiscal Year Change in Water Sales		-2.7%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
5	Total Water Sales HCF	1,253,878	1,219,680	1,219,680	1,219,680	1,219,680	1,219,680	1,219,680	1,219,680	1,219,680	1,219,680	1,219,680
6	Total Water Sales AF	2,879	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800
7	Total Production AF (sales + approx 7%)	3,080	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
8	Service Installation Charge (5/8")	$3,782	$3,782	$3,782	$3,782	$3,782	$3,782	$3,782	$3,782	$3,782	$3,782	$3,782
9	Water Capacity Charge (5/8")	$11,200	$11,200	$11,200	$11,200	$11,200	$11,200	$11,200	$11,200	$11,200	$11,200	$11,200
10	Water Demand Offset Fee	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
11	Cost Escalation	-	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
12	Interest Earnings Rate	0.3%	0.5%	0.75%	1.0%	1.5%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
13	**Begininning Fund Reserves**	$9,574,000	$9,205,000	$6,932,000	$7,026,000	$5,457,000	$5,528,000	$5,497,000	$5,934,000	$6,297,000	$6,844,000	$6,686,000
14	**REVENUES**											
15	Water Service Charges (incl fire)	4,504,000	4,919,000	5,739,000	6,429,000	7,108,000	7,602,000	7,981,000	8,381,000	8,800,000	9,361,000	10,203,000
16	Water Sales	9,053,000	11,051,000	12,220,000	13,390,000	14,500,000	15,297,000	15,920,000	16,567,000	17,240,000	18,156,000	19,471,000
17	Capacity & Installation Fees	341,000	0	0	0	0	0	0	0	0	0	0
18	Interest Income	35,000	46,000	52,000	70,000	82,000	111,000	110,000	119,000	126,000	137,000	134,000
19	Delinq/After Hrs Fees/Misc	70,000	75,000	77,000	79,000	81,000	83,000	85,000	88,000	91,000	94,000	97,000
20	Total Revenues	14,003,000	16,091,000	18,088,000	19,968,000	21,771,000	23,093,000	24,096,000	25,155,000	26,257,000	27,748,000	29,905,000
21	2011 COPs, Project Fund Drawdown	1,463,000										
22	2013 COPs, Project Fund Drawdown	5,000,000	8,700,000	4,000,000								
23	Future COP Proceeds: District CIP											
24	Future SRF Proceeds: Recycled Water Project				3,600,000	2,000,000	1,000,000	1,000,000	4,000,000	13,000,000	23,000,000	23,000,000
25	Grant Proceeds/Reimbursements	146,000	75,000									
26	Water Capacity Fee Reserve Drawdown		847,000									
27	**EXPENSES**											
28	Operating											
29	Salaries (excludes some org structure changes)	3,988,000	4,334,000	4,551,000	4,779,000	5,018,000	5,269,000	5,532,000	5,809,000	6,099,000	6,404,000	6,724,000
30	Benefits	1,563,000	1,563,000	1,641,000	1,723,000	1,809,000	1,899,000	1,994,000	2,094,000	2,199,000	2,309,000	2,424,000
31	*Less Personnel Allocation to CIP*	*(460,000)*	*(481,000)*	*(505,000)*	*(530,000)*	*(557,000)*	*(585,000)*	*(614,000)*	*(645,000)*	*(677,000)*	*(711,000)*	*(747,000)*
32	OPEB Funding Requirement	433,000	433,000	433,000	433,000	433,000	433,000	433,000	433,000	433,000	433,000	433,000
33	Power	538,000	565,000	593,000	623,000	654,000	687,000	721,000	757,000	795,000	835,000	877,000
34	Supplies	457,000	480,000	504,000	529,000	555,000	583,000	612,000	643,000	675,000	709,000	744,000
35	Services	1,176,000	1,235,000	1,297,000	1,362,000	1,430,000	1,502,000	1,577,000	1,656,000	1,739,000	1,826,000	1,917,000
36	Communications	382,000	401,000	421,000	442,000	464,000	487,000	511,000	537,000	564,000	592,000	622,000
37	Conservation Program (excl rebates)	171,000	875,000	898,000	943,000	990,000	1,040,000	1,092,000	1,147,000	1,204,000	1,264,000	1,327,000
