

Nevada County's Ability to Meet Future Pension Obligations

2023-2024 Nevada County Civil Grand Jury

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Table of Contents

Summary	2
Glossary	2
Background	2
Approach	3
Discussion	3
A. NEVADA COUNTY’S PENSION SYSTEM	3
B. CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM (CALPERS)	4
C. IMPORTANT NEGATIVE EVENTS	4
D. RESULTS OF THE NEGATIVE EVENTS	5
E. THE PRESENT PICTURE	7
Findings	9
Recommendations	9
Request for Responses	9

Summary

The Nevada County employee pension plan, which the county allows the California Public Employees Retirement System (CalPERS) to manage, once had a surplus. Today, it has a considerable deficit that increases every year: only about 68% of funds necessary to pay accumulating pension expenses are on hand. This change has occurred because CalPERS’s investment strategy over the past 20 years has failed. The 2023-2024 Grand Jury wonders why, in light of CalPERS’s continued underperformance, Nevada County has elected to remain in CalPERS. CalPERS, however, is not responsible for paying pensions; the counties that rely on CalPERS’s investments are responsible. Counties get their revenues from taxpayers, so county debt is ultimately taxpayer debt.

Glossary

Jury	2023-2024 Nevada County Civil Grand Jury
CalPERS	California Public Employees Retirement System
Entitlements	Benefits an employee has a right to receive upon retirement
PEPRA	Public Employees’ Pension Reform Act
Pension pot	The value of invested pension contributions of employers and employees as it rises and falls with the market
ROI	Return on Investment

Background

The 2017-2018 Nevada County Civil Grand Jury (2017-18 Jury) issued a report that highlighted the problem of accumulating unfunded pension liabilities. The 2023-2024 Jury decided to revisit the topic to see whether the current outlook is better.

A pension plan, in its simplest form, is how employer and employees provide employees with post-retirement financial security through periodic payments. They do this by contributing to a pension fund that the employer (or a fund manager that the employer hires) holds. For California counties, the state imposes some pension-fund requirements through legislation, and a county adopts others. Numerous factors affect the county's ability to meet future pension entitlements.

The California Public Employees Retirement System (CalPERS) began in 1932 to administer pension programs for government employees. CalPERS administers all Nevada County employee pension funds.¹ Employers and employees contribute based on the individual employee's salary and length of service. CalPERS accumulates and invests those contributions. Those investments and the returns on those investments (ROI) fund pensions. If the invested funds exceed accumulating pension entitlements, then there is a surplus, as there was prior to the Great Recession of 2007-2009. CalPERS investment portfolio peaked at \$260 billion then and exceeded pension-payment obligations. However, if the invested funds fall short of accumulating pension entitlements, there is a deficit—an unfunded liability. After the Great Recession, CalPERS portfolio had plunged to \$160 billion, a drop of 38.5%.

Approach

The previous grand jury report considered retirement programs at all county- and sub-county levels of government; this report focuses solely on county-level pensions. The 2023-2024 Jury examined county financial records, interviewed county personnel, researched other public information, and reviewed the previous report with particular attention to the issues that report said contribute to then-current and projected unfunded-liabilities problem.

Discussion

A. NEVADA COUNTY'S PENSION SYSTEM

The Nevada County Pension System retirement pensions are available to all full-time, eligible employees. Employees have a right to receive a fixed amount of money each month following retirement. The employee's years of service and salary determine the size of the pension payment. Employers' and all employees' contributions go into a single account, which one might think of as a "pension pot."

Pension-pot funds do not sit in a safe someplace. Recognizing that economies tend to grow over the long term, the administrator invests the pension pot to achieve a satisfactory return on investment. (ROI). Markets do not always rise in an unbroken line, of course, but experience shows that despite setbacks (some severe, such as the market crash of 1929), markets do rise over long periods of time. The pension pot's value ebbs and flows with markets fluctuations. If ROI meets or exceeds markets increases over time, the pension pot is healthy; it has enough funds to meet current and future pension obligations. Sometimes, ROI falls short of that target. One expects such events in the short term. If they continue over time, the pension pot becomes less healthy—less able to make meet current and future obligations. Thus, investment strategy and return are critical to pension-pot health.

