BARTEL ASSOCIATES, LLC

June 9, 2015

Dave Millican
Interim Finance Director
City of Oxnard
300 W 3rd St.
Oxnard, CA 93030

Re: City of Oxnard – Pension Override Tax

Dear Mr. Millican:

This letter summarizes our understanding of the portion of the City's CalPERS contribution rates that can be paid from the pension override tax. The attached discussion outline provides more detail than included in this letter. Please note Bartel Associates is an actuarial consulting firm and, as such, we cannot provide legal or tax advice. Because many of the issues associated with the pension override tax are legal in nature, we suggest the City consult with the City Attorney and/or outside legal counsel as appropriate.

Background
We understand the City of Oxnard pension override tax can be used to pay for only those benefits either contracted for or effective before July 1, 1978 for Safety employees. The City's CalPERS pension benefits at July 1, 1978 were based on the "½ @ 55" formula. Both Police and Fire plans have had benefit improvements since July 1, 1978 that affects the City's CalPERS contribution rates. The City hired Bartel Associates to review the cost of benefit improvements for each plan so that the pension override tax can be limited to the benefit level prior to July 1, 1978.

What is the "Cost" of Benefit Improvements
The Police Safety formula was improved from ½ @ 55 to 2% @ 50 in 1980 and then further improved to 3% @ 50 in 2001. Similarly the Fire Safety formula was improved from ½ @ 55 to 2% @ 50 in 1981, to 3% @ 55 in 2001 and then to 3% @ 50 in 2005. It's very important to understand there is no perfect way to determine the "cost" of each of these benefit improvements. For example, the improvement to 3% @ 50 in 2001 likely caused Police Safety employees to change behavior (principally retirement) from what they would have done under 2% @ 50. That behavior might manifest itself as a difference in retirement age or even in who the City might hire. For example, a Police Safety member hired at age 25 reaches the maximum eligible benefit (90%) at age 55 under 3% @ 50, while it would take them 3 years more to reach the maximum under 2% @ 50. On the other hand, agencies typically negotiated lower salary increases than would otherwise have been provided when implementing 3% @ 50. All of these various factors are virtually impossible to quantify, making it further impossible to determine the "true" cost of a benefit improvement.

Methodologies
Actuaries typically determine the "cost" of a benefit improvement by preparing an actuarial study using the two alternative benefit formulas, comparing the plan's funded status and contribution rate before and after the change. This is what CalPERS did when the City was considering all benefit improvements. It would be theoretically possible to make this comparison after benefits have been improved. However, doing so would require significant actuarial fees and results would not consider changes in behavior, salary increases, etc. For these reasons we recommend agencies look to CalPERS original Contract Amendment Cost Analysis to determine the "cost" of benefit improvements. When benefits are improved

under CalPERS law the benefit improvement applies to prior and future service. The City should consider the "cost" of a benefit improvement as the combination of prior cost (for service before the effective date), how that prior cost is paid for, and the normal cost (for service after the effective date). There are several methods to determine "cost". These include, but are not limited to:

- **Short Term Cash Flow** – This method refers to the change in the contribution rate when implementing a benefit improvement. If CalPERS' Contract Amendment Cost Analysis, provided to the City when implementing a benefit improvement, shows there was no increase in the City's contribution rate, meaning that the benefit improvement had no short term cost. This essentially freezes the "cost" at zero and allows excess assets to pay for both prior and future "cost". It is important to note this zero contribution rate is consistent with CalPERS' Board contribution policy at the time, which was to minimize agency contributions increases, within certain parameters, due to benefit improvements.

- **Normal Cost** – Normal Cost represents the value of benefits being earned (or allocated) to a particular year and is the best representation of the long term impact of a benefit improvement. In fact CalPERS' Contract Amendment Cost Analysis said:

  > *"Note that the change in normal cost in the table above may be much more indicative of the long term change in the employer contribution rate due to the plan amendment."*

  This method allows excess assets to pay for the prior cost, while attributing future costs to the increase in the Normal Cost.

