



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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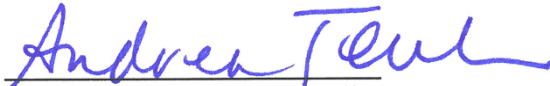
IBA Report Number: 19-08

Budget Review Committee Docket Date: May 6, 2019

Review of City Agencies FY 2020 Budgets: San Diego City Employees Retirement System

The IBA has reviewed the San Diego City Employees' Retirement System (SDCERS) FY 2020 budget, which is scheduled to be heard Monday, May 6th, 2019. Our review is attached.


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City Retirement System

The San Diego City Employees’ Retirement System (SDCERS) FY 2020 budget was approved by the SDCERS Board of Administration in March 2019. The SDCERS budget is scheduled to be presented as an informational item at the May 6, 2019 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 2020 Operating Budget

During the FY 2019 budget process, SDCERS modified its budget format. In prior years, SDCERS presented budget and current year projections for both *administrative* and *investment* expenses. For FY 2019, SDCERS did not include investment

expenses in the budget, as they are based on constantly changing fair values of assets under management, which are difficult to predict. FY 2020 continues that same format, but SDCERS supplements the budget presentation with FY 2018 actual investment expense data.

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.

Administrative Expenses

The administrative budget of \$13.7 million is decreasing by \$205,000, or 1.5%, from the \$13.9 million FY 2019 budget. The FY 2020 budget includes 50.00 FTEs, down 1.00 from FY 2019. Although the FY 2019 budget included funding for 51.00 FTEs, one of those was a supplemental position that SDCERS did not consider to be part of the permanent 50.00 FTE headcount.

As of the last completed fiscal year (FY 2018) approximately 7.7% of administrative expenses were allocated to the other SDCERS plan sponsors (the Unified Port

SDCERS ADMINISTRATION - BUDGET CHANGES					
	FY 2018 Actual	FY 2019 Budget	FY 2020 Budget	Increase/ (Decrease)	Percent Change
Budgeted Staff	50.00	51.00	50.00	(1.00)	(2.0%)
Salaries and Benefits	\$7,272,000	\$7,681,000	\$7,900,000	\$219,000	2.9%
Information Technology	1,863,000	2,081,000	2,132,000	51,000	2.5%
Legal Fees	647,000	835,000	235,000	(600,000)	(71.9%)
General Operations	<u>3,584,000</u>	<u>3,336,000</u>	<u>3,461,000</u>	<u>124,000</u>	3.7%
TOTAL	<u>\$13,366,000</u>	<u>\$13,934,000</u>	<u>\$13,729,000</u>	<u>(\$205,000)</u>	<u>(1.5%)</u>

Table may not total due to rounding.

City Agencies: City Retirement System

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 Contribution (ADC) pension payment.

Components of SDCERS' FY 2020 administrative budget are outlined below.

Salaries and Benefits

The \$7.9 million Salaries and Benefits budget category reflects an increase of \$219,000 consisting of \$144,000 for salaries and wages and \$75,000 for fringe benefits.

The salaries and wages increase is largely related to the 3.3% general salary increases included in the City's FY 2020 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.

FY 2020 fringe benefits costs are based on rates provided by the City. Because final FY 2020 fringe rates were not available at the time of SDCERS Board approval of the FY 2020 budget, the fringe amounts are anticipated to change.

Non-Personnel Expenditures

The \$2.1 million Information Technology budget for FY 2020 is increasing by a net \$51,000 from FY 2019. The largest components of this increase is \$76,000 related to cyber security and board room operations, which is partially offset with a \$42,000 decrease for prior allocated costs from the City.

The \$235,000 Legal Fees budget reflects a net decrease of \$600,000 from the \$835,000 FY 2019 Adopted Budget. The decrease is primarily attributable to prior resolution of three Purchase Service Credit (PSC) cases and several other cases. The PSC cases are on appeal, for which SDCERS has budgeted \$100,000. There is no budget related to the Proposition B case involving the City and four of its employee organizations.

For the \$3.5 million General Operations budget, there is a net increase of \$124,000, consisting of a number of increasing and decreasing components. The largest two increases are \$78,000 for actuary services and \$52,000 for a contractual rent increase.

The actuary services increase is related to the anticipated completion of an experience study in FY 2020. 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.

Capital Budget

In addition to the administrative budget, SDCERS maintains a capital budget. The capital budget is decreasing from \$270,000 in FY 2019 to \$130,000 in FY 2020.

The FY 2019 budget included a board agenda and voting system upgrade—currently projected to be completed at a cost of \$83,000 (\$8,000 higher than budgeted). The OnBase system is anticipated to go live this July.

City Agencies: City Retirement System

Additionally, FY 2019 projects expected to be completed include:

- Network server replacement—\$58,000
- UPS (Uninterruptible Power Supply) power backup replacement—\$35,000
- Backup tape drive replacement—\$35,000
- Computer hardware replacements—\$25,000

FY 2020 budgeted projects include:

- Accounting software: Great Plains upgrade to the latest release—\$45,000 (carry-over project from FY 2019)
- Server farm enclosure—\$35,000
- Network firewall replacement—\$25,000
- Office computer equipment—\$25,000

Investment Expenses

As stated earlier, SDCERS budget presentations previously included an investment expenses budget, which was discontinued for FY 2019 and FY 2020. 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 2018, were about 0.46% of the fair value of assets under management, or 46 basis points. (This is slightly different from SDCERS May 6, 2019 Budget Review Committee materials, which do not include SDCERS Personnel Expenditures in the investment expenses calculation.) The following table presents FY 2018 investment expenses by asset category, and also includes the target allocation percentages for each asset category as of June 30, 2018.

FY 2018 SDCERS Investment Expenses			
Asset Category	Expenses Paid	Expenses as % of Fair Value of Asset Category	SDCERS Target Asset Allocation ¹
Domestic Fixed Income	\$1,953,000	0.10%	22.0%
Domestic Equity	5,827,000	0.29%	18.0%
International Equity	4,326,000	0.33%	15.0%
Private Equity & Infrastructure	7,677,000	0.67%	13.0%
Real Estate	9,177,000	1.22%	11.0%
Opportunistic Strategies	1,365,000	0.48%	8.0%
Global Equity	2,424,000	0.61%	8.0%
Emerging Market Debt	2,385,000	0.65%	5.0%
Other Investment Expenses ²	<u>3,119,000</u>	0.04%	—
TOTAL	<u>\$38,253,000</u>	0.46%	<u>100.0%</u>

NOTE: Target asset allocations and investment expenses are based on information presented in the FY 2018 CAFR.

¹ The Target Asset Allocation was approved by the SDCERS Board on May 11, 2018.

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

City Agencies: City Retirement System

FY 2019 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 2018 investment return was 8.4%—with net investment earnings of approximately \$644.2 million. Note that the pension system's rate of return assumed for FY 2018 (in the FY 2017 actuarial valuation) was 6.75%.