¹ At least 20 counties have opted out of CalPERS pension-fund administration, but Nevada County remains in it.

B. CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM (CALPERS)

California has 58 counties, and there are obvious inefficiencies in having 58 separate systems administering pension pots. In 1932, the California legislature created CalPERS to administer pension plans for government employees of all participating counties. CalPERS administers all Nevada County pension funds, meaning that instead of Nevada County or its employees making investment decisions for its pension pot, CalPERS makes them. Thus, CalPERS does on a state-wide basis what individual counties would otherwise have to arrange for themselves: accumulating and investing payments to the pension pot with the goal of at least keeping pace with current and future pension obligations over the long term. Originally, state law limited CalPERS to very conservative investments—investments such as government bonds that are relatively insulated from market fluctuations.² The pension pot grew, slowly but steadily.

Employer and employee contributions to the pension pot are cash. CalPERS invests pension-pot cash in securities that have values that rise and fall according to supply and demand. For example, stock selling at \$60/share today may sell at only \$55/share tomorrow or may sell at \$65/share tomorrow, varying with supply and demand. At any time, the pension pot equals the value of the investments plus (or minus) the ROI.

If pension-pot value at any time exceeds accumulating pension rights, then there is a surplus—a healthy pension pot. On the other hand, if pension-pot value falls short of accumulating pension rights, the pension pot is less healthy. When current and future pension obligations exceed pension-pot value plus reasonably anticipated ROI, the difference is unfunded liability.

C. IMPORTANT NEGATIVE EVENTS

For many years, CalPERS investments did very well, generating a surplus. The pension pot exceeded future required payment obligations. CalPERS did so well that in the late 1990s, the state decided to make three changes.

1. It provided retroactive retirement-benefit increases.
2. It reduced the retirement age—the age at which long-term employees were eligible to begin receiving pensions, which reduced total employee contributions. For example, if the retirement age drops from 65 to 62, employees who retire three years early under the new system no longer make contributions and begin drawing their pensions, further depleting the pension pot.
3. It allowed CalPERS to employ a broader range of investments—that might allow for greater returns but also came with higher risk of losses.

Those changes assumed a growing economy. Having a surplus, such as CalPERS did in the 1990s, can help any system cushion the short-term effects of economic fluctuations. That does not mean that one should never spend any surplus money, but doing so reduces the size of the surplus, and economies do not always proceed smoothly.

When the dot-com bubble burst early in this century, the pension pot shrank. The changes California implemented in the late 1990s began to strain the system. The dot-com bubble was not the last jolt either.

² Conservative investments represent the investor's decision to forgo potential large market gains in exchange for being sheltered from large market losses.

Before the Great Recession of 2007-2009, CalPERS investment portfolio peaked at \$260 billion dollars, and generated high ROIs. After the Great Recession, CalPERS portfolio was worth only \$160 billion, a drop of 38.5%, and the pension pot declined accordingly. What had been a surplus became a deficit.

CalPERS's original investment plan achieved steady ROIs, far less affected by economic fluctuations than less safe investments. The third legislative change in the 1990s, which allowed CalPERS to invest more broadly, has been unsuccessful. Unfunded liabilities rose, and they continue to rise. The results of CalPERS's new investment strategy are disappointing.

In response, California passed the Public Employees' Pension Reform Act (PEPRA), which took effect in January 2013. It changed CalPERS retirement and health benefits available to new employees and placed compensation limits on current employees. (CalPERS admits that new employees feel the greatest effect of these changes.)