- **Use No (or Limited) Excess Assets** – One measure of "cost" is to look at the theoretical cash flow impact of the benefit improvement. This theoretical increase is comprised of the Normal Cost plus an amortization of the increase in the Plan's Unfunded Actuarial Liability due to the amendment. If a plan is very well funded when the benefit improvement was implemented, CalPERS' Contract Amendment Cost Analysis would use the excess assets to reduce the employer contribution rates due to the benefit improvements. The Actuarial Asset was increased to offset the increase in the actuarial liability due to benefit improvements. If the Actuarial Asset increase was excluded, the employer contribution rates due to the benefit improvement will be increased.

  This method includes either a small portion of excess assets (including Actuarial Asset Increase) or no excess assets (excluding Actuarial Asset Increases). Furthermore it amortizes the prior cost over 20-years, consistent with CalPERS general actuarial policy. Using a 20-year amortization means the City would use one rate for 20-years and the Normal Cost beyond 20-years. However, as pointed out by CalPERS staff, the City could theoretically amortize the prior cost in perpetuity. Under this method the City could use one rate into the future.

- **Use A Portion of Excess Assets –** This method excludes the portion of excess assets that can be attributed to City contributions made after July 1, 1978 from paying for the benefit increase. The above methods do not consider what portion of the plan's funded status (when the benefit improvement was implemented) was derived from sources that could legitimately be used to fund the improved benefit. For example the plan's funded status (and consequently contribution rate) can, theoretically, be segregated into three contribution sources:
  1. Pre July 1, 1978 employee and City contributions;

2. Post June 30, 1978 employee contributions; and
3. Post June 30, 1978 City contributions.

This method is a compromise between the *Normal Cost* method (which uses all plan assets to offset the benefit improvement) and the *Use No (or Limited) Excess Assets* method (which uses no assets to offset the benefit improvement). Essentially excess assets attributable to item 3 above would be excluded in determining the plan's funded status before the benefit improvement cost is determined.

Bartel Associates was unable to get historical information to prepare this calculation. However, we do have information from another, similar, agency. Assuming this information is the same for the City, we've estimated excess plan assets (before the benefit improvement cost is calculated) may be attributable to the following contribution sources:

Allocation Source	Allocation %
1. Pre July 1, 1978 employee and City contributions	51%
2. Post June 30, 1978 employee contributions	18%
3. Post June 30, 1978 City contributions	31%

Applying the above percentages to the plan's funded status results in the funded status change as well as the employer contribution rates. The method only provides very rough estimates. Alternative assumptions will likely yield very different results with a high degree of variance.

For administrative simplicity a single determined rate is preferable. However, there is an argument that the above method should also be used to allocate gains and losses after the valuation date from which the Contract Amendment Cost Analysis was prepared. Doing so will yield results that will vary from one year to the next, become administratively difficult and likely yield unreliable results.

There are advantages and disadvantages to each of the above methods. The *Short Term Cash Flow* method is not generally reasonable because it implies there is no "cost" to the benefit improvement. Furthermore, the *Use No (or Limited) Excess Assets* method virtually ignores how well funded the plan was when benefits were improved. Both the *Normal Cost* method and the *Use a Portion of Excess Assets* method consider the Plan's funded status.

If the plan had very large excess assets when the benefit improvement was implemented and all the excess assets, which generally were due to CalPERS investment returns greater than expected, are used to pay for the prior cost component of benefit improvement, then it is reasonable to consider the "Cost" of benefit improvements as being equal to the increase in the Normal Cost. An additional advantage to Normal Cost is that it represents the "cost" of the benefit improvement attributable to a single year. Another way to say this is that Normal Cost represents the value of benefits being earned during the year by members providing services to taxpayers. Consequently, from a taxpayer's generational equity standpoint the increase in the Normal Cost, due to the new formula, represents the best and most reasonable estimate of the value of the benefit increase. If the City wants to allocate excess assets based on their contribution source, the *Use a Portion of Excess Assets* method is theoretically reasonable. However, the information necessary to use this method is far from complete and different assumptions might yield dramatically different results.

