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MEMORANDUM
January 11, 2018

TO: RPEA

FROM: Marketplace Communications

RE: Daily Media Clips

Following are today's news clips:

How Much More Will Cities and Counties Pay CalPERS?

By Edward Ring
January 10, 2018

When speaking about pension burdens on California's cities and counties, a perennial question is how much are the costs going to increase? In recent years, California's biggest pension system, CalPERS, has offered "Public Agency Actuarial Valuation Reports" that purport to answer that question. Notwithstanding the fact that CalPERS predictive credibility is questionable – i.e., they've gotten it wrong before – these reports are quite useful. Before delving into them, it is reasonable to assert that what is presented here, using CalPERS data, are best case scenarios.

In partnership with researchers at the Reason Foundation, the California Policy Center has compiled the data for every agency client of CalPERS, including 427 cities and 36 counties. In this summary, that data has been distilled to present two sets of numbers – payments to CalPERS for the 2017-2018 fiscal year, and officially estimated payments to CalPERS in the 2024-25 fiscal year. In calculating these results, the only assumption we made (apart from the assumptions made by CalPERS), was for estimated payroll costs in 2024. We used a 3% annual growth rate for payroll expenses, the rate most commonly used in official actuarial analyses on this topic.

So how much more will cities and counties have to pay CalPERS between now and 2024? How much more will pensions cost, six years from now?

On the table below, we provide information for the 20 cities that are going to be hit the hardest by pension cost increases. To view this same information for all cities and counties that participate in the CalPERS system, download the spreadsheet "CalPERS Actuarial Report Data – Cities and Counties."

CalPERS Actuarial Report Data
The Twenty California Cities With the Highest Pension Burden ($=M)

	2017-18							2024-25						
	Payroll	PAYMENTS TO CALPERS						Payroll	PAYMENTS TO CALPERS					
CITY		Total	%	Normal	%	Catch-Up	%		Total	%	Normal	%	Catch-Up	%
Millbrae	6.3	3.7	59%	0.8	13%	2.9	46%	7.7	6.8	89%	1.0	13%	5.8	75%
Emeryville	4.5	2.4	53%	0.8	19%	1.5	34%	6.5	5.1	79%	1.4	22%	3.7	57%
Santa Fe Springs	17.2	8.7	51%	2.5	14%	6.3	37%	20.8	16.1	77%	3.5	17%	12.6	61%
Pacific Grove	6.1	2.4	40%	0.7	11%	1.7	28%	7.0	5.2	75%	0.9	13%	4.4	62%
Santa Ana	100.6	45.1	45%	13.9	14%	31.2	31%	121.4	89.8	74%	20.0	16%	69.8	57%
Costa Mesa	47.2	23.2	49%	7.1	15%	16.1	34%	56.5	41.7	74%	9.9	18%	31.8	56%
Bell	6.1	2.8	45%	1.0	16%	1.8	29%	7.4	5.4	73%	1.3	18%	4.0	55%
West Covina	28.3	13.1	46%	4.3	15%	8.8	31%	34.8	25.0	72%	6.1	18%	18.8	54%
Vallejo	45.6	22.7	50%	6.9	15%	15.8	35%	57.3	40.6	71%	10.3	18%	30.3	53%
El Cajon	32.2	15.1	47%	4.8	15%	10.4	32%	36.9	25.5	69%	6.5	18%	19.0	52%
Westminster	20.6	8.3	40%	3.0	14%	5.3	26%	24.2	16.7	69%	4.1	17%	12.6	52%
Compton	21.8	10.0	46%	2.9	13%	7.1	33%	28.9	19.3	67%	4.2	15%	15.1	52%
Rialto	26.2	12.2	47%	4.7	18%	7.5	29%	32.4	21.7	67%	6.7	21%	15.0	46%
El Monte	24.1	13.5	56%	4.1	17%	9.4	39%	29.9	20.0	67%	6.1	21%	13.8	46%
Montclair	12.5	5.1	41%	1.7	14%	3.3	27%	15.1	10.1	66%	2.4	16%	7.6	50%
San Bernardino	82.2	31.6	38%	11.5	14%	20.1	24%	92.6	61.1	66%	15.5	17%	45.6	49%
Monrovia	19.5	8.2	42%	3.3	17%	4.9	25%	23.3	15.4	66%	4.5	19%	10.9	47%
Inglewood	46.8	17.9	38%	6.8	15%	11.1	24%	56.9	37.0	65%	9.7	17%	27.2	48%
Newark	17.7	7.6	43%	2.4	14%	5.1	29%	21.7	14.1	65%	3.4	16%	10.7	49%
Upland	21.2	9.0	42%	3.1	14%	5.9	28%	25.7	16.6	65%	4.4	17%	12.2	47%

