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Research Brief

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Understanding Public Pensions in Sonoma County

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Highlights

Most public employees in Sonoma County and California as a whole are covered by defined-benefit pensions, which provide guaranteed monthly retirement income based on salary and years of service. In Sonoma County, K-12 teachers and other educators are covered by the California State Teachers' Retirement System (CalSTRS), county government and Sonoma Valley Fire District employees are covered by the Sonoma County Employee Retirement Association (SCERA), and most other state and local government employees are covered by the California Public Employee Retirement System (CalPERS). This brief examines pension benefits for public servants in Sonoma County in terms of their role in employee compensation, the evolving financial status of pension systems, the impact of pension reform on costs, and how different pensions within the county stack up against each other in terms of protection from inflation during retirement. Data sources analyzed include pension system actuarial data and Census data on employment and earnings. Key findings are as follows:

1. **Public employees in Sonoma County are paid significantly less on average than private sector employees given their education, and pensions help offset this pay penalty.**
   - Public employment in Sonoma County is dominated by local government employment, a majority (55%) of which is in education and health services. Public K-12 schools alone account for 34%. Other significant sectors are general government (14%), justice and public safety (10%), and transportation and utilities (8%).
   - Public employees in Sonoma County are significantly more likely to have at least a bachelor's degree (53%) than private sector employees (31%). They are almost three times as as likely to have a master's, professional, or doctoral degree compared to private sector employees (24% vs. 9%).

- The average wage income of full-time, year-round public employees in Sonoma County is 15.6% lower than that of similarly educated private sector employees. Employer spending on fringe benefits—which includes payments for legacy pension liabilities—closes most, but not all, of this pay gap.

- Public pensions help offset the public sector pay penalty in a fiscally efficient manner, by providing adequate retirement income at about half the cost that a 401(k) would require for the same benefit.

2. **SCERA and other public pensions in Sonoma County are on a stronger financial footing than a decade ago, with higher funding ratios, more conservative economic and demographic assumptions, gradually declining pension costs from 2012 statewide pension reform, and sound funding policy.**

   - As of FY 2021, SCERA was 102% funded on a market value basis and 93% funded based on an asset-smoothing method. CalPERS plans in Sonoma County were on average 83% funded on a market basis. CalSTRS was 73% funded based on an asset smoothing method and making progress on its 40-year funding plan.

   - While investment returns declined in 2022, employer contribution rates are being buffered by surplus FY 2021 returns that were deferred for contribution rate setting purposes. CalPERS posted -6.1% annual investment returns for FYE June 30, 2022, but 21.3% in FY 2021. CalSTRS returned -1.3% in FYE June 30, 2022, following 27.2% in FY 2021. SCERA is likely to see similar negative returns in FYE Decemer 31, 2022, but the impact will be blunted by its 17% investment returns in FY 2021.

   - SCERA, CalPERS, and CalSTRS have adopted more conservative economic and actuarial assumptions—including lower long-term investment returns and continuous improvement in life expectancy—that put them on a stronger footing in the long run.

   - Employer costs for pensions in Sonoma County are stabilizing or decreasing due to benefit reductions under the Public Employee Pension Reform Act of 2012 (PEPRA) and progress in paying down unfunded liabilities.

     - The cost of benefit accrual by current employees (called "normal cost") is gradually declining due to PEPRA, which reduced pension benefits, capped pensionable salaries, raised the retirement age, and required at least 50% normal cost sharing for employees hired after 2012.

     - Compared to legacy benefits, employer normal cost for PEPRA employees covered by SCERA is 42% lower for County of Sonoma and 54% lower for Sonoma Valley Fire District firefighters.

     - The employer normal cost for PEPRA benefits is low in absolute terms for non-safety workers, 7.68% of covered payroll as of the FY 2021 SCERA actuarial valuation.

- SCERA's average total employer contribution rate—combining normal cost and unfunded liability service—peaked at 22.56% with the FY 2012 valuation and declined to 18.69% as of the FY 2021 valuation. In comparison, average CalPERS employer rate in Sonoma County is 38.1%, and the CalSTRS rate (including both employer and state cost) is 26.9% based on FY 2021 valuations.

3. **SCERA stands out in the Bay Area as the only pension system to lack automatic inflation protection (COLA), which presents a serious challenge for the 11,000 members who rely on the system for retirement income.**

- While statewide pension reform has standardized base pension benefits, SCERA is the only public pension system in the nine-county Bay Area to not provide a guaranteed cost-of-living-adjustment, or COLA.
  - CalSTRS provides retired educators with a 2% simple (rather than compounding) COLA. In addition, the state voluntarily funds a supplemental benefit to maintain a floor of 85% of original purchasing power.
  - All other public employee pensions in the region—including CalPERS, MCERA in Marin County, SFERS in San Francisco, CCCERA in Contra Costa County, and ACERA in Alameda County—provide a 2% compound COLA.
- Current SCERA rules make COLA payments unlikely and rare. The last year any SCERA retirees received an increase was 2008, when older retirees saw their benefits adjusted to 80% of original purchasing power.
- SCERA retirees who retired in 2000 have lost 42% of the purchasing power of their monthly pension check. Between the beginning of the COVID-19 pandemic in March 2020 and November 2022, inflation eroded all SCERA retiree pensions by 13%.
- Half of County of Sonoma retirees will live to see the value of their monthly pension decline to a 33% lower pension benefit than they would have received if they had worked for any other county government in the Bay Area with the same base pension formula.

Introduction

Defined-benefit pensions, which provide guaranteed monthly retirement income based on a worker's salary and years of service, are a key pillar of public employee compensation. In Sonoma County, K-12 teachers and other educators are covered by the California State Teachers' Retirement System (CalSTRS), County of Sonoma (i.e., county government) employees and Sonoma Valley Fire District employees are covered by the Sonoma County Employee Retirement Association (SCERA), and most other state and local government employees are covered by the California Public Employee Retirement System (CalPERS).

This brief examines pension benefits for public servants in Sonoma County in terms of their role in employee compensation, the evolving financial status of pension systems, the impact of pension reform on costs, and how different pension systems in the county and surrounding Bay Area region stack up against each other in terms of protection from inflation during retirement.

Section 1 outlines the size and makeup of public employment and highlights the public sector pay penalty in Sonoma County based on Census data. **Section 2** analyzes pension system funded status and cost trends using retirement system actuarial data. **Section 3** compares cost-of-living adjustment (COLA) policies among public pensions across the Bay Area and highlights the impact of SCERA's lack of systematic inflation protection on retiree incomes and pension benefit value.

Much of the retirement system analysis in this brief focuses on SCERA. A more detailed analysis of CalPERS and CalSTRS funded status, costs, and accounting and actuarial reforms can be found in Brief #2 of the UC Berkeley Labor Center's *Marin Public Pension Series*.[1]

I. Pensions Help Offset the Public Sector Pay Penalty in Sonoma County

Public sector employees in Sonoma County are on average more educated than private sector employees, but are typically underpaid in relation to their qualifications. Pensions offset part of this pay penalty, promote the retention of experienced staff, and ensure that employees are able to retire in dignity after long service.

