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Ventura County Pension Reform Would Save $460 Million, Reduce Debt $1.8 Billion

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Summary: If adopted, the Initiative for Pension Fairness and Sustainability would save Ventura County $5.4 million in cash flow over the first two years, $51.6 million in cumulative savings over five years of reform, and $460 million in total savings over 15 years—all while separately eliminating $1.8 billion in pension debt. In the long run, moving to a new defined-contribution system would protect taxpayers from unfunded liabilities and investment return risks in public retirement systems.

The Problem: The Ventura County Employees' Retirement Association (VCERA) is poorly positioned to stay properly funded in the coming years, and local taxpayers may be forced to pick up a hefty tab of unfunded liabilities if substantive changes are not made in the near future.

While the county's payroll has increased just 6.2% from 2008 to 2013, annual taxpayer contributions to the pension system have grown 26.7% during the same time (from $104.4 million to $142.4 million). Despite this large increase in taxpayer payments, during this time period VCERA fell from having 91.3% of the funding needed to pay future pension benefits to having just 79.2%. And during that time, the defined-benefit pension system's unfunded liability has more than tripled to $953.4 million.

This funding disparity is a result of a few different dynamics, including the pension fund's asset investment inability to meet the unrealistic assumed 7.75%

rate of return. Investment returns have averaged just 5.82% over the last five years, and 6.93% over the past ten years, indicating that missing the investment target has not been only related to the financial crisis and recession.

Additionally, VCERA has not properly anticipated that retirees are living longer and that more funds are needed to pay those pension benefits over longer retirement spans. Taken together, these are indications of an unsustainable system.

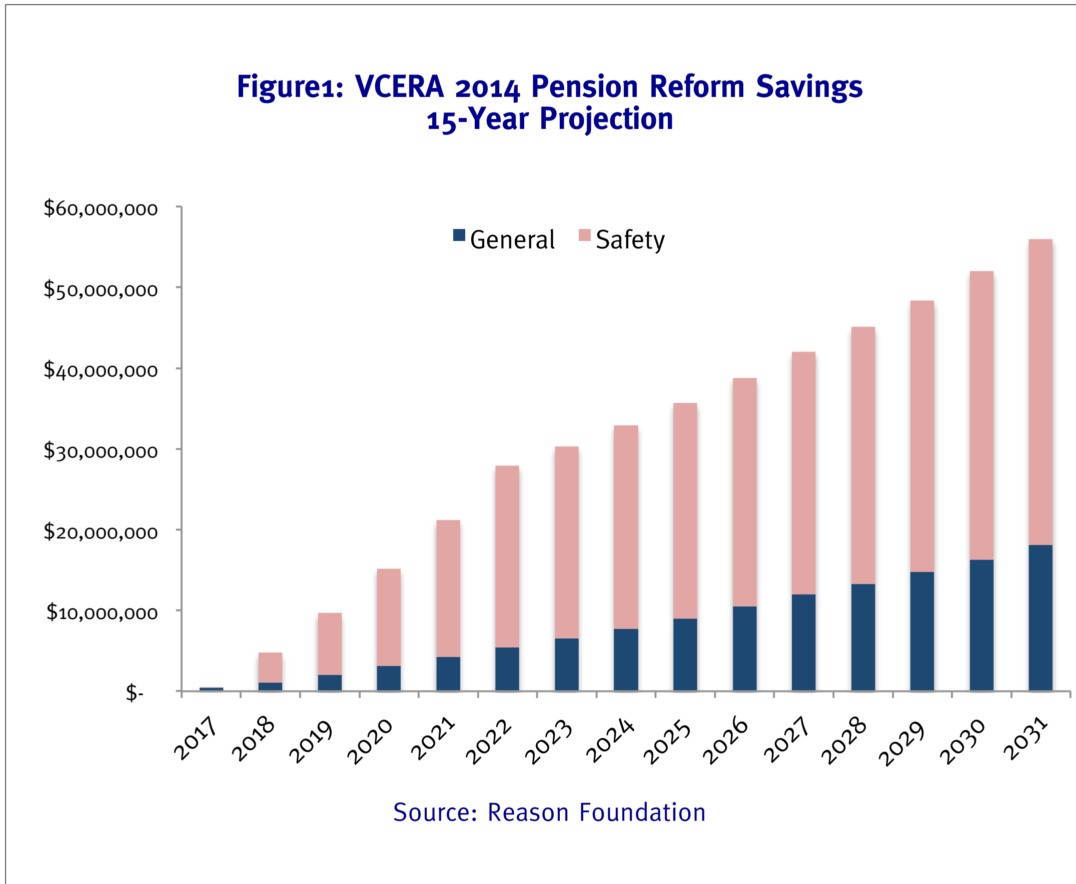
The California Public Employees' Pension Reform Act (PEPRA), which was passed in 2013, attempted to solve problems like these by changing the rules governing local government pension systems statewide. PEPRA does not solve Ventura County's core problems, however. For example, PEPRA has no effect on the county's unfunded liability. Neither does it address shortfalls in investment returns.

