Legislative Budget Analysis

Proposed FY 2017 Operating and Capital Budgets

Office of the County Auditor

Baltimore County, Maryland

May 9, 2016

Retirement

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Questions to Department Sent	Wednesday, April 20
Responses Requested By	Wednesday, April 27
Responses Received	Friday, April 29*
Analysis Due for Review	Monday, May 2
Analysis Completed	Monday, May 9
*Analysis considers all agency responses.	

BALTIMORE COUNTY
FISCAL YEAR 2017 RECOMMENDED BUDGET

RETIREMENT AND SOCIAL SECURITY (041)

BUDGET SUMMARY
$ in Thousands

	GENERAL	SPECIAL	TOTAL	% Change Prior Year
PROPOSED CHANGE				
FY 2016 - 2017 Change	$ 12,745.0	-	$ 12,745.0	
BUDGET TRENDS				
FY 2015 Actual	$ 113,115.4	$ -	$ 113,115.4	
FY 2016 Approp.	110,432.1	-	110,432.1	-2.4%
FY 2017 Proposed	123,177.1	-	123,177.1	11.5%
FY 2017 Budget Analysis	**123,177.1**	**-**	**123,177.1**	**11.5%**
POTENTIAL REDUCTIONS	**TBD**	**$ -**	**TBD**	

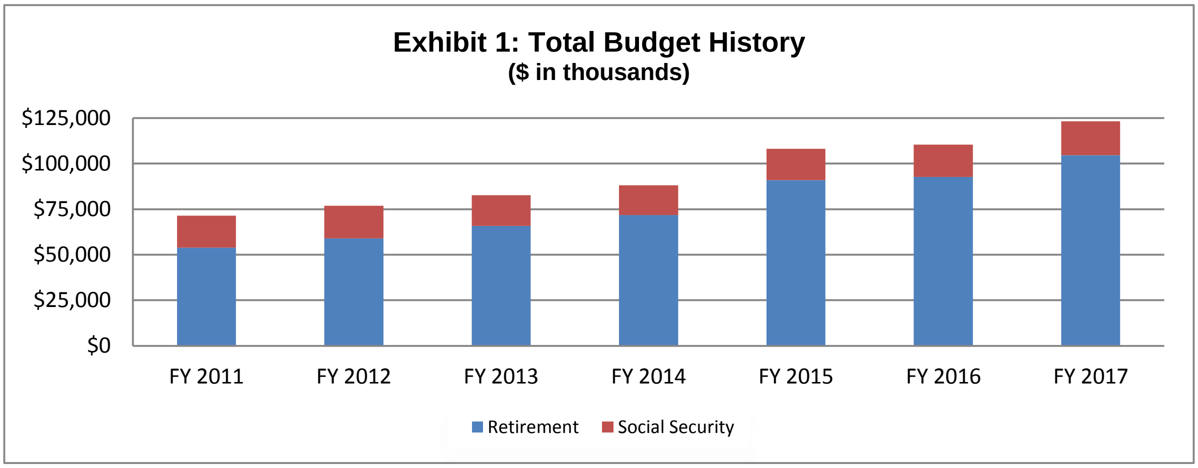
PERSONNEL

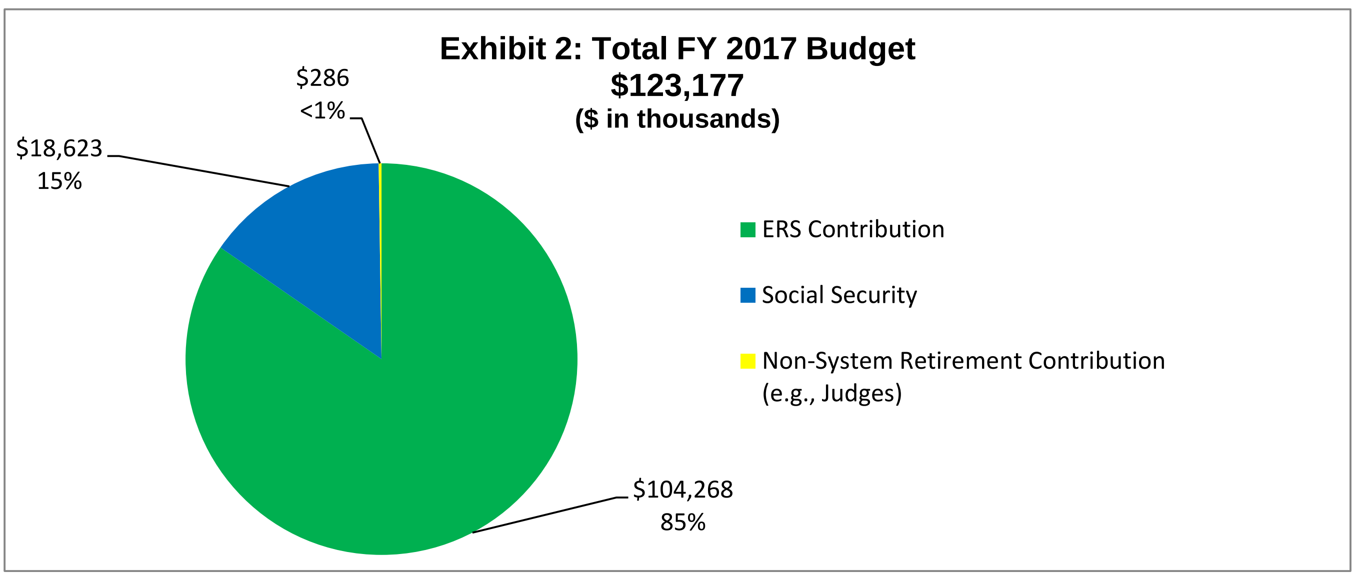
No personnel are funded in the Retirement and Social Security program budgets; rather, Retirement System personnel are paid out of the pension fund.

