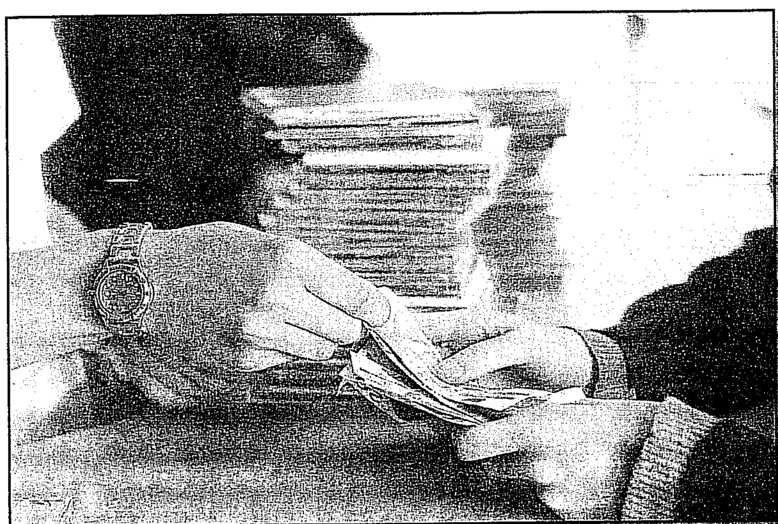
PRJ

THE PUBLIC RETIREMENT JOURNAL

FEBRUARY 2014

The Governor to PERS, "Let Us Pay More Now"

If you have been diligent in keeping up with the **Journal** – we know who you are – you are well aware of PERS' recommendations to adjust contribution rates over the next several years to, among other things, reflect the changes in mortality rates. Wonderful news: people are living longer. This is not so great news for an actuary, or your rates, which are likely to creep up by 2-4 percent over the next five years. And that may be a conservative estimate. Dust off last month's **Journal** for the extensive, wonky analysis of how another year of livin' translates to the increase in rates.



Now the Governor has weighed in. Earlier this month, he sent a letter to the PERS Board urging them to immediately account for the mortality rate changes, and phase in over three years the costs associated with those longer life spans, as opposed to the recommended five years.

By way of a quick background, in December, the PERS Board was presented with the final results of its actuary's demographic and economic experience study. As a result of that study, actuaries suggested changes in plan assumptions that will lead to rate increases beginning in FY 2016-17. This delayed effective date will allow employers to see the impact of these changes in your projected rates one year prior to implementation. The last demographic study was adopted in 2010 and economic assumptions were last reviewed 2 years ago. Actuaries are synchronizing these studies so employers will experience rate changes on a less frequent interval. But the Governor didn't want to wait until 2016-17. He told PERS to charge them now.

Brown wrote that waiting two years to acknowledge the changes in average life spans could cost the state an additional $3.7 billion over the next 20 years. According to the State Department of Finance, the amount was calculated based upon contribution rates, life expectancy and projected return on investments. Brown's letter read, "No one likes to pay more for pensions, but ignoring their true costs for two more years

Continued page 8

IN THIS ISSUE

GOVERNOR

Continued from page 1

will only burden the system and cost more in the long run."[1]

Paying the increases now, as opposed to 2016 may work for the State, but would it work for all of those contracting agencies (cities, counties and special districts) within PERS? That's what PERS was considering. In a prepared response to the Governor, PERS indicated that board members "must balance a number of factors in their decision making including the state of our financial markets, our economy and the ability of our member and employer partners to pay increased pension costs."[2]

Let's back up and delve into some of the details of these pending mortality rate increases.

Back in October, PERS staff conducted a workshop on these mortality assumptions. The PERS Chief Actuary's review of the mortality assumption showed a longer life expectancy for all groups. Men are expected to live about 2.1 years longer on average and women are expected to live about 1.6 years longer on average.

Because changes in mortality assumptions will have a significant impact on employer rates for many years to come, it's important to understand how longer living can significantly impact employer rates.