Recommendations
Determining the true "cost" of benefit improvement is virtually impossible. If accurate historical information were available we would be inclined to recommend using the Use a Portion of Excess Assets method. However, the available information is modest and assumptions used to estimate missing information can significantly skew results. Consequently, unless accurate historical information can be developed, we can not recommend this method.

Because Normal Cost is the most reasonable method and the change in Normal Cost is the long term indicator of "cost" due to the benefit improvement. Another advantage to using Normal Cost is that this amount is constant and should not vary into the future. Consequently we recommend use the Normal Cost method. In summary, the Normal Cost method is chosen because of the following reasons:

- Increase in normal cost is a good long term cost indicator,
- Normal cost is easy to retrieve with information available, and
- Normal cost does not consider past service.

Police Safety Plan
Since the Normal Cost increases due to benefit improvements after July 1, 1978 for the Police Safety Plan are not available, we have estimated them using various methods and sources of information. The following table summarizes the cost for each benefit improvement, the method and sources used to estimate the cost.

Police Safety Plan				
Benefit Improvements	**Date**	**Cost**	**Method**	**Sources**
■ 2%@50	7/6/1980	0.646%	Normal Cost	½ of Normal cost difference between Safety 2%@55 and 2%@50 pools
■ Enhanced IDR	7/6/1980	4.240%	Normal Cost	Benefit surcharge FAC1 from Safety 2%@50 risk pool
■ Final one year Compensation	12/28/1986	0.850%	Normal Cost	Benefit surcharge FAC1 from Safety 2%@50 pool
■ 3%@50	1/1/2001	4.984%	Normal Cost	Normal cost difference between 2001/02 and 2002/03
■ Total		**10.719%**		

The total cost of benefit improvements after July 1, 1978 for the Police Plan is 10.719%. This is the portion of the Police contribution rate that can not be paid from the pension override tax. Therefore, the maximum amount that the pension override tax can be used to pay for is the City's Safety contribution rate minus 10.719%. For example, the City's 2014/15 Police contribution rate is 38.748%. The maximum amount that the pension override tax can be used to pay for the 2014/15 Police contribution rate is 28.029% (38.748% minus 10.719%).

Fire Safety Plan

Since the Normal Cost increases due to benefit improvements after July 1, 1978 for the Fire Safety Plan are not available, we have estimated the normal cost increases using various methods and sources. The following table summarizes the cost for each benefit improvement, the method and sources used to estimate the cost.

Fire Safety Plan				
Benefit Improvements	**Date**	**Cost**	**Method**	**Sources**
■ 2%@50	4/1/1981	0.702%	Normal Cost	½ of Normal cost difference between Safety 2%@55 and 2%@50 pools
■ Final one year Compensation	4/3/1988	0.838%	Normal Cost	Benefit surcharge FAC1 from Safety 2%@50 pool
■ 3%@55	4/1/2001	1.199%	Normal Cost	Normal cost difference between Safety 2%@50 and 3%@55 pools
■ 3%@50	1/1/2005	2.418%	Normal Cost	City Normal cost difference between 2005/06 and 2006/07
■ Total		**5.158%**		

The total cost of benefit improvements after July 1, 1978 for the Fire Safety Plan is 5.158%. This is the portion of the Fire contribution rate that cannot be paid from the pension override tax. Therefore, the maximum amount that the pension override tax can be used to pay for is the City's Fire contribution rate minus 5.158%. For example, the City's 2014/15 Fire contribution rate is 38.283%. The maximum amount that the pension override tax can be used to pay for the 2015/16 Fire contribution rate is 33.125% (38.283% minus 5.158%).

Please feel free to contact me at (650) 377-1601 if you have any questions about this letter.