RETIREMENT AND SOCIAL SECURITY (041)

BUDGET SUMMARY:

The proposed FY 2017 budget for Retirement and Social Security totals $123.2 million, an increase of $12.8 million, or 11.5%, over the FY 2016 budget. The Retirement portion of the budget increases by $12.0 million, or 12.9%, primarily due to experience losses. The Social Security portion of the budget increases by $787 thousand, or 4.4%, due to an increase in FICA contributions associated with the budget's higher salaries. **See Exhibits 1 through 3 for additional detail.**





RETIREMENT AND SOCIAL SECURITY (041)

Exhibit 3
FY 2017 Proposed Budget ($ in 000's)

How Much it Grows:	Retirement [1]	Social Security	Total
2016 Appropriation	$ 92,596	$ 17,836	$ 110,432
2017 Request	104,554	18,623	123,177
$ Increase/(Decrease)	$ 11,958	$ 787	$ 12,745
% Increase/(Decrease)	12.9%	4.4%	11.5%

[1] Includes the Employees' Retirement System and non-system retirement plans* (Judges', Sheriffs', Board of Elections', and Volunteer Fire Widows' pension plans).

Why it Changes:

Retirement:

General Government, General Fund Portion of Increase……………………………………	$11,941
Non-System Plans* Benefit Payments……………………………………………………………	17
Total Retirement…..………………………………………………………………………..	11,958
Social Security…………………………………………………………………………………	787
Total:……………………………………………………………………………………………	$12,745

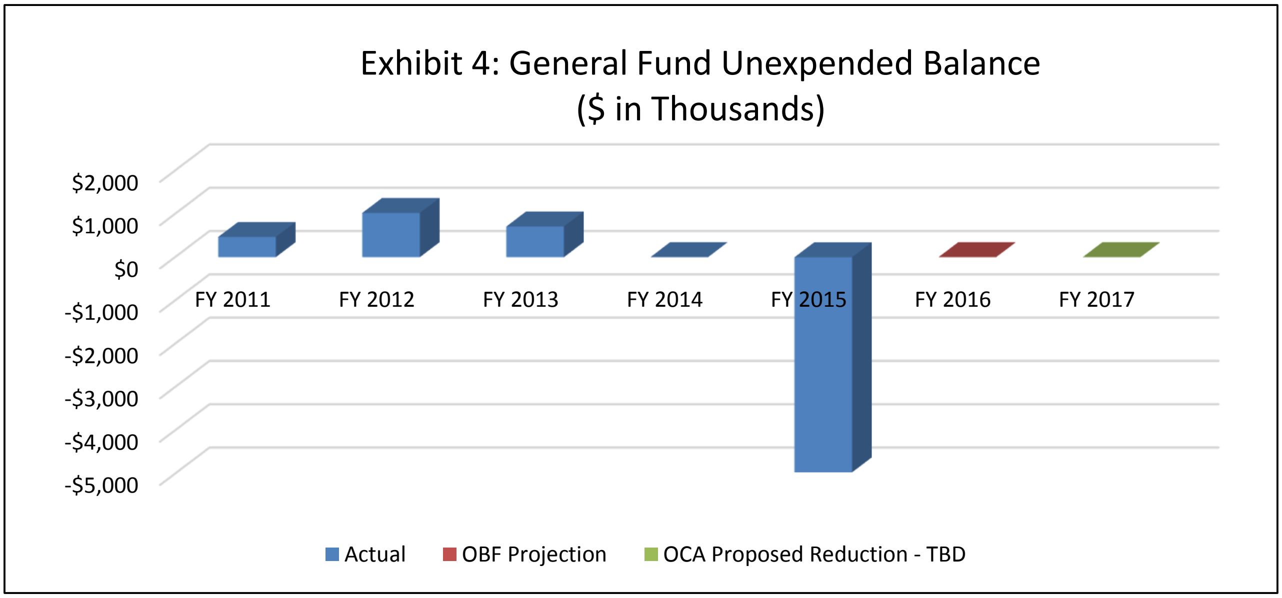
[1] Agency 041 includes the retirement contribution for General Government. The proposed budgets for Baltimore County Public Schools, the Community College of Baltimore County, and Baltimore County Public Library each include their respective funding for retirement contributions.