To begin, **Table 1** provides data on the size and distribution of state and local government in Sonoma County, by sector, from the U.S. Bureau of Labor Statistics' Quarterly Census of Employment and Wages. Public employment in Sonoma County consists primarily of local government employment, more than half of which consists of education and health services (55 %). Public elementary and secondary schools alone account for 42% of local government jobs. Other significant sectors are general government (10.2%), justice and public safety (9.0%), and other public administration (7.5%). State government employment in Sonoma County is about one-fifth the size of local government employment, and consists primarily of higher education (Sonoma State University) and public administration.

Data from the U.S. Census Bureau's American Community Survey (ACS)[2] show that Sonoma County's public sector workforce is significantly more educated than its private sector workforce (**Figure 1**). This is unsurprising given the makeup of public sector jobs; both education and health services entail a significant share of workers with four-year college degrees or advanced degrees. A majority (54%) of state and local government employees working in Sonoma County have at least a bachelor's degree, compared to 31% of local private sector employees. In fact, state and local government employees in Sonoma County skew heavily towards those with advanced degrees: 24% have a master's degree, professional degree, or doctorate, compared to 9% of local private sector wage and salary workers. Only 14% of state and local government employees who work in the county have no college education at all, compared to 34% of private sector employees.

Excluding agricultural workers does not change this difference. Notably, many public employees without a college education are in occupations that require significant occupational training and/or credentials, for instance firefighters, police, public transit operators, and utility workers.

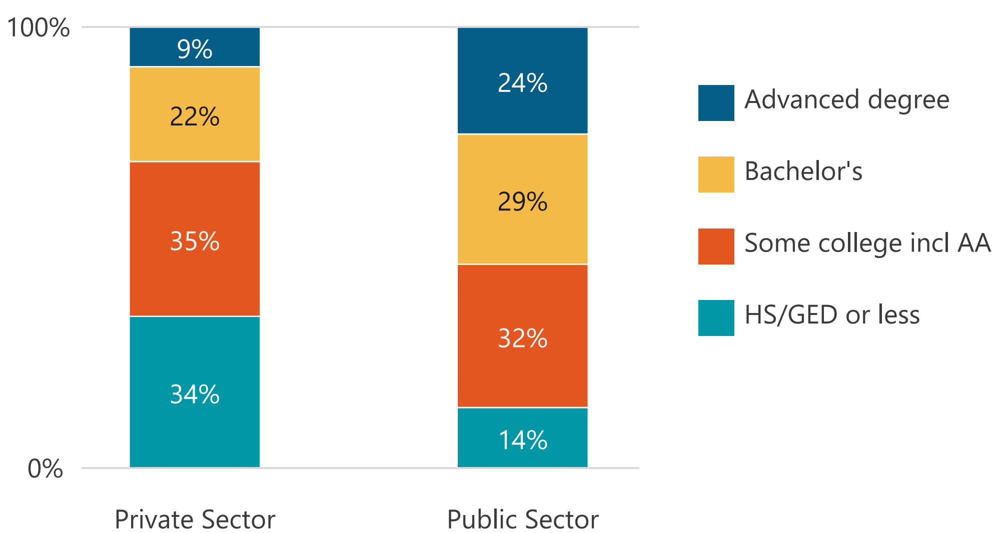
Table 1: Composition of Public Employment in Sonoma County, 2021

Category	Local Government		State Government	
	Average Monthly Employment	Share of Total	Average Monthly Employment	Share of Total
Total Employment	**21,984**	**100.0%**	**2,511**	**100.0%**
Elementary and Secondary Schools	9,198	41.8%		
Colleges and Universities			1,557	62.0%
Other Education and Health Services	2,295	10.4%	187	7.4%
Arts and Recreation	2,431	11.1%		
Executive, Legislative, & General Government	2,084	9.5%		
Justice, Public Order, & Safety	1,986	9.0%	103	4.1%
Other Public Administration	2,247	10.2%	570	22.7%
Transportation, Warehousing, & Utilities	1,003	4.6%		
Other	740	3.4%	94	3.7%

Note: Author's analysis of the Quarterly Census of Employment and Wages, 3rd Quarter 2021.

Figure 1: Sonoma County's Public Sector Workforce Is Significantly More Educated than the Private Sector Workforce

Educational attainment of wage & salary employees working in Sonoma County, 2016-2020



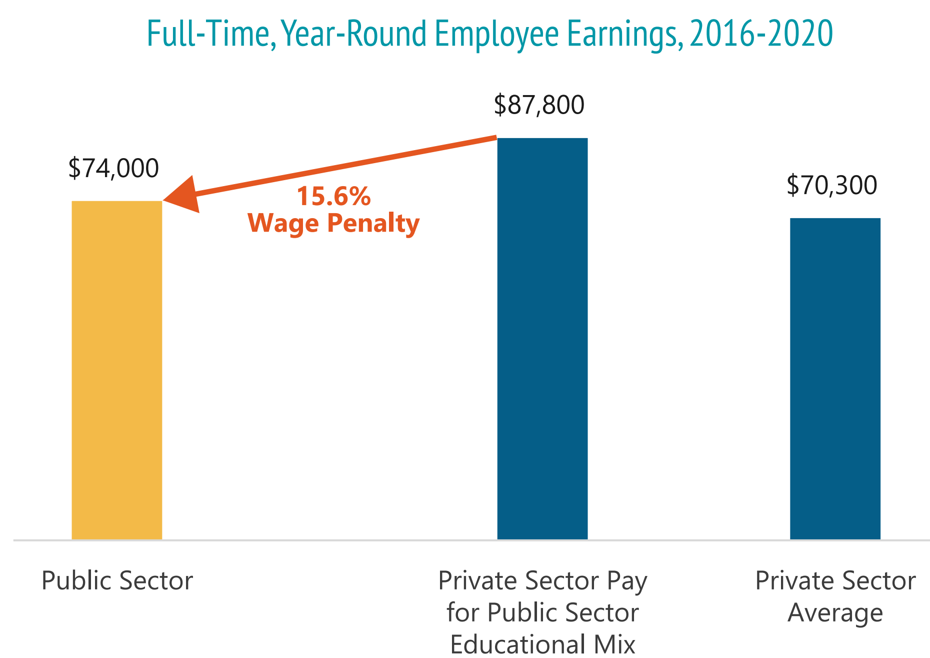
Note: Author's analysis of IPUMS ACS 2020 5-year sample. Totals may not add up to 100% due to rounding.

Figure 2 compares the annual average wage income of full-time, year-round workers employed in the public sector and private sector in Sonoma County, based on ACS data. In 2016-2020, full-time, year-round public employees in the county had an annual average wage income of $74,000 in 2020 dollars, slightly higher than the private sector average of $70,300. But when educational mix is factored in, the total wage income of full-time, year-round state and local government employees in Sonoma County is 15.6% less than it would be based on local private sector pay scales. In the private sector, a similarly educated workforce would have averaged $87,800 in annual pay, compared to the actual public sector average of $74,000.