38	Additional Billing Costs (Software & Staffing)	0	0	0	200,000	150,000	100,000	50,000	53,000	56,000	59,000	62,000
39	Legal & Professional Svcs (Eng/Network/Acct/Misc)	432,000	454,000	477,000	501,000	526,000	552,000	580,000	609,000	639,000	671,000	705,000
40	Other Operating Expenses	661,000	694,000	729,000	765,000	803,000	843,000	885,000	929,000	975,000	1,024,000	1,075,000
41	Hex Chrome Treatment	0	0	0	350,000	368,000	386,000	405,000	425,000	446,000	468,000	491,000
42	Recycled Water Operations	0	0	0	0	0	0	0	0	0	0	0
43	Subtotal	9,341,000	10,553,000	11,039,000	12,120,000	12,643,000	13,196,000	13,778,000	14,447,000	15,147,000	15,883,000	16,654,000
44	Debt Service											
45	2012 Refunding Bonds (Refi of 2004 Bonds)	629,000	629,000	629,000	629,000	0	0	0	0	0	0	0
46	2011 COPs	767,000	767,000	767,000	767,000	767,000	1,462,000	1,459,000	1,459,000	1,459,000	1,459,000	1,459,000
47	2013 COPs	1,095,000	1,095,000	1,094,000	1,093,000	1,678,000	1,028,000	1,029,000	1,028,000	1,027,000	1,031,000	1,031,000
48	Future COPs, District CIP	0	0	0	0	0	0	0	0	0	0	0
48	Future SRF Loans, Recycled Water Project	0	0	0	90,000	230,000	305,000	355,000	480,000	905,000	1,805,000	2,955,000
49	Subtotal	2,491,000	2,491,000	2,490,000	2,579,000	2,675,000	2,795,000	2,843,000	2,967,000	3,391,000	4,295,000	5,445,000
50	Capital Improvements & Other Non-Operating											
51	District CIP Projects	7,134,000	10,650,000	4,000,000	3,000,000	3,400,000	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000
52	Recycled Water Project Admin 100%	140,000	227,000	299,000	341,000	622,000	646,000	433,000	452,000	471,000	328,000	344,000
53	Recycled Water Project Costs 100%	15,000	319,000	716,000	3,622,000	1,858,000	927,000	985,000	4,243,000	12,953,000	23,584,000	23,351,000
54	Personnel Allocation to CIP	460,000	481,000	505,000	530,000	557,000	585,000	614,000	645,000	677,000	711,000	747,000
55	Capital Outlay/Studies/Planning	1,000,000	1,967,000	2,000,000	2,000,000	1,000,000	1,030,000	1,061,000	1,093,000	1,126,000	1,160,000	1,195,000
56	*Subtotal*	*8,749,000*	*13,644,000*	*7,520,000*	*9,493,000*	*7,437,000*	*7,188,000*	*7,093,000*	*10,433,000*	*19,227,000*	*29,783,000*	*29,637,000*
57	Conservation Program Rebates	400,000	375,000	375,000	375,000	375,000	375,000	375,000	375,000	375,000	375,000	375,000
58	Discretionary OPEB/Retirement Prepayments	0	923,000	570,000	570,000	570,000	570,000	570,000	570,000	570,000	570,000	570,000
59	Subtotal	9,149,000	14,942,000	8,465,000	10,438,000	8,382,000	8,133,000	8,038,000	11,378,000	20,172,000	30,728,000	30,582,000
60	Total Expenses	20,981,000	27,986,000	21,994,000	25,137,000	23,700,000	24,124,000	24,659,000	28,792,000	38,710,000	50,906,000	52,681,000
61	**Revenues Less Expenses**	(369,000)	(2,273,000)	94,000	(1,569,000)	71,000	(31,000)	437,000	363,000	547,000	(158,000)	224,000
62	**Ending Fund Reserves**	9,205,000	6,932,000	7,026,000	5,457,000	5,528,000	5,497,000	5,934,000	6,297,000	6,844,000	6,686,000	6,910,000
63	Min Operating Fund Rsrv Target (40% O&M)	3,736,000	4,221,000	4,416,000	4,848,000	5,057,000	5,278,000	5,511,000	5,779,000	6,059,000	6,353,000	6,662,000
64	Debt Svc Coverage: with Cap Outlay as non-operating	1.87	2.22	2.83	3.04	3.41	3.54	3.63	3.61	3.28	2.76	2.43
65	Debt Svc Coverage: with 1/2 Cap Outlay as operating	1.67	1.83	2.43	2.66	3.23	3.36	3.44	3.42	3.11	2.63	2.32