RETIREMENT AND SOCIAL SECURITY (041)

POTENTIAL BUDGET REDUCTIONS:

Budget Reductions TBD

The Retirement and Social Security budget has seen minimal or declining reversions in recent years. In FY 2015, additional funding was transferred to the Retirement budget in order to allow for full funding of the FY 2016 ARC, which was not known at the time the FY 2016 budget was adopted because of the change in actuaries. In FY 2016, the Office of Budget and Finance estimates it will fully expend budgeted funding.



Description (See detailed explanation below):	Reduction
1. Reduce Social Security corresponding to salary reductions taken (4107-0741)	TBD

Explanation:

1. To the extent that reductions are made to salary and salary-related expenses in agency budgets, an additional reduction equal to 7.65% of those reductions would be reflected in this account.

SIGNIFICANT PROGRAM/POLICY INITIATIVES AND/OR CHANGES

2. New Rate of Return on Investments $192,114

On July 10, 2012, the Board of Trustees (the Trustees) of the Baltimore County Employees' Retirement System (the System) voted to reduce the actuarial assumed rate of return on investments from 7.875% to 7.25%. This reduction was deemed necessary in order to ensure the future stability of the System, because when the assumed rate of return is consistently higher than the achieved rate of return, the System is at risk of being under-funded over the long term. The Office had advised that while the Administration felt that the rate should be lower than 7.25%, this rate was reasonable at that time. On April 8, 2014, the Trustees voted to reduce the assumed rate of return to 7.0% as of June 30, 2013, and on March 8, 2016, the Trustees voted to further reduce this rate to 6.75% as of June 30, 2015. The Administration has advised that the assumed rate of return will need to be reduced again in order to establish a realistic rate of return for the next 30 years. As part of each of these decisions to reduce the rate of return, the Trustees kept the 7.875% rate as the mechanism for funding the Post Retirement Increase Fund (see related Issue #4).

The County's actuary calculated that lowering the interest rate assumption to 7.25% increased the accrued liability of the portion of the System that was effectively closed to new membership as of July 1, 2007 by an estimated $255 million (present value). In order to fully fund this increased obligation, on October 15, 2012, the Council approved the issuance of up to $260 million in pension obligation bonds (POBs). The actuary calculated that further lowering the interest rate assumption to 7.0% increased the accrued liability of the System by an estimated $92.3 million (present value). This additional liability is being met through increased County contributions to the System. The recent reduction of the interest rate assumption to the current rate of 6.75% increased the accrued liability of the System by an estimated $102 million (present value), according to the actuary. This additional liability is also being met through increased County contributions to the System. However, the FY 2017 payment toward the System's unfunded actuarial liability was restarted on a 30-year amortization schedule, resulting in a smaller FY 2017 contribution, and the savings from this change in methodology paid for most of the increase in the FY 2017 contribution resulting from the decrease in the interest rate assumption. Therefore, the County's FY 2017 contribution includes an increase of just $192,114 attributable to the reduction of the interest rate assumption to 6.75%.

Bill 22-16 on the May 26, 2016 agenda requests Council approval of the issuance of up to $150 million in POBs. The Administration has advised that such POBs, the proceeds of which would be used to further reduce the interest rate assumption, would only be issued if economic conditions are favorable.

The System experienced a 1.3%, gross-of-fee return on investments in FY 2015, which, when taken with the losses and gains over the last 10 years, yields a 5.6% actuarial rate of return. This rate is still significantly less than the new actuarial assumed rate of return of 6.75%.

Other local jurisdictions with pension plans employ similar, though higher, rate-of-return assumptions, including Baltimore City and Anne Arundel, Howard, and Carroll counties, which used actuarial assumed rates of return of 7.75%, 7.5%, 7.5%, and 7.0%, respectively, as of their most recent actuarial valuations. The State uses an actuarial assumed rate of return of 7.55%. Note that both Howard County and the State reflect lower rates as of June 30, 2015 than as of June 30, 2014, when their rates were 7.75% and 7.65%, respectively.

