



# Board of Retirement Regular Meeting

## Sacramento County Employees' Retirement System

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### Agenda Item 13

**MEETING DATE:** June 17, 2020

**SUBJECT:** Amendment to Sacramento Metropolitan Fire District Funding Agreement

**SUBMITTED FOR:**  Consent       **Deliberation and Action**       **Receive and File**

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### **RECOMMENDATION**

Staff recommends the Board take the following actions:

- 1) Determine that a “triggering event” has occurred regarding outstanding pension liabilities on behalf of North Highlands Fire District retirees and liabilities;
- 2) Receive and file the actuarial analysis from Segal; and,
- 3) Authorize the Chief Executive Officer to execute an amended agreement with the Sacramento Metropolitan Fire District to provide a funding mechanism to address the North Highlands Fire District pension liabilities owed to SCERS.

### **PURPOSE**

This item supports the 2019-20 Strategic Management Plan to ensure funding integrity and sustainability of the plan by maintaining effective funding policies.

### **DISCUSSION**

On July 19, 2018, Sacramento Metropolitan Fire District (SMFD) and SCERS entered into an agreement pertaining to the funding of retirement benefits for a group of members formerly employed by Florin Fire Protection District. Specifically, SMFD agreed to make amortized payments over 20 years to SCERS to satisfy an unfunded actuarial accrued liability (UAAL) of approximately \$45 million associated with those members.

After executing the funding agreement, SCERS identified an additional UAAL associated with a separate and independent group of members, for whom SMFD also has funding obligations. Those members are former employees of the North Highlands Fire District.

North Highlands Fire District was formed in 1951 and became a participating SCERS employer in the late 1950s. In 1984, the North Highlands Fire District consolidated with the Citrus Heights Fire District, which received pension benefits through the California Public Employees'

Retirement System (CalPERS). That consolidation caused all employees of the North Highlands Fire District to become employees of the Citrus Heights Fire District, but did not disturb their membership in SCERS.

In 1989, the Citrus Heights Fire District merged with the Rancho Cordova Fire District to become the Sacramento County Fire Protection District. Again, the former North Highlands employees remained SCERS members after the reorganization. On December 1, 2000, the Sacramento County Fire Protection District merged with the American River Fire Department to form the Sacramento Metropolitan Fire District. For a third time, the North Highlands employees remained SCERS members after the reorganization.

In short, SMFD is the successor to the Sacramento County Fire Protection District, which was successor to the Citrus Heights Fire District, which was successor to the North Highlands Fire District. By virtue of that succession, SMFD is responsible for funding the pension benefits of the North Highlands employees, retirees, and their beneficiaries by making employer contributions to SCERS.

For years, SMFD did make such contributions. After the December 2000 merger, SMFD made regular pension payroll contributions to SCERS on behalf of the North Highlands Fire District members. By November 2011, all former North Highlands employees had retired from SMFD. At that point, the North Highlands Fire District employees were no longer on SMFD's payroll, and SMFD ceased making contributions to SCERS.

However, as of June 30, 2019, there remained a total of 16 North Highlands retirees and beneficiaries receiving SCERS benefits.

Because unfunded actuarial accrued liabilities are traditionally built into payroll contribution rates, it becomes necessary to establish a separate payment schedule for an employer that has a declining or no payroll. Even if there are no longer active employees making payroll contributions, the employer's obligation remains ongoing until the last retiree or beneficiary dies.

SCERS adopted a Declining Employer Payroll Policy in 2019 that sets out a process for determining unfunded actuarial accrued liabilities when an employer ceases adding new members in SCERS while benefits continue to be paid to retirees and beneficiaries.

The North Highlands situation is unique in that the true triggering event occurred in 1984 when the fire district merged into a CalPERS-covered agency, freezing the SCERS membership for the North Highlands group. However, it would be administratively difficult to recreate the contribution and benefit stream since 1984.

In consultation with Segal, Staff instead considers the triggering event to have occurred following the Board's adoption of the Declining Employer Payroll Policy in June 2019. SCERS has engaged Segal to calculate the UAAL attributable to the North Highlands retirees and beneficiaries as of June 30, 2019, under the policy. Using that methodology, Segal has calculated the SMFD's UAAL for North Highland retirees and beneficiaries to be \$3,155,414 as June 30, 2019.

The amended agreement adds a new amortization layer of approximately \$325,000 annually on top of the existing SMFD funding plan, and aligns the payment schedule to the remaining 17 years of the current Florin agreement.

The amendment also incorporates the North Highlands liabilities into the broader Florin funding structure going forward. Under the current agreement, Segal conducts an annual analysis of the SMFD liabilities and makes adjustments to the payment schedule based on economic and demographic experience and assumptions, amortizing gains and losses over a three-year period.

