



Office of the City Manager

WORK SESSION
February 25, 2014

To: Honorable Mayor and Members of the City Council
From:  Christine Daniel, City Manager
Submitted by: Teresa Berkeley-Simmons, Budget Manager
Subject: FY 2014 Mid-Year Budget Report and CalPERS Update

INTRODUCTION

This report presents to the Council the FY 2014 Mid-Year Budget Update and focuses on projected revenues and expenditures for both the General Fund and the Special Funds. This report also provides information on the California Public Employees' Retirement System actuarial valuations as of June 30, 2012 resulting in actual rates for the City for FY 2015 and preliminary projections for FY 2016 through fiscal year 2020.

CURRENT SITUATION AND ITS EFFECTS

The City of Berkeley is currently in FY 2014, the first of two years in the FY 2014 & FY 2015 Biennial Budget cycle. When the Council adopted the FY 2014 budget this past June, the General Fund was balanced as is shown in the chart below. In October the City Council approved "carryover" expenditures of \$6.3 million (the Adjusted Budget) relying on revenues accumulated in previous years for projects that had not yet been completed.

General Fund Summary			
<i>(dollars in millions)</i>	FY 2014 Adopted	FY 2014 Adjusted	FY 2014 Revised
Projected Revenue	\$150.8	150.8	151.6
Projected Expenses	150.7	157.0	154.9
<i>Use of Reserves</i>		6.3*	3.3
Balance	0.1	0.1	0

*Adjusted use of reserves includes appropriated carryover for projects and programs that were not completed in FY 2013 and were approved by Council as part of the [Amendment: FY 2014 Annual Appropriations Ordinance \(Item #2\)](#)¹ that went to Council on October 29, 2013.

¹ http://www.ci.berkeley.ca.us/Clerk/City_Council/2013/10Oct/City_Council_10-29-2013_-_Regular_Meeting_Annotated_Agenda.aspx

At the FY 2014 Mid-Year point, General Fund revenues are now projected to be above projections by \$800,000. General Fund expenditures are projected to be under the adjusted budget by \$2.1 million. This means that our projected use of reserves as part of the appropriated carryover will reduce from \$6.3 million to \$3.3 million.

FY 2014 General Fund Second Quarter – Projected Revenue (up \$0.8 million)

FY 2014 Mid-Year revenues reflect ongoing declines in parking fines, moving violations, and interest income. These declines in revenue are offset by projected increases in secured property taxes, property transfer taxes, and transient occupancy tax.

Attachment 1 provides a summary of the General Fund revenue projections and detailed information on the revenue declines and increases projected for FY 2014.

FY 2014 General Fund Second Quarter – Projected Expenditures (under adjusted budget amount by \$2.1 million)

General Fund expenditures are trending under the adjusted budget with projected expenditure reductions of about \$2.1 million by year-end. The reductions are primarily the result of salary savings from vacant positions.

FY 2014 Special Funds Second Quarter – Projected Expenditures (under adjusted budget amount by \$21.7 million)

Special Funds exclude the General Fund and are made up of a number of dedicated revenue funds, enterprise funds, and state and federal grant funds. Expenditures in these Special Funds are projected to be under budget by \$21.7 million. The expenditure reductions are primarily due to not fully spending funds for non-personnel and major capital improvement projects by the end of FY 2014. For example, federal funds allocated for Housing Trust Fund projects in the Department of Health, Housing, and Community Services have been or will be awarded to projects in FY 2014, but not expended until after July 1, 2014. In addition, in the Department of Public Works the Measure M projected year-end balance is allocated to the design and construction of the FY 2014 and FY 2015 streets and green infrastructure projects approved by Council, which have been project budgeted. Contracts are expected to be awarded this spring with construction to begin in the summer. All encumbered funding will be requested for rollover and all unencumbered funding will be requested for carryover to complete projects in FY 2015.

Attachment 2 provides a summary of the second quarter expenses (General Fund and All Funds) and year-end projections.

There are several special funds which have faced significant deficits over the last few years. Some of these funds are improving with the economy, like the Permit Service Center fund, while other funds continue to struggle due to several factors including the sluggish economy and natural disaster. Two funds facing structural deficits in FY 2014 are described below.

Department of Public Works – Zero Waste Division (increase loan amount by \$433,000)

At the time the FY 2014 budget was adopted in June, we anticipated the need for a \$614,857 loan to the Zero Waste Fund from the Workers' Compensation Fund. This was based on the assumption that the fund would end FY 2013 with a positive fund balance. However, the actual FY 2013 ending fund balance was a \$209,544 deficit. In addition, projected FY 2014 revenues are less due to lower revenue generated from internal service allocations and "exempt" agencies.. In order to balance the fund in FY 2014, a \$433,000 increase in the loan amount is required. This will bring the total loan amount to the Zero Waste Fund from the Worker's Compensation Fund to \$1,047,858. Additional information on the Zero Waste Fund is included in the Action item on the City Council Agenda for this same date.

Department of Parks Recreation and Waterfront – Camps Fund (\$850,000 shortfall)

The Camps Fund annually collects just over \$2 million in revenues from fees charged for the two resident camps (Echo Lake and Tuolumne Family Camp), the Day Camp Program, and lease revenue from Cazadero Camp. The revenues from Tuolumne Family Camp have typically been around \$1.5 to \$1.6 million per year. The revenues generated are used to support the resident and day camp program activities (personnel, supplies, transportation, maintenance, etc.) as well as provide support to the Recreation Division administrative costs. Total expenditures in FY 2013 were around \$1.8 million.