Actuaries must make an assumption about how long the pension fund will be paying benefits after a member retires. If an individual lives five years longer than expected, then the pension fund will accrue a significant unfunded liability for those extra years of benefit payments. For this reason, mortality estimates are among the most important demographic assumptions made by a pension actuary.

PERS' Chief Actuary, Alan Milligan, says people are living longer and longevity improvements have been continuous (though at different rates of improvement over time). Life expectancy for the PERS population will be better than the general public due to a number of factors including better health care, stable income, and higher average education level. Also, with pensions, you're dealing with a population healthy enough to work for most of their careers. Milligan said that over 30 years in the future, we should expect to see a significant difference in mortality – too big of a difference for a pension fund to ignore.

> "Actuaries must make an assumption about how long the pension fund will be paying benefits after a member retires. If an individual lives five years longer than expected, then the pension fund will accrue a significant unfunded liability for those extra years of benefit payments. For this reason, mortality estimates are among the most important demographic assumptions made by a pension actuary."

To bolster his point, Milligan said that in May 2011, the Actuarial Standards Board changed its policies governing how actuaries nationwide are required to perform their work, specifically addressing the issue of mortality. The new standard of practice says actuaries must now consider **future** mortality improvements. An actuary's job is to make an educated guess about what the future holds, and the standards board says that just because uncertainty about the future doesn't mean there's an assumption of zero future improvements. The Actuarial Standards Board said, "As mortality rates have continued to decline over time, concern has increased about the impact of potential future mortality improvements on the magnitude of pension commitments."

How Much Are we Talkin'?

Actuaries say the fiscal impact of these mortality assumption changes will be different for each employer plan because of demographic differences (particularly the mix of male/female employees) and the plan's ratio of liability to payroll (aka, the volatility index). Previous mortality improvements had a more significant impact on safety plans because of the higher percentage of male employees.

There are a few things to note. First, the mortality assumption has an immediate impact on the normal cost of benefits. This is an ongoing increase in the normal cost to fund benefits. (Employees may share part of the normal cost, which we'll discuss in just a moment.) The mortality improvement also has an impact on an

Continued page 9

GOVERNOR

Continued from page 8

employer's unfunded liability because it assumes the cost of providing benefits for all previously earned service has also increased. (An increase in unfunded liabilities is borne solely by the employer.)

The question is – how much should the PERS Board assume that life expectancy will improve?

After much deliberation on this topic, Milligan asked the Board to assume members will live about 1½ years longer. He believes, on average, that this is an accurate guess – while current retirees may not achieve that target, younger active workers may make greater longevity gains. This assumption that folks will live another 1½ years equates (coupled with mortality improvements reflected in this experience study and other factors) to what's called a 20-year static projection of mortality improvements in actuarial-speak.

Which Gets Us to the Point of This Whole Article

PERS' Actuary staff suggested to the Board that these assumption changes first be built into projected rates to give employers the opportunity to budget and plan for the increases. That means the rates would first take effect in FY 2016/17. In addition, Board policy calls for a 5-year ramp up of rate increases stemming from assumption changes. Milligan said that if these projected contribution increases are too much for stakeholders to bear, there are alternative funding possibilities, like a seven year phase in as opposed to five year phase in to pay off the increased longevity projection over 20 years.

"After much deliberation on this topic, Milligan asked the Board to assume members will live about 1½ years longer. He believes, on average, that this is an accurate guess – while current retirees may not achieve that target, younger active workers may make greater longevity gains. This assumption that folks will live another 1½ years equates (coupled with mortality improvements reflected in this experience study and other factors) translates to what's called a 20-year static projection of mortality improvements in actuarial-speak."

Ah, not so fast, said, Governor Brown. The State doesn't want to wait that long to pay. In fact, bill us now. And so, the Board decided to do just that.