### **BACKGROUND**

A 2019 appellate court ruling found that retirement boards retain significant authority to enforce payment of contributions from employers that have deferred or retired employees currently receiving benefits from the County retirement system, even if the employer no longer has active employees in the retirement system (*Mijares v. Orange County Employees Retirement System*, 32 Cal.App. 5<sup>th</sup> 316).

The *Mijares* court also found that the unfunded liability payment is not required to be deducted from active employee payroll and recognized the system's right to recommend changes in county and district contributions as necessary.

### **ATTACHMENT**

- Segal analysis of North Highlands Fire District liabilities as of June 30, 2019

Prepared by:

/S/

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Eric Stern  
Chief Executive Officer



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June 1, 2020

Mr. Eric Stern  
Chief Executive Officer  
Sacramento County Employees' Retirement System  
980 9th Street, Suite 1900  
Sacramento, CA 95814-2738

**Re: Sacramento County Employees' Retirement System (SCERS)  
North Highlands Fire Unfunded Actuarial Accrued Liability as of June 30, 2019**

Dear Eric:

As requested, we have determined SCERS' Unfunded Actuarial Accrued Liability (UAAL) that would be allocated to North Highlands Fire members as of June 30, 2019 using the methodology as described in SCERS' Declining Employer Payroll Policy (the Policy) adopted at the June 2019 Board meeting. We have determined the Actuarial Accrued Liability (AAL) and the resulting UAAL that have been allocated to North Highlands Fire as of June 30, 2019 based on the Policy. North Highlands Fire was an employer that merged with Sacramento Metro Fire District, but its active employees remained members of SCERS until the last of those employees retired in 2011.

In determining the UAAL, we have used the long-term actuarial assumptions (such as the 7.00% return assumption), assuming that there will be an annual update to the UAAL to reflect the actual experience and to reflect any new actuarial assumptions that may be adopted by the Board after June 30, 2019.<sup>1</sup> This annual update is provided for in the Policy.

Also included in the Policy is the Board discretion to allow North Highlands Fire to settle the UAAL through level and fixed-dollar installments. As directed by your office, we have amortized the UAAL for North Highlands Fire assuming annual payment will be made on each July 31 for 17 years from fiscal year 2020/2021 to 2036/2037. These payment terms are the same as those used in our withdrawal study as of June 30, 2019 for members from Florin Fire Protection District<sup>2</sup> to pay off their UAAL determined before the withdrawal study as of June 30, 2019.

<sup>1</sup> In particular, we provided in our triennial experience study report dated May 11, 2020 the actuarial assumptions that we recommend to the Board for use in the June 30, 2020 valuation. As those new actuarial assumptions will not be used until we update the UAAL for North Highlands Fire using membership and financial information in the next valuation as of June 30, 2020, any change in the UAAL associated with those new assumptions has not been included in this study.

<sup>2</sup> Florin Fire Protection District is now a part of Sacramento Metro Fire District.

## Summary of Results

After applying the Policy, we have determined North Highlands Fire's UAAL to be \$3,155,414 as of June 30, 2019. It is payable in 17 annual installments of \$325,021 starting on July 31, 2020.

## Background

As noted above, North Highlands Fire was an employer that merged with Sacramento Metro Fire District, but its active employees remained members of SCERS until the last of those employees retired in 2011. There are currently 16 retired members and beneficiaries from North Highlands Fire receiving benefits.

In 2004, Sacramento Metro Fire District issued Pension Obligation Bonds, and made a contribution of \$10.5 million to SCERS. Of this amount, \$895,000 was used to provide a UAAL rate credit for North Highlands Fire.<sup>3</sup> Using a 29-year amortization period in the June 30, 2004 valuation, the rate credit for this group was a flat 8.59% of payroll starting with fiscal year 2005/2006. As the last members from this group retired in 2011, there is some unused rate credit that can be applied to reduce the UAAL for North Highlands Fire. As directed by your office, we have applied that unused rate credit in our calculation.

For the purpose of this study, we have assumed that a triggering event occurred during 2019/2020 following the adoption of the Policy in June 2019.

## Allocation of UAAL Under Declining Employer Payroll Policy

Based on the methodology described in the Policy, North Highlands Fire would be allocated a pro-rata share of the total UAAL for their participation in the Safety membership group. That pro-rata share would be allocated based on North Highlands Fire's AAL as compared to the AAL for all the employers within the Safety membership group. The detailed calculations of the UAAL for North Highlands Fire based on applying the Policy are shown in Exhibit A. An amortization schedule is included in Exhibit B.

## Assumptions Used in Calculations

Unless otherwise noted, all of the above calculations are based on the June 30, 2019 actuarial valuation results, including the participant data and actuarial assumptions on which that valuation was based. This means that any actuarial gains and losses that may have arisen since June 30, 2019 from using these assumptions, as well as any changes in assumptions approved by the Board for the June 30, 2020 valuation, have not been included in this analysis. The June 30, 2019 valuation and these calculations were completed under the supervision of Andy Yeung, ASA, MAAA, Enrolled Actuary.