The Office should be prepared to discuss:

- ***Plans regarding the timing of a further reduction in the assumed rate of return; and***
- ***The favorable economic conditions under which the requested POBs might be issued, as well as the likelihood that this will occur.***

3. Change in Employee Contribution rates

The Administration is requesting Council approval of a Retirement bill (Bill 37-16 on the May 26, 2016 agenda). This bill makes changes to certain member contribution rates based on agreements with the labor unions and management (non-represented groups). The agreements serve to flatten all member contribution rates over the next three fiscal years (FY 2017 through FY 2019), which resolves the EEOC age discrimination lawsuit prospectively. The Office has advised that the settling of damages related to the EEOC lawsuit has not been resolved and is expected to be resolved in court. The bill also increases contribution rates overall, and the Administration has advised that once these increases are fully phased-in (in FY 2019), the

System will receive a net amount of approximately $3 million in additional employee contributions each year.

The Office should be prepared to discuss:

- ***The impact of the 2% COLA on the System (compared to the additional $3 million that the System will receive each year as a result of the increased employee contributions); and***
- ***Any estimates for the cost of resolving the damages related to the EEOC lawsuit.***

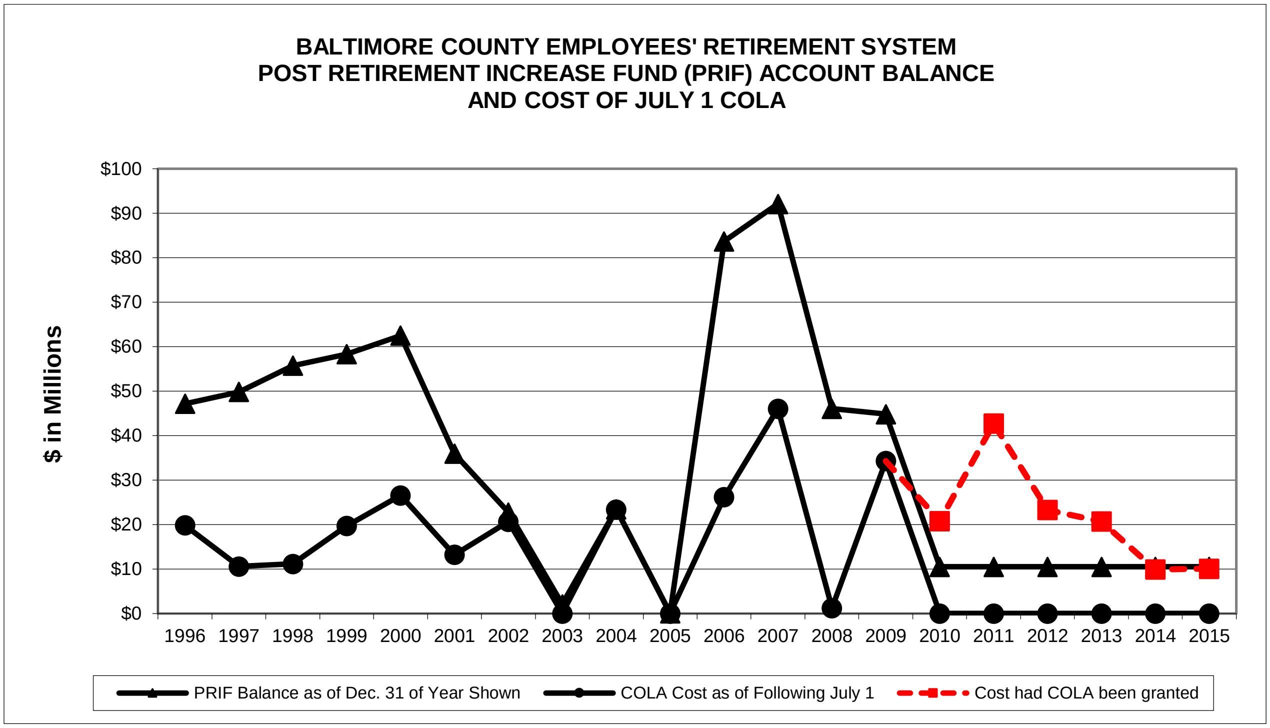
OTHER ISSUES

4. <u>0% COLA for Retirees on July 1, 2016</u>

The County's current pension law (Baltimore County Code, Section 5-1-235) provides that after 60 months of retirement, retirees are entitled to a cost-of-living-adjustment (COLA) increase to their pension checks each July 1 based on the annual increase in the Consumer Price Index – All Urban Consumers – United States City Average – All Items (CPI-U) as of the previous December 31 (up to a maximum 3%) if sufficient funds are available in the Post Retirement Increase Fund (PRIF). If the funds are insufficient to provide at least a 1% increase, then no increase is granted. This coming fiscal year is the sixth consecutive year, and the eighth year since FY 2004, that retirees have been denied a COLA due to insufficient funds in the PRIF. The seven other times were for fiscal years beginning July 1, 2004, 2006, 2011, 2012, 2013, 2014, and 2015.