While public sector employees are not collectively "overpaid," their wages are much less unequal than in the private sector. Due to sample size constraints in the ACS, average pay for government workers without four-year college degrees was not included in Figure 2. However, regional data indicate that in the public sector, workers with advanced degrees earn $2.00 for every dollar earned by and those with no college education, compared to $3.60 in the private sector.[3] And while public sector workers without four-year college degrees benefit from a pay premium—10% for those with no college education, and 7% for those with some college or an associate degree—this is outweighed by the larger wage penalty for the majority of public employees with bachelor's and advanced degrees.

More generous retirement benefits, health care, paid time off, and other fringe benefits offset much—but not all—of the public sector pay penalty. In 2018, benefits for state and local government employees averaged 39% of total compensation, or 64% of base pay, in the Pacific Census Division (California, Oregon, Washington, Alaska, and Hawaii).[4] Benefits for private sector employees averaged 30% of total compensation, or 43% of base pay in the Pacific Division.[5] After accounting for these higher benefit expenditures, total estimated compensation for Sonoma County public employees is about 3% less than that of their private sector counterparts.

Figure 2: Sonoma County Public Sector Workers are Paid Less than Similarly Educated Private Sector Workers



Note: Author's analysis of ACS 2020 5-year sample.

II. Sonoma County Public Employee Pensions Are on Sound Financial Footing

Since the 2008 financial crisis, public pension systems for state and local government employees in Sonoma County have strengthened their financial footing, through a number of measures. Systems currently have sound funding policy and have adopted more conservative economic and actuarial assumptions. In addition, lower benefits and increased cost sharing by employees under statewide pension reform have slashed employer costs for ongoing benefit accrual for employees hired after 2012, contributing to a long-term downward trajectory in pension costs.

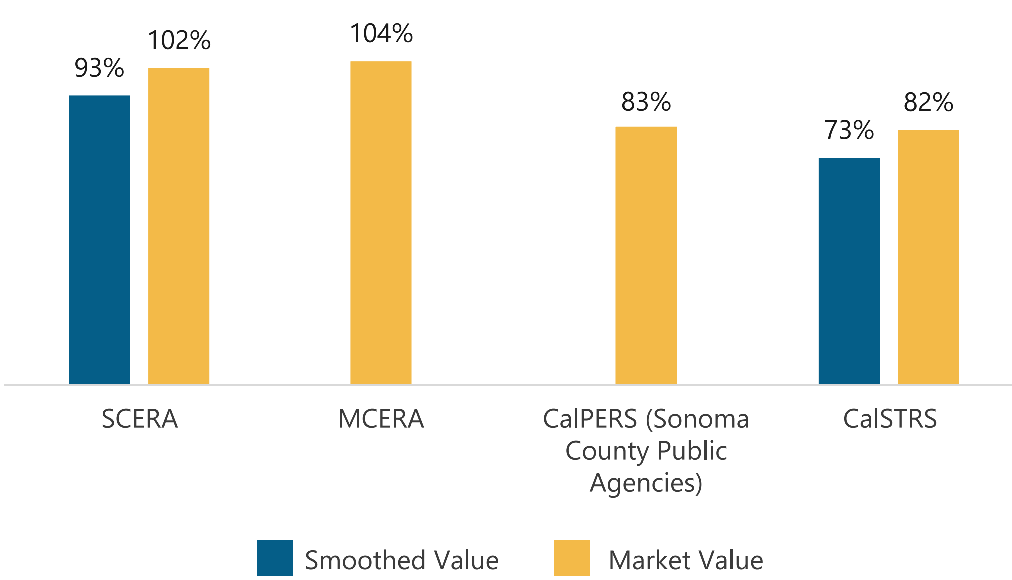
Improved Pension Funding Ratios and Strong Funding Policy

A key measure of a pension fund's financial health is the funding ratio, which is calculated by dividing pension assets by the present value of pension liabilities. It is important to understand that pension liabilities consist of estimated benefits that will be paid out over several decades, not all at once.

The latest published funding ratios of SCERA, CalSTRS, and CalPERS are shown in **Figure 3**. MCERA (the pension system for county government employees in Marin) is also shown for regional comparison purposes. As of December 31, 2021, SCERA had an official funding ratio of 93% based on a method that smooths gains and losses over three years, though the system was 102% funded based on the market value of assets. On the same date, MCERA, which calculates its official funding ratio on a market value basis, was 104% funded based.

CalPERS public agency plans in Sonoma County had an average funding ratio of 83% as of June 30, 2021, based on the market value of assets. CalSTRS, which administers a single statewide pension plan for educators in K-12 schools and community colleges, had a funding ratio of 73% as of June 30, 2021, based on an asset smoothing method that deferred recognition of two-thirds of the gains from FY 2021 to the next two fiscal years.[6] The teacher pension system was 82% funded on a market value basis.[7]

Figure 3: Pension System Funded Status, FY 2021



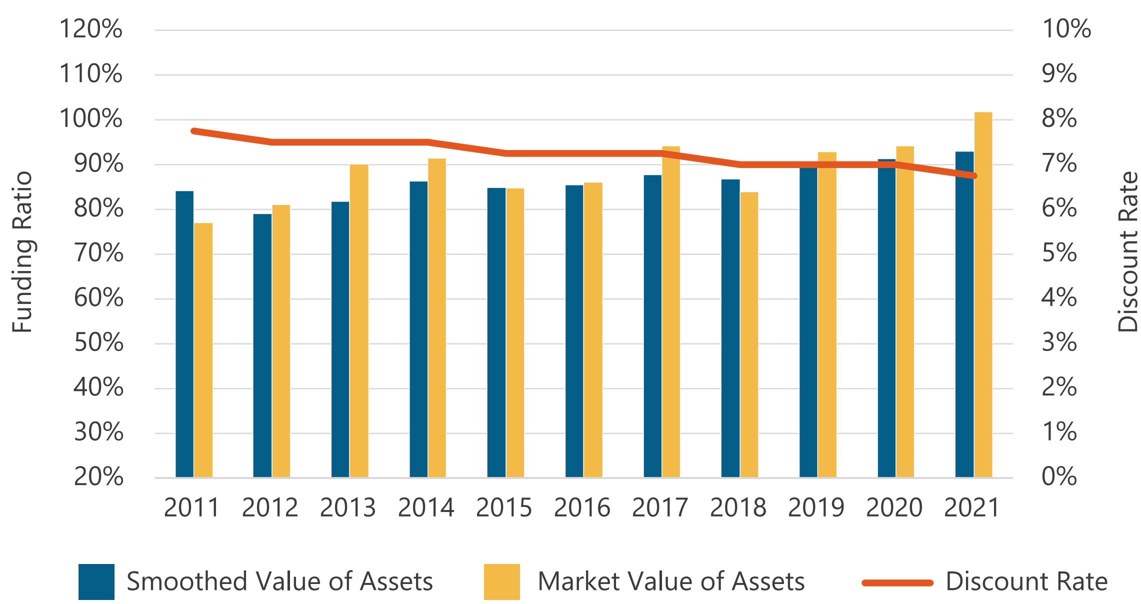
Note: Data from retirement system actuarial valuations and comprehensive annual financial reports. Fiscal year end is December 31 for SCERA and MCERA and June 30 for CalPERS and CalSTRS. MCERA and CalPERS only use market value of assets for calculating funding ratios. For CalPERS, the author calculated the liability-weighted average of active public agency plans in Sonoma County.