The combination of needing to both pay down the unfunded liability and adopt more realistic investment assumptions will require an increase in county taxpayer contributions into the system unless fundamental reforms beyond PEPRA are implemented.

The Solution: An initiative by county residents would address the risk of long-term liabilities by putting new hires into a 401(k)-style defined-contribution system and phasing out the defined-benefit system over time. Defined-contribution systems have no investment return assumptions, and eliminate taxpayer investment risk.

The defined-contribution system for all new Ventura County employees will have contribution rates from the county of 11% for public safety employees not enrolled in social security, and 4% for general employees enrolled in social security. The defined contribution system would create no long-term liabilities for the county. All current employees would continue accruing benefits as normal, subject to PEPRA.

The initiative also includes a provision that holds pensionable pay constant for five years for all General Tier 1, General Tier 1-PEPRA, and public safety employees. This would create immediate cash flow savings that would enable the county to pay for increased normal costs in phasing out the defined-benefit system.

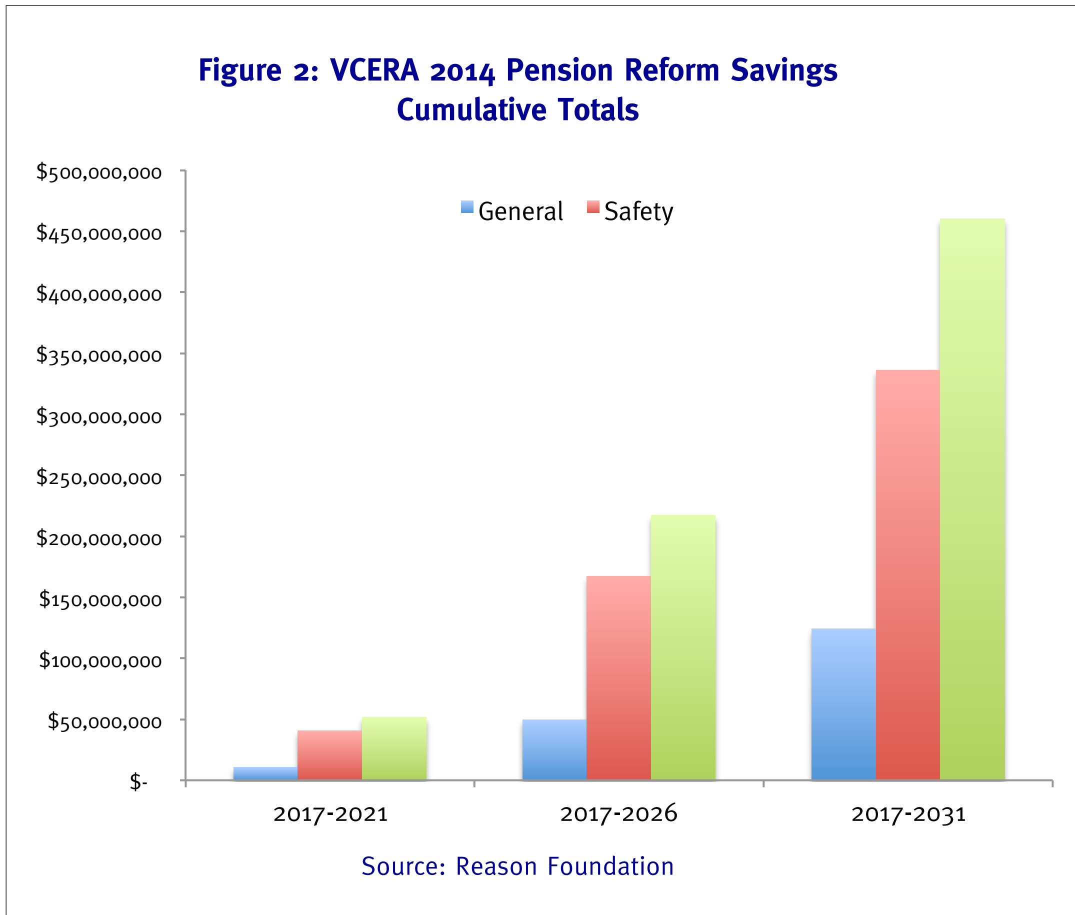


The Savings: Should all elements of this initiative be adopted, Ventura County would see cash flow savings of:

- $508,000 in the first year of implementation, and $4.9 million in the second year of implementation;
- $51.6 million in cumulative savings over the first five years;
- $217.1 million in cumulative savings over 10 years;
- $460.4 million in cumulative savings over 15 years. [1]

VCERA currently amortizes the unfunded liability over 15 years, which is why the independent actuarial analysis provides projected savings over that time frame. Importantly, these projected savings would be *in addition* to any savings that might occur as a result of implementing PEPRA.

Figure 1 above shows the annual net savings to Ventura County for both general employees and public safety employees. Figure 2 below shows the cumulative savings over 15 years for general and public safety employees.



The proposed initiative would also reduce the long-term liabilities of the defined-benefit fund, both by phasing it out it over time and as a result of holding pensionable pay constant. By the end of the 15-year amortization period, VCERA's liabilities would be $1.771 billion lower than without reform (see Table 1). This is separate from the annual cash-flow savings.