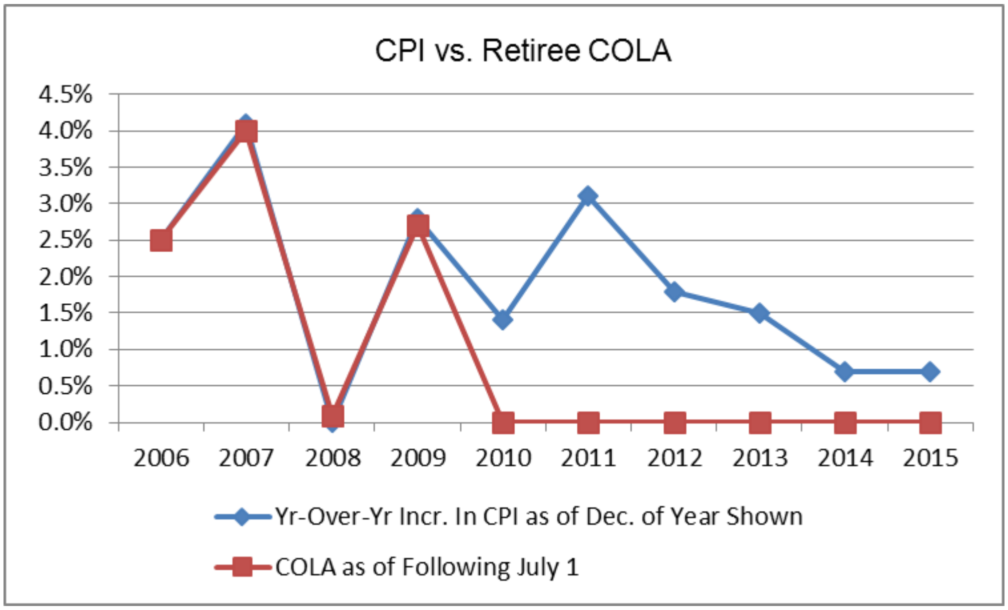
The increase in the CPI-U from December 2014 to December 2015 was equal to less than 1%. The estimated cost of a 1.0% increase in retirement allowances effective July 1, 2016 is $14.5 million. The PRIF balance as of December 31, 2015 is insufficient to cover this estimated cost. Therefore, no increase will be granted on July 1, 2016. The following graph illustrates the historical PRIF account balances and COLA costs.

RETIREMENT AND SOCIAL SECURITY (041)



The PRIF account balance has remained unchanged in recent years because the PRIF is funded through the System's excess investment earnings, meaning that funds are only transferred into the PRIF if the investment return on the System's 10-year smoothed actuarial value of assets for the previous calendar year exceeds 7.875%. Despite recent reductions in the System's assumed rate of return, the Trustees have decided to keep the 7.875% rate as the mechanism for funding the PRIF (see related Issue #2). The System experienced significant investment losses in CY 2008 resulting from the economic downturn, and because of the 10-year smoothing period, the System's investment return continues to be impacted by these losses. In CY 2015, the return on the System's 10-year smoothed actuarial value of assets was 4.8%, lower than both 7.875% and the new assumed rate of return of 6.75%.

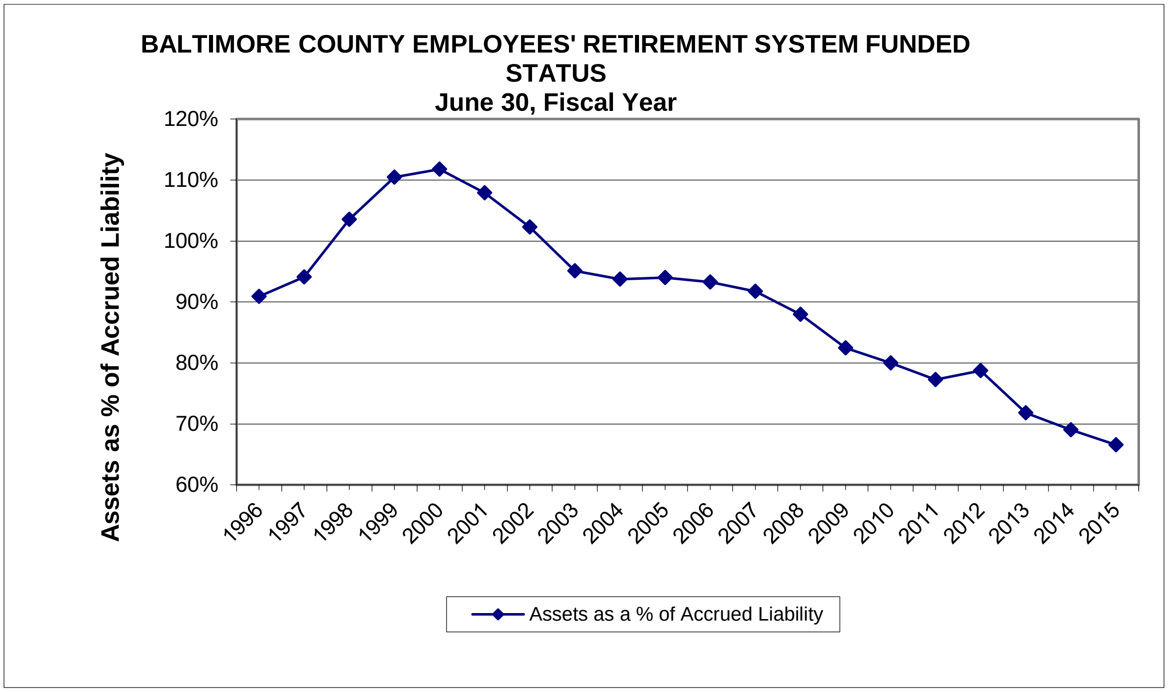
The absence of COLAs in recent years has had an impact on retirees. For example, a retiree who received a pension of $10,000 in FY 2006 would be receiving a pension of $10,959 in FY 2017. However, if that same retiree had received COLAs equivalent to the year-over-year increase in the CPI-U from the previous December in each of the last 10 years, his or her pension would total $12,015 in FY 2017. In today's dollars, this retiree's buying power has declined by $1,057 over the last 10 years. The following graph shows the increase in the CPI-U compared to the COLAs granted to retirees over the last 10 years.



