



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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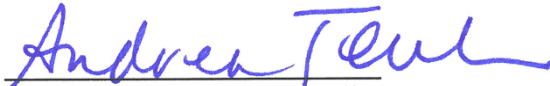
IBA Report Number: 18-09

Budget Review Committee Docket Date: May 7, 2018

Review of City Agencies FY 2019 Budgets: San Diego City Employees Retirement System

The IBA has reviewed the San Diego City Employees' Retirement System (SDCERS) FY 2019 budget, which is scheduled to be heard Monday, May 7th, 2018. Our review is attached.


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City Retirement System

The San Diego City Employees' Retirement System (SDCERS) FY 2019 budget was approved by the SDCERS Board of Administration in March 2018. The SDCERS budget is scheduled to be presented as an informational item at the May 7, 2018 hearing of the City's Budget Review Committee.

SDCERS maintains that its budget is approved by its Board of Administration and does not require approval of City Council. Article XVI, Section 17 of the California Constitution conveys to the Board "plenary authority and fiduciary responsibility for investment of moneys and administration of the [pension] system..." Per City Attorney's Report to Council 2005-18, the City maintains the authority to examine and audit the Board's accounts and records.

FY 2019 Operating Budget

SDCERS' FY 2019 budget format has changed from recent years. In the past, SDCERS has presented budget and current year projections for both administrative and investment expenses. For FY 2019, SDCERS has not included investment expenses in the budget, as they are based on constantly changing fair values of assets

under management, which are difficult to predict.

SDCERS' administrative budget is summarized in the table below. We discuss highlights of the budget changes on the following pages. We also include basic information on investment expenses. SDCERS' budget materials provide information on FY 2017 actual investment expenses, in addition to information on the FY 2019 budget for administrative expenses.

Administrative Expenses

The administrative budget of \$13.9 million is increasing by \$658,000, or 5%, from the \$13.3 million FY 2018 budget. The budget includes funding for 51.00 FTEs. However, one of these FTEs is a supplemental position that SDCERS does not consider to be part of the permanent 50.00 FTE headcount.

Note that for FY 2017 approximately 8.4% of administrative expenses were allocated to the other SDCERS plan sponsors (the Unified Port District and Airport Authority), with the remainder to the City of San Diego. Administrative expenses are charged to the City and other plan sponsors with the Actuarially Determined Con-

SDCERS ADMINISTRATION - BUDGET CHANGES					
	FY 2017 Actual	FY 2018 Budget	FY 2019 Budget	Increase/ (Decrease)	Percent Change
Budgeted Staff	54.00	50.00	51.00	1.00	2.0%
Salaries and Benefits	\$7,529,000	\$7,448,000	\$7,681,000	\$234,000	3.1%
Information Technology	1,866,000	2,050,000	2,081,000	31,000	1.5%
Legal Fees	421,000	411,000	835,000	424,000	103.2%
General Operations	3,563,000	3,368,000	3,336,000	(31,000)	(0.9%)
TOTAL	\$13,379,000	\$13,276,000	\$13,934,000	\$658,000	5.0%

Table may not total due to rounding.

City Agencies: City Retirement System

tribution (ADC) pension payment.

Components of SDCERS' FY 2019 administrative budget are outlined below.

Salaries and Benefits

The \$7.7 million Salaries and Benefits budget category reflects an increase of \$234,000. Of this, the increase in salaries and wages is \$245,000, which is partially offset with a \$12,000 decrease in fringe benefits.

The salaries and wages increase includes the 3.3% general salary increases included in the FY 2019 Salary Ordinance, which is based on approved agreements with the City's employee organizations. The labor terms that apply to City employees also apply to SDCERS employees. Note that the City manages the payment of SDCERS employees' salaries and fringe, and invoices SDCERS for those costs.

In addition to the 3.3% general salary increase, there are salary step increases and \$39,000 for the supplemental position mentioned earlier. This position replaces temporary labor that is being reduced for FY 2019, and is assigned to the Member Services Division, providing counseling, communications, and call center services.

FY 2019 fringe benefits costs are based on rates provided by the City. Because final FY 2019 fringe rates were not available at the time of SDCERS Board approval of the FY 2019 budget, the fringe amounts are anticipated to change.