At its February Board meeting, the PERS Board voted to grant the Governor's wishes by implementing a three-year phase in of those increases starting on July 1st of this year. Incidentally, the State has always had the option of paying more than the set rate. In fact, the State has done just that over the last two years.[3] So, was this all for show? Not necessarily. The Governor does not have to persuade the Legislature to make a higher contribution through budget negotiations. Considering the PERS Board decided to charge the state now, that hurdle disappears.

But the PERS Board didn't apply the "pay now" decision to its contracting agencies – all of you in local government land. The Board voted to approve staff's recommendation to implement a five year phase in beginning in July 2016, but didn't go so far as to vote for the seven year phase in to provide more breathing room for struggling local governments.

But the difference between five and seven year phase in seems like a sidebar on the grand scheme of things, rather than a thumb in the eye to local governments. The real issue here is the fact that the Board applied rates at differing times for the state and local governments. Setting separate standards for the state and local governments seems incongruous. But what do we know? Perhaps a different implementation date for various PERS members isn't that big of a deal. Maybe it is. Who knows?

What we do know is rates are going to go up. It's just a matter of timing. ■

---

1. California Healthline, Brown Urges CalPERS To Include Life Spans in Contribution Rates, February 6, 2014 www.californiahealthline.org
2. CapitolAlert, The Sacramento Bee, Jerry Brown says longer living state workers will drive pension costs up $1.2 billion a year. www.blogs sacbee.com, February 5, 2014
3. Calpensions.org, CalPERS rate hike: governor wins, cities, lose. February 19, 2014

CITYGATE ASSOCIATES, LLC
FIRE & EMERGENCY SERVICES

2250 East Bidwell Street, Suite 100 ▪ Folsom, CA 95630 ▪ PH 916-458-5100 ▪ FAX 916-983-2090

March 19, 2014

Dave Roberts
Fire Chief
El Dorado Hills Fire Department
1050 Wilson Blvd.
El Dorado Hills, CA 95762
droberts@edhfire.com

RE: PROPOSAL TO PERFORM A FISCAL PEER REVIEW OF THE ANNEXATION PROPOSAL FOR THE EL DORADO HILLS FIRE DEPARTMENT AND LATROBE FIRE PROTECTION DISTRICT

Dear Chief Roberts:

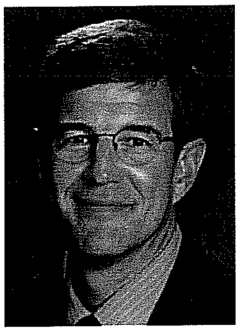
Citygate Associates, LLC is pleased to submit our proposal to perform a peer review of the fiscal and operational components of a merger between your Department and the adjoining Latrobe FPD. The scope of Citygate's work will be to:

- Review, evaluate and make recommendations as to the fiscal and operational details in the District's Application to El Dorado LAFCO dated February 4th, 2014;
- Citygate will review the fiscal, operational, and merger documents produced to date. As an option, we can interview key stakeholders at the start of the project, via phone or in-person, at our time and materials rates in this proposal;
- Conduct a conference call with your team to follow up on issues and to obtain as needed, further background fiscal documents from the two Districts;
- Prepare an Executive Summary letter and PowerPoint containing our findings and opinions;
- Upon review and acceptance of our draft work products, produce final exhibits and brief the El Dorado District Board of Directors at a meeting to be mutually scheduled.

Our project review will utilize our prior and updated knowledge of the two agencies given our prior fire services project work for El Dorado LAFCO. For this fire services review, Citygate will assign our Fire Practice and General Government Principals (described below), who have conducted the previous studies in the County. To control costs, we will use conference calls to gain information and review the draft work product. The cost identified in this proposal contains one on-site briefing meeting.

