



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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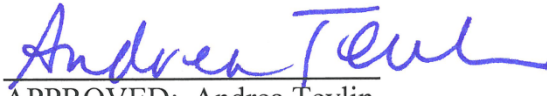
IBA Report Number: 20-08

Budget Review Committee Docket Date: May 7, 2020

Review of City Agencies FY 2021 Budgets: San Diego City Employees Retirement System

The IBA has reviewed the San Diego City Employees' Retirement System (SDCERS) FY 2021 budget, which is scheduled to be heard Monday, May 7th, 2020. Our review is attached.


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City Agencies: City Retirement System

City Retirement System

The San Diego City Employees' Retirement System (SDCERS) FY 2021 budget was approved by the SDCERS Board of Administration in March 2020. The SDCERS budget is scheduled to be presented as an informational item at the May 7, 2020 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.

This review covers the SDCERS' operating and capital budgets, as well as a brief discussion on investments and investment expenses.

FY 2021 Operating Budget

SDCERS' operating budget, or administrative budget, is summarized in the table below. We discuss highlights of the budget changes in the following sections.

The administrative budget of \$13.9 million is increasing by \$182,000, or 1.3%, from the \$13.7 million FY 2020 budget. The FY 2021 budget includes 48.00 FTEs, down 2.00 from

FY 2020. The reduced positions are both vacant.

Based on the FY 2019 actuarial valuations, 8.9% of shared administrative expenses are allocated to the other SDCERS plan sponsors (the Unified Port District and Airport Authority), with the remainder to the City of San Diego. These administrative expenses will be charged to the City and other plan sponsors with the FY 2021 Actuarially Determined Contribution (ADC) pension payment.

Components of SDCERS' FY 2021 administrative budget are outlined below.

Salaries and Benefits

The \$7.9 million Salaries and Benefits budget category is nearly the same as the FY 2020 budget (a \$28,000 decrease). Salary increases (largely merit increases) are offset by the salaries and benefits of the 2.00 FTE reductions.

The City manages the payment of SDCERS employees' salaries and fringe, and invoices SDCERS for those costs. FY 2021 fringe benefits costs are based on rates provided by the City. Because final FY 2021 fringe rates were not available at the time of SDCERS Board approval of the FY 2021 budget, the fringe amounts are anticipated to change.

SDCERS ADMINISTRATION - BUDGET CHANGES					
	FY 2019 Actual	FY 2020 Budget	FY 2021 Budget	Increase/ (Decrease)	Percent Change
Budgeted Staff	51.00	50.00	48.00	(2.00)	(4.0%)
Salaries and Benefits	\$7,568,000	\$7,900,000	\$7,873,000	(\$28,000)	(0.4%)
Information Technology	1,939,000	2,132,000	2,164,000	32,000	1.5%
Legal Fees	190,000	235,000	385,000	150,000	63.8%
General Operations	3,431,000	3,461,000	3,489,000	28,000	0.8%
TOTAL	\$13,128,000	\$13,729,000	\$13,911,000	\$182,000	1.3%

NOTE: Table may not total due to rounding.

City Agencies: City Retirement System

Non-Personnel Expenditures

The \$2.2 million information technology expenditures budget for FY 2021 is increasing by \$32,000, largely related to systems and technical support.

The largest non-personnel expenditures (NPE) increases are in the legal fees and general operations categories. The \$385,000 legal fees budget is increasing by \$150,000. Specifically, the largest increases are \$50,000 in projected litigation fees and \$50,000 for tax-related legal services.

The \$3.5 million general operations budget is nearly the same as the prior year (a \$28,000 increase), but there are some offsetting increases and decreases. The largest decrease is \$131,000 for actuarial services. This reduction is related to an experience study that is being completed in FY 2020 and not required for FY 2021.

An experience study involves historical analysis of pension plan assumptions, including the rate of investment return, salary inflation, and retirement and mortality rates. The plan experience study is the basis for the actuary's recommended changes to the plan's actuarial assumptions. Any recommended changes the Board approves are expected to be incorporated into the FY 2022 ADC.

Offsetting increases in the general operations budget include \$53,000 for a contractual rent increase and \$84,000 for office operations (including funding for member service videos, information systems audits, and the compliance program).

Capital Budget

In addition to the administrative/operating budget, SDCERS maintains a capital budget. The capital budget is increasing from \$130,000 in FY 2020 to \$195,000 in FY 2021.

The FY 2020 budget projects include:

- Accounting software: Great Plains upgrade to the latest release – \$45,000
- Server farm enclosure – \$35,000 (actual cost with upgraded technology was \$43,000).
- Network firewall replacement – \$25,000
- Office computer equipment replacement – \$25,000

FY 2021 budget projects include:

- Capacity expansion for storage area network – \$80,000
- Server connectivity switch replacement – \$50,000
- Replacement of load balancer for applications and perimeter server – \$25,000
- Office computer equipment replacement – \$25,000
- Replacement of systems management server – \$15,000

Investments

Investment Expenses

Investment expenses are authorized periodically as various investment and investment consultant contracts are brought to the SDCERS Board.

Investment expenses for the last completed fiscal year, FY 2019, were about 0.45% of the fair value of assets under management, or 45 basis points. (This is slightly different from SDCERS' May 7, 2020 Budget Review Committee materials, which do not include SDCERS' personnel and general operations expenditures in the investment expenses calculation.)

City Agencies: City Retirement System

The following table presents SDCERS' target asset allocation percentages for each asset category as of June 30, 2019; the FY 2019 fair value of assets; FY 2019 investment expenses by asset category; and investment expenses as a percent of the fair value in each asset category.

million. Note that the pension system's rate of return assumed for FY 2019 (in the FY 2018 actuarial valuation) was 6.5%. The return assumption for FY 2020 (in the FY 2019 actuarial valuation) is also 6.5%.

FY 2020 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 and increased overall assets under management. SDCERS does not currently anticipate significant changes to fee rates for the various asset categories but plans to evaluate asset allocations at the July 2020 Board meeting.

Investment Return

The most recent SDCERS CAFR indicates FY 2019 investment return was 7.0%, with net investment earnings of approximately \$518.2

SDCERS FY 2019 Investment Information				
Asset Category	Target Asset Allocation	Fair Value of Assets (\$ in billions)	Expenses Paid	Expenses as % of Fair Value of Asset Category
Domestic Fixed Income	22.0%	\$1.94	\$2,018,000	0.10%
Domestic Equity	18.0%	1.68	5,201,000	0.31%
International Equity	15.0%	1.31	4,152,000	0.32%
Private Equity & Infrastructure	13.0%	1.22	7,920,000	0.65%
Real Estate	11.0%	0.86	9,371,000	1.09%
Opportunistic Strategies	8.0%	0.39	1,484,000	0.38%
Global Equity	8.0%	0.69	3,112,000	0.45%
Emerging Market Debt	5.0%	0.43	2,443,000	0.57%
Cash and Cash Overlay	n/a	0.13	215,000	0.17%
Other Investment Expenses ^{1, 2}	n/a	n/a	3,170,000	0.04%
TOTAL	100.0%	\$8.64	\$39,086,000	0.45%

NOTES: Table may not total due to rounding.

Target asset allocations and investment expenses are based on information presented with the FY 2019 CAFR.

¹ Other Investment Expenses include those for certain SDCERS personnel expenses, investment consultants, legal services, taxes, expenses related to cash holdings, and other expenses.

² For Other Investment Expenses "Expenses as % of Fair Value of Asset Category" is as a percent of the total fair value of assets.