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December 11, 2008

Ms. Susan Paul
Assistant CEO / HR Director
County of Santa Barbara
105 E. Anapamu Street
Santa Barbara, CA 93101

Via E-Mail

Subject: Projected Contribution Rate Estimates

Dear Sue:

As requested, we estimated potential contribution rates to the Santa Barbara County Employees Retirement System (SBCERS) that may become effective July 1, 2010. We understand that the SBCERS actuary has warned the system that contribution rates based on the June 30, 2009 actuarial valuation that will become effective July 1, 2010 may be significantly higher than current contribution rates due to the recent market downturn. The table below shows our estimates, using SBCERS' current actuarial methods and reflecting actual market activity through November 30, 2008, of the range of likely contribution rates under normal market volatility and elevated market volatility scenarios.

	Normal Market Volatility		Elevated Market Volatility	
Percentile	6/30/08 – 6/30/09 Investment Return	7/1/2010 Estimated Contribution Rate	6/30/08 – 6/30/09 Investment Return	7/1/2010 Estimated Contribution Rate
5th	-28.4%	38.3%	-38.3%	44.2%
25th	-24.7%	36.1%	-29.2%	38.8%
50th	-22.2%	34.6%	-23.3%	35.3%
75th	-19.8%	33.2%	-17.7%	31.9%
95th	-16.4%	31.2%	-10.1%	27.4%

These potential contribution rates are all significantly higher than the contribution rate of approximately 23 percent of payroll that will become effective July 1, 2009.

The contribution rates shown above only reflect the potential impact for the 2010-11 fiscal year. The severe market downturn has exceeded the capacity of the current asset smoothing method to smooth contribution rates. The current method requires that the actuarial value of assets remain between 80 percent and 120 percent of the market value. With the severe drop in the market value of assets, the actuarial value is simply 120 percent of the market value. Therefore, any additional changes affect the actuarial value by 120 percent of the change in market value. In addition, if all assumptions are met in the future, the actuarial value of assets will converge on the market value of assets resulting in future increases in contribution rates as the additional investment losses are recognized. To illustrate the impact of the pending future increases, the table below shows what the contribution rates would be if SBCERS changed to use the market value of assets instead of the actuarial value of assets.

Contribution Rates Based on Change to Market Value of Assets				
	Normal Market Volatility		Elevated Market Volatility	
Percentile	6/30/08 – 6/30/09 Investment Return	7/1/2010 Estimated Contribution Rate	6/30/08 – 6/30/09 Investment Return	7/1/2010 Estimated Contribution Rate
5th	-28.4%	45.4%	-38.3%	50.3%
25th	-24.7%	43.5%	-29.2%	45.8%
50th	-22.2%	42.3%	-23.3%	42.8%
75th	-19.8%	41.1%	-17.7%	40.1%
95th	-16.4%	39.4%	-10.1%	36.3%

The increase in contribution rates is driven by a steep decline in funded status. On June 30, 2008, the system was 89 percent funded based on the actuarial value of assets and 83 percent funded based on the market value of assets. The table below shows the projected funded status as of June 30, 2009.

Projected Funded Status as of 6/30/2009				
	Normal Market Volatility		Elevated Market Volatility	
Percentile	Market Value of Assets	Actuarial Value of Assets	Market Value of Assets	Actuarial Value of Assets
5th	55%	66%	47%	57%
25th	58%	70%	55%	65%
50th	60%	72%	59%	71%
75th	62%	74%	63%	76%
95th	64%	77%	69%	83%

Changes in benefit design or structure will not provide any short-term relief from the potential increases in contribution rates. The most immediate impact can be made by engaging SBCERS in a discussion of appropriate changes to actuarial methods to ease the immediate impact on the County without threatening the long-term viability of system. There are a variety of approaches that could be used, including eliminating the collar on the asset smoothing method, extending the amortization period, or smoothing contribution rates directly. However, under the current structure, SBCERS (not the County) would need to adopt these changes.

Data, Methods, Assumptions and Provisions

Our estimates are based on the June 30, 2008 actuarial valuation for SBCERS conducted by Milliman, assets of approximately $1.37 billion as of October 31, 2008, and an estimated return of -4.1 percent for November. Projected investment returns are based on the asset allocation as reported in the June 30, 2008 actuarial valuation, Mercer Investment Consulting's capital market assumptions and 20 basis points in administrative expenses. The median annual returns, net of expenses, in the normal and elevated volatility scenarios are 7.2 percent and 4.8 percent respectively. The annual standard deviations of returns are 11.2 percent and 26.1 percent for the normal and elevated volatility scenarios respectively.

Our analysis and conclusions are based on the data, methods and assumptions described above. Differences in the data, methods, assumptions and interpretations of the plan provisions may produce different results. In particular, it should be noted that normal models for predicting the capital markets over the next few months may produce significantly different results than the actual capital markets. As such, the projections in this letter should be used as illustrations of some of the potential outcomes. Actual outcomes could be significantly better or worse than the range shown.

If you have any questions about the information in this letter or need any additional information, please let us know.

Sincerely,

[WRH]

William R. Hallmark, ASA, EA, MAAA
Principal

SDP/WRH/mm:gjw

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Jeri Muth, Bob Geis

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