Attachment A

County Of Santa Barbara

Mona Miyasato
County Executive Officer

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Executive Office

October 19, 2016

Mr. Gregory E. Levin, CPA,
SBCERS Chief Executive Officer
3916 State Street, Suite 100
Santa Barbara, CA 93105

RE: Request to SBCERS Board of Retirement Phase-In Investment Rate of Return Changes

Dear Mr. Levin,

At the October 18, 2016 Board of Supervisors' meeting, action was taken by the BOS relating to the possible action by the Board of Retirement of the Santa Barbara County Employees' Retirement System to lower the investment rate of return assumption on invested assets from its current rate of 7.5%. Given the possible, sizeable impact this will have on the County's resources and services, the County is requesting that the Board of Retirement delay adopting any assumption changes until the County has adequate time (approximately one month) to review the actuarial study and impacts of such changes on the County's pension contribution rate.

The County is also requesting that, should the SBCERS Board make changes to certain actuarial assumptions, these changes be implemented over a period of time rather than all at once to allow the County an ability to manage and plan for the increased costs, which are estimated to range from $30 million to $43.1 million over 5 years. The request is that:

i. A reduction to the assumed investment rate of return (ROR) on plan assets in FY 2017-18 be no more than a 25 basis point reduction (from the current 7.5% to 7.25%); and

ii. Any <u>additional</u> reductions also be limited to 25 basis points (i.e., from 7.25% to 7%) per year and be implemented in FY 2020-21 after the next experience study is performed; this would bring the ROR from 7.5% to 7.0% in 4 years.

This issue and the related impacts are detailed in the attached County Board of Supervisors Agenda Letter of October 18, 2016.

This request is being made because the cost impacts of a 50-basis point reduction in ROR occurring in FY 2017-18, coupled with the significant underperformance in the 2016 investment returns, is estimated to result in an additional $43.1 million increase in County pension costs annually in 5 years. Policies to smooth in the impact over 5-years help to somewhat mitigate the increase, but the result is still additional, new costs to the County, starting with $12.6 million (in FY 2017-18) and steadily increasing to $43.1 million (in FY 2021/22), where it is projected to continue at the higher contribution rate. (County staff's numbers are estimates, based on prior information provided by the SBCERS actuary, given that the current information will not be available until shortly before the SBCERS meeting on October 26, 2016).

Estimated Impact on County Budget and Services

The County has not yet prepared its FY 2017-18 Budget, and therefore, specific impacts to County services are not yet identified. **However, it is anticipated that that significant increases cannot be absorbed given the County's expected revenue, which would mean reductions in County services and/or staff.**

- **Discretionary General Revenues (DGRs) –** The County's discretionary general revenues are those that are generated locally, primarily by property tax revenues. Over the coming five years, the General Discretionary Revenues are expected to grow only between $1.5 - $2.0 million per year, after deducting funding for obligated commitments such as the Northern Branch Jail operations, existing employee labor contracts and other Board-adopted priorities.

- **Charges for Services, State, Federal and Other Sources –** A large portion of the County's revenue is from State and Federal sources for specific services or charges for services. These funding sources are fixed in the short term and in other cases, fixed in general. With these pension increases, some reimbursement rates could be raised over time, but a large portion of the increases would not be able to be absorbed without reductions elsewhere.

- Departments such as Behavioral Wellness, Social Services, Child Support Services, Sheriff, District Attorney and others are currently having difficulty absorbing relatively minor cost increases; it is probable that some of the services within these departments could not absorb greater costs, and would be required to reduce levels of public service through staff, contractor or other service reductions given expected revenues.

- The magnitude of a 50-basis point increase over 5 years is similar to the pension cost increase experienced during the Great Recession. At that time, the County's pension contribution costs grew from $70.5 million to $113.0 million or $42.5 million over 5 years ending in FY 2014-15. Those cost increases, combined with reduced growth in revenues, was the driver of the County's budget gap, which resulted in service reductions and staffing cuts: between FY 2007-08 through FY 2011-12, there was a 655 position reduction in the adopted County workforce (4,495 positions in FY 2007-08 vs. 3,840 in FY 2011-12), staff furloughs, labor concessions and reductions in services to the public.

Request for Gradual or Phased Approach

A 25 basis point reduction in ROR occurring in FY 2017-18, with the investment losses, would result in an additional $7.9 million increase in County pension in FY 2017-18 growing to $30.3 million in FY 2021-22. These costs would also be difficult to absorb, given the issues described above, but compared to a 50 basis point ROR reduction, would lessen the impact and mitigate some level of service and/or staff reductions.

Should the Board of Retirement wish to pursue an additional reduction beyond 25 basis points in FY 2017-18, the County requests the change be limited to 25 basis points (i.e., from 7.25% to 7.0%) and be implemented no sooner than in FY 2020-21 after the next experience study is performed; this would bring the ROR from 7.5% to 7.0% in 4 years. This would result in a more gradual increase and while it would still require additional funding, it would allow the County time to look at structural changes and more gradually reduce the impact on County residents as well as impacted employees.

Attachment A

Sincerely,

Mona Miyasato
County Executive Officer

Cc: Santa Barbara County Board of Supervisors
SBCERS Board of Retirement
Theo Fallati, Auditor Controller
Tom Alvarez, Budget Director
John Jayasinghe, Fiscal & Policy Analyst

Attachments:
Board Agenda Letter