If you are a local elected official, or if you are an activist, journalist, or anyone else with a keen interest in pensions, these tables merit close scrutiny. Because they not only show costs estimates today, and seven years from now, but they break these costs into two very distinct areas – the so-called "normal" costs, which are how much employers have to pay into the pension fund for current workers who are vesting one more year of future benefits, and the "catch-up" costs, which are what CalPERS charges employers whose pension plan is underfunded.

Take the first city listed, Millbrae. By 2024, we predict Millbrae will have the highest total pension payments of any city in California that belongs to the CalPERS system.

The table presents are two blocks of data – the set of columns on the left show current costs for pensions, and the set of columns on the right show the predicted cost for pensions. In all cases, the cost in millions is shown, along with the cost in terms of percent of total payroll.

Currently, as can be seen on the table, for every dollar it pays active employees in base wages, Millbrae must contribute 59 cents to CalPERS. This does not include payments to CalPERS that Millbrae collects from its employees via withholding. The same data show that, by 2024, for every dollar Millbrae pays active employees in base wages, they will have to contribute 89 cents to CalPERS. Put another way, while Millbrae may expect its payroll costs to increase by $1.4 million, from $6.3 million today to $7.7 million in six years, their payment to CalPERS will increase by $3.1 million, from $3.7 million today to $6.8 million in 2024.

But here's the rub. Nearly all of this increase to Millbrae's pension costs are the "catch-up" payments on the city's unfunded liability. In just six years Millbrae's payment on its unfunded liability will increase by 99%, from $2.9 million today to $5.8 million in 2024.

Why?

What are the implications?

It is difficult to overstate how outrageous this is. Here's a list:

1 – Virtually every pension "reform" over the past decade or so has exempted active public employees from helping to pay down the unfunded liability via withholding. Instead, their increased withholding – in some cases supposedly rising to "fifty percent of pension costs" (the PEPRA reforms) – only apply to the normal contribution.

2 – In order to appease the unions who, quite understandably, lobby for the lowest possible employee contributions to pension funds, the "normal cost" is calculated based on financially optimistic projections. The less time an actuary predicts a retiree will live, and the more an actuary predicts investments will earn, the lower the normal contribution.

3 – In order to cajole local elected officials to agree to pension benefit enhancements, the same overly optimistic, misleading projections were provided, duping decision makers into thinking pension contributions would never become a significant burden on cities and counties, and by extension, taxpayers.

4 – Because cities and counties couldn't afford to pay down the growing unfunded liabilities attached to their pension plans, tricky accounting gimmicks were employed, where minimal catch-up payments were made in the present in exchange for bigger catch-up payments in the future. The closest financial analogy to what they did would be the "negative amortization" mortgages that were popular prior to the housing crash of 2008.

5 – The consequence of this chicanery is that today, as can be seen, catch-up payments on the unfunded liability are typically two to three times greater than the normal contribution. And it's getting worse. In 2024, Millbrae, for example, will have a catch-up contribution that is nearly six times as much as their normal contribution.

6 – When a normal contribution isn't enough, and the plan becomes underfunded, the level of underfunding is compounded every year because there isn't enough money in the fund earning interest. The longer catch-up payments are deferred, the worse the situation gets.

Yet the normal contribution has always been represented as all that should be required for pension plans to remain fully funded. Just how bad it has gotten can be clearly seen on the table.

Take a look at Pacific Grove, fourth on the list of CalPERS cities with the highest pension burden. Pacific Grove is already paying 40 cents to CalPERS for every dollar it pays to its active employees. But in six years, that amount will go up to 75 cents to CalPERS per dollar of salary to active employees. And take a look at where the increase comes from: Their catch-up payment goes from 1.7 million to $4.4 million in just six years.

Why?

Why isn't Pacific Grove paying more, now, so that it can avoid more years of having too little money in its pension plan, earning interest to properly fund future pensions? The reason is simple: Telling Pacific Grove to go out and find another $2.7 million, right now, is politically unpalatable. In six years, most of the local elected officials in Pacific Grove will be gone. But where is Pacific Grove going to find this kind of money? Where are any of California's cities and counties going to find this kind of money?