As also shown in Table 1, the proposed initiative would lead to $230 million in reduced unfunded liabilities over the first five years. By fiscal year 2024, the defined-benefit fund would be fully funded.

The Details: These savings were determined through an independent actuarial analysis performed for Ventura County Taxpayers Association.[2] The actuary modeled the anticipated changes proposed in the reform initiative versus the projected growth in liabilities of the current pension system.

The actuary adopted all of the assumptions used in the most recent valuation for VCERA, except employment growth.[3] Thus, the baseline that the proposed initiative was compared to incorporated changes due to PEPRA. The costs and savings were amortized over 15 years, consistent with current policy. The

actuary also assumed that the county would continue to make 100% of its annual contributions.

Table 1: Changes in VCERA Liabilities Due to Pension Reform

FY	Unfunded Liability			Accrued Liability		
	Current	After Reform	Net Reduced	Current	After Reform	Net Reduced
2015	$862,000,000	$862,000,000	$0	$5,120,000,000	$5,120,000,000	$0
2016	$767,000,000	$767,000,000	$0	$5,412,000,000	$5,375,000,000	$37,000,000
2017	$741,000,000	$660,000,000	$81,000,000	$5,659,000,000	$5,579,000,000	$81,000,000
2018	$667,000,000	$540,000,000	$127,000,000	$5,963,000,000	$5,810,000,000	$153,000,000
2019	$583,000,000	$407,000,000	$176,000,000	$6,268,000,000	$6,037,000,000	$231,000,000
2020	$488,000,000	$260,000,000	$228,000,000	$6,578,000,000	$6,254,000,000	$324,000,000
2021	$380,000,000	$150,000,000	$230,000,000	$6,893,000,000	$6,512,000,000	$381,000,000
2022	$312,000,000	$86,000,000	$226,000,000	$7,211,000,000	$6,764,000,000	$447,000,000
2023	$242,000,000	$21,000,000	$221,000,000	$7,532,000,000	$7,006,000,000	$526,000,000
2024	$182,000,000	-$33,000,000	$215,000,000	$7,853,000,000	$7,236,000,000	$618,000,000
2025	$97,000,000	-$111,000,000	$208,000,000	$8,174,000,000	$7,450,000,000	$724,000,000
2026	-$11,000,000	-$210,000,000	$199,000,000	$8,494,000,000	$7,646,000,000	$848,000,000
2027	-$83,000,000	-$271,000,000	$188,000,000	$8,809,000,000	$7,820,000,000	$989,000,000
2028	-$129,000,000	-$305,000,000	$176,000,000	$9,119,000,000	$7,970,000,000	$1,149,000,000
2029	-$177,000,000	-$338,000,000	$161,000,000	$9,420,000,000	$8,088,000,000	$1,332,000,000
2030	-$228,000,000	-$373,000,000	$145,000,000	$9,709,000,000	$8,171,000,000	$1,538,000,000
2031	-$281,000,000	-$406,000,000	$125,000,000	$9,982,000,000	$8,211,000,000	$1,771,000,000