<sup>3</sup> The remaining amount from the \$10.5 million was previously reported by SCERS and included by the actuary in determining the withdrawal liability for Florin Fire Protection District.

Mr. Eric Stern  
June 1, 2020  
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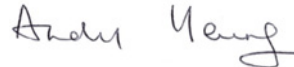
The undersigned are Members of the American Academy of Actuaries and meet the qualification requirements to render the actuarial opinion contained herein.

Please let us know if you have any questions.

Sincerely,



Paul Angelo, FSA, MAAA, FCA, EA  
Senior Vice President & Actuary



Andy Yeung, ASA, MAAA, FCA, EA  
Vice President & Actuary

MAM/bbf  
Enclosures

## North Highlands Fire Allocated Initial UAAL After Triggering Event

North Highlands Fire's former employees are currently included in SCERS' Safety membership group. Also included in that membership group are members from the County. As of June 30, 2019, there were 12 service retirees, 1 disabled retiree, and 3 beneficiaries with North Highlands Fire who rendered service at North Highlands Fire while participating as active members in SCERS.

Based on the methodology described in the Policy, North Highlands Fire would be allocated a pro-rata share of the total UAAL in the Safety membership group. That pro-rata share would be allocated based on North Highlands Fire's AAL as compared to the AAL for the entire Safety membership group.

Consistent with the Sacramento Metro Fire District's other arrangement related to the withdrawn employer Florin Fire Protection District, we have calculated North Highlands Fire's UAAL using assets determined on a market value basis.

Here are the specific steps involved in the determination of the UAAL for North Highlands Fire:

1. Determine the AAL for North Highlands Fire as of June 30, 2019

The June 30, 2019 AAL for North Highlands Fire was calculated to be \$24,266,531 using the membership data for North Highlands Fire as of the same date.

2. Determine the Preliminary UAAL for North Highlands Fire as of June 30, 2019

We have allocated a pro-rata share of the UAAL to North Highlands Fire. That pro-rata share was calculated by dividing the AAL for North Highlands Fire by the AAL for the Safety membership group. As noted above, we have also applied an adjustment to express the UAAL on a market value basis.

Based on a valuation value of assets of \$3,343,735,000 for all of Safety, the UAAL for the Safety membership group is \$999,509,000.

- For the purposes of this study, we reduce the Safety UAAL by the outstanding balance of the UAAL established as a result of the Early Retirement Incentive Program for LEMA members, because North Highlands Fire is not responsible for paying that liability. This reduces the UAAL used for this study by \$649,000.
- For the purposes of this study, we increase the Safety UAAL by the outstanding balance of the County's Pension Obligation Bonds (POBs) for Safety.<sup>4</sup> Additional contributions have been made by the County to buy down the County Safety UAAL contribution rate through the issuance of POBs. As North Highlands Fire did not participate in the County's POBs, their contributions should not recognize this future buy-down. As a result, the Safety UAAL used for this study increases by \$3,011,975.

<sup>4</sup> The adjustment to reflect the POBs issued by Sacramento Metro Fire for North Highlands Fire is provided in step 3.

After reflecting the above adjustments, the UAAL on a valuation value of assets basis for the Safety membership group is \$1,001,871,975.

To obtain the UAAL on a valuation value of assets basis for North Highlands Fire, we multiply the above result by the ratio of North Highlands Fire AAL, or \$24,266,531, to the total Safety AAL, or \$4,343,244,000. The result is that the UAAL on a valuation value basis for North Highlands Fire is \$5,597,649.

In order to determine the North Highlands Fire UAAL on a market value basis, we determine the valuation value of assets attributable to North Highlands Fire based on the above results, and then adjust that value using the following procedures to obtain the market value of assets.

- The valuation value of assets for North Highlands Fire is their AAL of \$24,266,531 minus their UAAL of \$5,597,649, or \$18,668,882.
- In general, the actuarial value of assets equals the valuation value of assets plus the non-valuation reserves, in particular, the contingency reserve. The value of the contingency reserve allocated to the Safety membership group is \$44,750,100. Using the ratio of valuation value of assets for North Highlands Fire to the valuation value of assets for all Safety as above, the contingency reserve allocated to North Highlands Fire is \$249,851. After adding this to the valuation value of assets above, the resulting actuarial value of assets is \$18,918,733.
- For the total plan, the market value of assets is \$9,821,694,000, and the actuarial value of assets is \$9,703,312,936. If we apply the ratio of these two numbers to the actuarial value of assets determined above, we obtain a market value of assets for North Highlands Fire of \$19,149,543.

