

Unfunded Pension Liabilities: Shasta County and the Cities of Redding, Anderson, and Shasta Lake Pay Now or Pay More Later



[Image source: <http://www.ips-dc.org/five-simple-ways-can-fix-broken-economy/>]

SUMMARY

Unfunded pension and other post-employment benefit liabilities have become a major problem nationwide for public agencies such as cities, counties, and states. Some agencies, such as the Cities of Stockton and Vallejo, have had to declare bankruptcy due in part to these large unfunded liabilities. The 2016/17 Shasta County Grand Jury investigated the unfunded liabilities of four local agencies: Shasta County and the Cities of Redding, Anderson, and Shasta Lake. Examination and comparison of these local agencies with each other and with other California agencies was helpful in determining how serious these unfunded liabilities are for the agencies' financial stability, and the degree to which they threaten public services funded by taxpayers. This examination also assisted in identifying successful strategies to reduce the impact on future services to the public.

Shasta County's local agencies must closely monitor their situation and look for ways to reduce their unfunded liabilities without having to drastically cut the vital services they provide to the community. Although this is a serious concern, the Grand Jury found that all four agencies are attempting to be proactive and mitigate future budgetary difficulties.

BACKGROUND

The California Public Employees' Retirement System (CalPERS) is the nation's largest public pension fund, and manages the investments and medical benefits for most of the public agencies in California. CalPERS was established in 1932; by 2014, it had surpassed \$300 billion in total fund market value. According to the CalPERS website, the CalPERS pension fund serves more than 1.7 million members in the CalPERS retirement system and administers health benefits for nearly 1.4 million members and their families.

The "unfunded liability" is the amount of the accrued liability that is not currently covered by the plan's assets and is the sole responsibility of the employer. The recessions, one in 2001-2002 and another in 2008-2009, greatly contributed to increased unfunded liabilities because of large stock market losses and because many public agencies made unrealistic retirement promises. Prior to 2000, most public agency pension plans in the State were 100% funded; now, less than 10% of them are fully funded.

Another concern is that, in past years, a large percentage of bond and fixed income investments (with a smaller percentage of stocks) provided good and safe returns. Due to lower interest rates, CalPERS must now invest a larger part of its funds in stocks, real estate, and overseas investments to improve returns, which subjects its funds to much higher risks.

In an effort to address these issues, California implemented a different retirement plan for new employees. The California Public Employees' Pension Reform Act (PEPRA), which took effect in January 2013, changes the way CalPERS retirement and health benefits are applied to new members and places limits on future pension compensation for those members. As more employees are hired into the lower plans, future costs will be lower and unfunded ratios will improve.

METHODOLOGY

The Grand Jury interviewed:

- Shasta County Board of Supervisors member
- Shasta County Administrative Office personnel
- Shasta County Auditor-Controller's Office personnel
- City of Redding City Council member
- City of Redding City Management personnel
- City of Redding Finance Department personnel
- City of Anderson City Council member
- City of Anderson City Management personnel
- City of Anderson Finance Department personnel
- City of Shasta Lake City Council member
- City of Shasta Lake City Management personnel

The Grand Jury reviewed:

- CalPERS actuarial valuation reports for all four agencies, FY 2014/15
- CalPERS Comprehensive Annual Financial Report, FYE June 30, 2016
- CalPERS PERSpective Winter 2017 newsletter
- Unfunded liabilities for Shasta County, from FY 2005/06 to 2015/16
- Unfunded liabilities for the City of Redding, from FY 2005/06 to 2015/16
- Unfunded liabilities for the City of Anderson, from FY 2005/06 to 2015/16
- Unfunded liabilities for the City of Shasta Lake, from 2013/14 to 2014/15
- Shasta County Comprehensive Annual Financial Report, FYE June 30, 2016
- City of Redding Comprehensive Annual Financial Report, FYE June 30, 2016
- City of Anderson Comprehensive Annual Financial Report, FYE June 30, 2016