Source: Reason Foundation

The official VCERA actuary has been making the unrealistic assumption that the county would not expand the workforce by even one person over the next 15 years.[4] That has not been true over the last 15 years and is not likely to be true in the future.

The independent actuary assumes there will be modest employment growth in county government, which makes the estimate of savings from the proposed initiative more conservative.[5] If the county actuary turns out to be right and Ventura County does not hire more workers over the next 15 years, savings from the initiative will be even greater than those predicted here.

The independent actuary had to assume no additional changes to the existing VCERA defined-benefit pension plan over the next 15 years, but should any future reforms be implemented, they could result in costs or savings not included in this analysis. Additionally, any future underfunded contributions or missed investment return targets would affect the net position of VCERA's financial condition.

Finally, the savings projection assumes that pensionable pay will increase on a normal basis after the five-year holding period. However, if county leaders decide in the future to retroactively add the five-year of pay increases into

pensionable pay (known as "catching up" pensionable pay)—that is, if all pay increases over the next five years are rolled back into pensionable pay—that would be costly to county taxpayers as employee contributions could not be increased to cover the sudden increase in liabilities.

Zero "Transition Costs": The proposed initiative requires *zero additional costs* for Ventura County taxpayers. The county could make separate policy choices that mean costs increase beyond the status quo, such as increasing the debt payments for VCERA. But any costs related to these policy choices would be *unrelated* to transitioning from defined-benefit to defined-contribution.

There are two components to pension funding: the annual cost to pre-fund pension liabilities (known as "normal cost"), and the cost to pay off unfunded pension debt. There is no legal reason that VCERA would have to change its defined-benefit debt payment plan due to the transition toward a defined-contribution system. It is important to clarify that employee contributions *never* subsidize debt payments. So there are no transition costs related to debt repayment.

More importantly, the actuary's model shows that the county would save $318,000 from its normal, annual pension cost in the first year, and would spend $332 million less over 15 years because of the change to a defined-contribution plan (see Table 2).

Holding pensionable pay constant saves the county $190,000 in the first year of reform and $128.6 million after 15 years *on top of normal pension cost savings* (see Table 2). These savings could be passed from VCERA to the county. Or it might be necessary to reinvest the money into the defined-benefit fund to offset future losses that the defined-benefit system may still experience due to its unrealistic actuarial assumptions.

Importantly, there may be increased costs in the future for the county due to missing investment targets in the defined-benefit system as it is phased out—the proposed initiative does not change county investment return assumptions for the defined-benefit plan. But any increased costs would be because of faulty assumptions presently in the system, and thus would be incurred even without the transition to defined-contribution system.

However, after those on the defined-benefit payroll have completely retired, there would be no further accrued liabilities for VCERA, eliminating all normal annual pension costs.

Table 2: Pension Reform Savings

FY	Reduced Normal Cost	Savings from Pensionable Pay Change	Net Savings
2017	$318,000	$190,000	$508,000
2018	$2,548,000	$2,302,000	$4,850,000
2019	$5,323,000	$4,415,000	$9,738,000
2020	$8,662,000	$6,555,000	$15,217,000
2021	$13,179,000	$8,082,000	$21,261,000
2022	$18,841,000	$8,983,000	$27,824,000
2023	$20,914,000	$9,344,000	$30,258,000
2024	$23,192,000	$9,708,000	$32,900,000
2025	$25,576,000	$10,130,000	$35,706,000
2026	$28,323,000	$10,464,000	$38,787,000
2027	$31,088,000	$10,858,000	$41,946,000
2028	$33,724,000	$11,354,000	$45,078,000
2029	$36,682,000	$11,710,000	$48,392,000
2030	$39,841,000	$12,137,000	$51,978,000
2031	$43,563,000	$12,398,000	$55,961,000
2017-2021	$30,030,000	$21,544,000	$51,574,000
2017-2026	$146,876,000	$70,173,000	$217,049,000
2017-2031	$331,774,000	$128,630,000	$460,404,000

For a more detailed breakdown of the savings numbers see Table 3 at the end of this document.