One final point: These pension plans are underfunded after a bull market in stocks has doubled since it's last peak in June 2007, and has nearly quadrupled since it's last low in March 2009. When stocks and real estate have been running up in value for eight years, pension plans should not be underfunded. But they are. CalPERS should be overfunded at a time like this, not underfunded. That bodes ill for the financial status of CalPERS if and when stocks and real estate undergo a downward correction.

CalPERS, and the public employee unions that dominate CalPERS, have done a disservice to taxpayers, public agencies, and ultimately, to the individual participants who are counting on them to know what they're doing. They were too optimistic, and the consequences are just beginning to be felt.

California's Brown Raises Prospect of Pension Cuts in Downturn

By
Romy Varghese
January 10, 2018, 1:28 PM PST

Jerry Brown Photographer: David Paul Morris/Bloomberg

California Governor Jerry Brown said legal rulings may clear the way for making cuts to public pension benefits, which would go against long-standing assumptions and potentially provide financial relief to the state and its local governments.

Brown said he has a "hunch" the courts would "modify" the so-called California rule, which holds that benefits promised to public employees can't be rolled back. The state's Supreme Court is set to hear a case in which lower courts ruled that reductions to pensions are permissible if the payments remain "reasonable"for workers.

"There is more flexibility than there is currently assumed by those who discuss the California rule," Brown said during a briefing on the budget in Sacramento. He said that in the next recession, the governor "will have the option of considering pension cutbacks for the first time."

That would be a major shift in California, where municipal officials have long believed they couldn't adjust the benefits even as they struggle to cover the cost. They have raised taxes and dipped into reserves to meet rising contributions. The California Public Employees' Retirement System, the nation's largest public

pension, has about 68 percent of assets needed to cover its liabilities. For the fiscal year beginning in July, the state's contribution to Calpers is double what it was in fiscal 2009.
Across the country, states and local governments have about $1.7 trillion lessthan what they need to cover retirement benefits -- the result of investment losses, the failure by governments to make adequate contributions and perks granted in boom times.

"In the next downturn, when things look pretty dire, that would be one of the items on the chopping block," Brown said.

Opinion: Brown suffers major setback on pension reform

(Photo by Max Whittaker/Getty Images)

In 2011, Gov. Jerry Brown announces his public employee pension reform plan.
By **DANIEL BORENSTEIN** | dborenstein@bayareanewsgroup.com | Bay Area News Group
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Gov. Jerry Brown suffered a significant legal setback this week when a state appeals court dealt a blow to hopes for meaningful pension reform in California.

The decision after five years of litigation over pension spiking could undermine key portions of legislation the governor signed in 2012 to end such abuses and help shore up retirement systems across the state.

The good news is that the decision, issued by a three-justice panel in San Francisco, probably won't be the final word on the issue. The state Supreme Court had already agreed to hear appeals of two other cases stemming from the 2012 legislation and is expected to take the latest one too.

Each case confronts the question of how much the state can alter retirement benefits without violating past promises to workers. In the two other cases, separate panels of the same appeals court in San Francisco had upheld implementations of Brown's legislation.

Monday's ruling broke that momentum, showing that the road to meaningful reform is fraught with legal obstacles.

The ruling blocked a lower court decision that had stopped some of the state's worst pension spiking in Alameda, Merced and especially Contra Costa counties. Workers there had been able to count large payments for unused leave time as income to inflate their final-year salaries on which their pensions were calculated.

Under a legal doctrine known as the California Rule, pension attorneys across the state have said that once public employees start working, their retirement benefits can never be trimmed, even for benefits they haven't yet earned. The unalterable benefit level was considered a constitutionally protected "vested right."
For example, a police officer who accepted the job when it included a pension equal to 3 percent of top salary for every year worked would be entitled to accrue benefits using that formula for his or her entire career.

But the costs of current benefit levels in California are strangling local government budgets and are forecast to continue rising. Without the ability to lower the rate of future pension accruals for existing employees, local governments will be forced to raise taxes or forego more public services.
While the 2012 legislative changes generally worked around the California Rule by reducing benefits for new workers, they did alter some pension-padding practices that benefited existing workers. It's those reforms that are at issue in the three cases.