- City of Shasta Lake Comprehensive Annual Financial Report, FYE June 30, 2016
- City of Redding City Council special meeting agenda packet, February 22, 2017
- 2015/16 Orange County Grand Jury Report – “Orange County’s \$4.5 Billion Unfunded Pension Liability & Retirement Plans”
- Reason Foundation Pension Integrity Project Analysis of the City of Redding
- Stanford Institute for Economic Policy Research website, www.pensiontracker.org
- Reason Foundation Pension Integrity Project website, www.reason.org
- Website, www.pensionsunami.com

DISCUSSION

The four local public agencies’ retirement or pension plans for their employees are called “Defined Benefit Plans”, which are designed to provide retired employees with a specified amount of monthly retirement income for the rest of their lives. These plans are typically based on a formula: the employee’s salary, times the number of years worked, times a percentage factor. Limitations on each pension are determined by each bargaining unit’s contract.

These plans are designed to be pre-funded from both employer and employee contributions. When an employee retires, the employer should have reserved enough money in the CalPERS plan to pay for all the promised retirement benefits. Currently, most plans in California have some unfunded liability. The unfunded liabilities of four local agencies were studied: Shasta County, and the Cities of Redding, Anderson, and Shasta Lake. According to the CalPERS actuarial valuations, as of June 30, 2015, City of Redding’s pension plan is only about 70% funded; City of Anderson’s plan is about 76% funded; City of Shasta Lake’s plan is about 81% funded; Shasta County’s plan is about 78% funded. 18 years ago, these plans were all 100% funded.

CalPERS plans are categorized by employee role: the Safety Plan is for law enforcement and fire employees; the Miscellaneous Plan is for all other employees. All four agencies have Miscellaneous Plans. The City of Shasta Lake is the only one of the four agencies that does not have a Safety Plan.

In addition to the unfunded pension liabilities, some of the four agencies studied have other types of unfunded liabilities. City of Redding has an unfunded Public Agency Services Retirement Enhancement (PARS) plan that was used to increase retirement benefits for non-safety employees. This PARS plan is being phased out. Both City of Redding and Shasta County also have unfunded liabilities in other post-employment benefits (OPEB) plans which pay for retired employees’ health benefits.

CalPERS annually releases an actuarial valuation report to each contributing agency. These reports include amortization schedules, which project the agencies’ future annual payments towards paying off their current unfunded liabilities. Agencies are, by default, on 30-year amortization schedules; 20-year and 15-year alternative schedules are also available options. While 30-year schedules have lower annual payments, the 20- and 15-year schedules result in a

lower overall payment. For example, if the City of Redding went from its current 30-year to a 20-year amortization schedule, the total savings are projected to be \$29,577,073. To go to a shorter amortization schedule, an agency just makes the annual contribution identified in the preferred schedule.

The CalPERS actuarial reports also identify both the monthly payment amounts and annual prepayment amount the agencies must make. Each agency chooses how often to pay their annual CalPERS contribution. If an agency takes the annual prepayment option instead of the monthly payments, the agency can save on interest. For example, Shasta County opts for the annual prepayment and saves approximately \$700,000 per year on interest.

Total CalPERS contribution rates are partially based on CalPERS investment results. According to the CalPERS PERSpective Winter 2017 newsletter, the investment returns have been much lower over the past few years which may, in turn, require higher contribution rates by employers and, in some cases, employees. If CalPERS investment returns remain low, or if there is another major downturn in the stock market or the economy, agencies must increase their contributions to CalPERS, risking further reductions in services to the local community. According to the CalPERS actuarial reports, contributions from all four agencies are projected to almost double over the next five years. This will likely consume an increasing percentage of their budgets and reduce funds available for other services, including police protection and fire safety.

With the 2016 CalPERS investment rate of return at 0.6%, and the 2015 return at 2.4%, the CalPERS current assumed 7.5% investment rate of return is not realistic. CalPERS is slowly lowering the rate to 7.0% over the next three years, but that rate is still much higher than their average 5.1% return of the past 10 years as reported in the most recent CalPERS Comprehensive Annual Financial Report. Lowering the investment rate of return will automatically require increased contributions from all agencies.