There may still be debt payments required for the defined-benefit system because the actuarial assumptions did not lead the county to completely pre-fund promised benefits. But, again, these debt payments would be required whether or not the county transitioned to a defined-contribution system.
The dynamic effects of the proposed initiative mean that the county would not only reduce liabilities in the long-term, but also save money on a cash flow basis in the short-term, shoring up pension obligations it has for current employees and retirees.

Conclusion: The proposed reform to VCERA saves $460 million over 15 years, eventually eliminates unfunded liabilities by closing the current defined-benefit plan, and puts new hires into a defined-contribution system. Holding pensionable pay constant would pay for the transition from defined-benefit to defined-contribution and provide cash flow savings in the first fiscal year it is adopted for Ventura County, as well as every subsequent year.

Table 3: Pension Reform Savings Detailed Breakdown (in thousands ($000))

In thousands ($000); Source: Reason Foundation									
	Reduced Normal Cost			Pensionable Pay Change Savings			Net Savings		
FY	General	Safety	Overall	General	Safety	Overall	General	Safety	Overall
2017	$277	$41	$318	$91	$99	$190	$368	$140	$508
2018	$748	$1,800	$2,548	$383	$1,919	$2,302	$1,131	$3,719	$4,850
2019	$868	$4,455	$5,323	$1,167	$3,248	$4,415	$2,035	$7,703	$9,738
2020	$1,152	$7,510	$8,662	$1,936	$4,619	$6,555	$3,088	$12,129	$15,217
2021	$2,173	$11,006	$13,179	$2,051	$6,031	$8,082	$4,224	$17,037	$21,261
2022	$3,236	$15,605	$18,841	$2,118	$6,865	$8,983	$5,354	$22,470	$27,824
2023	$4,242	$16,672	$20,914	$2,238	$7,106	$9,344	$6,480	$23,778	$30,258
2024	$5,333	$17,859	$23,192	$2,354	$7,354	$9,708	$7,687	$25,213	$32,900
2025	$6,462	$19,114	$25,576	$2,519	$7,611	$10,130	$8,981	$26,725	$35,706
2026	$7,883	$20,440	$28,323	$2,587	$7,877	$10,464	$10,470	$28,317	$38,787
2027	$9,243	$21,845	$31,088	$2,708	$8,150	$10,858	$11,951	$29,995	$41,946
2028	$10,389	$23,335	$33,724	$2,927	$8,427	$11,354	$13,316	$31,762	$45,078
2029	$11,773	$24,909	$36,682	$2,998	$8,712	$11,710	$14,771	$33,621	$48,392
2030	$13,198	$26,643	$39,841	$3,124	$9,013	$12,137	$16,322	$35,656	$51,978
2031	$15,028	$28,535	$43,563	$3,071	$9,327	$12,398	$18,099	$37,862	$55,961
2017-2021	$5,218	$24,812	$30,030	$5,628	$15,916	$21,544	$10,846	$40,728	$51,574
2017-2026	$32,374	$114,502	$146,876	$17,444	$52,729	$70,173	$49,818	$167,231	$217,049
2017-2031	$92,005	$239,769	$331,774	$32,272	$96,358	$128,630	$124,277	$336,127	$460,404

About the Author

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Endnotes

[1] The county will be voting on the proposed initiative after the start of fiscal year 2015; as a result, the changes would be implemented in fiscal year 2016. Therefore, independent actuarial analysis assumes that accrued liability would change starting in fiscal year 2016, and reductions to normal cost would start in fiscal year 2017. The 15-year cumulative savings period is from fiscal years 2017 to 2031.

[2] The independent actuary was William J. Sheffler, FCA, EA, MSPA, ASA of Sheffler Consulting Actuaries, Inc. The actuary reports that his modeling approach was inherently conservative.

[3] The actuary used the most recent Segal Co. valuation for VCERA, Fiscal Year ended June 30, 2013.

[4] This actuarial valuation was completed by Segal Co.

[5] The actuary used headcount changes from 2011–2013 to estimate new hires into the future and then applied the salary change assumptions from the Segal valuation.