CalPERS also established mandatory 20-year amortization payments from participating counties to address the growing unfunded-liabilities problem. The amortization-payment amounts represent what CalPERS believes will return the pension to fully funded status in 20 years. CalPERS recalculates required amortization payments annually. CalPERS's ROI goal is 7.75%, but on average, its portfolio has underperformed over the last decade. When the portfolio returns less than the target, the unfunded-liabilities problem grows. To compensate for that, CalPERS increases counties' annual amortization payments. Thus, tracking county amortization payments in successive years gives an indirect picture of CalPERS's performance.

But CalPERS has no obligation to pay pensions; those obligations remain with the taxpayers of the counties that use CalPERS as their investment agent. Counties' liabilities are ultimately taxpayer liabilities. Although CalPERS is Nevada County's chosen agent for managing the pension plan, the responsibility to pay the pensions when due is ours.

The county has made CalPERS-required amortization payments without interruption. The county has also created a trust to segregate funds dedicated to pension uses for the purpose of moderating fluctuations in required amortization payments. If there is unspent revenue from the budget at the end of the fiscal year, the county funds the trust by depositing some portion of that revenue in it. Expecting regular budget surpluses is not realistic, and the county invests trust assets conservatively to minimize financial risk, which protects the trust's principal but also limits its ROI. Thus, the trust is not a major funding source.

County officials have considered issuing bonds to address the problem, but that sword is double-edged. In a rising market, bond issues are good for the issuer but bad for investors in the bonds because the investors cannot reap the benefits of market increases. A falling market reverses that situation; bonds are good for investors because they insulate investors from the decline. They are bad for bond issuers because bonds are a fixed obligation to pay; the payments do not go down as the market goes down. When there is a deficit, issuing bonds is unlikely to help erase it. On balance, the county regards having a bond issue as too risky to be prudent.

D. RESULTS OF THE NEGATIVE EVENTS

The prior jury report noted Nevada County unfunded liabilities of \$143,511,040 as of June 30, 2016. This year (2024), the unfunded liabilities are \$222,955,318. The 2016

amortization payment was \$16,934,949. This year’s amortization payment is \$20,454,679. Over the past eight years, the county’s ability to meet future pension payments has declined.

Date	Unfunded Pension Liabilities	Amortization Payment
June 30, 2016	\$143,511,040	\$16,934,949
June 30, 2024	\$222,955,318	\$20,454,679

CalPERS’s return was lower than anticipated in 2023, causing unfunded liabilities to increase. Right now, only 68% of needed funds are available.

Net Pension Loss (NPL) is the difference between how much a county should be saving to cover future pension obligations and how much it has actually saved. CalPERS originally targeted 20 years to return to fully funded status and set county amortization payments accordingly. CalPERS set amortization payments based on its *expected* ROI, but continuing underperformance of CalPERS’s portfolio has pushed the recovery date back and required increases in each year’s amortization payments. The following chart shows the trend in required payments to CalPERS and the percentage of Nevada County’s annual budget devoted to those payments.

A	B	C	D	E
Fiscal Year Ending	Nevada County Unfunded Liability	Nevada County Total Revenue	Unfunded Liability Amortization Payment	Percentage of Nevada County Revenue
6/30/2015	\$117,142,264	\$156,023,184	\$9,508,354	6.09%
6/30/2016	\$121,883,869	\$160,203,830	\$11,504,051	7.18%
6/30/2017	\$142,013,974	\$172,843,855	\$14,166,315	8.20%
6/30/2018	\$156,241,618	\$185,373,845	\$14,974,655	8.08%
6/30/2019	\$157,811,061	\$188,584,249	\$16,345,792	8.67%
6/30/2020	\$168,446,468	\$204,787,521	\$17,561,506	8.58%
6/30/2021	\$178,388,939	\$226,401,732	\$19,276,099	8.51%
6/30/2022	\$131,901,645	\$234,312,944	\$20,846,126	8.90%
6/30/2023	\$200,440,179	\$261,920,434	\$22,769,808	8.69%

Columns B through E each tell a story. Column B shows that Nevada County’s unfunded liability grew from 2015 through 2021 but dropped in 2022 because CalPERS (the pension pot) had a good ROI that year. Over that period the net increase in unfunded liability was 12.6%. Column C shows an unbroken rise in county revenues, amounting to 50.2%. If those were the only relevant figures, the outlook would be good, but county revenues go to many things other than unfunded-liabilities; they fund all county services.