In addition, since 2001, four large corrections in the stock market have resulted in major losses to CalPERS investments, as shown below:

Year	2001	2002	2008	2009
CalPERS Actual Returns	-7.2%	-6.1%	-5.1%	-24.0%

Another large economic correction could be catastrophic to the agencies. During the CalPERS loss of 24% in 2009, Shasta County's Miscellaneous Plan dropped from 96.7% funded to only 66.4% funded, and Redding's Miscellaneous Plan dropped from 87.5% funded to only 60.3% funded. While the outlook for the four local agencies has not reached a critical point yet, they are likely to be affected by CalPERS' poor investment results.

In addition, contributions will become increasingly difficult to pay because all four agencies now have more retired employees receiving pensions than they have active employees paying into the CalPERS system.

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Number of Employees vs. Retirees*							
		Employees	Retirees			Employees	Retirees
Shasta County	Miscellaneous	1600	2050	Anderson	Miscellaneous	27	62
	Safety	246	359		Safety	10	23
Redding	Miscellaneous	570	694	Shasta Lake	Miscellaneous	39	49
	Safety	178	259		Safety	N/A	N/A

*2014/15 CalPERS Actuarial Reports, as of June 30, 2015

Shasta County

As of June 30, 2015 (the latest data available from CalPERS), Shasta County has an unfunded pension liability of \$125,386,389 in its Miscellaneous Plan and \$62,598,535 in its Safety Plan. In addition, there is an unfunded liability of \$186,000,000 in an OPEB Plan.

Shasta County has taken the following steps to help mitigate these unfunded liabilities:

- In FY 2015/16, the County began contributing an additional 3% of salaries toward unfunded OPEB.
- On January 1, 2017, the County began implementing a 401(a) plan for new employees as agreements are made with the bargaining units. These two steps are expected to eliminate the unfunded OPEB liability in about 25 years.
- The County saves approximately \$700,000 in interest each year by prepaying the annual CalPERS contribution.

The Shasta County Unfunded Liabilities Table summarizes the unfunded liabilities for Shasta County.

Shasta County Unfunded Liabilities			
Criteria	Miscellaneous Plan	Safety Plan	Total
Pension Liability	\$570,496,682	\$213,609,445	\$784,106,127
Value of Assets	\$445,110,293	\$151,010,910	\$596,121,203
Unfunded Liability	\$125,386,389	\$ 62,598,535	\$187,984,924
Funded Ratio	78%	71%	76%
Payroll	\$ 78,152,237	\$ 14,381,016	\$ 92,533,253
Unfunded Liability/Payroll	160%	435%	203%
Pension Debt per Household*	\$ 1,783	\$ 890	\$ 2,673
Employer Contribution**	\$ 14,133,876	\$ 6,766,274	\$ 20,900,150
Employer Contribution/Payroll	18%	47%	23%

*Stanford Institute Report

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City of Redding

As of June 30, 2015, the City of Redding has an unfunded pension liability of \$113,424,867 in its Miscellaneous Plan and \$93,717,077 in its Safety Plan. In addition, there is an unfunded pension liability of \$31,063,921 in a PARS Plan and \$102,580,000 in an OPEB Plan.

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The City of Redding has taken the following steps to help mitigate these unfunded liabilities:

- After the passage of Measure A in 2010, the City began to negotiate for the city workers to pay a portion of their own CalPERS member contribution.
- Effective September 8, 2012, the safety bargaining units reached an agreement to change the retirement benefit formula from 3% at age 50 to 3% at age 55 for all new hires and to use the highest paid consecutive 36 months of employment when determining final compensation.
- In 2011, the City began eliminating new hires from PARS eligibility.
- After the passage of Measure B in 2010, new employees retiring with five or more years of service will pay a proportionate share of the retiree health insurance premium using a “City pays 2% for every year of service” formula, up to a maximum of 50%. Retirees and spouses under this new formula are required to join Medicare, if eligible.
- The City has reduced its ongoing pension contributions by negotiating with bargaining units to increase its members’ contributions towards the CalPERS retirement plans. Miscellaneous members now contribute 7%, and safety members contribute 9%. Two other safety units agreed to contribute an additional 3%, for a total employee contribution of 12%.