While a pension system's funding ratio offers one snapshot of its financial health, the funding policy and the assumptions underlying pension obligation estimates are just as important. All four systems including SCERA have taken steps to strengthen their underlying financial and demographic assumptions. They have lowered the discount rate used to estimate pension liabilities and payments, which reduces the risk of unfunded liability growth in the future. (Discount rates are interest rates used to convert flows of money over time into a single lump-sum "present value". Public pensions use the expected long-term return on their investments as the discount rate in order to determine contribution rates that, combined with investment returns, will be sufficient to fund promised benefits.) They have also adopted generational improvements in mortality rates, which has the effect of embedding continuous future increases in retiree life expectancy into today's pension funding.

Both CalPERS and CalSTRS struggled to improve their funding ratios until they adopted policies to speed up progress in paying down their unfunded liabilities. CalPERS did this by changing from an open-ended, 30-year amortization policy—comparable to refinancing a home loan every year to a new 30-year mortgage—to a close-ended 20-year period for each year's unfunded liability increase or decrease and frontloading payments.[8] CalSTRS, which was systematically under-funded by state policy for over a decade, has benefited from a 2014 funding deal with the state to ensure that the system reaches 100% funding by 2046.[9] (For more detail on CalPERS and CalSTRS accounting and funding policy reforms, see *Marin Public Pension Series Brief #2*).

SCERA incrementally reduced its discount rate multiple times, from 7.75% in FY 2011 to 6.75% in FY 2021.[10] Decreasing the discount rate and increasing life expectancy both have the effect of increasing pension liabilities and costs, but SCERA managed to steadily increase its official funding ratio, from a low of 79% in 2012 to 93% in 2021. (See **Figure 4.**)

Figure 4: SCERA Funded Status and Discount Rate History, 2011-2021



Note: Data from SCERA actuarial valuations for FY 2012 through FY 2021. The smoothed value of assets reflects SCERA's "Valuation Value of Assets."

Funding discipline is a key reason that SCERA has steadily improved its funding ratio since the Great Recession: the contribution history in SCERA valuations shows that the County of Sonoma and other employers participating in the retirement system paid actuarially determined contributions in full every year. (SCERA prudently uses closed 20-year periods to amortize unfunded liability.) The County also made several one-time supplemental payments—$3.5 million in FY 2016, $4 million in 2020, and $3.75 million in FY 2022—which are expected to save almost $10 million in interest payments to SCERA.[11]

In addition, the County paid SCERA $289 million in 2010 with money borrowed through the issuance of pension obligation bonds (POBs) which are gradually being paid off through 2030.[12] This wiped out most of the County's unfunded liability resulting from the 2008 financial crisis.[13] By the end of FY 2023, the County will finish paying off another set of POBs issued in 2003, totaling $231.2 million, used to pay for pension benefit enhancements for then-current employees.

POBs are a risky strategy: they can help employers reduce the overall cost of paying down unfunded liabilities if pension fund investment returns on the pre-payment exceed the interest cost of the bonds, or incur higher costs if they are issued shortly before a large market decline.[14] Fortunately, the former turned out to be true and Sonoma County has been able to steadily pay down the remaining SCERA unfunded liability as well as the POB bonds.[15]

Taxpayer Pension Costs for SCERA Are on a Downward Trajectory due to Statewide Pension Reform

There are two components of employer cost for pensions: the **normal cost** of ongoing benefit accrual (net of employee contributions) and **unfunded liability service** (the annual cost of paying down unfunded liabilities). On average, ongoing benefit accrual by current employees accounts for one-third of employer costs for the average CalPERS Public Agency plan in Sonoma County, one-third of combined employer and state contributions to CalSTRS for teacher pensions, and two-thirds of average employer costs for SCERA. (The ratio is higher for SCERA because it has a lower unfunded liability cost rate.) Employer normal cost is being slowly reduced by benefit cuts imposed by PEPRA on employees hired after 2012.

Figure 5 shows the latest normal cost, unfunded liability service, and total cost (as a percentage of payroll) resulting from FY 2021 valuations for SCERA, CalPERS, and CalSTRS as well as MCERA in neighboring Marin County. Rates based on a given pension valuation year are implemented 1-3 fiscal years later, depending on the employer.

- CalPERS FY 2023 Public Agency rates for Sonoma County employers, based on the FY 2021 valuation, average 38.1% of payroll. This includes 13.7% for ongoing benefit accrual and 24.4% to pay down unfunded liabilities. Individual plan total rates vary widely around this average, from 9% to 69% total. Miscellaneous plans for non-safety employees cost somewhat less than these averages. Safety plans, which cover police officers and firefighters, cost significantly more. In addition, plans with lower funding ratios have higher unfunded liability service cost rates than well-funded plans.

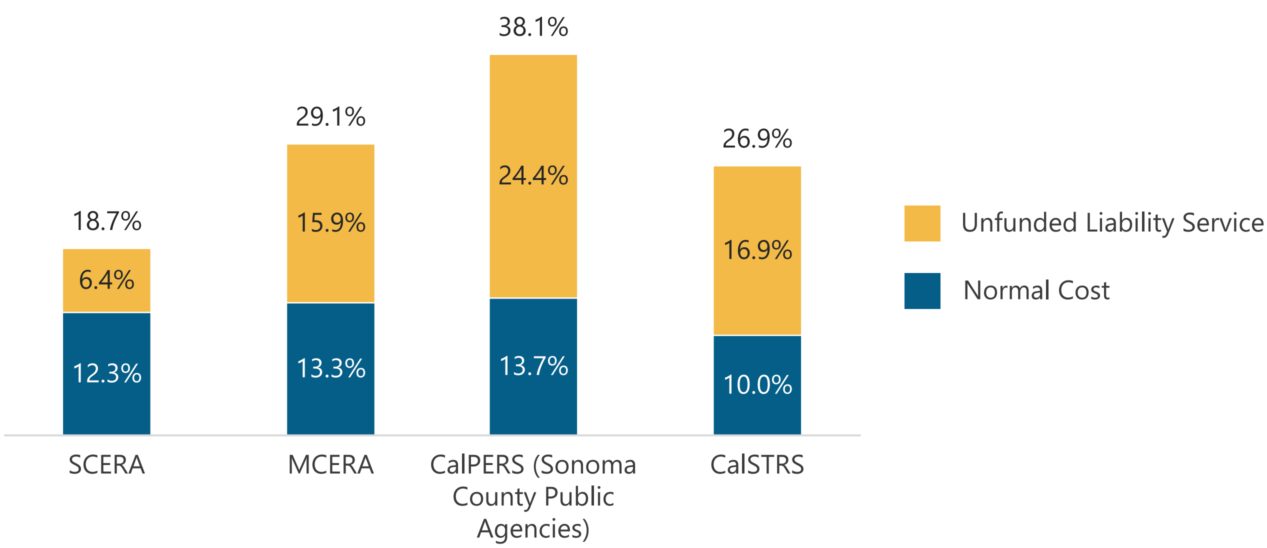
- CalSTRS FY 2023 school and state contributions total 26.9%, of which a little over one-third (10.0%) goes to normal cost and a little less than two-thirds (16.9%) to unfunded liability service. Under the statutory funding plan for CalSTRS, employers and the state contribute 19.1% and 7.828%, respectively, in FY 2023.[16]

- For MCERA as a whole, slightly more than half of payments are dedicated to paying down unfunded liabilities, and less than half to ongoing benefit accrual. Similar to CalPERS, there is wide variation in funded status among individual plans.
- SCERA has the lowest average employer contribution rate among pension systems in the region, with a normal cost of 12.3% of payroll and 6.4% for unfunded liability service as of its FY 2021 valuation. (Rates are effective FY 2022 for Sonoma Valley Fire District and FY 2024 for the County with adjustments to reflect payroll changes.)