The Office should be prepared to discuss whether any consideration has been given to amending the retirement law to allow a COLA to be granted without the prerequisite that there be at least a sufficient amount of funding to provide a 1% increase, as well as the effects of such a potential change on the System's accrued liability and ARC.

RETIREMENT AND SOCIAL SECURITY (041)

5. The System's Financial Condition

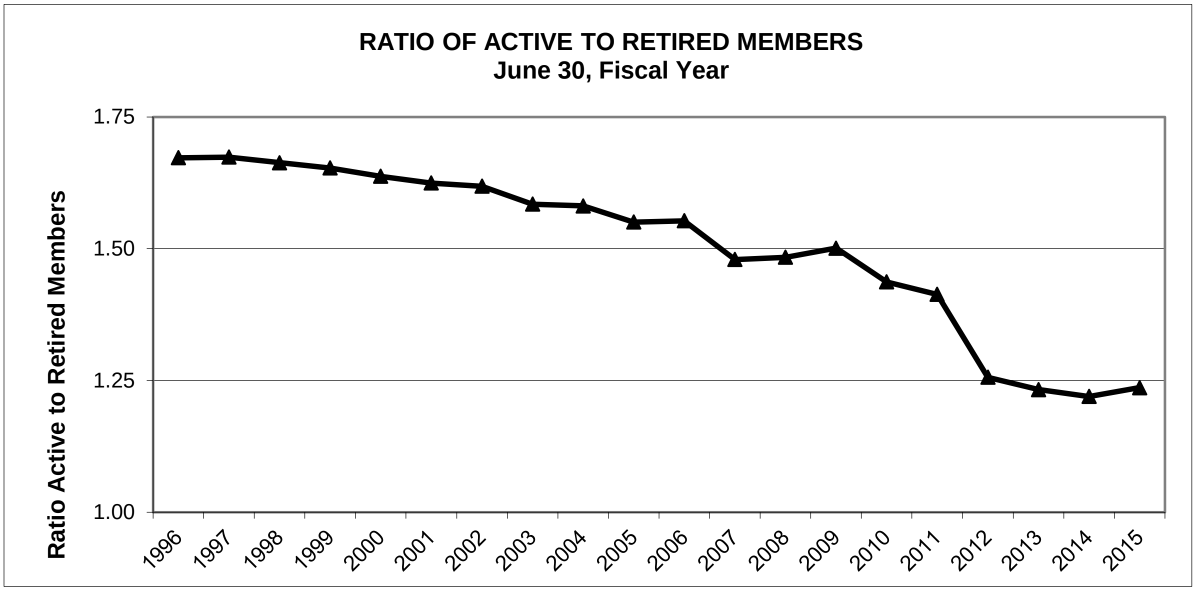


The funded status of the System at the end of FY 2015 was 66.6%, down from 69.1% at the end of FY 2014, and considerably lower than the funded status at the end of FY 2000 when it reached a peak of 111.8%. The decline in funded status in FY 2015 was attributable to the lowering of the interest rate assumption from 7.0% to 6.75%. The Administration has advised that if the System's interest rate assumption remained unchanged at the pre-FY 2013 level of 7.875%, the System's funded status would be approximately 80%.

Expressing plan net assets as a percentage of the actuarial accrued liability provides one indication of the System's funded status. Analysis of this percentage over time indicates whether the System is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the System.