One provision eliminated “airtime,” which had allowed employees to increase their pensions by purchasing additional years of service credit at what turned out to be discount rates. Another set of provisions ended pension spiking.

Labor unions contend that, just as their pension benefit formulas cannot be reduced under the California Rule, so too were the airtime and spiking practices unalterable if they resulted in reductions in retirement pay.

The appellate courts ruled in 2016 decisions in an airtime case involving state firefighters and a Marin County spiking case that vested rights are not absolute. So long as pension modifications are “reasonable,” the court panels said, they do not violate workers’ constitutional rights. Public employees do not have “an immutable entitlement to the most optimal formula of calculating the pension.”

Those rulings gave reformers hope that meaningful alterations to future pension accruals were also possible. But then came Monday’s ruling, involving the spiking cases in Alameda, Contra Costa and Merced counties.

While agreeing that there are limits to the California Rule, the justices in that case set a much tougher standard for changes than the appellate panel in the similar Marin County case.

In the latest decision, the justices ruled that pension benefit adjustments require “compelling” evidence that they are necessary and a showing that the pension system would otherwise have difficulty meeting its financial obligations.
The justices also said that state pension law did not permit the pension spiking that had been allowed in the three counties. But they said it was nevertheless binding because the county pension systems had agreed to permit it as part of legal settlements with the unions nearly two decades ago.

A Brown spokesman said the administration is “closely reviewing the decision and considering next steps.” Anything short of a full-throated appeal to the state Supreme Court would be a concession of defeat.

For Whom the California Budget Tolls

By David Crane
Lecturer and Research Scholar at Stanford University and President of Govern for California

Wednesday, January 10th, 2018

Journalists and elected officials occasionally make the mistake of viewing budget problems in terms of size rather than where the budget item falls. For example, the costs of unfunded pensions and retiree healthcare in the current fiscal year (FYE16–17) add up to 6% of the state's General Fund, a much smaller share than retirement spending in, say, Los Angeles where retirement spending consumes 20% of the local budget. ***But all the consequences of that 6% fall on a small portion of the General Fund.*** That's because General Fund expenditures are like a waterfall in which money is first captured by expenditures protected by constitution, contract or statute. Unprotected programs get funded from the balance. For example:

Assume General Fund revenues this fiscal year are $100. The first $40 plus unpaid balances (if any) goes to K-14 education as a result of constitutional protection (Proposition 98). The next $7 goes to General Obligation bond debt service as a result of constitutional and contractual protection and another $7 goes to pensions and retiree healthcare as a result of contractual protection*. Medi-Cal, a statutory entitlement, takes 15% of the General Fund (plus additional amounts from Special Funds) and another 7% is consumed in part by entitlements administered by the Department of Social Services.

Together, those protected obligations (ie, K-14, debt service, pensions, OPEB, Medi-Cal and DSS) will consume 78% of the General Fund this fiscal year, up from 69% just six years ago.

That leaves only 22% (ie, 100–78) for everything else, but that 22% must also cover Corrections, CHP and CalFire, all involving public safety and politically protected by powerful government employee unions. Public safety takes 10+% of the General Fund, leaving only 12% for UC, CSU and other discretionary categories not protected by contract, statute or the constitution. That's down from 21% just six years ago; ie, the share of the General Fund available for discretionary items declined 43% in just six years.

The share of the General Fund available for UC, CSU and other discretionary categories declined 43% in just six years.

General Fund revenues were robust over that six-year period, growing 28%, and were even enhanced by a substantial tax increase, but UC and CSU saw only 19% and 23% growth in state spending. That's in part because General Fund spending on pensions and retiree healthcare grew 99% and 47%.

Looked at another way, California's General Fund is no different than a household in which discretionary spending is a function of how much is left over after non-discretionary spending. If your salary rises less than your mortgage and healthcare costs, you must reduce discretionary spending.

This explains how UC, CSU and other discretionary programs are paying the price for rapid growth in unfunded retirement costs. ***Every dollar by which protected expenditures exceed revenue growth comes out of unprotected pockets.*** After so many years of degradation (state spending on retirement costs has grown 70% since FYE11; see below), now only 12% of the General Fund is left to fund them—and that's after a seven year bull market. Just imagine the consequences when revenues revert to the mean. That's what happens when unfunded retirement obligations are not seriously addressed.