PROJECT TEAM

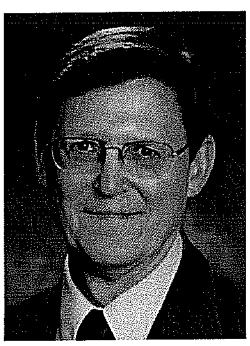
Chief Stewart W. Gary, MPA, Fire Practice Principal and Project Director



Chief Gary is the Fire Practice Principal for Citygate Associates and is the retired Fire Chief of the Livermore-Pleasanton Fire Department in Alameda County, California. In 1996 he successfully designed and led the implementation of the Livermore-Pleasanton fire department consolidation, which won a California League of Cities Helen Putnam award. For many years, he also has been the lead instructor and program content developer for the Standards of Coverage process. For many years, he annually taught a 40-hour course on this systems approach for fire deployment at the California Fire Academy and he teaches and consults across the United States and Canada on the Standards of Response Coverage process. He has worked with a variety of communities on fire service studies including deployment, consolidation, and master plan studies.

As Project Director, Mr. Gary will conduct the fire operational analysis, participate in a meeting with the client, and co-author and deliver the executive summary letter and PowerPoint.

Dr. Dwane N. Milnes, DPA, General Government Principal



Dr. Dwane Milnes is the General Government Principal with Citygate Associates. Dr. Milnes has extensive experience in municipal management having served as City Manager or Assistant City Manager for 24 years. He retired as the City Manager of Stockton, CA where he supervised where he supervised an ISO Class 1 Fire Department. He earned a doctorate in Public Administration from the University of Southern California. As a Citygate consultant, he has worked with Chief Gary on many fire services and EMS studies.

From his operational and fiscal perspectives as a city manager, Dr. Milnes will perform financial analysis, participate in a meeting with the client, and co-author and deliver the executive summary letter and PowerPoint.

PROJECT COST/BILLING

Our charges are based on actual time spent by our consultants at their established billing rates, plus reimbursable expenses incurred in conjunction with travel, printing, clerical, and support services related to the engagement. All work will be done on a time and materials basis at our hourly rates below.

For the initial technical project review work, plus the executive summary letter draft review cycle, we anticipate no more than 40 consultant hours with administrative support plus travel costs for one site meeting.

As such, our not-to-exceed cost will be **$13,568**.

We anticipate one site meeting with the Board of Directors; all other work will be done via telephone and email.

If we encounter the need to conduct additional research beyond what is reasonable to prepare a summary letter, we will notify you prior to undertaking the research.

The price quoted above is effective for 30 days from the date of receipt for this proposal and includes one (1) draft letter cycle completed by Citygate within 30 calendar days. Additional draft letter cycles or processing delays requested by the Department would be billed in addition to the contracted amount at our time and materials rates.

When changes are agreed upon, Citygate will provide up a reproducible master copy via email. The draft letter will be considered to be final if there are no suggested changes within thirty (30) days of the delivery of the draft letter.

Standard Hourly Billing Rates

Classification	Rate	Consultant
Citygate President	$225 per hour	David DeRoos
Fire Practice Principal / Project Director	$250 per hour	Stewart Gary
General Government Principal	$250 per hour	Dwane Milnes
Project Report Administrator	$ 95 per hour	Chad Jackson
Administrative Support	$ 85 per hour	Various

Billing Schedule

We will bill monthly for time, reimbursable expenses incurred (if any), and a five percent (5%) administration fee calculated on fees in lieu of individual charges for copies, phone, etc. We request payment within 30 days of invoicing. Citygate's billing terms are net thirty (30) days plus two percent (2%) for day thirty-one (31) and two percent (2%) per month thereafter.

* * *

If this proposal is acceptable, you can sign acceptance below, or forward a standard consultant contract for us to complete.

As President of the firm, I am authorized to execute a binding contract on behalf of Citygate Associates, LLC. Please feel free to contact me at (916) 458-5100, extension 101 or via e-mail at **dderoos@citygateassociates.com** if you wish further information.

Sincerely,

David C. DeRoos, MPA, CMC
President

cc: Stewart Gary
Dwane Milnes

Acceptance of Citygate's proposal and terms:

Name Signature

Title Date