Columns D and E each tell their own story. As of June 30, 2015, CalPERS expected that 20 years of annual county payments of \$9,508,354 would erase the county’s unfunded-liability debt. By the next year, CalPERS realized that doing so would require a new 20-year period and increased annual county payments: \$11,504,051. The rest of Column D shows that CalPERS has increased required annual payments every year. Perhaps most noteworthy is that CalPERS, although having a good 2021-2022 year that reduced the

county's unfunded liability debt significantly, still felt it necessary to *increase* the county's annual amortization payments by approximately \$1.5 million (8.1%). Each annual CalPERS prediction of the level of county amortization payments that over 20 years would return to a fully funded pension plan has been too low, and begins a new 20-year period. Column D shows that we are losing ground.

Column E's story is concerning also. In the year ending June 30, 2015, the county was spending 6.9% of its revenue to reduce its unfunded-liability exposure. That figure has climbed, so that in the year ending June 30, 2023, the county was spending 8.69% of its revenue on the problem. If annual amortization payments continue to consume larger portions of the county budget, other county operations will suffer.

Looking back, since 2015, the county has paid amortization totaling \$146,952,706 on an unfunded-liabilities debt that began as \$117,142,264. Despite nine years of payments to CalPERS, exceeding the original debt amount by more than 20%, we, the taxpayers, now owe \$200,440,179 of unfunded-liability debt—almost twice what we began with. This means that for Nevada County's approximate current population of 102,000, each resident would have to pay approximately \$2,000 to eliminate the debt today. Of course, not all residents are taxpayers; each taxpayer's payment would have to be significantly higher.

E. THE PRESENT PICTURE

We cannot allow the pattern of the past 20 years to continue unchecked. The pension bill that unfunded liabilities represent will come due. The county has been losing ground, and that needs to change. Unfortunately, the county, as all counties, has limited options. To make more money available for unfunded liabilities, the county has only two tools to avoid defaulting on its pension payments to retirees. It can increase its annual revenue by raising taxes or cut expenses (and the services they fund) to free money that would otherwise be spent on services (or it may do some of each). Either way, the burden falls on us—the taxpayers.

It is possible that CalPERS's annual performance will turn around and begin to yield greater than expected funds on a regular basis. The CalPERS story over the past two decades, however, is poor, as the chart above demonstrates. If CalPERS has figured out a way to get steady, satisfactory returns on its investments, it is not visible. Instead, it appears that CalPERS has no way to address the problem. As always, the obligation to pay pensions as they become due is the county's, not CalPERS's. CalPERS is merely the county's chosen plan administrator. The State Association of County Retirement Systems, composed of counties that are not participating in CalPERS, now boasts 20 county members—counties that decline to be part of CalPERS's pension administration.

The jury asked the county whether it has in place a long-term plan to address the growing unfunded-liability problem. Here are the steps the county reports it is taking:

Yes, the County has a plan to pay down our unfunded liability and improve the health of our pension plan. The Board of supervisors/County has taken the following steps as part of that plan:

- Required employee paid contributions (to share pension costs) beginning in 2006. PEPRA also requires employee paid contributions.
- Created 2 new tiers of benefits for retirees, including the PEPRA tier which applies to all staff since January 2013. The new tiers result in lower long-term pension costs and lower volatility in unfunded liabilities.

- Added a General Fund assignment for pension management in 2016 to highlight/assist in the priority of meeting pension obligations.
- In 2017 created the Pension Trust Fund to assist in stabilizing our pension payments including unfunded liability impacts.
- In 2019 adopted the Pension Management Policy to guide pension management and continuing review of options for funding our pension costs and unfunded liabilities.
- We have pre-paid our unfunded liabilities for the past 5+ years and saved up to \$500,000 per year in doing so.