SOQUEL CREEK WATER DISTRICT
FINANCIAL AND BUSINESS SERVICES DEPARTMENT
STATUS REPORT
Item 7.4
April 21, 2015

Informational Report on California Public Employees' Retirement System (CalPERS) Risk Pool Changes

The purpose of this report is to provide an overview of the District's retirement benefits under its contract with CalPERS and to provide information regarding revisions to the risk pool that affect future benefits costs. The report is intended to serve as a resource for the discussion and development of funding strategies during next month's Budget discussions.

Background

The Soquel Creek Water District contracts with CalPERS to provide retirement benefits to its employees. CalPERS is a separate and distinct legal entity from the District and serves as an independent fiduciary in managing the District's retirement plan assets. It is an agency in the State of California's executive branch and it manages a pension fund that serves more than 1.7 million public agency members.

The District contracts with CalPERS for services related to the defined benefit retirement plan which covers all regular employees. The defined benefit plan guarantees a benefit amount based upon a formula that considers age at retirement, years of service credit, and the average of the highest three years of compensation credit. These plans promote stability and low turnover and help attract employees to public sector employment. CalPERS plans are funded through employee and employer contributions and earnings on those investments.

Ca1PERS retirement benefits are based on three key factors at retirement:

1. Age. To be eligible for retirement, a Ca1PERS member must be at least 50 years of age and have a minimum of five years of Ca1PERS credited service. The "normal" retirement age is the age indicated in the agency's benefit formula. The District's "2.5% at 55" plan specifies that 55 is the normal retirement age and 62 is the normal retirement age for the "2% at 62" plan. Benefits are reduced if an employee retires before the normal retirement age.

2. Service Credit. This is determined by the number of years an employee has worked for a Ca1PERS agency.

3. Final Compensation. Compensation is defined by Ca1PERS as base pay plus other special compensation. Special compensation includes pay for performing and maintaining skills for normally required duties. For the District, special compensation includes uniform allowance and stipends for obtaining water

treatment and water distribution certification at certain advanced levels. However, compensation for services outside of regular duties such as overtime, on call, call back, pay in -lieu of medical benefits, and leave cash-outs **are not** included in calculating final compensation. Final compensation is based on the average of the three highest years of compensable earnings.

Under the District's retirement plans an employee with 15 years of service would have their retirement benefit calculated as either 15 x 2.5% = 37.5% of final compensation or as 15 x 2% = 30% of final compensation.

As mentioned above, pensions are funded through a combination of employee and employer contributions and earnings on investments. Employee contribution rates are set by State statute and are 8% of compensable earnings for District employees who are classic members of CalPERS and 6.25% for District employees who are PEPRA members. The Public Employees' Pension Reform Act of 2013 (PEPRA) applies to employees hired after January 1, 2013 who did not experience a break in CalPERS membership for more than six months or who were never previously enrolled in a CalPERS plan. The employee contribution rate for PEPRA members is lower than that of classic members because they receive a lesser benefit. The retirement age for PEPRA members is extended to 62 from 55 and they will earn 2% as opposed to 2.5% of final compensation.