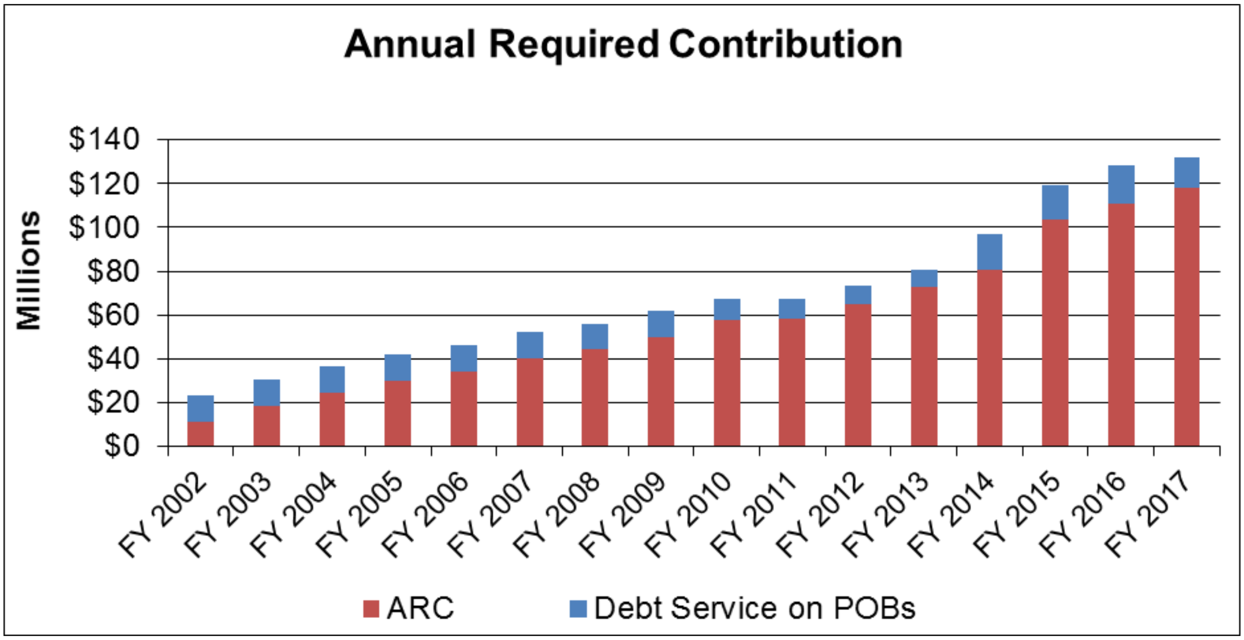
One factor that contributed to the decline in the System's funded status during the last decade is the active to retired member ratio. The retirement system is maturing with 9,412 active members and 7,613 retirees (a ratio of 1.24 to 1) as of June 30, 2015. The 311 employees (including one

Revenue Authority employee) who retired in FY 2012 under the Retirement Incentive Program caused this ratio to decline significantly between June 30, 2011 (when the ratio was 1.41 to 1) and June 30, 2012 (when the ratio was 1.26 to 1). The following graph illustrates the ratio of active to retired members in the System over the past 20 years.



A second measure of the System's financial health is an expression of the unfunded actuarial accrued liability (the difference between liabilities from prior years and the value of current assets to fund those liabilities) as a percentage of annual covered payroll. This measure approximately adjusts for the effects of inflation and aids analysis of the System's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the System. The unfunded actuarial accrued liability as a percentage of annual covered payroll increased to 226.8% as of June 30, 2015, up from 217.5% as of June 30, 2014.

As the System has grown financially weaker, the total annual required contribution (ARC) has increased more than ten-fold since FY 2002 to $118.2 million in FY 2017. In addition, debt service payments on the County's pension obligation bonds (POBs) have increased significantly following the FY 2013 issuance of $255 million in POBs. In FY 2017, the ARC and the debt service payments on the County's POBs combine to total $131.8 million, or 6.6% of the FY 2017 General Fund budget. This percentage is almost twice what it was 10 years ago, when the ARC and debt service on POBs made up just 3.4% of the FY 2008 General Fund budget. The following chart shows the increase in both the ARC and the debt service on the County's POBs since FY 2002.



The Office should be prepared to provide:

- ***The long-term outlook for the System's financial condition and the contribution costs to the County and employees;***
- ***The impact that the proposed FY 2017 COLA will have on the accrued liability of the System as well as the ARC; and***
- ***The calculations that support the Administration's statement that if the System's interest rate assumption remained unchanged at the pre-FY 2013 level of 7.875%, the System's funded status would be approximately 80%.***

6. <u>Pension Administration Software Replacement – CPAS</u>

On August 1, 2013, the County implemented a new pension administration and record-keeping application, CPAS, replacing its long-time system, Pension Gold. The Office advised that a new system was necessary because of various issues with data retention, rate calculation, and manual intervention with Pension Gold. The new system is expected to increase productivity and efficiency and improve customer service while replacing manual calculations and an unsupported software. Additionally, the new web-based design will enable members to view and change their account information (e.g., contact information) online and independently.