Have fully paid our pension costs to CalPERS every year.

Outside of the county specific actions above, CalPERS has a plan and requirements for paying off county unfunded liabilities. They have adopted measures to improve the health and reduce volatility of pension costs and unfunded liability. Those measures include: PEPRAs which capped pensionable compensation, required 3yr average salary to calculate benefits, employees pay 50% of costs, reduced expected investment return, shortened the amortization of unfunded liability, and other measures. We plan to continue to comply with all CalPERS requirements and continue to review potential county actions that may further address our pension costs and unfunded liabilities.

The jury offers the following observations about the county's response. The response comes in two parts. The first part (the bullet parts) talks about what the county has done and is doing. The first five points are all things that the county did in the past, the most recent being five years ago. Yet the total unfunded liabilities debt has continued to grow (nearly doubling in the last eight years), as the chart on page 6 shows.

The final item on the bullet list deserves special mention. As noted, the county has made a practice of prepaying the CalPERS annual amortization payment, which saves the county money. That is good, but it is critical to note that although prepayment saves money on interest, it does not *reduce* the increasing amount of total unfunded liability, which continues to grow despite the county's admirable practice of saving money on interest. The best one can say is that it prevents the deficit from growing even faster. Despite the county having pursued each of the steps noted for a minimum of five years, the *total amount* of unfunded liabilities continues to grow.

The second part of the county's response concerns what CalPERS has done or is doing to address the problem. There are some noteworthy things in that part of the response as well. PEPRAs became law in January 2013. It is now eleven years later. Amortization payments to CalPERS have also continued to grow, more than doubling in the past eight years. And still, the county's total liability grows. Whatever CalPERS is doing has neither halted nor even slowed the significant and continuing increases in county unfunded liabilities.

None of the steps the county has taken has had any noticeable impact on the total unfunded liability debt that continues to accumulate. Realistically, none of those steps can have any significant impact on the now \$200-million-plus total debt. The steps may be good things to do, but they are like trying to move a mountain with a teaspoon. The county seems to have no realistic plan to address the principal of the debt, now over \$200 million. Instead, it appears to be hoping that something beneficial will happen at CalPERS. Hope

is neither a plan nor a strategy. CalPERS's performance this century gives little support to that hope.

Findings

1. The county pension plan currently lacks the funds to meet foreseeable pension-payment obligations, having only about 68% of the necessary funds.
2. If unfunded liabilities continue to rise, the county will have to increase revenues by increasing taxes, reduce expenses and the operations they fund (or a combination of the two), or become unable to make pension payments.
3. Because of economic fluctuations and existing unfunded liabilities, the county has decided that issuing bonds is not a good way to address the problem.
4. The constant rise in CalPERS's-required annual amortization payments shows that CalPERS predictions of financial recovery are highly questionable.
5. The county does not appear to have any *realistic* plan to address the steady increases in the total amount of unfunded debt the county and its taxpayers will owe its retirees.

Recommendations

1. The county should consider offering voters the opportunity to approve a special tax to resolve the unfunded-liabilities problem.
2. If the county decides not to approach the problem through a special tax, it should, within six months, produce a comprehensive plan to eliminate the unfunded pension liabilities.
3. The county should consider withdrawing from CalPERS and employing an institutional investment advisor with a better performance record than CalPERS achieves.

Request for Responses

Pursuant to California Penal Code § 933.05, the Nevada County Civil Grand Jury requires from the Nevada County Board of Supervisors, within 90 days of publication of this report, responses to the following:

Findings 1, 2, 3, 4, and 5

Recommendations 1, 2, and 3

Responses go to the Presiding Judge of the Nevada County Superior Court in accord with the provisions of California Penal Code § 933.05. Responses must include the information that § 933.05 requires.