Figure 6 shows the history of SCERA employer and employee contribution rates since FY 2011. The average employer rate peaked with the FY 2012 valuation at 22.56%, after losses from the 2008 financial crisis (less a $289 million payment by the County from its 2010 pension obligation bonds) were fully phased into contribution rates, and gradually declined to 18.69% in FY 2021. The average employee contribution rate has remained relatively steady at about 12% of pay.

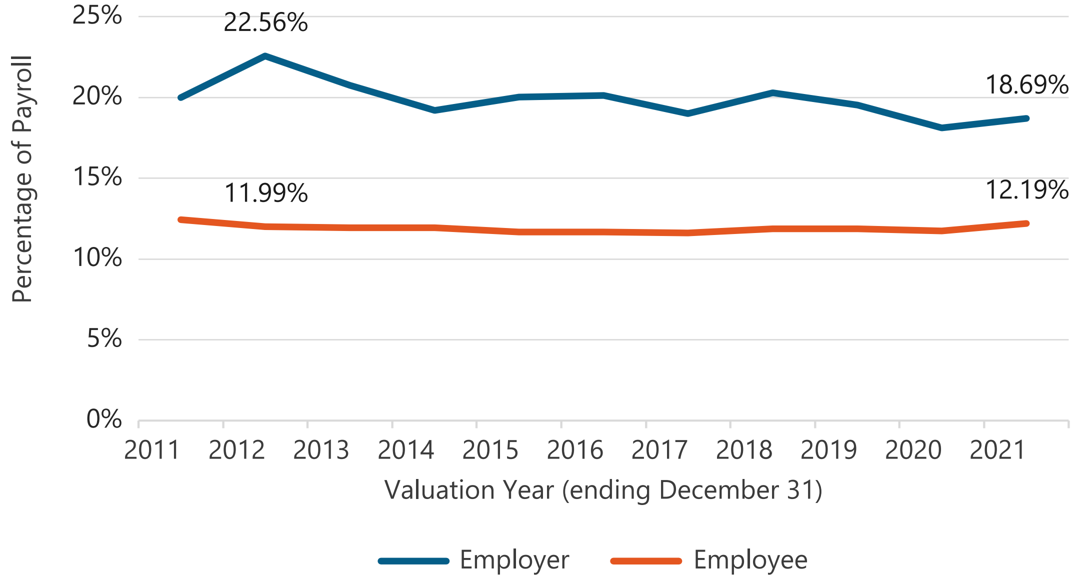
As **Figure 7** shows, both SCERA's average employer normal cost and unfunded liability service have been slowly declining since 2012. This is due to progress in improving its funding ratio and the long-term impact of statewide pension reform, which will be discussed in the next section. As the share of employees covered by the lower pension benefits increases, average normal cost trends down. Currently, over half of SCERA active members are covered by PEPRA. The adoption of more conservative actuarial assumptions in recent years—for instance, the investment return assumption reduction from 7% to 6.75% in 2021—has periodically interrupted this trend, but costs resume their decline after assumption changes are phased in.

Figure 5: Average Employer Costs for Public Employee Pension Benefits as a Percentage of Payroll, FY 2021 Valuation Year



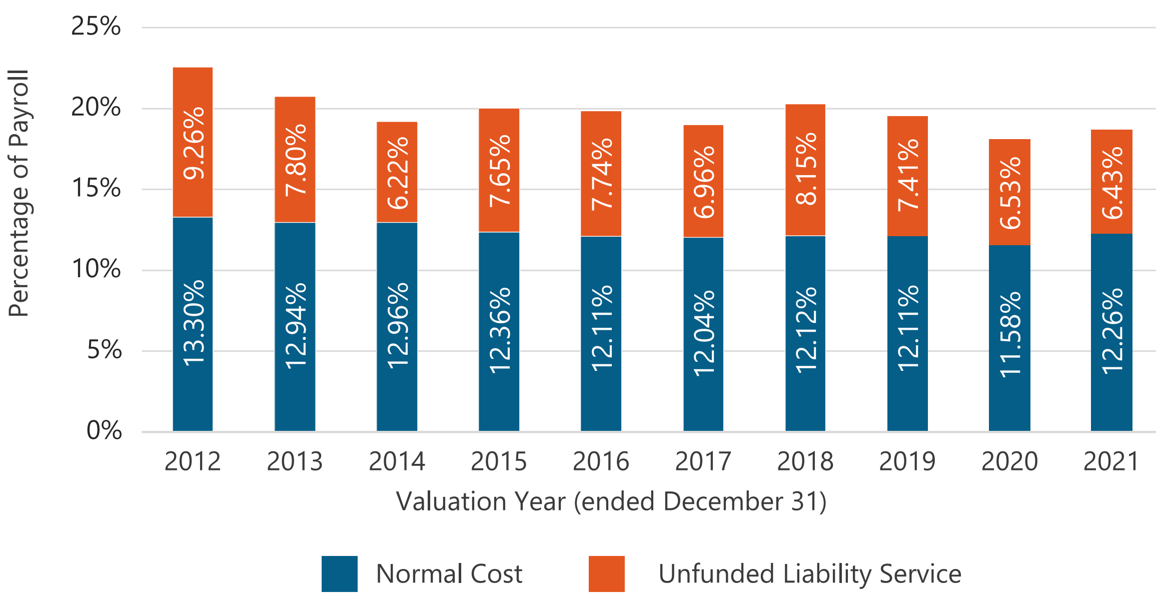
Note: Data from retirement system actuarial valuations. CalPERS data shown is the payroll-weighted public agency average for Sonoma County.

Figure 6: SCERA Employer and Employee Average Contribution Rate History, FY 2011-2021



Note: Data reflect recommended contribution rates from SCERA actuarial valuations. The Sonoma Valley Fire District and County of Sonoma pay the rates based on each SCERA fiscal year's valuation in different fiscal years. Rates based on the December 31, 2021, SCERA valuation were paid during SVFD fiscal year ending June 30, 2022, but will not be paid by the County until the fiscal year ending June 30, 2024. The average County employee rate includes a supplemental contribution of 3.03% for General Plan members and 3.00% for Safety Plan members employed by Sonoma County.