Sincerely,

John E. Bartel
President

c Michael More, CPFO, City of Oxnard Financial Services Manager
Bianca Lin, Bartel Associates, LLC

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CITY OF OXNARD
CALPERS SAFETY PLANS

Pension Override Tax Study

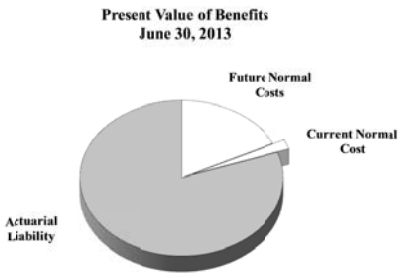
Final Results

Presented by **John E. Bartel, President**
Prepared by Bianca Lin, Assistant Vice President
Adam Zimmerer, Actuarial Analyst
Bartel Associates, LLC

June 8, 2015

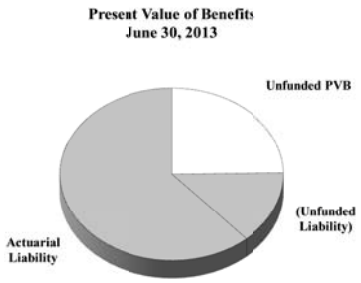
Agenda

DEFINITIONS



- **PVB - Present Value of all Projected Benefits:**
  - Discounted value (at valuation date - 6/30/13), of all future expected benefit payments based on various (actuarial) assumptions
- **Actuarial Liability:**
  - Discounted value (at valuation date) of benefits earned through valuation date [value of past service benefit]
  - Portion of PVB "earned" at measurement
- **Current Normal Cost:**
  - Portion of PVB allocated to (or "earned" during) current year
  - Value of employee and employer current service benefit

DEFINITIONS



- **Target-** Have money in the bank to cover Actuarial Liability (past service)
- **Unfunded Liability -** Money short of target <u>at valuation date</u>
- **Excess Assets / Surplus:**
  - Money over and above target <u>at that point in time</u>
  - Doesn't mean you're done contributing
- **Super Funded:**
  - Assets cover whole pie (PVB)
  - If everything goes exactly like PERS calculated, you'll never have to put another (employer or employee) dime in

INFORMATION RECEIVED

- The following information received from City
  - Police
    - MyCalPERS benefit provisions and effective dates
    - CalPERS actuarial valuation reports: 1998 (partial), 1999, 2000, 2002- 2013
    - Executed 3%@50 Contract amendment
  - Fire
    - MyCalPERS benefit provisions and effective dates
    - CalPERS actuarial valuation reports: 1998 (partial), 1999, 2000, 2002-2013
    - Executed 3%@55 Contract amendment

PENSION OVERRIDE TAX

- Pension Override Tax can pay pension benefits in effect on July 1, 1978.
- Benefit improvement since July 1, 1978 must be separated:
  - Police Safety Plan:
    - 2% @ 50 7/6/1980
    - Enhanced Industrial Disability Retirement 7/6/1980
    - Final one year average compensation 12/28/1986
    - 3% @ 50 1/1/2001
    - EMPC N/A
  - Fire Safety Plan:
    - 2% @ 50 1/4/1981
    - Final one year average compensation 4/3/1988
    - 3% @ 55 4/1/2001
    - 3% @ 50 1/1/2005
    - EMPC N/A

PENSION OVERRIDE TAX

- "Cost" of Benefit Improvements:
  - No perfect way to evaluate "true cost"
    - Benefit changes typically cause behavior changes
    - Salary negotiations would differ
  - Normal cost good indicator
    - Increase in normal cost good long term cost indicator
    - Can be estimated with information available
    - Does not consider past service