The preliminary UAAL for North Highlands Fire on a market value basis is their AAL of \$24,266,531 minus the asset value of \$19,149,543, or \$5,116,988.

### 3. Apply Outstanding Balance of North Highlands Fire Pension Obligation Bonds

As described in the Background section of this letter, North Highlands Fire had a UAAL rate credit of 8.59% of payroll attributable to a contribution that Sacramento Metro Fire District made to SCERS in 2004/2005 from the proceeds of Pension Obligation Bonds. The contribution amount originally allocated to North Highlands Fire was \$895,000. That amount has been decreased through its application to North Highlands Fire contributions through 2011, and it has also been increased with interest at the assumed rate used in the valuations over time. The outstanding balance as of June 30, 2019 is \$1,858,804.

After applying this credit, the UAAL for North Highlands Fire decreases from \$5,116,988 to \$3,258,184.

### 4. Impact of Section 415 Dollar Limit

The UAAL is further reduced to reflect the reduction in AAL for North Highlands Fire due to the limitation imposed by IRC Section 415 on benefits that could be paid by SCERS for one retiree in North Highlands Fire whose benefit was in excess of that limit determined as of June 30, 2019. This reduction incorporates information provided by SCERS about this member's benefit, as well as a projection of future IRC Section 415 dollar limits for the



purposes of this study only. The projection of the member's benefit is based on assumed 3.00% cost-of-living increases starting on April 1, 2021, and future Section 415 dollar limits starting in 2021 have been projected at the assumed 3.00% rate of inflation, rounded down to the nearest \$5,000 to mimic the procedure used by the IRS. The member's excess benefits over the dollar limit have been discounted to June 30, 2019 using valuation mortality assumptions and an interest rate of 7.00%. The reduction in AAL is \$102,770.

As a result, the UAAL for North Highlands Fire decreases from \$3,258,184 to \$3,155,414.

#### 5. Payment Schedule

Exhibit B contains a payment schedule showing level dollar amortization payments for North Highlands Fire. Consistent with Sacramento Metro Fire District's payment schedule for Florin Fire Protection District, the schedule includes payments every July 31 from fiscal year 2020/2021 until fiscal year 2036/2037, at which point the UAAL for North Highlands Fire is expected to be paid off.

The payment amounts we have assumed in preparing the schedule below are as follows:

- i) Contributions for the 2020/2021 and later fiscal years will be made on July 31 of every fiscal year; and
- ii) Contributions will be a level dollar amount from 2020/2021 to 2036/2037.

Annual Interest Rate: 7.00%  
 Annual Payment Growth: 0.00%

Fiscal Year	Beginning of Period UAAL Balance	Annual Payment	Interest Paid	Principal Paid	Additional Interest Accrued on UAAL	End of Period UAAL Balance
2019/2020	\$ 3,155,414	\$ -	\$ -	\$ -	\$ 220,879	\$ 3,376,293 <sup>(1)</sup>
2020/2021	3,376,293	325,021	215,544	109,477	-	3,266,816
2021/2022	3,266,816	325,021	207,881	117,140	-	3,149,676
2022/2023	3,149,676	325,021	199,681	125,340	-	3,024,336
2023/2024	3,024,336	325,021	190,907	134,114	-	2,890,222
2024/2025	2,890,222	325,021	181,519	143,502	-	2,746,720
2025/2026	2,746,720	325,021	171,474	153,547	-	2,593,173
2026/2027	2,593,173	325,021	160,726	164,295	-	2,428,877
2027/2028	2,428,877	325,021	149,225	175,796	-	2,253,081
2028/2029	2,253,081	325,021	136,919	188,102	-	2,064,979
2029/2030	2,064,979	325,021	123,752	201,269	-	1,863,710
2030/2031	1,863,710	325,021	109,664	215,358	-	1,648,353
2031/2032	1,648,353	325,021	94,588	230,433	-	1,417,920
2032/2033	1,417,920	325,021	78,458	246,563	-	1,171,357
2033/2034	1,171,357	325,021	61,199	263,822	-	907,534
2034/2035	907,534	325,021	42,731	282,290	-	625,244
2035/2036	625,244	325,021	22,971	302,050	-	323,194
2036/2037	323,194	325,021	1,827	323,194	-	-
<b>Total</b>		\$ 5,525,362	\$ 2,149,069	\$ 3,376,293 <sup>(2)</sup>		

<sup>(1)</sup> We have adjusted the \$3,155,414 as of June 30, 2019 with interest at 7.00% (\$3,155,414 × 7.00% is equal to \$220,879) to come up with \$3,376,293 as of June 30, 2020.

<sup>(2)</sup> This amount is \$220,879 higher than the \$3,155,414 as of June 30, 2019 to reflect interest added to the \$3.2 million in additional UAAL determined as of June 30, 2019 until payment is made starting in 2020/2021.

Note: Results may not add due to rounding.