The employee contribution may be paid by either the employee or the employer. The Employer "pick-up" of the employee contribution is often negotiated in lieu of salary increases and the District paid the employee contribution for many years. The District was an early adopter of some the pension reforms outlined in PEPRA and negotiated a contract change with all groups to discontinue this benefit in September of 2013. District employees currently pay the employee contribution through payroll withholdings.

CalPERS calculates the required employer contribution rate each year. This rate is driven by a number of actuarial factors including:

- Participation levels (How many employees will actually retire under the system and receive benefits?)
- Age of current participants (How close to retirement age are current employees?)
- Mortality (How long will they live after retirement?)
- Salary costs and inflation (How will these rise over today's levels?)
- Contractual benefit levels
- Status of current funding (Are current assets greater or less than accrued liabilities?)
- Investment returns

All of these factors can affect contribution rates but lower investment yields due to the economic downturn have had a significant impact on employer rates in recent years. It should be noted that the District consistently submits 100% of its annual required contribution to CalPERS through bi-weekly payroll deductions expressed as a percentage of payroll.

CalPERS requires employers with less than 100 active members to participate in mandatory risk pools to protect them from large fluctuations in employer contribution rates caused by unexpected demographic events. The District has three plans in the mandated risk pool:

Plan Name	**Retirement Formula**	**Membership FTE**
Miscellaneous First Tier	2.5% at Age 55	16
Miscellaneous Second Tier	2.5% at Age 55	18.375
PEPRA Miscellaneous	2% at Age 62	12

*FTE = Full Time Equivalent employees as of 03/31/2015

Employees enrolled in the Miscellaneous First Tier plan were hired prior to December 18, 2005 and are the only group eligible to receive the Industrial Disability Retirement (IDR) benefit. Once a public employee begins to work, that employee has a vested right to the benefits that were in effect on the day they were hired. Retirement benefits for public employees are viewed as deferred compensation and are protected under the Contracts clause of the U.S. Constitution. Additional obligations exist under Public Employees Retirement Law (PERL). Agencies that contract with CalPERS must comply with PERL even if PERL provides greater protection than the Constitution requires.

The best option available to the District for changing the IDR benefit was to create a new tier for future hires. Future hires are not vested so their benefits can be lowered within certain statutory limits under CalPERS. The District successfully negotiated to discontinue the benefit for employees hired after December 18, 2005. Employees enrolled in the Miscellaneous Second Tier plan were hired after that date and are not eligible to receive the IDR benefit.

Employees hired after January 1, 2013 who meet criteria discussed earlier are enrolled in the PEPRA Miscellaneous plan which is subject to the legislative reforms of the Public Employees' Pension Reform Act of 2013.

CalPERS performs an actuarial valuation of each plan which measures the assets, liabilities, and funded status of the plan as of June 30 each year. The actuarial valuation is used to determine the required employer contribution rate(s) for the fiscal year beginning two years after the valuation date. The actuarial valuation as of June 30, 2013 is the basis for the employer contribution rates for the 2015-16 fiscal year. The two-year lag is necessary due to the amount of time needed to extract and test the membership and financial data of the plans. It also gives CalPERS the ability to provide public agencies with their employer contribution well in advance of the start of the fiscal year for planning purposes.

Discussion

Risk Pool Structural Changes

On January 1, 2013, PEPRA took effect. In addition to creating new retirement formulas for newly hired members, PEPRA also effectively closed all existing active risk pools to new employees and created some unintended consequences as follows:

- The payroll of the risk pools for the classic formulas will not continue to grow at three percent (3%) annually, so the actuarial valuations can no longer assume a three percent (3%) growth rate of the risk pools.

- Using the established methodology of having employers make contributions as a percentage of payroll will lead to the underfunding of the plans.

- Using the established methodology of allocating existing unfunded liabilities based on payroll will create equity issues for employers within the risk pools.

- The declining payroll of the classic formula risk pools will lead to unacceptable levels of employer contribution rate volatility.