With the loss of the Berkeley Tuolumne Family Camp as a result of the August 2013 Rim Fire Disaster, staff is projecting a shortfall in the Camps Fund of \$850,000 in FY 2014 and a shortfall of \$500,000 in FY 2015. The fund shortfall is the direct result of losing the regular amount of Tuolumne Family Camp revenue that is annually earned. The Camps Fund expenditure budget, adopted by Council in June 2013, planned for the operation of resident camps, the Day Camp program, and Cazadero Camp. Staff has been working with the various local, state and federal agencies who are involved with assessing the rebuilding of Tuolumne Camp and will continue to do so through FY 2015. In the meantime, the City Council approved a new fee scheduled for Echo Lake Camp as an alternative location for family camp the summer of 2014. Staff will provide a report in the fall regarding the outcome of that program.

California Public Employees’ Retirement System (CalPERS)

On May 28, 2013, and again on November 19, 2013, we informed Council of the new CALPERS rate structure based on the CalPERS board’s April 17, 2013 vote to change the actuarial model for the pension plans. First, the new model provides that the plans will be 100 percent funded in a fixed 30-year time period. Previously CalPERS had used a rolling 30-year period. Second, the time period to “smooth out” the impacts of CalPERS’ investment losses due to the recession was reduced from 15 years to 5 years. Finally, the rates will be structured in such a way that the first five years will be a “ramp up” period to improve the plans funded percentage. That means that FY 2016, 2017, 2018, 2019 and 2020 will have higher rates, and then the rates will flatten out. However, there is no cap on rate increases each year. We anticipated that these changes would have a significant impact on the City’s rates, and corresponding financial obligations, beginning in FY 2016. That impact is further described below.

In December the Budget Office received the CalPERS annual valuation report as of June 30, 2012, which included the Minimum Employer Contribution Rate for FY 2015 and rate projections through fiscal year 2020. The table below shows CalPERS’ projected employer contribution rates for the next five fiscal years.

Percent (%) of Employer Contribution*

	FY 2015 Actual	FY 2016 Projected	FY2017 Projected	FY 2018 Projected	FY 2019 Projected	FY 2020 Projected
Miscellaneous	21.912	23.3	24.7	26.1	27.5	28.9
Police	46.573	48.7	50.7	52.8	54.9	57.0
Fire	33.156	35.6	38.1	40.6	43.1	45.5

*Rates do not reflect any employee cost sharing or outcomes of the February 2014 CalPERS Board meeting.

The chart below shows the City’s financial contribution to PERS each year for the next six years, based on the projected rate increases. These dollar amounts are generated by multiplying the rates above with the “PERSable compensation” received by the active employees (those currently working) covered by each Plan. For purposes of this analysis, the calculations in the chart reflect two significant assumptions: (1) no salary increases for the period described, and (2) no addition of staff positions. In other words, the chart below reflects no growth in payroll for this period. Even with those assumptions, the City’s contribution to PERS grows by approximately \$2 million each year, starting in FY 2016, due to the increases in the rates. If either of those assumptions changes, the amount contributed to PERS would also change.

Dollar (\$) Contribution Based on Projected Rate Increases All Funds (dollars in millions)						
	FY 2015 Budgeted	FY 2016 Projected	FY2017 Projected	FY 2018 Projected	FY 2019 Projected	FY 2020 Projected
Miscellaneous*	27.1	28.6	29.9	31.2	32.5	33.8
Police	10.5	10.8	11.3	11.8	12.2	12.7
Fire	5.2	5.6	5.9	6.3	6.7	7.0
Total	42.8	45.0	47.1	49.3	51.4	53.5

* Includes annual \$7.3 million 8% employee contribution which is paid by the City on the employee's behalf.

The rates above assume CalPERS earned 12 percent for FY 2013 and will earn 7.50 percent every fiscal year thereafter. It also assumes that all other actuarial assumptions will be realized and that no further changes to assumptions, contributions, benefits or funding will occur between now and the beginning of FY 2016. However, the CalPERS board is scheduled to meet in February 2014 to discuss the final recommendation for the adoption of new actuarial assumptions, both economic and demographic. With respect to demographics, the CalPERS staff analysis indicates that retirees are living longer and that Safety plan members are retiring earlier than had been originally anticipated. Both of these factors indicate a need to increase employer rates to generate additional funding for the system. If adopted by the CalPERS board, the updated recommended assumptions are expected to increase contribution rates for most employers. It is anticipated that the impact will begin with the FY 2017 rates, with a 5-year ramp up, and the full impact being realized in the FY 2021 rates. (See Attachment 3 for the December report to the CalPERS Board describing these changes.) Thus, the financial contributions in the table above are likely to increase once the projected FY 2017 rates are revised.

Change in Market Value Funded Ratio

Another aspect of CalPERS' new approach to valuation of plans is its shift to relaying on the Market Value of the assets, rather than the Actuarial Value. The chart below shows the funding history of the City's three plans. The funded ratio based on the Actuarial Value of Assets (AVA) represents the progress towards fully funding the future benefits for current plan participants. The funded ratio based on the Market Value of Assets (MVA) is an indicator of the short-term solvency of the plan based on the market value of the plan's assets at the time of the valuation analysis.

Percent (%) Funded Ratios						
	Miscellaneous		Police		Fire	
	AVA	MVA	AVA	MVA	AVA	MVA
6/30/08	87.8	89.5	76.0	78.2	89.8	92.5
6/30/09	82.9	60.5	73.1	53.4	86.9	63.6
6/30/10	82.8	65.0	71.9	56.4	86.6	67.7
6/30/11	81.8	73.1	70.5	63.1	85.1	75.8
6/30/12	81.7	68.5	70.6	59.1	84.3	70.2

Beginning with the June 30, 2013 valuations that will be used to establish the FY 2016 rates, CalPERS will provide only the market value of assets and will no longer provide or use the actuarial value of assets. The new policies are intended to achieve full funding of the plans over a fixed 30-year period.