Figure 7: Average SCERA Employer Contribution Rates, 2012-2021 Valuation Years



Note: Data from SCERA actuarial valuations. Contribution rates are set based on previous year actuarial valuations, e.g., contributions for County fiscal year ending June 30, 2023, are based on the actuarial valuation for SCERA fiscal year ending December 31, 2021. The County has also made supplemental payments towards its share of the unfunded liability since FY 2020.

Impact of PEPRA on Benefit Levels and Current Accrual Costs for Employees Hired After 2012

The Public Employee Pension Reform Act of 2012 (PEPRA) capped benefits and increased cost sharing for California public employees hired on or after January 1, 2013. Key benefit-related provisions of PEPRA are as follows:

- Benefits for new hires are capped at 2% of highest average salary per year of service at age 62 (2% @ 62) for non-safety employees per year of service, and 2% at 55 for safety employees—or their actuarial equivalent.[17] For SCERA, the PEPRA benefit is 2.5% @ 67 for non-safety employees and 2.7% @ 57 for police and firefighters.
- Pension benefits for new hires are calculated based on the three-year highest average salary, rather than the single highest year.
- The final salary base for benefit calculations is capped at the Social Security taxable income limit, which was $147,000 in 2022. This affects a small share of public employees, such as high-level agency managers, senior ranking police and firefighters, and doctors.
- New hires are required to contribute at least 50% of the normal cost of their benefits.
- Pension "spiking"—such as using overtime pay or unused sick leave to increase base pay for pension benefit calculations—is prohibited for all employees.

PEPRA benefit formulas represent a significant reduction in benefits compared to previous pension tiers for public employees. For non-safety employees (categorized as Miscellaneous), benefits previously ranged from 2% @ 60 (teachers) to 2.5% @ 60 or 2% @ 55 (many CalPERS plans). Police and firefighters traditionally had earlier retirement age (e.g., 50) as well as higher multipliers up to 3%.

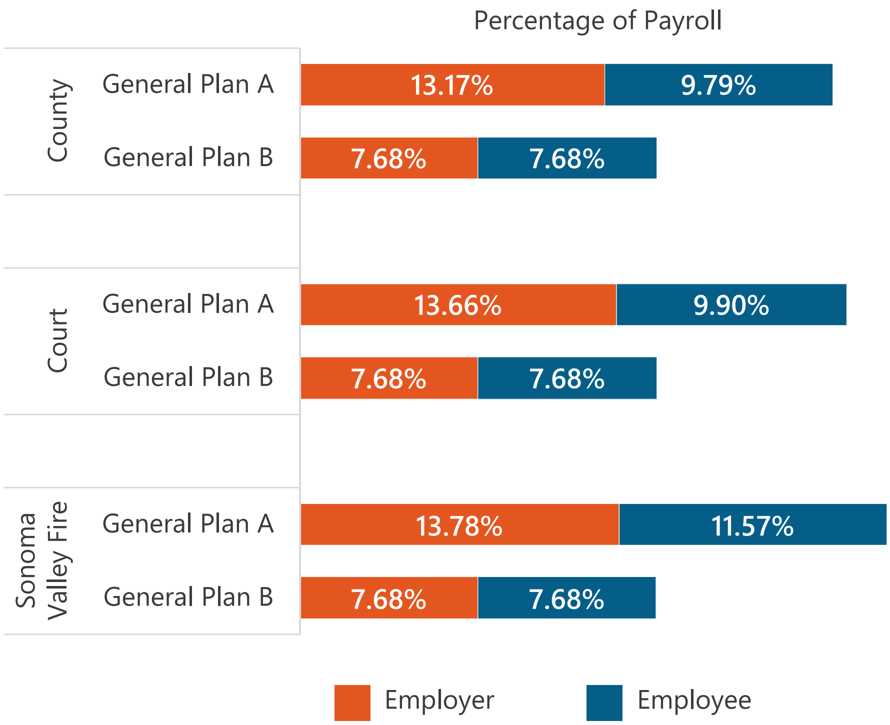
Figures 8a-b compare the employer and employee portions of normal cost for SCERA legacy and PEPRA benefits. **Figure 8a** focuses on non-safety plans and **Figure 8b** focuses on and safety plans. The rates reflect the FY 2021 actuarial valuation but are implemented with different lag times depending on the employer.

For non-safety workers employed by Sonoma County, the employer normal cost of benefits for those hired since 2013 (Plan B) is 7.68% of covered payroll, compared to 13.17% for legacy benefits (Plan A)—a 42% reduction (**Figure 8a**). Similarly, current benefit accrual for County public safety employees covered by PEPRA also costs 42% less than legacy benefits, 13.27% vs 22.78% of covered payroll (**Figure 8b**). The employer normal cost of pension benefits for Sonoma Valley Fire District firefighters covered by PEPRA is less than half that of legacy benefits, 14.00% vs. 30.29%.

County employee contributions to SCERA include 50% of total normal cost for PEPRA benefits (or negotiated share for legacy benefits), plus a supplemental rate of 3.00-3.03% of pay (not included in Figures 8a and 8b) that reduces the County's unfunded liability payments by an equivalent amount. This supplemental rate was negotiated between the County and its unions as a cost-sharing arrangement for the 2003 pension obligation bonds, and is scheduled to sunset for most employment units at the end of FY 2023, when those bonds will be fully paid.

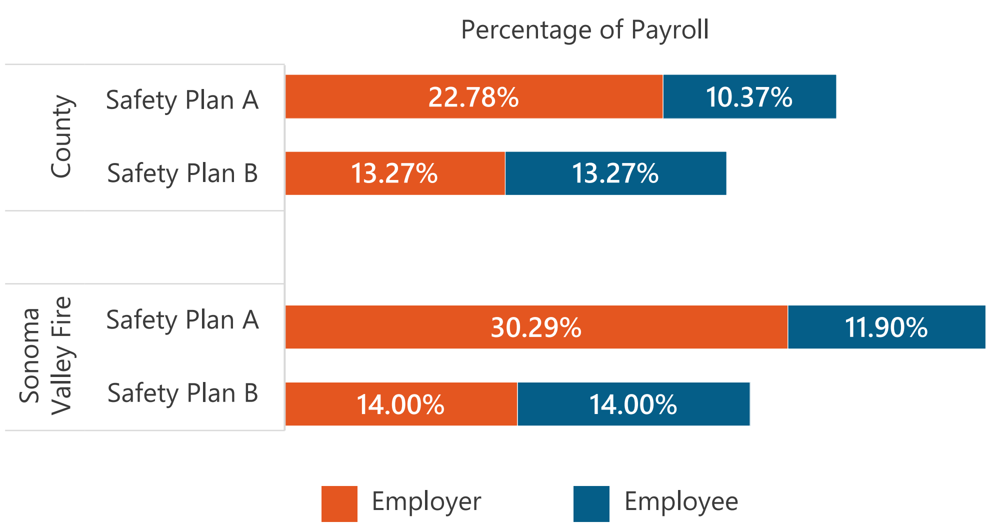
Figures 8a-b: Employer Cost for Pension Benefit Accrual Slashed for Workers Hires since 2013

8a: Normal Cost Contribution Rates for SCERA General Employee Pensions



Note: Data reflects recommended rates in the 2021 SCERA actuarial valuation.

