McLean Citizens Association

MCA

The Voice of McLean for Over 100 Years

McLean Citizens Association Resolution
Sustainability of Fairfax County Public Schools Pension Plans
January 6, 2021

Whereas, Fairfax County Public Schools (FCPS) continues to face longstanding capital and operating budget constraints, and now faces new challenges from the pandemic; and

Whereas, approximately 80% of FCPS employees participate in three pension plans, each of which pays benefits for life: (i) the federal government's Social Security; (ii) the state-run Virginia Retirement System (VRS), plus (iii) the Education Employees' Supplementary Retirement System of Fairfax County (ERFC)[1]; and

Whereas, rising FCPS cash contributions to pension plans necessitate growth in government funding and/or reductions in other FCPS expenditures; and

Whereas, the McLean Citizens Association (MCA) adopted a resolution on March 1, 2017 urging the Fairfax County School Board (School Board) to make its pension plans financially sustainable; and

Whereas, the MCA adopted a resolution on November 4, 2020 urging the Fairfax County Board of Supervisors to make its pension plans financially sustainable; and

Whereas, the purposes of this resolution are to update the MCA's 2017 resolution about ERFC, to contrast ERFC and VRS, and to make recommendations regarding ERFC; and

VRS

Whereas, VRS includes multiple pension plans, the largest of which is for employees of Virginia's local public school systems (VRS Teachers Plan); and

Whereas, VRS Teachers Plan's nine trustees are appointed by the Governor and Joint Rules Committee of the General Assembly, four of five trustees are required to be investment experts, and one is required to have employee benefit plan experience; and

Whereas, Virginia made significant reforms to VRS Teachers Plan in 2012, by creating the VRS Hybrid pension plan for employees hired on or after January 1, 2014; and

Whereas, employer costs as a percentage of employee salaries are lower for VRS Hybrid plan than prior VRS pension plans; and

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[1] The remaining 20% of FCPS employees participate in Social Security plus the Fairfax County Employees' Retirement System (FCERS), the costs of which were addressed in the MCA's November 4, 2020 resolution.

Whereas, in 2017 the Virginia General Assembly voted to require VRS to report "sensitivity and stress test analyses" with projections of benefit levels, pension costs, liabilities, and debt reduction under various economic and investment scenarios; and

Whereas, VRS' 2018 stress test computed an expected median return of 6.83% on its assets; and

Whereas, starting in 2019, VRS Teachers Plan assumed a 6.75% rate of return on its assets[2]; and

Whereas, VRS Teachers Plan was reported as about 107% funded in FY 2001 (*i.e.*, had assets to cover 107% of estimated future pension obligations),[3] 62% funded in FY 2013 and 72% funded in FY 2020[4]: and

ERFC

Whereas, ERFC was established in 1973 to supplement pension benefits provided to retired FCPS employees under the federal Social Security system plus VRS Teachers[5]; and

Whereas, ERFC's plan documents require ERFC Trustees to set contribution rates that "will remain approximately level from generation to generation of citizens,"[6] which implies that this refers primarily or solely to employer contribution rates; and

Whereas, as of June 30, 2020, ERFC's total pension liabilities were $3.54 billion, its assets were worth $2.59 billion, and its unfunded liabilities (debt) were $0.95 billion, as reflected in the table below; and

Value of ERFC Pension Benefits Owed	Value of ERFC Assets	ERFC Unfunded Pension Liabilities (Debt)
($3.54 B)	$ 2.59 B	($ 0.95 B)

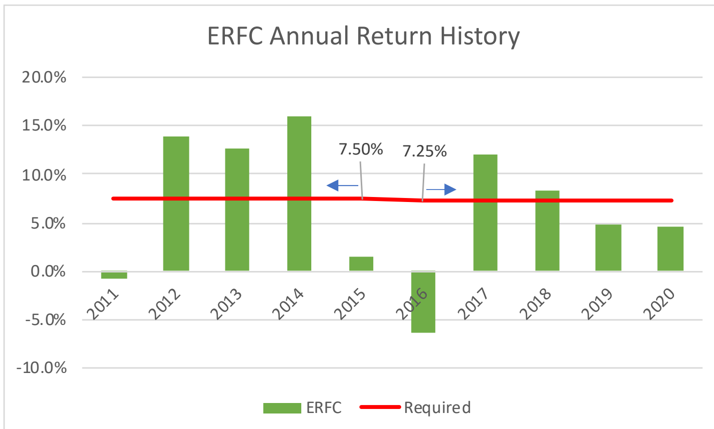
Whereas, from June 30, 2001 to December 31, 2019:

- ERFC's reported ratio of assets to total pension liabilities declined from 103% to 74.5% (the ratio was 76.7% in 2013 – see same time period for VRS above),
- unfunded liabilities increased from 0% to 54% of total payroll for active FCPS employees participating in ERFC (active member payroll),[7]
- FCPS employer contributions increased from $29 million to $105 million,
- The FCPS employer contribution rate rose from 3.69% to 6.44% of active member payroll; and

[2] VRS assumed an 8% discount rate from FY 1996-2004, a 7.5% discount rate from FY 2005-2009, and a 7.0% discount rate from FY 2010 through 2018. VRS FY 2020 Actuarial Valuation, page 39.
[3] VRS FY 2002 CAFR, p. 49 (Required Supplemental Schedule of Funding Progress).
[4] VRS FY 2020 Actuarial Valuation, page 39.
[5] ERFC FY 2019 CAFR, page 2
[6] ERFC Actuarial Valuation Report as of December 31, 2019, p. 2 (Funding Requirements Summary).
[7] ERFC CAFR FY 2010, pages 29 (Financial Section) and 70 (Statistical Section); ERFC Actuarial Valuation as of December 31, 2019, p. 10 (Accounting Requirements).