Analysis of Investment Volatility and Discount Rate Sensitivity

The City’s contribution rates are tied to CalPERS’ investment performance. The current assumed rate of return on those investments is 7.50 percent. While the FY 2013 return outperformed that expectation, over the past several years CalPERS has experienced significant volatility in its returns. Between the period June 30, 2008 and June 30, 2013 CalPERS’ investments had an overall accumulated market value loss of 27 percent, as illustrated in the chart below. As we have learned from the experience demonstrated in the chart below, investment return volatility can significantly affect the City’s budget due to the impact on PERS rates.

Investment Return Variances (7.50% Assumed)*		
Period	Market	Gain/(Loss)
June 30, 2008	(5.1%)	(12.9%)
June 30, 2009	(24.0)	(31.8%)
June 30, 2010	13.3%	5.5%
June 30, 2011	21.7%	13.9%
June 30, 2012	0.1%	(7.4%)
June 30, 2013	13.2%	5.7%
Accumulated Market Value Gains/(Losses) through June 30, 2013		(27.0%)

*Beginning June 30, 2012 the assumed rate of return on investments went from 7.75% to 7.50%.

GASB 68

Another change approaching for FY 2015 is a change imposed on the City’s financial reporting of its pension obligations by the Governmental Accounting Standards Board (GASB). Statement No. 68 from GASB is the accounting standard governing a state or local governmental employer’s accounting and financial reporting for pensions. GASB 68 replaces GASB 27 effective the first fiscal year beginning after June 15, 2014. GASB 27 does not accurately reflect the amount for the pension liability and the amount of the annual expense incurred on the financial statements. GASB 68 corrects this. GASB 68 will require additional reporting. State and local governments will be required to post their net pension liability – the difference between the projected benefit payments and the assets set aside to cover those payments – on the face of the financial statements instead of in the notes to the financial statements, where the information is currently reported.

It is important to note that GASB 68 does not change the City’s financial position. Rather, it requires that information previously reported in the notes to the financial statements is now included in the statement of net assets. The information in the table below was provided by CalPERS in the most recent valuation of the City’s plans.

June 30, 2012 Unfunded Actuarial Liability (in millions)			
Plan	Total Pension Liability (AAL)	Fiduciary Net Position (MVA)	Net Pension Liability (UAL)
Miscellaneous	746.0	510.7	235.3
Police	314.7	186.1	128.6
Fire	216.5	152.1	64.4
Total Net Pension Liability			\$428.3

Retirement contributions represent one of the most significant elements of the City’s expenditures, and the cost of these plans are projected to rise.

CONTACT PERSON

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Attachments:

- 1: FY 2014 Second Quarter General Fund Revenue Summary
- 2: FY 2014 Second Quarter General Fund and All Funds Expenditure Summaries
- 3: [Review of Actuarial Assumptions \(Agenda Item 7a\)](#)²

² <http://www.calpers.ca.gov/index.jsp?bc=/about/committee-meetings/archives/financeadmin-201312.xml>

FY 2014 First Half General Fund Revenues

(7/1/13 - 12/31/13)

Revenue Categories	Adopted FY 2014	Actual 7/1/13- 12/31/13	% Received To Date	Projected FY 2014	Variance
Secured Property	\$41,180,566	\$21,804,398	53.0%	\$42,220,854	\$1,040,288
Unsecured Property Taxes	2,447,266	2,148,352	87.8%	2,298,523	(148,743)
Supplemental Taxes	630,000	280,442	44.5%	630,000	0
Property Transfer Tax	10,000,000	7,300,805	73.0%	11,000,000	1,000,000
Sales Taxes	15,972,075	8,238,260	51.6%	16,022,873	50,798
Utility Users Taxes	15,011,223	6,941,168	46.2%	14,637,002	(374,221)
Transient Occupancy Taxes	5,234,447	3,421,441	65.4%	5,840,276	605,829
Business License Tax	15,852,545	381,367	2.4%	15,449,787	(402,758)
Vehicle In-Lieu Taxes	9,259,210	4,614,305	49.8%	9,228,609	(30,601)
Parking Fines-Regular Collections	8,285,000	3,605,915	43.5%	7,300,000	(985,000)
Parking Fines-Booting Collections	350,000	90,953	26.0%	250,000	(100,000)
Moving Violations	300,000	126,592	42.2%	230,000	(70,000)
Interest Income	3,200,000	1,205,166	37.7%	3,000,000	(200,000)
Ambulance Fees	3,988,508	1,992,810	50.0%	4,258,921	270,413
Franchise fees	1,800,799	467,621	26.0%	1,800,799	0
Other Revenue	8,860,283	3,980,488	44.9%	9,351,116	490,833
Transfers	8,428,628	3,938,616	46.7%	8,037,070	(391,558)
Total Revenue:	\$150,800,550	\$70,538,699	46.8%	\$151,555,830	\$755,280

This first half review focuses on the major revenue fluctuations and key projection adjustments.

Secured Property Tax (+\$1,040,288)

During the first half of FY 2014, Secured Property Tax revenues totaled \$21,804,398, which was \$918,593 or 4.4% more than the \$20,885,805 received for the same period in FY 2013. This revenue source is expected to increase in line with FY 2014 assessed value growth of approximately 5%. As a result, the revenue projection was increased by \$1,040,288. The higher growth rate is attributable to the significant increase in the turnover of Berkeley properties at higher sales prices in calendar year 2012.

