Early Retirement Incentive Program Study #4 and Amortization Period

LACERS

Ad Hoc Committee

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Early Retirement Incentive (Window)

- Fourth in a series of studies requested by LA City (CAO and Mayor's Office)
  - ERI Program Study #4, July 30, 2009
- Five membership Groups each receive one of five benefit "Scenarios"
  - Groups 1 through 5 described on page 4
  - Benefit Scenarios A through E on page 5
- Two "take rate" alternatives
- Also "backfill" rates (used only for projections)

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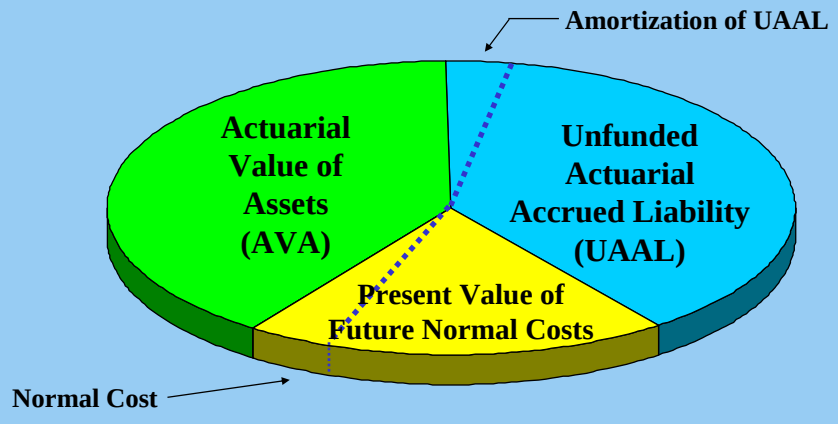
Normal Cost and UAAL Cost



Measuring the Cost of an ERIP

- Must consider changes in both contribution rate (% of pay) and in contribution amount
- Reduction in force generally lowers cost in dollars but increases cost rate
  - Same normal cost rate applied to smaller payroll
  - Same (pre-ERIP) UAAL cost dollars spread over smaller payroll means higher UAAL cost rate
- ERIP benefit increases UAAL cost dollars and UAAL cost rate (as a % of post-ERIP payroll)

Effect of ERIP on UAAL, UAAL Cost

- UAAL and UAAL cost increases for two reasons
  - Members retire earlier than assumed, increasing value of pre-ERIP benefit
  - Member received additional benefit from extra age and/or service
- UAAL cost issues in first year (2009-10)
  - UAAL rate set in 2008 valuation to produce fixed UAAL cost based on pre-ERIP payroll
  - UAAL rate applied to lower payroll
    - Temporary savings underfunds pre-ERIP UAAL

Effect of ERIP on Normal Cost, Payroll

- Normal Cost rate generally unchanged
- Normal Cost dollars decrease with payroll
- Normal Cost and payroll "savings" hard to specify
  - Would positions have been eliminated anyway?
    - For example, GFOA 2004 Recommended Practice: "Regarding financially driven ERIs, a cost/benefit analysis should compare long-term benefits and costs against the default scenario of a hiring freeze."
  - Even if not, how long do "savings" continue?
    - As long as positions stay vacant? ("backfill" rates)
    - Only until ERIP members would have retired anyway?

Basic Funding Considerations

- Increased benefits means increased costs
- Increase in UAAL increases the City contributions
  - Relatively easy to measure once members elect
- Possible offsets to increased City contributions
  - Increased member contributions
    - Either to LACERS or to City
  - Salary concessions
    - Pay reductions, deferred COLAs

Valuation results (estimated for 2009)

- Alternative 1 Take Rates (2,229 ERIP members)
  - Payroll decrease: $175 million
  - **UAAL increase*: $250 million**
  - Change in Contribution rate:
    - Due to reduction in payroll: 1.46%
    - Due to ERIP benefit**: 1.07%
  - Change in Contribution dollars:
    - Due to reduction in payroll: ($24.95 million)
    - Due to ERIP benefit**: $20.14 million

* Excludes cash incentives of $43 million

** Based on 15 year amortization

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Valuation results (estimated for 2009)

- Alternative 2 Take Rates (2,763 ERIP members)
  - Payroll decrease: $215 million
  - **UAAL increase*: $354 million**
  - Change in Contribution rate:
    - Due to reduction in payroll: 1.86%
    - Due to ERIP benefit**: 1.51%
  - Change in Contribution dollars:
    - Due to reduction in payroll: ($30.10 million)
    - Due to ERIP benefit**: $27.95 million