PENSION OVERRIDE TAX

- Sample for Benefit Improvements vs. Reduction in Salary Increases

		2% @ 50	3% @ 50% Same Final Comp.	3% @ 50% Lower Final Comp.
1.	Retirement Age	55	55	55
2.	Benefit Factor	2.70%	3.00%	3.00%
3.	Final Compensation	$ 50,000	$ 50,000	$ 47,500
4.	Service	30 years	30 years	30 years
5.	Annual Retirement Benefit [(2) x (3) x (4)]	$ 40,500	$ 45,000	$ 42,750
6.	3% @ 50 Increase over 2% @ 50 [{(5) for 3% @ 50}/{(5) for 2% @ 50} - 1]		11.1%	5.6%

METHODOLOGY OPTIONS

- Short Term Cash Flow
  - Sometimes no increase in contributions when actuarial asset value increased to offset liability increase
  - Generally not reasonable
- Use No (or Limited) Excess Assets
  - Ignores plan funded status
- Use Portion of Excess Assets
  - May not reflect full funded status, not use all assets available
- Normal Cost
  - From CACA, CalPERS states:
    "Note that the change in normal cost in the table above may be much more indicative of the long term change in the employer contribution rate due to the plan amendment."

METHODOLOGY OPTIONS

- Illustration of Use No Excess Assets Method
  - 3%@50 Actuarial Liability Increase : $12 million
  - No Change to Actuarial Asset Value ($105.8 million)

	Before 3% @ 50	After 3% @ 50
Unfunded PVB	$ 15,100,000	$ 30,500,000
Excess Assets	18,100,000	6,900,000
Actuarial Liability	87,700,000	98,900,000
PVB	120,900,000	136,300,000

  - Contribution Rate Impact

	20 year Amortization	Perpetuity
Normal Cost	5.0%	5.0%
Past Service Amortization	6.6%	3.8%
Total	11.6%	8.8%

Police Safety Plan

Benefit Improvements	Effective Date	Method	Estimated Cost	Sources
2%@50	7/6/1980	Normal Cost	0.646%	½ of Normal cost difference between Safety 2%@55 and 2%@50 pools
Enhanced IDR	7/6/1980	Normal Cost	4.240%	Benefit surcharge FAC1 from Safety 2%@50 risk pool
Final one year Compensation	12/28/1986	Normal Cost	0.850%	Benefit surcharge FAC1 from Safety 2%@50 pool
3%@50	1/1/2001	Normal Cost	4.984%	Normal cost difference between 2001/02 and 2002/03
Total			**10.719%**	

Fire Safety Plan

Benefit Improvements	Effective Date	Method	Estimated Cost	Sources
2%@50	4/1/1981	Normal Cost	0.702%	½ of Normal cost difference between Safety 2%@55 and 2%@50 pools
Final one year Compensation	4/3/1988	Normal Cost	0.838%	Benefit surcharge FAC1 from Safety 2%@50 pool
3%@55	4/1/2001	Normal Cost	1.199%	Normal cost difference between Safety 2%@50 and 3%@55 pools
3%@50	1/1/2005	Normal Cost	2.418%	City Normal cost difference between 2005/06 and 2006/07
Total			**5.158%**	

RECOMMENDATIONS

- For Example (Fiscal Year 2014/15)

	Police Safety	Fire Safety
• Total Employer Rate	38.748%	38.283%
• Amount that cannot be paid from Pension Override Tax	10.719%	5.158%
• Net amount payable from Pension Override Tax	28.029%	33.125%
• Estimated PERSable Wages	25,705,304	10,367,834
• Total Estimated Dollar Amount Payable from Pension Override Tax	7,204,940	3,434,345

- Amounts that cannot be paid from Pension Override Tax have not been adjusted to reflect lower PEPRA benefits
  - Over time these amounts should be reduced

RECOMMENDATIONS

Historical Contribution Rates Cannot Be Paid From Pension Override Tax
Police Safety

FY	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86
Rates	0.000%	0.000%	0.000%	4.886%	4.886%	4.886%	4.886%	4.886%
FY	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94
Rates	4.886%	5.735%	5.735%	5.735%	5.735%	5.735%	5.735%	5.735%
FY	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02
Rates	5.735%	5.735%	5.735%	5.735%	5.735%	5.735%	5.735%	10.719%
FY	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Rates	10.719%	10.719%	10.719%	10.719%	10.719%	10.719%	10.719%	10.719%
FY	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16		
Rates	10.719%	10.719%	10.719%	10.719%	10.719%	10.719%		