Property Transfer Tax (+\$1,000,000)

During the first half of FY 2014 (June through November reports), Property Transfer Tax revenue increased by \$1,110,628 or 17.9% to \$7,300,805, from the \$6,213,537 received for the same period in FY 2013. This increase is due primarily to a \$64.1 million or 14.5% increase in the dollar value of property sales in the first half of FY 2014 to \$506.7 million, from \$442.6 million for the same period in FY 2013. This was accomplished despite a decline in the number of property sales from 551 in FY 2013 to 546 in FY 2014.

As a result, Staff increased the revenue projection for this revenue source by \$1 million. The mid-year results above appear to indicate that a higher increase in

the revenue projection is warranted. However, in the following month (December), year-over-year Property Transfer Tax revenue declined \$999,525.

Sales Tax (+\$121,872)

For the first half of FY 2014, Sales Tax revenue totaled \$8,238,260, which is \$149,607 or 1.8% more than the \$8,088,653 received for the same period in FY 2013.

Transient Occupancy Tax(+\$605,829)

Transient Occupancy Tax (TOT) revenue increased by \$424,393 or 14.2% in the first half of FY 2014 to \$3,421,441, from \$2,997,048 for the same period in FY 2013. The increase was the result of double digit growth by 7 of the City's 12 largest hotels. As a result of the current trend, the revenue projection for this revenue source was increased by \$605,829,

Parking Fines (-\$985,000)

For the first half of FY 2014, Parking Fines revenue (excluding booting collections) showed a decrease of \$741,217 or 22.0% to \$3,326,043 in FY 2014, from \$4,067,260 received for the same period in FY 2013. This decrease resulted primarily from a decline of 13,999 or 15.2% in ticket writing, from 91,914 citations in FY 2013 to 77,915 citations in FY 2014.

During that period, booting collections totaled \$90,953, down 63.8% or \$160,265 from the total of \$251,218 received for the same period in FY 2013.

As a result of the current trend, the revenue projection for Parking Fines was lowered by \$985,000, and booting fines was lowered by \$100,000. Staff are monitoring this revenue source closely for a further possible decrease in the revenue projection.

Interest Income (-\$200,000)

For the first half of FY 2014, Interest Income totaled \$1,205,166, which is \$252,852 or 17.3% less than the total of \$1,458,018 received for the same period in FY 2013. This revenue source is trending lower than the adopted budget total because some high yielding securities held by the City matured before the first quarter of FY 2014 began. However, yields on medium-term securities have increased slightly recently, and it is too soon to determine whether or not those higher yields will be sufficient to offset the income lost from the matured securities.

Ambulance Fees (+\$270,413)

For the first half of FY 2014, Ambulance Fees revenue totaled \$1,992,810, which is \$256,674 or 14.8% more than the \$1,736,136 received for the same period in FY 2013. The Berkeley Fire Department experienced an increase in the first couple of months in the half due to increased call volume. With the transition to electronic patient care reports, the City has been able to process invoices quicker.

Other revenue (+410,833)

Other revenue decreased by \$380,396 or 8.7% in the first half of FY 2014 to \$3,980,488, from \$4,360,884 for the same period in FY 2013. The revenue projection for FY 2014 was increased by \$410,833 due primarily to the receipt of the County refund of \$270,302 for overcharging prior years' property tax administration fees, and due to the adjustment of charges for services revenues, based on the final results for FY 2013. This revenue was allocated to community agencies in the FY 2014 budget.

Transfers (-\$391,558)

Transfers decreased by \$18,848 or .5% in the first half of FY 2014 to \$3,938,616, from \$3,957,464 for the same period in FY 2013. The revenue projection for FY 2014 was decreased by nearly \$400,000 due to lower indirect costs expected to be charged during the year as result of a slightly lower indirect cost base (total direct salaries and wages) and a lower indirect cost rate calculated.

FY 2014 General Fund Expenditures (7/1/13 – 12/31/13)

Department	FY 2014 Adopted	FY 2014 Adjusted	YTD Actuals + Encumbrances	% Budget Spent	Year-End Projected	Surplus/ Deficit	% Over/ Under
Mayor & Council	1,753,239	1,798,641	826,448	46%	1,798,641	0	0.0%
Auditor	2,020,158	2,252,531	925,453	41%	1,965,586	286,945	12.7%
City Manager	4,716,201	4,723,241	2,222,454	47%	4,582,087	141,154	3.0%
Police Review Commission	535,837	536,044	220,723	41%	488,527	47,517	8.9%
City Attorney	2,252,298	2,284,109	1,097,702	48%	2,284,109	0	0.0%
City Clerk	1,930,981	2,144,269	698,504	33%	1,972,101	172,168	8.0%
Information Technology	4,861,456	6,912,667	3,419,062	49%	6,659,574	253,093	3.7%
Finance	5,381,523	5,583,117	2,660,522	48%	5,353,561	229,556	4.1%
Human Resources	1,905,011	1,907,313	866,222	45%	1,820,199	87,114	4.6%
Health, Housing & Community Svcs.	12,045,968	12,355,574	6,035,885	49%	12,293,553	62,021	0.5%
Public Works	2,590,838	2,653,385	1,282,244	48%	2,532,478	120,907	4.6%
Parks, Recreation and Waterfront	5,372,250	5,538,875	3,002,025	54%	5,459,514	79,361	1.4%
Fire	26,963,283	27,138,205	12,973,742	48%	26,141,022	997,183	3.7%
Police	55,461,475	55,524,924	27,505,342	50%	55,959,025	-434,101	-0.8%
Planning	1,672,315	1,720,650	794,534	46%	1,695,118	25,532	1.5%
Economic Development	1,939,004	2,059,041	1,371,573	67%	2,059,041	0	0.0%
Non-Departmental	19,294,907	21,912,175	12,603,509	58%	21,912,175	0	0.0%
Total	150,696,744	157,044,761	78,505,944	50%	154,976,311	2,068,450	1.3%

FY 2014 Special Funds Expenditures (7/1/13 – 12/31/13)

Note: Special Funds are non-discretionary funds allocated for specific purposes (e.g. Community Development Block Grant, Sewer Fund, and Parks Taxes).