Figure SWE-01

State Retirement and Health Care Contributions[1]

(Dollars in Millions)

	CalPERS[2]	CSU CalPERS	CalSTRS	JRS	JRS II	LRS	Active Health & Dental[3]	Retiree Health & Dental	CSU Retiree Health
2007-08	$2,999		$1,623 [4]	$162	$37	$0	$2,020	$1,114	
2008-09	3,063		1,133	189	40	0	2,146	1,183	
2009-10	2,861		1,191	184	32	0	2,120	1,182	
2010-11	3,230		1,200	166	54	0	2,277	1,387	
2011-12	3,174		1,259	195	58	0	2,439	1,505	
2012-13	2,948 [5]	$449 [5]	1,303	160	51	0	2,567	1,365 [5]	$222 [5]
2013-14	3,269	474	1,360	188	52	1	2,697	1,383	225
2014-15	4,042	543	1,486	179	63	1	2,797	1,462	256
2015-16[6]	4,338	585	1,935	190	67	1	2,938	1,585	264
2016-17[6]	4,829	636	2,468	202	68	1	3,131	1,744	291

Page 126, Governor's Budget Summary—2016–17

Pension and OPEB costs are just starting their sharp rise. Action can be taken. For the benefit of discretionary programs, taxpayers and fee-payers, legislators and governors should pay attention.

*There is an argument that pensions and retiree healthcare are senior to or at minimum *pari-passu* with debt service (see eg bankruptcy court decisions relating to Stockton and Detroit) but in the case of a state that cannot declare bankruptcy and that has the power to tax, that's probably a distinction without a substantive difference.

California Today: Jerry Brown Warns of Recession and Reveals His Final Budget

California Today

By JOSE A. DEL REAL JAN. 11, 2018

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Gov. Jerry Brown delivered his budget proposal on Wednesday, warning of the need to protect California's finances from "darkness, uncertainty, decline and recession." CreditRich Pedroncelli/Associated Press

Good morning.

(Want to get California Today by email? [Here's the sign-up](#).)

Gov. Jerry Brown moved to bolster California's "rainy day" fund Wednesday when he unveiled the final budget proposal of his administration in Sacramento, asking the Legislature not to take the state's economic stability for granted, while also deflecting questions about his legacy.

His message centered on a warning: "What's out there is darkness, uncertainty, decline and recession. So good luck, baby," he said with a smile.

Flanked by blown-up cardboard graphs, he predicted that his successors would probably face an economic recession in the near future and said he was determined to minimize the damage. The $132 billion budget plan centered heavily on infusing the emergency fund with $5 billion in the coming fiscal year — bringing the total stash to $13.5 billion — in order to prevent layoffs and soften other painful budget cuts in a downturn.

He and his team said the progress California has made since 2011, when it was teetering on the edge of financial catastrophe, is more reason to double-down on the emergency fund. Today the state has a $6.1 billion surplus. "Yes, we have had some very good years and program spending has steadily increased," reads his opening message in the budget. "Let's not blow it now."

There are several obstacles facing the governor before his term expires. Namely, brewing clashes with Republicans in Washington — over immigration, health care, and state and local tax deductions. Those could throw curveballs at the state's budget in the years to come.

Governor Brown hesitated to say California was at "war" with Washington during a question-and-answer session with reporters. But he acknowledged the Republican tax plan that passed through Congress last month will mean some high-income earners in California will be tempted to leave the state.

"If we have a rainy-day fund, and if people don't move out of the state who have a lot of money, things will be O.K.," he said.

And his legacy? What about it?

"Can you tell me the legacy of Goodwin Knight? Or Governor Merriam? Or Deukmejian? Governors don't have legacies, that's my No. 1 proposition," he said. "Look, we have a whole political system that judges our executives by the state of the economy, over which they have virtually no impact. So, you figure it out."

More coverage:

• The proposed budget calls for $4.6 billion in spending on California's transportation infrastructure, reports The Los Angeles Times.

• The governor's proposed budget would boost education funding, wrote Capital Public Radio, including $570 million for community colleges.

• Some Republicans, reported the San Francisco Chronicle, said the state's $6.1 billion in revenue should go back to taxpayers.

• George Skelton: In his last budget, Governor Brown ties up loose ends and gives himself some protection. But there is a "stench of hypocrisy here too."

• Unlike his predecessors, Governor Brown is poised to leave office without major budget deficits, writes The Wall Street Journal.