RECOMMENDATIONS

Historical Contribution Rates Cannot Be Paid From Pension Override Tax

Fire Safety

FY	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86
Rates	0.000%	0.000%	0.000%	0.702%	0.702%	0.702%	0.702%	0.702%
FY	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94
Rates	0.702%	0.702%	1.541%	1.541%	1.541%	1.541%	1.541%	1.541%
FY	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02
Rates	1.541%	1.541%	1.541%	1.541%	1.541%	1.541%	1.541%	2.740%
FY	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Rates	2.740%	2.740%	2.740%	5.158%	5.158%	5.158%	5.158%	5.158%
FY	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16		
Rates	5.158%	5.158%	5.158%	5.158%	5.158%	5.158%		

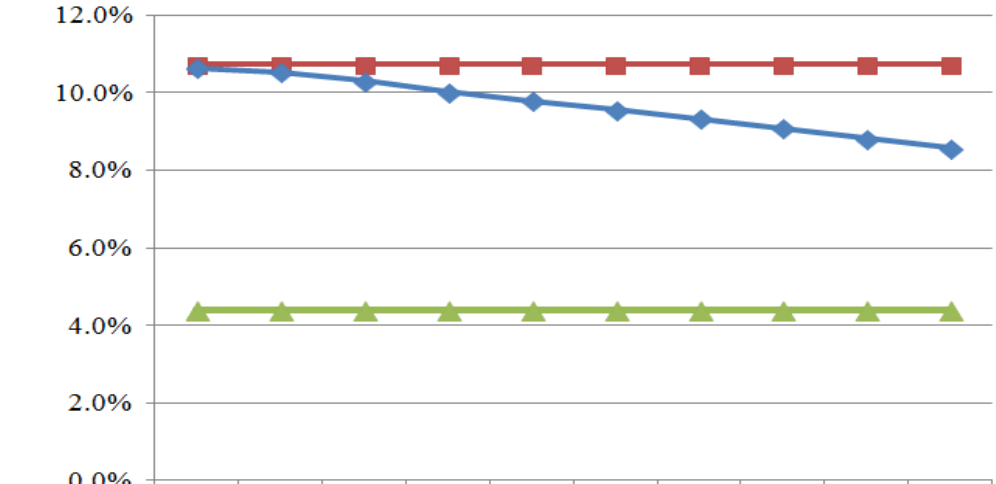
PEPRA

Police Safety PEPRA Plan

Benefit Improvements	Effective Date	Method	Estimated Cost	Sources
2.7%@57	1/1/2013	Normal Cost	0.581%	45% of Normal cost difference between Safety 2%@55 and 2%@50 pools
Enhanced IDR	1/1/2013	Normal Cost	3.816%	90% of benefit surcharge from Safety 2%@50 risk pool
Total			**4.397%**	

Projection – Contribution Rates Cannot Be Paid From Pension Override Tax

Police Safety



	15/16	16/17	17/18	18/19	19/20	20/21	21/22	22/23	23/24	24/25
Tier 1	10.719%	10.719%	10.719%	10.719%	10.719%	10.719%	10.719%	10.719%	10.719%	10.719%
PEPRA	4.397%	4.397%	4.397%	4.397%	4.397%	4.397%	4.397%	4.397%	4.397%	4.397%
Combined	10.640%	10.532%	10.303%	10.015%	9.793%	9.554%	9.317%	9.073%	8.812%	8.567%

Fire Safety PEPRA Plan

Benefit Improvements	Effective Date	Method	Estimated Cost	Sources
2%@50	1/1/2013	Normal Cost	0.632%	45% of Normal cost difference between Safety 2%@55 and 2%@50 pools
Total			**0.632%**	