CalPERS

Finance and Administration Committee

Agenda Item 6a

May 14, 2019

Item Name: Vacancy Rate Assumption

Program: Financial Office

Item Type: Action

Recommendation

Approve personal services expenditures of $415.6 million as currently calculated and presented in the 1st Reading of the 2019-20 Proposed Budget.

Executive Summary

The 2019-20 Administrative Operating Costs Budget includes $415.6 million for personal services expenditures (salaries, wages, and benefits). CalPERS estimated these expenditures using the mid-step costs for employee classifications as specified in the pay scales published by the California Department of Human Resources (CalHR), and it did not apply a salary savings reduction based on vacancy rates. CalPERS applied this methodology because it is consistent with State of California budgeting practices, provides more consistent budgeting year over year, and it streamlined internal budgeting processes. However, this application is a departure from prior years when CalPERS budgeted salaries using estimated payroll expenditures as published in the Department of Finance's *Salaries and Wages Supplement*, which it then reduced for anticipated vacancies.

Strategic Plan

This agenda item supports CalPERS' 2017-22 Strategic Plan and the 2018-19 Business Plan in that the proposed budget represents the financial resources needed to achieve strategic goals and priorities, meet core business needs, and further the mission of delivering retirement and health care benefits to members and their beneficiaries. Further, the revised budgeting methodology streamlines processes to gain efficiencies, improve productivity, and reduce costs.

Background

Prior to fiscal year 2019-20, CalPERS budgeted its personal services expenditures using estimated payroll included in the Department of Finance's annual *Salaries and Wages Supplement*. This document reports actual payroll data for the prior fiscal year, and estimated payroll for the current and subsequent fiscal years assuming continuous, 100 percent occupancy of all authorized positions. Beginning in fiscal year 2013-14, CalPERS began reducing its personal services budget for anticipated savings resulting from position vacancies (salary savings). This entailed reviewing each division's current and past year vacancy rates, making assumptions about future hiring actions, and reducing specific divisions' personal services budgets based on those assumptions. Over the past six years, this effort resulted in total personal services expenditure reductions ranging from 4.2% to 6.9%, as displayed in the following table.

	Salary Savings Reductions ($ in thousands)					
	2013-14	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**
Personal Services Expenditures	$ 301,931	$ 329,191	$ 352,465	$ 369,608	$ 387,176	$ 401,498
Less: Salary Savings	(12,794)	(18,400)	(17,144)	(25,226)	(26,628)	(18,738)
Total Personal Services	$ 289,137	$ 310,791	$ 335,321	$ 344,382	$ 360,548	$ 382,760
Salary Savings Reduction	4.2%	5.6%	4.9%	6.8%	6.9%	4.7%

For many years, state departments budgeted their personal services expenditures in a similar manner in that they would reduce expenditures for anticipated salary savings. However, the State abandoned this practice in fiscal year 2012-13 and departmental budgets no longer reflect salary savings reductions.

When preparing the 2019-20 proposed budget, CalPERS changed its methodology for estimating personal services expenditures to align with State budgeting processes, and to implement more consistent, streamlined budgeting practices. More specifically, CalPERS budgeted personal services expenditures based on the mid-step of classification pay scales published by CalHR, which is the basis traditionally used by state departments when seeking budget authority for new positions. The practice of budgeting at mid-step acknowledges that not all positions are continuously filled, and that some employees will be paid at the lowest step of the pay scale while others will be paid at the highest step. When calculating personal services expenditures using the new methodology, CalPERS did not apply a salary savings reduction because the new methodology already reduces expenditures to reflect that not all positions will be filled at all times.

Analysis

Based on the April FAC discussion, the CalPERS Budget Office recalculated salaries, wages, and benefits under the historic methodology (using estimated payroll in the *Salaries and Wages Supplement*). In comparison to the 1st Reading Proposed Budget, total personal services expenditures increased $19.7 million, or 4.7 percent. Because the difference of the two calculations is consistent with prior year salary savings reductions, the $19.7 million is a reasonable proxy for the salary savings reduction in 2019-20. The following table displays the restated personal services budget with the salary savings reduction.

	As Proposed New Methodology	Historic Methodology	$ Increase	% Increase
PERSONAL SERVICES ($ in 000's)				
Salaries & Wages	$ 264,944	$ 275,964	$ 11,020	4.2%
Temporary Help	5,138	5,138	-	-
Overtime	2,048	2,048	-	-
Benefits	143,520	152,165	8,645	6.0%
Total Personal Services	$ 415,650	$ 435,315	$ 19,665	4.7%
Less Salary Savings	-	(19,665)	(19,665)	-
Revised Total Personal Services	$ 415,650	$ 415,650	$ -	-

Budget and Fiscal Impacts

Based on the above analysis, there is no 2019-20 fiscal impact between the two methodologies. However, the revised methodology is more streamlined in that it reduces workload related to analyzing division vacancy rates, meeting with division and human resources staff to estimate future hiring activities, and reducing individual divisions' budgets. This methodology change, along with other recently-implemented streamlined processes, enabled the Budget Office to reduce its position count by 2.0 authorized positions, which were transferred to the position pool.

Benefits and Risks

The new methodology for budgeting personal services expenditures aligns with State budgeting practices and provides more consistent budgeting year over year because it removes uncertainty regarding potential hiring assumptions that influenced previous salary savings calculations. In addition, the new methodology achieves process efficiencies that resulted in position reductions. Moreover, it avoids concerns that divisions have when filling vacancies while at the same time endeavoring to meet salary savings targets.

If CalPERS were to revert to its historic budgeting process, the methodology would be inconsistent with how other state departments budget their personal services expenditures. The older methodology will also continue to result in year-over-year variances in salary savings reductions. This is because the reductions are based on assumptions regarding future hiring activities that are dependent on factors outside CalPERS' control, such as the availability and interest of qualified candidates. Finally, reverting to the historic budgeting process may result in the need to redirect a pooled position back to the Budget Office.

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