Department	FY 2014 Adopted	FY 2014 Adjusted	YTD Actual + Encumbrances	% Budget Spent	Year -End Projected	Surplus/ Deficit	% Over/ Under
Mayor & Council							
Auditor	140,208	140,208	65,115	46%	140,208	-	0.0%
City Manager	235,933	314,154	160,539	51%	311,207	2,947	0.9%
Police Review Commission						-	
City Attorney	1,698,125	2,434,229	1,396,567	57%	2,404,839	29,390	1.2%
City Clerk						-	
Information Technology	2,674,937	5,160,745	1,791,503	35%	5,131,882	28,863	0.6%
Finance	1,900,206	1,925,386	929,550	48%	1,848,678	76,708	4.0%
Human Resources	1,306,698	1,361,408	549,583	40%	1,180,436	180,972	13.3%
Health, Housing & Community Svcs.	24,285,966	31,565,107	14,269,893	45%	24,765,837	6,799,270	21.5%
Public Works	87,864,205	110,996,074	62,234,409	56%	103,053,513	7,942,561	7.2%
Parks and Waterfront	18,472,781	22,359,043	11,792,985	53%	20,456,713	1,902,330	8.5%
Fire	6,489,519	6,786,206	2,556,106	38%	5,401,103	1,385,103	20.4%
Police	4,286,053	4,531,079	1,503,329	33%	4,028,002	503,077	11.1%
Planning	10,604,954	11,623,471	5,710,129	49%	11,056,915	566,556	4.9%
Economic Development	2,085,849	2,732,461	850,642	31%	2,732,461	-	0.0%
Rent Board	3,999,042	4,127,438	1,993,374	48%	4,127,438	-	0.0%
Library	21,235,497	23,481,025	12,256,277	52%	23,284,994	196,031	0.8%
Non-Departmental	26,272,834	28,039,217	13,923,314	50%	28,039,217	-	0.0%
Total All Other Funds	213,552,807	257,577,251	131,983,315	51%	237,963,443	19,613,808	7.6%
Berkeley Housing Authority*	46,490	51,707	8,497		51,707	-	
Total General Fund	150,696,744	157,044,761	78,505,944	50%	154,976,311	2,068,450	1.3%
Total Citywide Budget	364,296,041	414,673,719	210,489,259	51%	392,991,461	21,682,258	5.2%
*Berkeley Housing Authority has been a separate entity since 2008. Budget and actual expenditures are for costs to be reimbursed back to the City.							

Budget Assumptions

- ⇒ Budgeted target savings for some departments are built into FY 2014 Adopted and Adjusted General Fund budgets.
- ⇒ Year-to-date payroll through 12/31/13 equals 48% of the payroll budget expended.
- ⇒ Non-personnel YTD expenditures through 12/31/13 are generally assumed to be fully expended, except for capital improvement project funding.
- ⇒ Expenses are measured against the Adjusted Budget, which includes carryover of funds from FY 2013 into FY 2014 as approved by Council on October 29, 2013.

Second Quarter Variance Analysis

The following variance analysis is an expenditure snapshot by City departments and is intended to present possible expenditure trends for this fiscal year.

General Fund spending by department

The General Fund is projected to end FY 2014 under the adjusted budget by almost \$2.1 million. Salary savings generated by vacancies is the main reason most of the departments are under budget.

The Fire Department expenditures are projected to be under budget by approximately \$1.0 million. A significant amount of this saving is due to 8 vacant sworn positions in the first half of FY 2014. These positions have now all been filled. In addition, the department currently has 6 employees out on Workers' Compensation leave and military leave.

The Police Department expenditures are projected to be over budget by close to \$434,000 due to overtime expenditures exceeding the budgeted amounts. However, unlike in prior fiscal years, end of shift overtime in the Patrol Division is trending downward due to the implementation of a new schedule. Salary savings, non-personnel savings, and shifting costs to other funds help to reduce the overage in the General Fund budget but are not expected to be able to completely cover it.

The City Auditor's Office and the Finance Department are both projected to finish under budget by approximately \$287,000 and \$230,000 respectively. In both cases, a portion of these unspent funds will be carried over to FY 2015. The City Auditor's Office will be carrying over \$286,945 for consulting for audits and electronic time entry software. Finance is planning to carry over the projected savings of \$229,556 for centralized cash receipts software and a customer service waiting system.

Special Funds spending by department

Special Funds excludes the City's General Fund and are made up of numerous dedicated revenue funds, enterprise funds, and state and federal grant funds. Revenues generated by these activities are restricted. Staff is projecting unspent funds totaling approximately \$22 million in FY 2014. This is due almost exclusively to several large capital improvement projects that are in progress and will not be completed in this fiscal year, as well as salary savings from vacancies.

Public Works (General Fund +\$120,907; Special Funds +\$7,942,561)

The vast majority of the unspent funds in the Public Works are attributed to pending capital projects.