Annual maintenance costs for the new software approximated $52,000 in each of the first 2 years. The Office of Information Technology's (OIT's) FY 2016 budget included $52,780 for the software maintenance fee; however, OIT has advised that this item was under-budgeted by approximately $48,000 due to additional annual support and maintenance costs. Therefore, OIT's FY 2017 budget includes $102,008 for annual maintenance and support costs for CPAS.

In addition, OIT previously advised that post-implementation activities, including data validation, software corrections, and additional training were necessary at an additional cost to the County. The Office of Budget and Finance also advised that the data validation process remains ongoing, with the next "build" that incorporates important fixes scheduled to be submitted in mid-May. Provided that everything goes according to plan, the Office further advised that most employees will be able to view their pension information online starting July 1st. Sworn Police and Fire personnel as well as Corrections and Sheriff employees should be able to view their pension information online starting August 1st due to additional data validation that is necessary in order to ensure accurate treatment of their additional service time earned from purchase of prior service, transfer of service from another jurisdiction, and/or prior military service.

In light of the delay in the implementation of the online portal, most employees received paper statements by mail in FY 2016, as encouraged by the Council in its FY 2016 Budget Message. The Office of Budget and Finance advised that the creditable service reported on these statements was incorrect for Sworn Public Safety personnel because it did not accurately account for the previously mentioned additional service time. Because similar errors were expected to occur in the statements for Corrections and Sheriff employees, the Office advised that these employees will receive their FY 2016 statements once their data is validated. The Office further advised that FY 2016 statements for department heads and elected officials will be mailed shortly. The Office intends to issue paper statements again in FY 2017, regardless of the availability of online access to pension information, so that all employees can have an accurate statement that corresponds to the information available through the online portal.

The Office should be prepared to discuss:

- ***The total cost of all post-implementation activities, including data validation; and***
- ***How employees will be trained in the use of the new online portal.***

7. Teacher Pension Costs

The proposed FY 2017 budget for BCPS includes $31.6 million to fund the cost of teacher pensions, based on projections by the State Retirement Agency. This amount represents an increase of $6.8 million over the cost of teacher pensions in FY 2016, the final year of the phase-in of the teacher pension cost shift. In FY 2012, when the cost shift was enacted by the General Assembly, the County's FY 2017 cost was estimated at $28.7 million. According to the Department of Legislative Services, the increase in the projected FY 2017 cost for local jurisdictions is a result of assumption changes enacted by the Board of Trustees of the State Retirement and Pension System. Presumably, the County's FY 2018 teacher pension cost will also reflect an increase due to the payroll growth resulting from the FY 2016 COLA. The FY 2017 COLA will not impact teacher pension costs until FY 2019.

Although teacher pension costs are shown in the budgets of local boards of education, county governments are responsible for paying this expense through an increase in their Maintenance of Effort (MOE) requirement. A county that does not meet its MOE requirement is subject to an offset of its local income tax by the State with the amount owed directly diverted to the school system. In order to partially offset the impact of this cost shift, in FY 2013 the State began providing counties with a Teachers Retirement Supplemental Grant. The County received $3 million from this grant in FYs 2013 through FY 2016, and the State's FY 2017 budget maintained that funding.

The Office should be prepared to discuss the impact to the County of the additional teachers' pension liability associated with the FY 2016 COLA as well as the proposed 2% COLA for FY 2017.

BALTIMORE COUNTY
FISCAL YEAR 2017 RECOMMENDED BUDGET

RETIREMENT & SOCIAL SECURITY (041)

APPROPRIATION DETAIL

	2015 ACTUAL	2016 APPROP	2017 REQUEST	NET CHANGE AMOUNT	NET CHANGE %
4102 Employees' Retirement Cont.	$ 95,362,831	$ 92,327,520	$ 104,268,499	$ 11,940,979	12.9%
4107 Social Security Contribution	17,497,380	17,836,000	18,623,000	787,000	4.4%
4109 Non-System Retirement	255,199	268,600	285,600	17,000	6.3%
General Fund Total	$ 113,115,410	$ 110,432,120	$ 123,177,099	$ 12,744,979	11.5%

FISCAL YEAR 2017 RECOMMENDED BUDGET

RETIREMENT & SOCIAL SECURITY (041)

PERSONNEL DETAIL

	FY 2015 ACTUAL		FY 2016 APPROP		FY 2017 REQUEST		NET CHANGE	
	FULL	PART	FULL	PART	FULL	PART	FULL	PART
Employees' Ret. System [(A)]	-	-	-	-	-	-	-	-

[(A)] No personnel are funded in the Retirement and Social Security program budgets; rather, Retirement System personnel are paid out of the pension fund.