



Finance and Administration Committee

Agenda Item 5f

April 15, 2024

Item Name: Schools Valuation and Employer/Employee Contribution Rates

Program: Actuarial Office

Item Type: Action

Recommendation

Approve an employer contribution rate of 27.05% for the Schools Pool. Rate is applicable for the period of July 1, 2024 to June 30, 2025.

Executive Summary

The employer contribution rate has increased from the prior fiscal year, but it is lower than what was projected in the June 30, 2022 annual valuation report.

The following table summarizes key results of the June 30, 2023 valuation.

Key Valuation Results (\$ in millions)

Funded Status	June 30, 2022	June 30, 2023
Accrued Liability	\$116,982	\$124,924
Market Value of Assets	\$79,386	\$84,292
Unfunded Accrued Liability	\$37,596	\$40,632
Funded Ratio	67.9%	67.5%

Contribution Rates	Fiscal Year 2023-24	Fiscal Year 2024-25
Employer Contribution Rate	26.68%	27.05%
PEPRA Member Contribution Rate	8.00%	8.00%

Strategic Plan

This action item is being presented as part of the regular and ongoing workload of the Actuarial Office and supports the Pension Sustainability goal of the Strategic Plan: Strengthen the long-term sustainability of the pension fund.

Background

The Schools Pool provides retirement benefits to classified employees of K-12 school districts, community college districts, and most county offices of education in California. It generally does not cover certificated school employees as they are covered by the California State Teachers' Retirement System (CalSTRS).

This actuarial valuation determines the funded status as of June 30, 2023 and sets forth the Schools employer and PEPRA employee contribution rates for fiscal year July 1, 2024 through June 30, 2025.

Investment Return

Based on final June 30, 2023 assets, the money-weighted investment return for 2022-23 was 6.1%, generating an actuarial investment loss of \$0.6 billion. This loss will be amortized over 20 years with a five-year ramp, increasing the employer contribution rate in 2024-25 by 0.07% of pay. Due to the five-year ramp, this impact will increase each year until it reaches an estimated 0.33% of pay in 2028-29.

Other Plan Experience

Non-investment experience during 2022-23, which includes both demographic experience and economic experience other than from investments, produced an actuarial loss of \$2.5 billion. This loss will be amortized over 20 years, increasing the employer contribution rate by 1.09% in 2024-25. Combined with a 0.19% decrease in the employer normal cost rate, the net effect of non-investment experience is an increase of 0.90% in the employer rate.

The most significant source of non-investment experience was salary increases for active members, which generated an actuarial experience loss. The average salary increase was 9.8% for members actively employed during the entire year ending June 30, 2023.

Total reported payroll in 2022-23 increased by 13.9% over the prior year, compared with 2.8% expected. This change, driven by a combination of active headcount growth and the salary increases mentioned above, served to reduce the employer contribution rate for 2024-25 by 1.74% of pay as the dollar amount of the unfunded liability contribution is divided by a larger payroll.

Analysis

Schools Employer Contribution Rate for 2024-25

The Actuarial Office has completed the calculation of the employer contribution rate for the Schools Pool for 2024-25. The full actuarial report will be completed later this year and will be provided to the board and posted online when complete. The additional information provided in the report will include details on assumptions, methods, and participant data.

The following table compares the 2024-25 employer contribution rate and corresponding dollar amount estimated to be generated by the rate to amounts for 2023-24.

Schools Pool Employer Contribution (\$ in millions)

Employer Costs by Rate and Dollars	Fiscal Year 2023-24	Fiscal Year 2024-25
Required Employer Contribution Rate		
Employer Normal Cost	9.77%	9.58%
Unfunded Liability Rate	<u>16.91%</u>	<u>17.47%</u>
Employer Contribution Rate	26.68%	27.05%
Projected Payroll ¹	\$ 16,731	\$ 19,055
Expected Employer Contribution Dollars		
Employer Normal Cost	\$ 1,635	\$ 1,825
Unfunded Liability Contribution	<u>2,830</u>	<u>3,328</u>
Expected Employer Contributions	\$ 4,465	\$ 5,153