Even with these important steps, at the Redding City Council’s Special “Priority Setting” Meeting on February 22, 2017, unfunded liabilities were not included in the list of 18 prospective priority issues.

The City of Redding Unfunded Liabilities Table summarizes the unfunded liabilities for the City of Redding.

City of Redding Unfunded Liabilities			
Criteria	Miscellaneous Plan	Safety Plan	Total
Pension Liability	\$386,418,241	\$263,765,193	\$650,183,434
Value of Assets	\$272,993,374	\$170,048,116	\$443,041,490
Unfunded Liability	\$113,424,867	\$ 93,717,077	\$207,141,944
Funded Ratio	71%	65%	68%
Payroll	\$ 40,119,666	\$ 16,809,335	\$ 56,929,001
Unfunded Liability/Payroll	283%	558%	364%
Pension Debt per Household*	\$ 3,159	\$ 2,610	\$ 5,769
Employer Contribution**	\$ 10,101,802	\$ 8,714,028	\$ 18,815,830
Employer Contribution/Payroll	25%	60%	34%

*Stanford Institute Report

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City of Anderson

As of June 30, 2015, the City of Anderson has an unfunded pension liability of \$5,437,112 in its Miscellaneous Plan and \$3,172,331 in its Safety Plan. The City of Anderson does not have any OPEB liabilities because it does not pay medical benefits for retirees.

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The City of Anderson has taken the following steps to help mitigate these unfunded liabilities:

- Prior to 2013, the City implemented lower tiered retirement formulas to reduce unfunded liabilities and current pension costs.
- Where appropriate, the City contracts out services that can be performed by a consultant or contractor.

The City of Anderson Unfunded Liabilities Table summarizes the unfunded liabilities for the City of Anderson.

City of Anderson Unfunded Liabilities			
Criteria	Miscellaneous Plan	Safety Plan	Total
Pension Liability	\$22,853,816	\$13,526,727	\$36,380,543
Value of Assets	\$17,416,704	\$10,354,396	\$27,771,100
Unfunded Liability	\$ 5,437,112	\$ 3,172,331	\$ 8,609,443
Funded Ratio	76%	77%	76%
Payroll	\$ 1,484,286	\$ 707,519	\$ 2,191,805
Unfunded Liability/Payroll	366%	448%	393%
Pension Debt per Household*	\$ 1,315	\$ 764	\$ 2,079
Employer Contribution**	\$ 506,486	\$ 295,379	\$ 801,865
Employer Contribution/Payroll	34%	42%	37%

*Stanford Institute Report

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City of Shasta Lake

As of June 30, 2015, the City of Shasta Lake has an unfunded pension liability of \$5,312,983 in its Miscellaneous Plan. The City of Shasta Lake does not have a Safety Plan because it contracts for those services with the Shasta County Sheriff's Office. In addition, there is an unfunded liability of \$1,320,440 in an OPEB plan.

The City of Shasta Lake has taken the following steps to help mitigate these unfunded liabilities:

- The City's employees now pay the 8% employee share of CalPERS pension. Prior to 2012, employees only paid 2%.
- In 2013, the City refinanced part of its pension obligation debt with CalPERS, which reduced the interest rate from 7.5% to 2% and will save more than \$630,000 over 10 years.
- Beginning in 2016, the City now requires all employees to contribute a portion of their salaries towards retiree health care. Prior to that time, employees contributed nothing.

The City of Shasta Lake Unfunded Liabilities Table summarizes the unfunded liabilities for the City of Shasta Lake.