Whereas, from FY 2000 to FY 2010, ERFC's average return of 4.3% was lower than its assumed return of 7.5%;[8] and

Whereas, from FY 2011 to FY 2020, ERFC's average return exceeded its assumed return assumptions (the 7.5% assumed return rate was reduced to 7.25% in 2015), as reflected in the table below, yet ERFC's unfunded liability increased by over 50% during that same period; and



Whereas, ERFC's 10-year average investment return as of June 30, 2020 is not a good gauge of future returns because that 10-year period does not include market declines during the Great Recession in FY 2009 and includes only the subsequent financial market recovery; and

Whereas, in its 2018 report to ERFC's trustees, Cheiron, Inc., an actuarial firm, estimated that ERFC's pension fund investments had a 37% chance of meeting or exceeding ERFC's 7.25% assumed return over 20 years and recommended that the ERFC trustees consider reducing the assumed return[9]; and

Whereas, if ERFC earns less than its assumed annual return of 7.25%, its unfunded liabilities will increase more than projected and actuaries will likely recommend further increases in contribution rates as a percentage of active employees' salaries; and

Whereas, if ERFC had used a 6.25% investment return (1% less than its assumed 7.25% return) to compute its pension liabilities, ERFC's unfunded pension liabilities as of June 30, 2020 would be estimated as $1.38 billion rather than the reported $0.95 billion; and

Whereas, ERFC's employer contribution rate was 3.37% of participating employees' payroll from FY 2005 through FY 2006, rose to 6.44% in FY 2020, and ERFC's actuaries have recommended that the employer contribution rate increase to 6.7% of salary in FY 2022;[10] and

[8] ERFC CAFR FY 2010, p. 41 (Investment Section).

[9] Cheiron, Independent Actuarial Review of the ERFC Actuarial Valuation, March 8, 2018, p. 39.

[10] ERFC Actuarial Valuation as of December 31, 2019, p. 5 (Accounting Requirements Summary).

Whereas, the School Board increased the ERFC employee contribution rate from 2% to 4% of salary in 2005, then reduced the employee rate from 4% to 3% starting in FY 2013;[11] and

Whereas, the School Board created a less generous ERFC 2001 Tier 2 set of benefits for employees hired on or after July 1, 2017, which only reduced FCPS' contribution rate by 0.06% as of December 31, 2018 and 0.05% as of December 31, 2019;[12] and

Whereas, the December 31, 2019 actuarial valuation of ERFC's current actuarial firm, AON, used economic and demographic assumptions prescribed by ERFC's Board of Trustees and "due to the limited scope of [its] engagement," AON did not analyze the potential range of future measurements of funding progress such as:

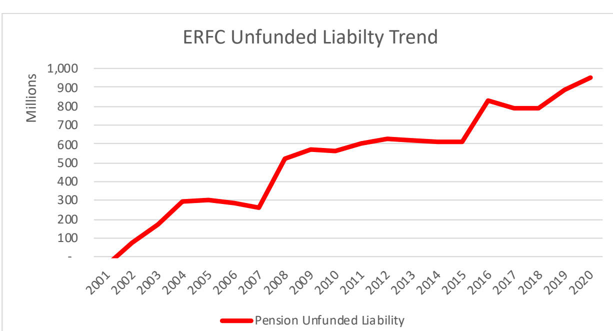
- plan experience differing from economic or demographic assumptions
- changes in actuarial methods, economic or demographic assumptions; and

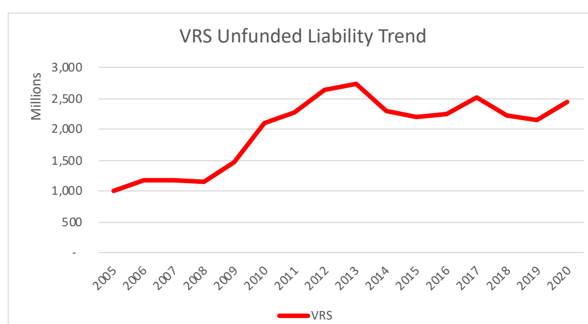
Whereas, ERFC's seven board members are not required to have a background in investments or pension plans, and six of seven ERFC trustees are FCPS employees; and