8b: Normal Cost Contribution Rates for SCERA Public Safety Employee Pensions



Note: Data reflects recommended rates in the 2021 SCERA actuarial valuation.

III. Lack of COLA Poses Challenges for SCERA Members

The normal cost rates discussed earlier in this brief represent the average cost of benefit accrual for an employer, and are sensitive to differences in turnover rates and average age at hire. But for individual employees, retirement income is ultimately determined by the benefit formula—e.g., 2% at 60 or 2.5% at 67—and whether or not their pension is protected from inflation through an automatic annual COLA (Cost of Living Adjustment). The importance of this protection is underscored by the negative impact of recent high inflation on retirees with fixed incomes. Indeed, COLA policy figures heavily in the real value of a pension.

Most public employee pensions in California and the U.S. have automatic COLAs. Indeed, all pensions for public employees in the region except for those covered by SCERA have an automatic COLA.

Table 2 compares COLA policies by county and type of employee within in the nine-county Bay Area. County employees in Sonoma, Marin, Contra Costa, and the City and County of San Francisco are covered by county retirement systems, while those in other counties are covered by CalPERS. CalPERS also covers most city and town employees and many special district employees (except for a few covered by county systems), as well as all K-12 school classified (non-instructional) employees. In addition, the City of San José has a pension system for its own employees. CalSTRS covers educators in K-12 schools and community colleges. All of these employees—except for employees of the County of Sonoma, the Sonoma County Superior Court, and the Sonoma Valley Fire District—have pension benefits with a guaranteed annual COLA.[18]

COLAs for public employees in the region are typically tied to inflation with a maximum annual increase of 2%.[19] Except for CalSTRS, these public pension systems provide a compounding COLA, in which each year's COLA is added to the base for calculating the next year's COLA. CalSTRS provides retired teachers a 2% simple COLA (increase capped at 2% of original benefit), but the state funds a supplemental benefit to keep teacher pensions from falling below 85% of original purchasing power.

In contrast, employees and retirees of the County of Sonoma, the Superior Court, and Sonoma Valley Fire Department lack any kind of systematic inflation protection for their pension benefits.[20] SCERA does have a policy that allows for ad hoc COLA awards, under certain conditions. But the last time a COLA was awarded was in 2008, and the required conditions are not likely to be met any time in the foreseeable future.

The impact of past inflation on the incomes of current SCERA retirees is illustrated in **Figure 9**. A former County employee who retired in 2000 at age 62, now 82 years old, has seen seen the value of her monthly retirement income reduced by 46%. A 72-year old retiree who began receiving benefits in 2010 has already lost 20% of the value of their pension. Retirees in this position are likely anxious about how far their monthly pension checks will stretch, given current inflation trends.

Figure 10 compares the impact of 2.5% annual inflation over 20 years on SCERA retirees versus other pension system retirees under their respective COLA policies. SCERA currently assumes a long-term general inflation rate of 2.5%.[21] For each $1,000 of initial monthly benefit, a CalPERS pension gradually declines in valueto $907 and a CalSTRS pension declines to $854; the same goes for county pensions from Marin, San Francisco, Alameda, and Contra Costa. The SCERA pension loses almost 40% of its original value and plummets to $610. The SCERA pension after 20 years is 33% less than the CalPERS pension, even with the same initial benefit. According to SCERA mortality assumptions, about half of workers retiring at age 62 will live to age 82 and beyond.

In other words, half of SCERA retirees will see the value of their monthly pension decline to 33% less than the benefit they would have received by working for any other county government in the Bay Area. The significant share of retirees expected to live beyond 82 will see their benefits lag even farther behind.

The SCERA Board, Sonoma County, and employee unions are in discussions about the ad hoc COLA policy, including removing some of the arcane rules that restrict when they can be awarded. Current rules effectively prohibit ad hoc COLAs from being awarded unless historical investment losses are fully offset by surplus investment returns—even when the pension system reaches full funding, and the unfunded liabilities associated with those losses no longer exist.[22] However, a larger concern is that ad hoc COLA policies that rely on pension overfunding offer little protection to retirees. In order to prevent severe erosion of purchasing power, COLAs need to be planned for and funded in advance, just like base pension benefits.

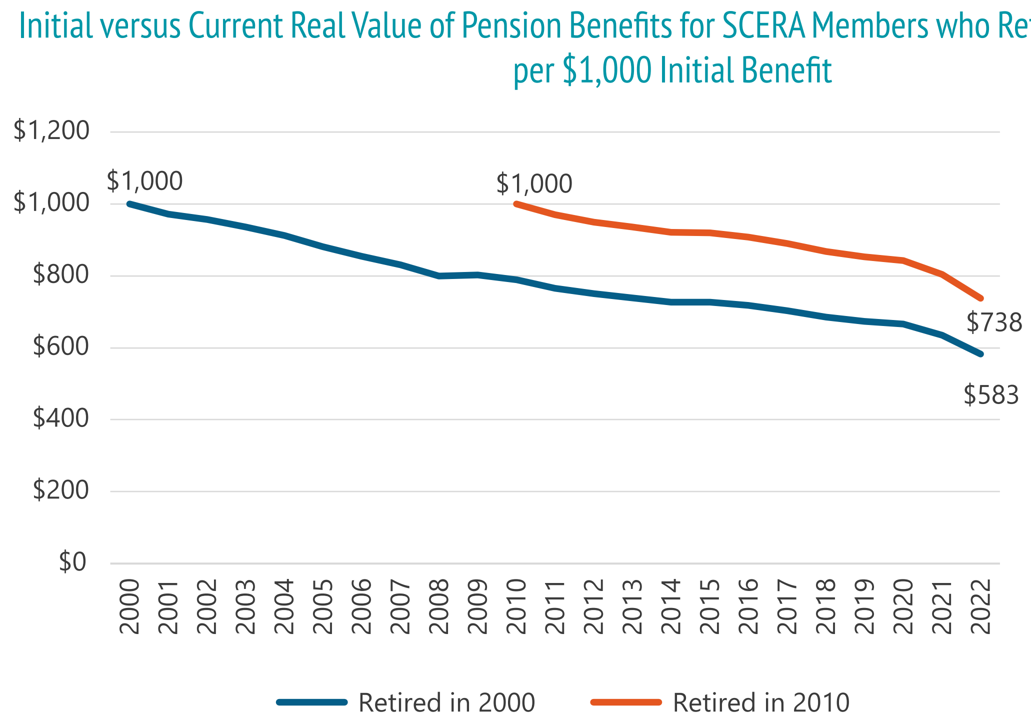
Table 2: Cost-of-Living Adjustment (COLA) Policies for in Public Employee Pensions in the Bay Area

County	Employer/Employee Type	Pension System	Automatic COLA?	Typical Annual Inflation Increase Cap
Sonoma County	County Employees	SCERA	NO	NA
	Sonoma Valley Fire & Rescue			
	Other Special Districts	CalPERS	YES	2%
	Cities	CalPERS	YES	2%
	Teachers	CalSTRS	YES	2%*
	Other School Staff	CalPERS	YES	2%
Marin, Solano, Lake, Contra Costa, San Francisco, and All Other Bay Area Counties	County Employees	MCERA, CCERA, SFERS, CalPERS	YES	2%
	Most Special Districts	CalPERS	YES	2%
	Cities	CalPERS, San Jose	YES	2%
	Teachers	CalSTRS	YES	2%*
	Other School Staff	CalPERS	YES	2%

*CalSTRS provides a 2% simple COLA (2% of original benefit) rather than a compound COLA. In addition, the state funds a Supplemental Benefit Maintenance Account (SBMA) sufficient to keep teacher pensions from falling below 85% of original purchasing power.