In order to address these issues, the CalPERS Board of Administration approved, at their May 21, 2014 meeting, structural changes to the risk pools. These changes will take effect for fiscal year 2015/16 based on the Annual Valuation Report as of June 30, 2013. The structural changes are as follows:

1. All pooled plans (i.e., active and inactive, classic and PEPRA formulas) will be combined into two active pools – one for all Miscellaneous groups and one for all Safety groups.

   By combining the pools, the payroll of the risk pools and the employers within the pools can once again be expected to increase at the assumed three percent (3%) annual growth.

   Prior to the combining of all plans into two active pools, each prior pool's Unfunded Accrued Liability (UAL) was allocated proportionately to each individual plan based on each plan's total liability. The UAL is the difference between assets and liabilities within the plan on a Market Value of Assets (MVA) basis.

2. CalPERS will collect employer contributions toward the newly isolated Unfunded Liability and Side Fund as a flat dollar amount instead of the prior method of a contribution rate expressed as a percentage of payroll. It should be noted that the District has no Side Fund obligation as it was proactively paid off in June 2011.

Employers are now able to track their own Unfunded Liability and Side Fund and pay them down faster if they choose. Employers will be invoiced at the beginning of the fiscal year for their Unfunded Liability and Side Fund payments, which are **mandatory** payments that must be made to CalPERS regardless of payroll. The unfunded liability rate represents what is required to amortize past unfunded liability costs over a 30 year time period. Unfunded liabilities are accrued to an employer when circumstances, such as investment losses or change in benefits, mean that current contributions will not meet the obligations to fund retiree benefits.

This change in ensuring that employers pay a specified dollar amount, and not a potentially varied amount based on payroll, addresses the funding issue that would still arise from the declining population of classic formula members. Since the classic formulas are essentially closed to new employees, the payroll will inherently decline and employers would be required to pay an exponentially higher percentage of payroll to address the Unfunded Liability associated with already retired employees.

3. Employers will continue to make payments for the plan's normal costs as a contribution rate expressed as a percentage of payroll. The normal cost rate is what is required to actuarially ensure that current contributions will meet future benefit requirements, assuming there are no excess assets or unfunded liabilities.

Actuarial Assumption Changes

In parallel to the implementation of the risk pool changes, CalPERS regularly analyzes and makes improvements to its actuarial assumptions and policies toward the objective of having a fully funded and sustainable system. The following is a listing of actuarial assumptions and policy changes that have already taken effect or will take effect in the near future:

Effective fiscal year 2015/16:

CalPERS will use an amortization and smoothing policy that will pay for all gains and losses over a fixed 30-year period with the increases and decreases in the rate spread directly over a 5-year period.

The discount rate assumption remains at 7.5%. However, the CalPERS Board made modest changes to the asset allocation that will reduce the expected volatility of returns.

Effective fiscal year 2016/17:

Demographic assumptions are adjusted to more closely align with actual experience. The most significant of these demographic assumption changes is mortality improvement to acknowledge the greater life expectancies that have occurred. The increase in liability due to the new assumptions will be amortized over a 20-year period with the increases phased in over the first five years and ramped down over the last five years of the 20-year amortization period.

GASB 68

Another related, significant change is mandated by the Governmental Accounting Standards Board Statement 68 (GASB 68) in effect for all financial statements for the year ended June 30, 2015 and thereafter. GASB 68 is intended to improve information provided by state and local governmental employers about financial support for pensions that is provided by other entities (i.e., CalPERS). It establishes new pension reporting standards for the District's financial statements such that the funded status of the pension plans must be disclosed on the District's balance sheet, where in prior years this information was only provided in the footnotes. In addition, the figures to be reported are based on accounting liabilities, which are determined on the Market Value of Assets (MVA) basis and likely to be higher than funding liabilities.

GASB 68 will require separate valuation reports for each employer within the risk pools. State Law does not allow pension funding to be used to prepare these individual reports so CalPERS will be providing them at the request of individual employers at a cost of $850 per report. Each plan requires a separate report so the District will need to request three reports each year. Staff ordered the reports from CalPERS, rather than hire another actuarial firm to complete them since the source data resides with CalPERS and the cost was reasonable.

