CalPERS Discount Rate Reduction and the Impacts on Local Public Agencies

NH Alert — Winter 2017

Background

In December 2016, CalPERS (PERS) announced it would lower its discount rate (expected earnings rate) from 7.50% to 7.00%. PERS most recently reduced the discount rate in 2013 from 7.75% to 7.50%, and from 8.25% to 7.75% in 2003.

Implementation

The discount rate reduction will be phased in over the next three years, requiring increases in the Unfunded Actuarial Liability (UAL) to be amortized over a 20-year period. Similar to recent 30-year amortization bases implemented by PERS, these new UAL bases will have a trapezoidal amortization, meaning that payments will ramp up in the first five years and decrease in the last five years. Most participating agencies were already facing increasing UAL repayment structures, which will be exacerbated by this change and add new budgetary pressures.

Why the Change?

PERS actual investment performance has significantly lagged expectations, with the $300 billion fund only 68% funded. According to PERS, lowering the discount rate will help stabilize the fund and align the long-term economic forecasts with expected investment returns.

What are the Impacts to Your Agency?

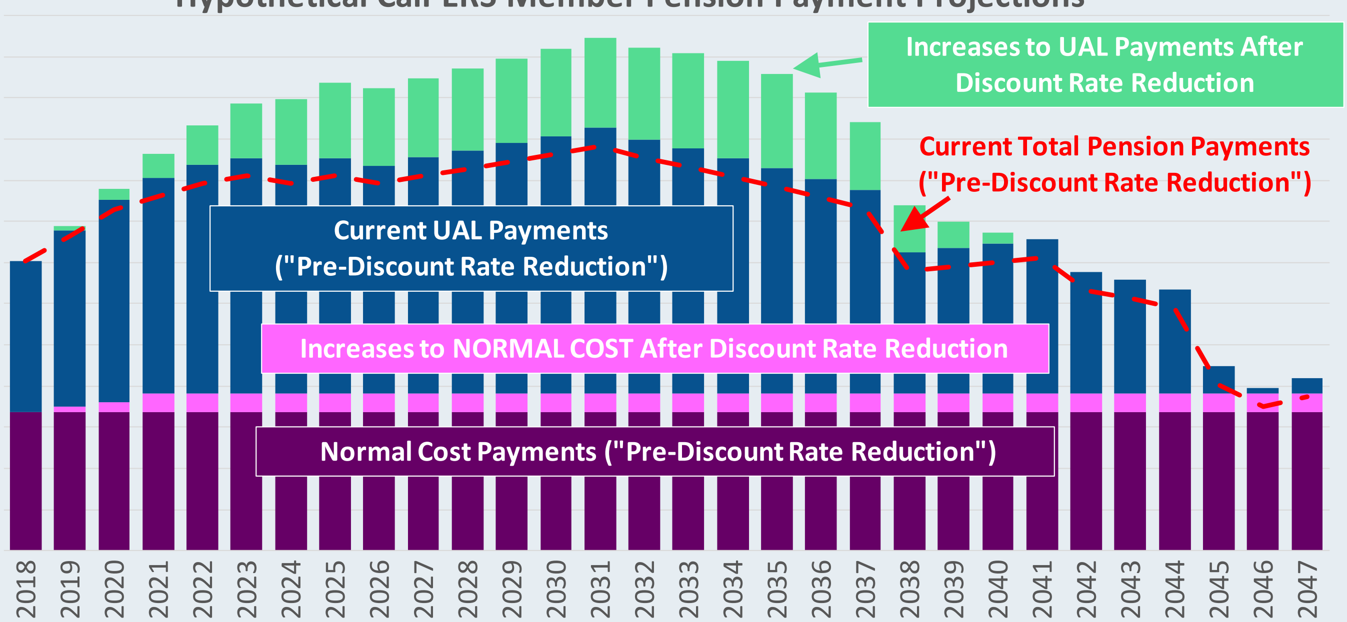
NHA estimates that the UAL balance for most agencies will increase between 25% and 30% over the next three years. On average, for non-risk pool members, payments to amortize the UAL will nearly double* over the next 10 years. Inclusive of the less volatile "Normal Cost" portion of pension payments, combined annual PERS payments will grow approximately 45%-50%* over the next 5 years and 65%-70%* by 2030. Note that payment increases* for risk-pool member plans will be much less than those stated above, given their unique "side-fund" induced amortization shape. These figures are general estimates based on analyses prepared by NHA for various California agencies. We encourage each agency to assess its own unique situation.

* % increase relative to 2017/18 levels

What Should You Do?

Understanding the financial impacts and planning for rapidly increasing PERS contributions will require evaluating options to manage or lower this obligation. Projecting cash flow needs that account for elevated future PERS contributions is the first step in addressing long-term fiscal health. NHA encourages all impacted public agencies to contact their PERS actuary, independent actuary, and/or municipal advisor to better understand the cost projections and possible strategies to offset the financial impacts. Be on the lookout for webinars and conference calls from professional organizations on this topic. The League and CSMFO are expected to host events in the coming weeks.

Hypothetical CalPERS Member Pension Payment Projections



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