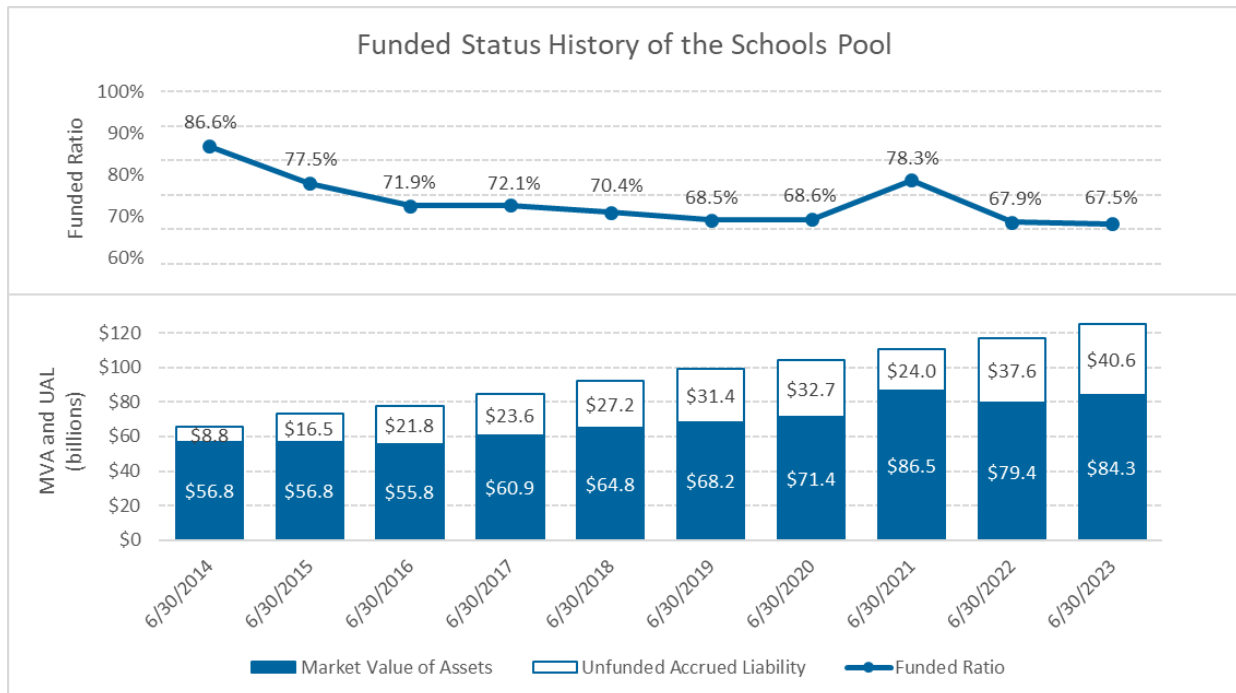
¹ Projected payroll used to calculate the expected dollar contributions is payroll reported for the year ending on the valuation date, increased for two years of growth at the prevailing payroll growth assumption (2.80% per year for the June 30, 2023 valuation). To the extent that payroll in the contribution year is different than projected, actual contribution amounts will differ from the expected contributions shown in the table above.

Funded Status

The chart below illustrates two different measures of funded status: funded ratio and Unfunded Accrued Liability (UAL). The funded ratio equals assets divided by accrued liability. It is a relative measure of funded status and allows for comparisons between plans of different sizes. Plans with a lower funded ratio are, all other things equal, more costly and at higher risk of not being able to meet their future benefit obligations. The UAL, a dollar amount, equals accrued liability minus assets and is an absolute measure of funded status.

From June 30, 2022 to June 30, 2023, the funded ratio of the Schools Pool decreased by 0.4% and the UAL increased by \$3.0 billion. This deterioration in funded status was due primarily to greater-than-expected salary increases in 2022-23.

The graph below shows funded ratio and UAL for the past ten years.



Change in Required Employer Contribution

Overall, the required employer contribution rate for the Schools Pool increased by 0.37% of payroll from the prior year. The dollar amount of employer contributions expected to be generated in 2024-25 is approximately \$688 million higher than in 2023-24. An explanation of the key sources of plan experience is provided on page 2.

The following table reconciles the required employer contribution from last year to this year.

Reconciliation of Required Employer Contribution

	Rate (% of Payroll)	Estimated Dollars (millions)
Employer Normal Cost		
2023-24 employer normal cost contribution	9.77%	\$1,635
Change in payroll	0.00%	226
Demographic experience	<u>(0.19%)</u>	<u>(36)</u>
2024-25 employer normal cost contribution	9.58%	\$1,825
Unfunded Liability Contribution		
2023-24 unfunded liability contribution	16.91%	\$2,830
Progression of amortization bases and change in payroll	(0.60%)	276
Investment (gain)/loss	0.07%	14
Non-investment (gain)/loss	<u>1.09%</u>	<u>208</u>
2024-25 unfunded liability contribution	17.47%	\$3,328
Total Required Employer Contribution		
2023-24 total required employer contribution	26.68%	\$4,465
Progression of amortization bases and change in payroll	(0.60%)	502
Experience (gains)/losses	<u>0.97%</u>	<u>186</u>
2024-25 total required employer contribution	27.05%	\$5,153

PEPRA Member Contribution Rate

Under PEPRA, new members hired on or after January 1, 2013 are required to contribute 50% of the total normal cost of their pension benefit as determined by the actuarial valuation. PEPRA school members currently contribute 8.00% of salary. The contribution rate for school members not subject to PEPRA (i.e., classic members) is set by statute and is currently 7.00% of salary.

A change in the PEPRA member contribution rate is required when the total normal cost changes by more than 1% of payroll. When a change is triggered, the member contribution rate is adjusted to equal half the total normal cost, rounded to the nearest quarter of one percent.

In this valuation, the total normal cost did not change by more than 1% relative to the basis currently in effect. Therefore, the PEPRA member contribution rate will remain 8.00% for 2024-25.

On June 30, 2023, PEPRA members represented 62% of the total active population of the Schools Pool by headcount and 54% by payroll.

Expected Future Changes

The following table shows projected employer contribution rates for 2025-26 through 2029-30. Projected rates assume all actuarial assumptions will be realized and no changes to assumptions, methods, or benefits will occur during the projection period. The projected rates further reflect that normal cost is expected to continue to decline gradually over time as new employees enter the PEPRA benefit tier. Projected rates are estimates only; actual rates will be determined by future actuarial valuations.

Projected Schools Employer Contribution Rate (% of payroll)

Fiscal Year	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Employer Contribution	27.05%	27.6%	28.0%	29.2%	29.0%	28.8%

The actual investment return for 2023-24 was not known at the time this item was prepared. The projections above assume the investment return for that year will be 6.80%. ***If the actual investment return differs from 6.80%, the actual contribution requirements for the projected years will differ from those shown above.***

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

Information about the risks associated with the funding of these plans will be included in the valuation report that is expected to be released later this year. This information includes investment return scenarios, discount rate sensitivity, volatility ratios, and other risk analyses.

Attachments

Attachment 1 – Schools Valuation Presentation

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