- *Capital Improvement Fund (\$1.4 million)*: The \$1.4 million projected balance is due to a number of approved streets, sidewalks, city buildings, and storm water projects not being completed by fiscal year-end. Project encumbrances will be requested for rollover and unencumbered project funds will be requested for carryover for project completion (and payment) in FY 2015.
- *Measure M (\$2.9 million)*: The Measure M projected year-end balance of \$2.9 million is allocated to the design and construction of the FY 2014 and FY 2015 streets and green infrastructure projects approved by Council. All funds have been project budgeted and contracts are expected to be awarded this spring with construction to begin in the summer. All encumbered funding will be requested for rollover and all unencumbered funding will be requested for carryover to complete projects in FY 2015.
- *MTC Fund (\$0.7 million)*: Funds budgeted for the Berkeley Transportation Action Plan Parking Management and Transportation Demand Management projects will not be fully spent by the end of FY 2014 and will be carried over to FY 2015.
- *CALTRANS Grant (\$0.9 million)*: Grant funds will not be fully spent for the Berkeley Transportation Action Plan – Parking Management project and Ashby Corridor Improvement project by the end of FY 2014.
- *Sewer Fund (0.85 million)*: The \$0.85 million balance is projected to be encumbered but not spent in FY 2014 due to continuing projects that are anticipated to be completed in FY 2015.

Health, Housing & Community Services (General Fund +\$62,021; Special Funds +\$6,799,270)

Health, Housing & Community Services expenditures are projected to be under the adjusted budget by almost \$6.8 million at the end of FY 2014. \$2.2 million of these unspent funds represent funds committed to Housing Trust Fund projects that will not be expended until after FY 2014, and \$1 million are other unspent CDBG funds mostly for capital projects that will also be carried over for use in FY2015. \$1.7 million of the unspent funds are Mental Health Service Act Funds which will be spent according the adopted plan in future fiscal years. Almost \$1 million reflects lower spending based on actual expected revenue from state funding sources. This is being realized through vacancies and cost shifts to other available funds.

Parks Recreation & Waterfront (General Fund +\$79,361; Special Funds +\$1,902,330)

Under-spending in the special funds in the Parks Recreation & Waterfront Department is due primarily to capital improvement work that will begin this year, but be completed in FY 2015. The Department's capital program funds include Measure WW, MTC, Coastal Conservancy, Marina and Cosco Busan grant funds. These funds have been programmed and funds that are not fully spent in FY 2014 will be requested for carryover to FY 2015.

Fire (General Fund +997,183; Special Funds +1,385,103)

The Fire Department is projected to finish under the adjusted budget by approximately \$1.4 million. These savings are the result of personnel savings due to vacancies that have now been filled and a reduction in overtime costs.



Finance & Administration Committee

California Public Employees' Retirement System

Agenda Item 7a

December 17, 2013

ITEM NAME: Review of Actuarial Assumptions

PROGRAM: Actuarial Office

ITEM TYPE: Information

EXECUTIVE SUMMARY

Actuarial staff has completed its scheduled review of actuarial assumptions through a process called an experience study. The assumptions reviewed included both economic assumptions and demographic assumptions. This agenda item contains the preliminary recommendation for new actuarial assumptions as well as a draft copy of the experience study report. The final recommendation for the adoption of new actuarial assumptions by the Board is currently scheduled to occur in February 2014.

The recommended assumptions are expected to increase contribution rates for most employers at a time when their budgets are already strained. Concern has been raised that the contribution increases may be too much for employers to bear. In order to assist employers in preparing and planning for these changes, the agenda item recommends building the impact of the changes into the projected rates one year prior to implementing them in the rates. This meant that the contribution increases would not take effect until FY 2016-2017. This agenda item also looks at possible alternative amortization schedules that could be adopted.

See attachment 1 for a copy of the draft experience study report.

STRATEGIC PLAN

This agenda item supports the Strategic Plan Goal A - Improve long-term pension and health benefit sustainability. This item further supports the Strategic Plan by providing employers and other stakeholders with thorough, risk-based information about the expected course and variability of future contribution rates. In alignment with these goals, this agenda item provides this transparency well in advance of the expected impact of the assumption changes on the contribution rates.

BACKGROUND

An experience study is a summarization of actual experience over a defined period of time and is used as a guide in setting future actuarial assumptions. Experience studies which include reviews of both economic and demographic assumptions are required every four years under Board policy ACT-95-05D. The previous experience study which reviewed solely demographic assumptions was completed in 2009 and

presented to the Board for adoption in 2010. The most recent review of economic assumptions was completed two years ago. Under the current Board policy, the review of economic assumptions is not due as it has not been four years since the last review. The review of economic assumptions has been advanced by two years to synchronize it with the review of demographic assumptions.

The demographic study focused on recent patterns of termination, death, disability, retirement and salary increases. It presents the results of the (demographic) experience study on the California Public Employees Retirement System using data from 1997 to 2011.

Not all demographic assumptions have the same relative impact on the results of the actuarial valuations (and hence on employer contribution rates). In almost all cases, retirement benefits make up most of the liabilities of a retirement system such as CalPERS. Accordingly, assumptions that affect retirement benefits will have more of an impact than assumptions that only affect death, disability or termination benefits. Since retirement rates, salary increases and post-retirement mortality all affect the valuation of retirement benefits, these assumptions generally have a much greater impact on contribution rates than do other demographic assumptions.

Economic assumptions affect all benefits and tend to have a significant impact on contribution rates.

ANALYSIS

Review of Economic Assumptions

To perform actuarial valuations, actuaries use certain economic assumptions to set a contribution schedule of employee and employer contributions designed to accumulate with interest to equal the total present value of benefits by the time every member has left employment. The economic assumptions used by actuarial staff to determine liabilities and set contribution rates are price inflation, wage inflation, payroll growth and the discount rate assumption.

The key results of the review of economic assumptions can be found in the draft experience study report provided as Attachment 1. Currently, staff is not recommending any changes to any of the economic assumptions.

