SEATTLE CITY COUNCIL
CENTRAL STAFF

October 11, 2023

M E M O R A N D U M

To: Select Budget Committee
From: Tom Mikesell, Analyst
Subject: Seattle City Employees Retirement System (SCERS) - 2024 Proposed Budget Adjustments City Contribution Rate Analysis

The Mayor's Proposed Adjustment to the 2024 Endorsed Budget is built using a Seattle City Employees Retirement System (SCERS) City contribution rate of 16.22 of covered payroll. This is higher than: (1) the rate actuarially necessary to fully fund the 2024 contribution pursuant to Seattle Municipal Code Section 4.36.545, and the rate recommended by the SCERS Board of Administration (SCERS Board) at its June 8, 2023, regular meeting, and (2) the rate used to build the 2024 Endorsed Budget. As this policy decision would require the City to contribute more to the retirement system than is necessary, in the context of a myriad of budget and sustainability challenges, this memorandum describes the budget impacts of using alternative legally viable rates and describes options.

Background

The City's employee retirement system, of which most non-uniformed City employees are members, is a defined benefit pension program funded by a combination of salary-based employer (i.e., the City) and employee contributions, and investment earnings At retirement, members are eligible to receive a recurring annual benefit roughly based on their years of service with the City, and a percentage applied to their highest earnings averaged over several years. SCERS staff, who manage the system, are advised by external consultants, including an investment advisor, that provides insight on investment portfolio management, and an actuary that uses employee demographic, economic and investment earnings assumptions approved by the SCERS Board to determine the annual City contribution rates that would be necessary to ensure retirement balances will be sufficient to make retiree benefit payments now and in the future.

The SCERS Board, which is chaired by the Chair of the Finance & Housing Committee, and includes the Human Resources Director, the City Finance Director, and a mix of retired and active retirement system members, relies on information provided by the actuary to make an annual City contribution rate recommendation to the City Council, who ultimately approves the rate by way of adopting the City Budget and a separate resolution, submitted as budget legislation, which affirms the SCERS Board recommendation. The rate is multiplied by active City employee member salaries to determine the annual budget for total City retirement contributions.

The SCERS Board rate recommendation is advisory in nature; ultimately the City Council can choose any rate, though Seattle Municipal Code (SMC) Chapter 4.36.545 requires that the City contributions are sufficient to meet the actuarially determined City contribution to guarantee benefit payments.

Analysis

In fall of 2022, relying on the best available data from the SCERS contracted actuary, the 2023 Adopted and 2024 Endorsed budgets were built using City retirement contribution rates of 15.82 percent and 15.32 percent of salaries, respectively. Based on recent data, at the June 8, 2023, meeting, the SCERS actuary reported that the City's 2024 retirement contribution rate could be reduced to 15.17 percent, while still providing sufficient funding to the retirement system.

As shown in the '[Seattle City Employees' Retirement System January 1,2023 Actuarial Valuation]', using assumptions adopted by the SCERS Board, Milliman, Inc, (SCERS' contracted actuary), indicated the most likely projected path of employer contributions rates, as shown in Table 1.

Table 1. Projected Employer Contribution Rate (Assuming 6.75% Returns

Contribution year	City Employer Rate of Payroll [1/]
2024	15.17
2025	15.28
2026	15.65
2027	16.46
1/Data from page 4 of Seattle City Employees' Retirement System January 1,2023 Actuarial Valuation	

Rather than use the actuary's suggested rate, the SCERS Board voted to keep the rate at 15.82 percent, in line with the rate used to calculate the City's contribution funded in the 2023 Adopted Budget. This is not uncommon. In past years, the SCERS Board has recommended a rate higher than the actuary's recommendation, to provide additional funding to the system to reach 100 percent funded status sooner (currently, the retirement system has assets sufficient to meet 75.7 percent of liabilities, with a plan to reach 100 percent funded status by the end of 2042). In addition, this keeps the rate at a consistent level from one year to the next. Submitted as budget legislation, a resolution drafted by SCERS staff would endorse a 15.82 rate, consistent with the SCERS Board's recommendation.

However, in contrast to both the SCERS Board recommendation in the proposed resolution, and the actuarially required rate, the 2024 Proposed Budget Adjustments are built using a City contribution rate of 16.22 percent. This higher rate is a CBO estimate derived early in 2023, prior to when the actuarial results were known. Referring to Table 1, it is worth noting that this rate is higher than the actuarial rates projected for 2024 through 2026.

Options

Given the constraints on the City's budget, the following options detail the potential budget savings of using alternative and viable lower rates.

Option1: Use the SCERS Board recommended rate (15.82 percent).

As detailed in Table 2 below, compared to the 2024 Proposed Adjustments, using the SCERS Board's recommended rate would decrease the City budget by $1.3 million GF, and $2.8 million from all other City funds. Further, the investable funds deposited into the Retirement Fund in 2024 would be $4.1 million lower than possible at the higher rate. However, since the SCERs Board rate is higher than the actuary's recommendation, the City retirement system would remain on course to meet 100 percent funded status by end of 2042 given available assumptions.

Table 2. Estimated City retirement contributions - 2024 Proposed Budget Adjustments compared to using SCERS Board recommended rate.

Fund	2024 Proposed Budget**	2024 Using SCERS Board Rate Recommendation	Difference
General Fund *	$52.9 million	$51.6 million	$1.3 million
Other Fund	$111.5 million	$108.8 million	$2.8 million
Total:	**$164.4 million**	**$160.4 million**	**$4.1 million**

*Includes amounts from the Library Fund, OLS Fund and portions of Internal Service funds supported by GF transfers.
**Data provided by the City Budget Office.

Option 2. Use the SCERS Actuary Rate (15.17 percent)

As indicated in the 'Background' section above, SMC 4.36.545 only requires adoption of the actuarially derived rate, which is 15.17 percent, for the City's contribution. As shown in Table 3 below, compared to the 2024 Proposed Budget, using the actuarially derived rate would decrease the City budget by $3.4 million GF, and $10.6 million from all other City funds. Further, the investable funds deposited into the Retirement Fund in 2024 would be $10.6 million lower than possible at the proposed budget rate. However, since the actuarially derived rate is the rate determined sufficient to meet the plan's future funding objectives, the City retirement system would remain on course to meet 100 percent funded status by end of 2042 given available assumptions.

Table 3. Estimated City retirement contributions-2024 Proposed Budget compared to amounts calculated using SCERS actuary rate recommendation.

Fund	2024 Proposed Budget**	2024 Using SCERS Actuary Rate	Difference
General Fund *	$52.9 million	$49.5 million	$3.4 million
Other Fund	$111.5 million	$104.3 million	$7.2 million
Total:	**$164.4 million**	**$153.9 million**	**$10.6 million**

* Includes amounts from the Library Fund, OLS Fund and portions of Internal Service funds supported by GF transfers.
**Baseline data provided by the City Budget Office.

Final Observations

From the perspective of the retirement system, and from the perspective of an individual person, contributing more money towards retirement is always preferred over less, when possible. This helps buffer against future uncertainty and gives money a slightly longer horizon for the effects of compounding to apply. As such, there is no doubt that putting more money than is strictly necessary into the Retirement Fund in 2024 makes the goal of attaining 100 percent funded status by 2042 marginally easier in future years.

However, in the context of other City budget demands, not the least of which is a projected average GF funding gap of $247 million beginning in 2025, it is important to make clear that this is a choice, not a requirement, and that there are fiscal trade-offs to consider.