How do these changes impact the Soquel Creek Water District?

The District's fiscal year 2015/16 required employer contributions based on the June 30, 2013 valuation reports relative to the fiscal year 2014/15 employer contribution is as follows:

Plan	**FY 2014/15**	**FY 2015/16**	
	Employer Rate	Normal Cost Rate	Unfunded Liability (UL)
Miscellaneous First Tier Plan	15.581%	9.528%	$280,465
Miscellaneous Second Tier Plan	15.135%	9.067%	$5,514
PEPRA Miscellaneous Plan	6.25%	6.237%	$0

The UL contributions can be reduced in fiscal year 2015/16 to $270,504 (First Tier Plan) and $5,318 (Second Tier Plan) for a savings of $10,157 if an annual lump sum prepayment is made instead of bi-weekly payments throughout the year. Staff will bring this option back for the Board's consideration as part of the fiscal year 2015/16 Budget discussions.

The June 2013 CalPERS valuation report also contains a calculation of the flat Unfunded Liability as a percentage of payroll which allows for a better year over year comparative analysis. It also more clearly demonstrates the impact of the Unfunded Liability on employer rates. The chart below illustrates the difference in the *effective employer rates* for fiscal year 2015/16, relative to fiscal year 2014/15 as follows:

Plan	**FY 2014/15**	**FY 2015/16**	
	Employer Rate	*Effective* Employer Rate	Increase / (Decrease)
Miscellaneous First Tier Plan	15.581%	27.278%	11.697%
Miscellaneous Second Tier Plan	15.135%	9.473%	(5.662%)
PEPRA Miscellaneous Plan	6.25%	6.237%	(.013%)

The District has Unfunded Liabilities of $6,078,257 which, as amortized by CalPERS over a period of 30 years, will cost a total of $14,860,274 as illustrated below.

Plan	**Unfunded Liability**	**Total Payments**	**Interest Expense**
Miscellaneous First Tier Plan	$5,879,830	$14,324,854	$8,445,024
Miscellaneous Second Tier Plan	$198,427	$535,420	$336,993
PEPRA Miscellaneous Plan	-$91	0	0
Total – All Plans	$6,078,257	$14,860,274	$8,782,017

A Staff recommendation to make a lump sum payment of the Unfunded Liability of $198,427 for the Miscellaneous Second Tier Plan will be presented for the Board's consideration at the Budget Workshop.

CalPERS offers two alternate amortization schedules. The alternate schedules for the First Tier Plan liability of $5,879,830 are as follows:

Period (Years)	**2015-16 Payment**	**Total Payments**	**Total Interest**	**Savings**
25	$388,624	$14,168,945	$8,289,115	$155,909
20	$443,959	$11,929,345	$6,049,515	$2,395,509

The level rate payments for both periods are expected to increase by 3% each year into the future. It should also be noted that once an agency opts into one of the alternate amortization plans it cannot opt out.

Staff contacted the District's CalPERS actuary and requested a copy of the amortization schedule for the First Tier Plan. Staff used the schedule to compute potential savings in paying down the Unfunded Liabilities in 10, 12, and 15 years.

Period (Years)	Annual Payment	Total Payments	Savings
15	$669,233	$10,038,495	$4,286,359
12	$752,639	$9,031,668	$5,293,186
10	$841,390	$8,413,902	$5,910,952

The 10, 12, and 15 year amortization schedules are not offered by CalPERS; however CalPERS Board policy allows lump sum contributions in excess of the required contribution. Excess contributions are not obligatory and can be made at the District's discretion. There is considerable savings in accelerating payments towards the Unfunded Liabilities but the potential savings must be weighed against the financial impacts of the payments. Staff would recommend that the Board give further consideration to this within the context of both the upcoming fiscal year Budget and the District's 10 Year Finance Plan. Staff will bring this item back for discussion at the Budget Workshop in May.

By________________________________

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