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City of Shasta Lake Unfunded Liabilities			
Criteria	Miscellaneous Plan	Safety Plan	Total
Pension Liability	\$28,478,849	N/A	\$28,478,849
Value of Assets	\$23,165,866	N/A	\$23,165,866
Unfunded Liability	\$ 5,312,983	N/A	\$ 5,312,983
Funded Ratio	81%	N/A	81%
Payroll	\$ 3,036,853	N/A	\$ 3,036,853
Unfunded Liability/Payroll	175%	N/A	175%
Pension Debt/Household*	\$ 1,311	N/A	\$ 1,311
Employer Contribution**	\$ 677,089	N/A	\$ 677,089
Employer Contribution/Payroll	22%	N/A	22%

*Stanford Institute Report

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Stanford Institute for Economic Policy Research

The Stanford Institute for Economic Policy Research (“the Institute”) is a research arm of Stanford University “committed to scholarship that helps address the real-world challenges facing governments and businesses in the United States and around the world.” With its annual “Pension Tracker”, the Institute compiles and ranks annual pension debt figures for 509 California agencies. Agencies with higher rankings (#1 being the highest) have more serious debt. The Market Pension Debt figure uses a more conservative discount or investment rate of return of 3.25% instead of the 7.5% rate that has been used in the past by CalPERS.

The Agency Comparison Table compares the Institute’s rankings and “Market Pension Debt per Household” figures of Shasta County’s four agencies over the past three years.

Agency Comparison				
		2013	2014	2015
City of Redding	Ranking	#72	#63	#66
	Debt	\$30,390	\$15,249	\$18,768
City of Anderson	Ranking	#261	#274	#262
	Debt	\$13,582	\$ 6,529	\$ 8,336
City of Shasta Lake	Ranking	#303	#325	#318
	Debt	\$10,319	\$ 4,493	\$ 5,884
County of Shasta	Ranking	#225	#368	#349
	Debt	\$15,884	\$ 3,177	\$ 4,679

Reason Foundation

The Reason Foundation is a 501(c)(3) nonprofit organization founded in 1978 dedicated to “advancing free minds and free markets.” The Foundation focuses on many areas, one of which is pension reform in the United States. A current project is a comprehensive Pension Analysis of

15 individual cities nationwide, titled the Reason Foundation Pension Integrity Project. The City of Redding was chosen as one of the 15 cities. The City of Redding Pension Analysis shows both the Miscellaneous and Safety Plan contribution rates have increased significantly from 2000 to 2015. In addition, the Pension Analysis indicates the City continues to budget more money for public service departments such as the Redding Police Department (74% funding increase) while staffing has decreased (17% for department staffing and 24% for patrol staffing). The City's pension liability funding ratio has gone from overfunded to 71.1% funded (68.5% if PARS is included).

The Pension Analysis' conclusion is that the City's current defined benefit structure "leaves taxpayers, employers, and employees vulnerable to volatile contribution rates and continuously increasing costs."

Observations

The Grand Jury's investigation, supported by external research projects such as the Reason Foundation's Pension Analysis and the Stanford Institute for Economic Policy Research's Pension Tracker, revealed that, like most cities and counties in California, significant unfunded pension liabilities are confronting all four public agencies studied. These unfunded liabilities are threatening to increase as the CalPERS discount rate decreases, with potential investment losses in the future, and with the reduced number of current employees paying into the retirement system. Although much of this is beyond the control of local agencies, each has taken a variety of measures to mitigate these liabilities.

Required contributions to CalPERS will continue to increase and therefore represent a budgetary dilemma for these agencies. Agencies will have to find ways to increase available revenues, reduce funding of public services, or a combination of both to balance their finite budgets. Options could include renegotiating employee benefit plans, increasing efficiency, or utilizing reserve monies. In this way, unfunded liabilities threaten to undercut services by these agencies that the public has come to expect and upon which the public relies. While none of the agencies are in immediate danger of insolvency, the goal is to be 100% funded.