* Excludes cash incentives of $51 million

** Based on 15 year amortization

Preview of Alternative Periods

- 5 methods/rationales in LACERS staff report
  1. Period of salary savings compared to layoff scenario: **0 years** (immediate payment since no salary savings)
  2. Average period of salary savings until expected retirement: **5 years**
  3. Average period of salary savings until positions backfilled: **8 years**
  4. Average period of additional ERIP benefit cashflows: **10 years**
  5. Typical practice for general (non-ERIP) past service increase: **15 years**

Amortization Period for ERIP UAAL

- Current policy is 30 years for benefit improvements
- Model practice is linked to member demographics
  - Average future service or life expectancy
  - 15 years is typical for a past service benefit increase
- Special considerations for ERIP/Window benefits
  - Linked to period of ERIP related savings
  - For example, GFOA 2004 Recommended Practice: "The incremental costs of an ERI should be amortized over a short-term payback period, such as three to five years. This payback period should match the period in which the savings are realized"

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Amortization Period for ERIP UAAL

- Consider salaries that would have been paid to ERIP members if they had retired when assumed
  - Measure average, salary weighted "duration"
    - Can also weight Groups/Scenarios by UAAL
  - Link amortization period to that duration
- Under Alternative 1 Take Rates (2,229 ERIP members)
  - Average savings is from 4.3 to 5.1 years of salaries
- Under Alternative 2 Take Rates (2,763 ERIP members)
  - Average savings is from 4.7 to 5.4 years of salaries
- Basis for staff recommendation of 5 years

Alternative ERIP Amortization Period

- Alternatively, consider salaries savings from ERIP date as long as position stays vacant
  - Regardless of when member would have retired
- Depends critically on "backfill rate"
  - 7% for first year, 6% for 2nd to 15th year
  - 91% of the group replaced at 16th year
- Average duration of salary savings is about 8 years
  - Much less than 15 years because savings decrease immediately, only 9% savings remaining in 15 years

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Alternative ERIP Amortization Period

- Alternatively, consider duration of additional benefit payments under the ERIP
  - Compare expected payments before and after ERIP
  - Earlier retirements and additional age & service
- Average duration is about 10 years
  - Independent of "backfill rate"
  - Average is less than full length of payments because payments decrease over time

Review of Alternative Periods

- 5 methods/rationales in LACERS staff report
  1. Period of salary savings compared to layoff scenario: **0 years** (immediate payment since no salary savings)
  2. Average period of salary savings until expected retirement: **5 years**
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Alternative ERIP Amortization Costs

- Alternative 1 Take Rates (2,229 ERIP members):
  - **UAAL Increase: $250 million**

Amortization period:	5	8	10	15
Amortization cost:	2.86%	1.85%	1.51%	1.07%

- Alternative 2 Take Rates (2,763 ERIP members):
  - **UAAL Increase: $354 million**

Amortization period:	5	8	10	15
Amortization cost:	4.10%	2.64%	2.15%	1.51%

- Actual costs depend on final group of actual ERIP members

Funding ERIP with Member Contributions

- Suppose intent is to have members fund the ERIP
  - Increase in UAAL plus cash incentives
  - Well defined once actual ERIP elections are known
- Member cost could differ from City costs in report
  - Start date and timing of member contributions
  - Member contributions are refundable
  - Payback period for member funding of ERIP
    - Not necessarily the same as UAAL amortization period

Alternative ERIP Member Payback Costs

- Alternative 1 Take Rates (2,229 ERIP members):
  - **UAAL Increase: $250 million**

Payback period:	5	8	10	**15**
Additional member cost*:	3.10%	2.02%	1.66%	**1.19%**

- Alternative 2 Take Rates (2,763 ERIP members):
  - **UAAL Increase: $354 million**

Payback period:	5	8	10	**15**
Additional member cost*:	4.45%	2.90%	2.39%	**1.70%**

* Actual costs depend on final group of ERIP members. "Refundability" will increase above costs.

UAAL amortization vs member payback period

- Two separate decisions, with some interrelation
  - UAAL amortization is between LACERS and City
  - Payback period is between City and members
- Already no perfect match between the two
  - One year lag for UAAL amortization
  - Two year lag for member repayments
- Possibly different rationale for payment periods
- Member payments at 0.75% do not fund entire UAAL
  - Other savings may be considered by City