Non-Personnel Expenditures

The \$2.1 million Information Technology budget for FY 2019 is increasing by \$31,000 from FY 2018. This increase is largely due to \$62,000 in contractual increases for the pension system and other

technical support, which are offset with a \$40,000 decrease for computer hardware expenses.

The \$835,000 Legal Fees budget category reflects an increase of \$424,000—more than doubling the \$411,000 FY 2018 Adopted Budget. The increase is primarily attributable to anticipated litigation expenses related to the remaining three Purchase Service Credit (PSC) cases and two other cases. In addition to the FY 2019 budget increase for these cases, anticipated FY 2018 spending has also increased. The cases are on appeal, and SDCERS anticipates defending them all.

For the \$3.3 million General Operations budget, there is a net decrease of \$31,000. The largest change is a \$123,000 decrease in office operations expenses, largely attributable to temporary labor in the Member Services Division.

Partially offsetting budget increases (for General Operations) include \$30,000 for rent (which totals \$1.0 million for FY 2019) and \$32,000 for travel and training (which totals \$127,000). Fiduciary insurance is decreasing by \$20,000 to \$280,000.

Capital Budget

In addition to the administrative budget, SDCERS maintains a capital budget. The capital budget is decreasing from \$289,000 in FY 2018 to \$270,000 in FY 2019.

Projected expenditures in FY 2018 include \$80,000 related to core network switch replacement (for management of network traffic). This project is anticipated to be completed for \$70,000 less than its \$150,000 budget.

The FY 2018 budget included a board

City Agencies: City Retirement System

agenda and voting system upgrade—at \$75,000. This project has been delayed two budget cycles, since FY 2017, as the desired software functionality has not been available; and it is re-budgeted for FY 2019.

The FY 2019 budget also includes:

- Network server replacement—\$60,000
- UPS (Uninterruptible Power Supply) power backup replacement—\$50,000
- Backup tape drive replacement—\$35,000
- Computer hardware replacements—\$25,000
- Accounting software (Great Plains upgrade to 2016 version)—\$25,000

Investment Expenses

As stated earlier, SDCERS budget presentations previously included an investment expenses budget, which has been discontinued for FY 2019. Investment expenses are authorized periodically as various investment and investment consultant contracts are brought to the SDCERS Board.

Investment expenses for FY 2017 were about 0.46% of the fair value of assets under management, or 46 basis points. (This is slightly different from SDCERS May 1, 2018 Budget Review Committee materials, which do not include SDCERS Personnel Expenditures in the investment expenses calculation.) The table at the bottom of the page presents FY 2017 investment expenses, by asset category, and also includes the target allocation percentages for each asset category.

FY 2018 investment expenses will be based on the changing value of assets under management. Investment expenses have seen increased fees over the last few years related to increased real estate and private equity investments. However, SDCERS does not currently anticipate significant changes to asset allocations or fee rates for the various asset categories.

SDCERS' most recent Investment Policy Statement, which explains its investment philosophy, and goals, asset allocation policy, and implementation and monitoring efforts can be found at the following link: <https://www.sdcers.org/Investments/Overview/Policy.aspx>

Investment Return

The most recent SDCERS CAFR indicates FY 2017 investment return was 13.5%—with net investment earnings of approximately \$928.0 million. Note that the pension system's rate of return assumed for FY 2017 (in the FY 2016 actuarial valuation) was 7%.

FY 2017 SDCERS Investment Expenses			
Asset Category	Expenses Paid	Expenses as % of Fair Value of Asset Category	SDCERS Target Asset Allocation ¹
Domestic Fixed Income	\$1,897,000	0.11%	22.0%
Domestic Equity	5,510,000	0.31%	21.0%
International Equity	3,878,000	0.30%	15.0%
Private Equity & Infrastructure	6,812,000	0.60%	13.0%
Real Estate	7,880,000	1.10%	11.0%
Opportunistic Strategies	1,997,000	0.84%	8.0%
Global Equity	2,150,000	0.55%	5.0%
Emerging Market Debt	2,012,000	0.58%	5.0%
Other Investment Expenses ²	3,212,000	0.04%	-
TOTAL	\$35,348,000	0.46%	100.0%

NOTE: Target asset allocations and investment expenses are based on information presented in the FY 2017 CAFR.

¹The current Target Asset Allocation was approved by the SDCERS Board on May 12, 2017.

² Other Investment Expenses include those for investment consultants, legal services, taxes, expenses related to cash holdings, and other expenses.