FINDINGS

- F1. The unfunded pension liabilities of Shasta County and the Cities of Redding, Anderson, and Shasta Lake have significantly increased over the last 15 years, going from being fully funded to only partially funded.
- F2. Because CalPERS is reducing its assumed investment rate of return from 7.5% to 7.0%, the pension plans of Shasta County and the Cities of Redding, Anderson, and Shasta Lake will be less funded over the next five years and must increase their contributions.
- F3. Because CalPERS contributions from Shasta County and the Cities of Redding, Anderson, and Shasta Lake will increase, an increase in available revenues, a reduction in services provided, or both will be necessary to cover these contributions.

- F4. None of the agencies have any control over their CalPERS investment returns, which are directed by CalPERS and are subject to the fluctuations of the stock market.
- F5. The City of Redding, which already has the lowest funded ratio of all four agencies, is at greater risk of increased unfunded liabilities because of its other post-employment benefits and Public Agency Services Retirement Enhancement plans.

COMMENDATIONS

The Grand Jury commends:

- C1. Shasta County and the Cities of Anderson and Shasta Lake for recognizing the potential fiscal impact of unfunded pension liabilities and for the agencies' efforts to control their increases.
- C2. Shasta County, at the recommendation of the Shasta County Auditor-Controller, for increasing its contributions towards its unfunded other post-employment benefits and saving interest by prepaying its annual CalPERS contribution.
- C3. The City of Shasta Lake for its efforts to reduce its pension and other post-employment benefit liabilities by refinancing its pension obligation debt.
- C4. The City of Anderson for its efforts to reduce its pension liabilities by using consultants and contracted labor when possible.

RECOMMENDATIONS

The Grand Jury recommends:

- R1. By October 31, 2017, the Shasta County Board of Supervisors, with the Shasta County Auditor-Controller, and the Cities of Redding, Anderson, and Shasta Lake City Councils each look for ways to increase their contributions to CalPERS over the next twelve years with minimal loss of key services. Options could include reducing their current amortization schedules and exploring debt refinancing opportunities.
- R2. By October 31, 2017, the Shasta County Board of Supervisors, with the Shasta County Auditor-Controller, and the Cities of Redding, Anderson, and Shasta Lake City Councils each look for ways to increase their revenues or reduce other expenditures, with minimal loss of key services, as CalPERS contributions increase.
- R3. By December 31, 2017, the City of Redding City Council establish a five-year financial plan to increase its funded ratio for its CalPERS Safety Plan from 64.5% to 70%, and for its Miscellaneous Plan from 70% to 75%, with minimal loss of key services.

REQUIRED RESPONSES

Pursuant to Penal Code section 933.05, the following responses are required:

From the following governing bodies (within 90 days):

- Shasta County Board of Supervisors: **F1, F2, F3, F4 and R1, R2**
- City of Redding City Council: **F1, F2, F3, F4, F5 and R1, R2, R3**
- City of Anderson City Council: **F1, F2, F3, F4 and R1, R2**
- City of Shasta Lake City Council: **F1, F2, F3, F4 and R1, R2**

From the following elected governmental officer (within 60 days):

- Shasta County Auditor-Controller: **F1, F2, F3, F4 and R1, R2**

The Grand Jury recommends that all governing bodies place their responses to all Grand Jury Reports on their Regular Calendars for public discussion, not on their Consent Calendars.

INVITED RESPONSES

The Grand Jury invites the following responses:

From the following governmental officials (requested within 60 days):

- Shasta County Executive Officer: **F1, F2, F3, F4 and R1, R2**
- City of Anderson City Manager: **F1, F2, F3, F4 and R1, R2**
- City of Redding City Manager: **F1, F2, F3, F4, F5 and R1, R2, R3**
- City of Shasta Lake City Manager: **F1, F2, F3, F4 and R1, R2**

DISCLAIMER

Reports issued by the Grand Jury do not identify individuals interviewed. Penal Code §929 requires that reports of the Grand Jury not contain the name of any person or facts leading to the identity of any person who provides information to the Grand Jury.

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