The summary of the result of the review of economic assumptions is as follows:

- **Price Inflation Assumption:** Currently, the Board approved annual price inflation assumption is 2.75 percent which was recently reduced from 3 percent in the last economic study in 2012. Since the 2012 study, price inflation has registered under 2% per year. Going forward, market indicators today point to an expectation that future price inflation may be less than the

current assumption of 2.75 percent per year. Staff is not recommending a change at this time and will revisit this assumption as part of the next review of assumptions in four years.

- **Wage Inflation Assumption:** Currently, the real wage inflation assumption is 0.25 percent. Historical data shows that wage inflation has generally been higher than price inflation by close to one percent. In the current economic environment, staff believes that low real wage inflation in the public sector is likely to continue in the near term and so is not recommending a change in this assumption. Staff expects that over time the real wage inflation assumption will need to move toward the historical levels of wage inflation.
- **Payroll Growth Assumption:** The payroll growth assumption is used when amortizing the unfunded liability of open plans as a level percentage of payroll in accordance with Board policy. The current Board adopted assumption is that payroll of open plans will grow at a rate of 3% per year. Staff is not recommending any changes to this assumption. The application of this assumption to the “classic” risk pools that were closed as a result of PEPRA is the subject of another agenda item this month.
- **Discount Rate Assumptions:** The primary economic assumption is the discount rate assumption. The current discount rate assumption is 7.50 percent per year. Over the course of the last year, the Board has reviewed its capital market assumptions and had an Asset Liability Management (ALM) workshop in November 2013. At that workshop the Board expressed a preference for a level of funding risk consistent with the base case portfolio and no margin for adverse deviation. Assuming that the Board adopts an asset allocation substantially similar in risk/return characteristics, the Actuarial Office is not recommending any change to the discount rate assumption – that it remain at 7.5% per year.

Review of Demographic Assumptions

To perform actuarial valuations, actuaries use several demographic assumptions to set a contribution schedule of employee and employer contributions designed to accumulate with interest to equal the total present value of benefits by the time every member has left employment. These demographic assumptions include for example mortality rates, retirement rates, disability rates (both work and non-work related), and rates of salary increases due to seniority and promotion.

After performing the review of demographic assumptions, staff is recommending several changes to these assumptions. The new demographic assumptions being proposed would have predicted retirement, termination and mortality experience much closer to the actual experience than the current assumptions. Staff feels that these new assumptions will be substantially better at predicting long-term future experience than the current assumptions.

Life expectancies in the developed world are continuously improving and this is consistent with the data used in the experience study. Staff believes that proper funding of the system requires the inclusion of mortality improvements in the mortality assumption. This is consistent with best practices and changing actuarial standards. Not responding to these changes could lead to a requirement to qualify the valuation report with implications for our financial statements and the financial statements of participating employers.

While the data in the experience study shows even greater improvements in mortality, staff is recommending using a 20 year mortality improvement projection using Scale BB. This recommendation is composed of a 7 year static improvement projection to bring mortality data to the current valuation cycle and another 13 years to account for future improvements. Scale BB is the most current national standard mortality projection scale and is based on Social Security data. Given the data requirements needed to build a mortality improvement scale, staff feels that the use of a national standard table is preferable to developing a CalPERS specific table. .

The key results of the review of demographic assumptions can be found in the draft experience study report provided as Attachment 1. The summary of the result of the review of demographic assumptions is as follows:

- **Mortality:** The review of mortality rates has shown that members have a longer post-retirement life expectancy than currently assumed. Under the proposed assumptions, the life expectancy of males is increasing on average by about two years and is increasing on average by about one and a half years for females.
- **Retirement Ages:** The review of retirement rates has shown a continued trend of significantly earlier retirement ages for State CHP and POFF members as well as Public Agency members subject to the 3% @ 50 benefit formula. The review also showed slightly earlier retirement ages for State Safety, State Miscellaneous, and local agency safety CPO and Police members while slightly higher retirement age on averages for local agency safety Fire and Miscellaneous members. Changes are being proposed to the retirement rates to better reflect the observed trend.
- **Salary scale:** The review showed a continuation of the trend of higher than expected salary increases for Public Agency safety members, State POFF and CHP members with high service. Staff believes it is the result of longevity pay or increased promotional activity. Staff is recommending increasing the salary scale assumption for these groups. Changes are also being recommended for most other groups. However, the changes being proposed for the other groups have minimal impact with some resulting in slight increases in contributions and some resulting in slight decreases in contributions.

- **Disability Retirement:** The review of disability experience revealed a continued trend downward in the last four years. Staff is recommending lowering the rates of disability retirements across all safety groups.
- **Other assumptions:** Mixed results for other assumptions that have minimal overall impact on cost. These are described in detail in the experience study report.

Possible Alternative Assumption for Mortality Improvement

At the Board workshop on projecting mortality improvement held in October, there was considerable discussion about the level of future improvement to assume. As was discussed at that time, there is at least one consideration – the lower level of smoking in California – which could indicate that future improvements in mortality will be less in the future in California relative to the rest of the nation. In effect, smoking rates do not have as much room to fall so mortality improvements may be less.

As a result of two other issues discussed at the mortality projection workshop – an indication that mortality is improving faster amongst groups with higher levels of educational attainment and better access to health care and the higher rates of improvement experienced by the CalPERS covered population in recent years – the Actuarial Office is recommending a 20 year static projection using Scale BB.

However, if the Board believes that the recommended mortality improvement will overstate the amount of improvement achieved in the future, it could select a lower level of improvement than recommended above. If it were to do so, the Actuarial Office would suggest using a 15 year static projection using Scale BB.

External Review of Experience Study

As in the prior experience study, staff is having an external review performed. This review is expected to be complete prior to bringing the recommended assumptions back to the Board in February for action.