Comparison of VRS and ERFC

Whereas, ERFC unfunded debt increased by 70% ($0.56 to $0.95 B) while FCPS' share of VRS' unfunded debt increased by 18% ($2.1 to $2.43 B) between FY 2010 and FY 2020, as reflect in the following table and chart; and

FCPS' Unfunded Debt to VRS and ERFC			
Pension Plan	**June 30, 2010**	**June 30, 2015**	**June 30, 2020**
ERFC	$0.56 B	$0.61 B	$0.95 B
VRS	$2.10 B	$2.19 B	$2.43 B
ERFC + VRS	$2.66 B	$2.80 B	$3.38 B

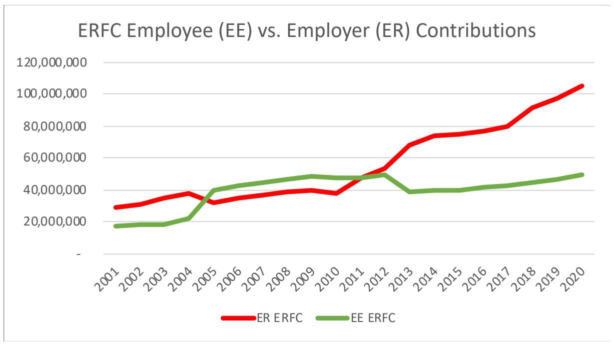


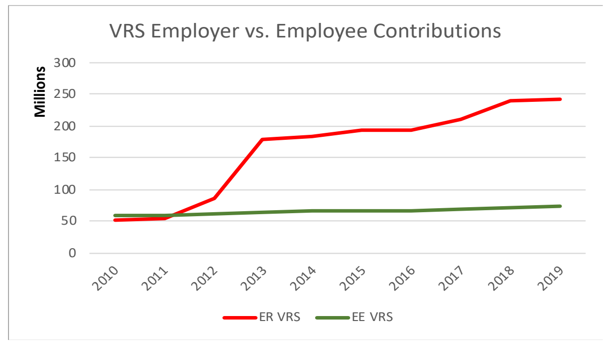


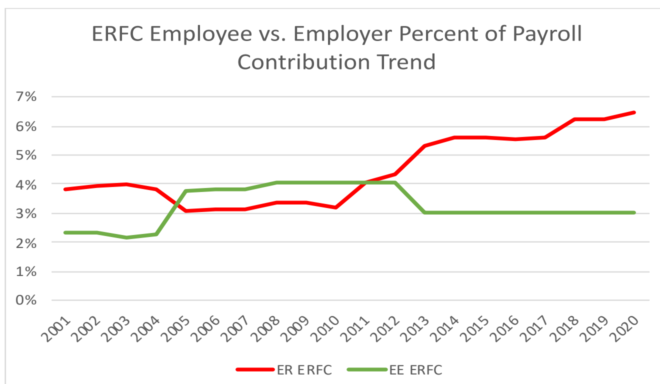
[11] ERFC Actuarial Valuation as of December 31, 2019, p. 5 (Accounting Requirements Summary) and p.35.
[12] ERFC Actuarial Valuation as of December 31, 2019, p. 4 (Funding Requirements Summary)

Whereas, VRS Teachers uses a 6.75% assumed return to calculate its pension liabilities, while ERFC uses a 7.25% assumed return to calculate its pension liabilities; and

Whereas, employer contribution rates have risen more quickly for ERFC than for VRS since 2013, even though school systems are still making extra contributions to VRS to "repay" VRS Teachers for legislatively-mandated lower contributions during the Great Recession as depicted on the following charts;[13] and







Whereas, FCPS' cash contributions to ERFC are already crowding out other critical expenditures by the County and FCPS, such as salary increases for County and FCPS employees, public schools, roads, public safety, affordable housing, parks and recreation.

Now therefore, be it resolved that the McLean Citizens Association urges the School Board to hire an actuarial firm that has not provided services to ERFC or FCPS during the past decade to conduct a sensitivity and stress test for ERFC similar to the VRS sensitivity and stress test, which includes recommended changes to FCPS pension benefits, pension contribution rates, and to ERFC's economic and demographic assumptions, which in the aggregate will ensure FCPS pension benefits are sustainable and consistent with best practices; and

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[13] Martz, "Northam looks to spend $100 million to reduce teacher retirement liabilities," Richmond Times-Dispatch, December 14, 2020.

Be it further resolved that the McLean Citizens Association urges that such independent pension actuarial firm present its findings directly to the School Board during FY 2021 and FY 2022, and implement reforms to make FCPS pension benefits financially sustainable no later than FY 2023.

Approved by the MCA Board of Directors
January 6, 2021

McLean Citizens Association, P.O. Box 273, McLean, Virginia 22101

cc: Elaine Tholen, Dranesville District School Board Member
Karl Frisch, Providence District School Board Member
Fairfax County School Board Members
Scott Brabrand, FCPS Superintendent
Leigh Burden, FCPS Chief Financial Officer
John Foust, Dranesville District Supervisor
Dalia Palchik, Providence District Supervisor
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Bryan Hill, Fairfax County Executive
Joseph Mondoro, Fairfax County Chief Financial Officer