Impact on Employer Contribution Rates

The estimated impact of the recommended assumption changes on the total employer contribution rate and the total normal cost are listed in attachment 2. Note that the increase in unfunded liability resulting from the proposed assumption changes has been amortized in accordance with existing Board policy. The current Board policy states that the impact of changes in actuarial assumptions be amortized over 20 years with a 5 year phase-in at the beginning and a 5 year ramp down at the end of the 20 year amortization period. The demographics of each plan will dictate the actual impact to each plan. The ranges provided for public agencies in Attachment 2 are expected to capture about 90% of the public agency plans. The

change in total normal cost and member rate would be one time impacts and are included in the change in total contribution rate.

The assumption causing the biggest impact on employer rates is the assumption for post-retirement mortality for service retirement. Since the life expectancy of male members continues to increase at a faster pace than female members, safety plans, which tend to have a much higher proportion of male members, are affected more by this change than miscellaneous plans. The impact from the change in post-retirement mortality alone is causing employer rates (after the end of the five year phase in) for most miscellaneous groups to increase by about 2.5% to 5.0% of payroll, while its causing the employer rates for safety plans to go up by about 2.8% to 6.4% of payroll. Safety groups are also being impacted by the proposed changes to the salary scale assumptions. Other groups such as CHP and POFF are also impacted by the proposed changes to service retirement rates.

Note that the final impact for the State won't be known until the Board approves the 2016/2017 contribution rates for the State plans and the Schools pool in early 2016. The final impact for public agencies will be known when the Actuarial Office has completed the June 30, 2014 actuarial valuations for all employers in the summer/fall of 2015.

Impact on PEPRA Normal Costs

With the enactment of the Public Employees' Pension Reform Act of 2013 (PEPRA) new benefits were put in place for new public employees in California hired after January 1st, 2013. PEPRA requires that all new public employees in California be covered by one of the four benefit formulas created by PEPRA. In addition, PEPRA require all new PEPRA members to contribute at least 50 percent of the total annual normal cost of their pension benefit as determined by the actuary. Last year, staff determined the required contribution rate for PEPRA members based on the actuarial assumptions in place at the time. PEPRA contains a provision that states that when the normal cost has changed by more than 1% of payroll that the member contribution rate be adjusted.

Under the proposed assumption, the normal cost for miscellaneous employees is expected to increase by less than 1% of payroll and as a result should not result in an increase in member rate for miscellaneous employees. The normal cost for most safety plans is expected to increase between 1% and 2% of payroll and in some rare cases increases by as much as 3% of payroll. As a result, the proposed assumption changes are expected to result in an increase in contribution rates for safety PEPRA members ranging in most cases between 0.5% and 1% of salary. Please refer to Attachment 3 for more details on the impact of the proposed assumption change on normal cost for the PEPRA members.

Possible Alternative Amortization Schedules

The recommended changes to the actuarial assumptions will have a significant impact on participating employers at a time when their budgets are already strained. Concern has been raised that the contribution increases may be too much for employers to bear. To address this, staff has looked at two possible alternative amortization schedules that could be adopted. These are shown for the recommended assumptions. In addition, at the request of the Board, staff has included the alternative financing options for the alternative mortality assumption (i.e., 15 years of mortality projections).

The first alternative is to smooth the impact over seven years instead of the five years prescribed by current Board policy. Under this alternative the increase in actuarial liabilities is still amortized over 20 years. While it results in a more gradual increase than current policy, it has the disadvantage of resulting in a higher peak rate due to the delay in increasing contributions.

The second alternative is to amortize the increase in liability over 30 years rather than the 20 years provided by current Board policy. Under this alternative the contribution increases are still phased in over 5 years. While this alternative result in both a more gradual increase and a lower peak rate, it extends the period over which the increase will have to be paid resulting in higher overall contributions.

Attachment 5 shows the impact on employer rates with the two alternative amortization schedules

Implementation of New Assumptions

If approved, staff recommends that the new actuarial assumptions be used to set the 2016/2017 contribution rates for all employers. That means that they would be used for the first time in the June 30, 2015 actuarial valuations for the State plans and the Schools pool and in the June 30, 2014 actuarial valuations for the public agencies.

The new actuarial assumptions will also affect certain member calculations. These include the cost of any service purchased under the present value method for example military service and any optional form of benefit elected by a member. Assuming the Board adopts the new actuarial assumptions at the February Board meeting, members retiring on or after February 20, 2014, would be subject to new optional settlement factors based on the new assumptions.

The application of the new actuarial assumptions for actuarial equivalent option factors will result in most cases in a smaller reduction in benefit for members selecting an optional form of retirement, or said another way, the implementation of the new assumptions will generally benefit members upon retirement. Note that the

assumption changes will result in an increase in cost for members to purchase service.

For service credit purchases under the present value method, any request postmarked, faxed or delivered to CalPERS on or after February 20, 2014, would be based upon the new assumptions.

BUDGET AND FISCAL IMPACTS

The experience study and review of assumptions was prepared internally and will be reviewed externally. Funding was already identified within existing budgetary resources. If adopted by the Board, the recommended assumption changes would result in increased contributions to the system.

ATTACHMENTS

- Attachment 1 – Draft Experience Study and Review of Actuarial Assumptions
- Attachment 2 – Contribution Rate Impacts of Recommended Assumptions using Current Board Amortization Policy
- Attachment 3 – Impact on PEPR Normal Cost
- Attachment 4 – Contribution Rate Impacts of Recommended Assumptions with Alternative Mortality Assumption using Current Board Amortization Policy
- Attachment 5 – Contribution Rate Impacts under Other Financing Options

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