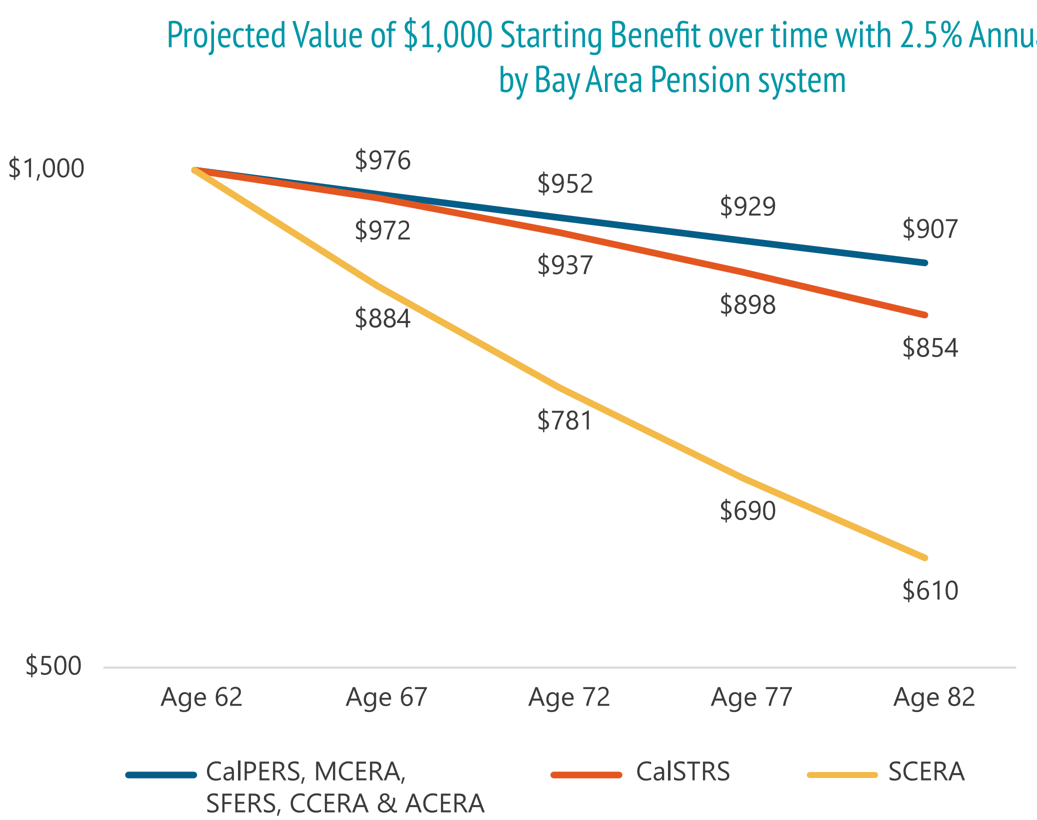
Note: Data from actuarial valuations of active employee pension plans. San Jose's Federated City Employees plan Tier 2 has a graduated COLA cap from 1.25% to 2% depending on years of service, while its Police & Fire plan Tier 2 has a 2% cap on annual inflation adjustments.

Figure 9: Current SCERA Retirees Have Seen Steep Declines in the Value of their Monthly Pension Income Due to Inflation



Note: Inflation adjustment based on CPI-U. "Retired in 2000" pension value includes ad hoc purchasing power restoration to 80% of original value in 2008.

Figure 10: Over Time, a SCERA Pension Loses Almost Half its Purchasing Power and Lags Behind Other Public Employee Pensions



Note: Author's calculations based on pension system COLA policies. SCERA currently assumes 2.5% general price inflation.

Conclusion

Secure pensions play a critical role in the compensation of Sonoma County public employees, who are paid wages that are on average 15.6% less than similarly educated private sector workers. Fortunately, the retirement systems that provide these workers with pensions—SCERA, CalPERS, and CalSTRS—are on significantly stronger financial footing compared to a decade ago based on a number of critical factors. These include improved funding ratios; strong long-term investment returns; prudent funding policies; and more conservative financial and demographic assumptions.

In addition, employer pension costs are declining over the long term. For example, SCERA's employer costs have been slowly declining since 2012 due to progress in paying down unfunded liabilities and steady growth in the share of employees covered by PEPRA, which reduced benefits and increased pension cost sharing for new hires.

At the same time, SCERA stands out as the only public pension system in the Bay Area that lacks systematic protection against inflation for retirees. Current SCERA retirees who began to collect benefits in 2000 have lost 42% of their pension to inflation. Between the beginning of the COVID-19 pandemic in March 2020 and November 2022, SCERA retirees saw their purchasing power decline by 13%. Looking forward, half of retiring SCERA members will live to see the value of their pension decline by 39% over 20 years, under a scenario of 2.5% long-term average inflation. At that time, their monthly benefit will be 33% lower than it would have been if they had worked for any other county in the Bay Area with the same base pension formula.

Endnotes

1 Nari Rhee, “Marin Public Pension Series Brief #2: Understanding the Financial Status, Cost, and Sustainability of Public Pensions in Marin County,” UC Berkeley Labor Center, May 2022, https://laborcenter.berkeley.edu/marin-pension-brief-no-2/.

2 Steven Ruggles, Sarah Flood, Ronald Goeken, Megan Schouweiler and Matthew Sobek, IPUMS USA: Version 12.0 [dataset], Minneapolis, MN: IPUMS, 2022, https://doi.org/10.18128/D010.V12.0.

3 Author’s analysis of IPUMS ACS 2015-2019 5-year sample.

4 U.S. Census Bureau, National Compensation Survey/Employer Costs for Employer Compensation.

5 Ibid

6 CalSTRS, “Annual Comprehensive Financial Report – For Fiscal Year Ended June 30, 2021”, https://www.calstrs.com/files/b43a53a11/acfr2021.pdf.

7 Ibid.

8 CalPERS, “2021 Annual Review of Funding Levels and Risks,” p. 23, https://www.calpers.ca.gov/docs/forms-publications/annual-review-funding-2020.pdf.

9 CalSTRS funding progress report

10 Author’s review of SCERA actuarial valuations for FY2012 through FY2021.

11 Sonoma County Board of Supervisors, “State of the Retirement System Annual Report (April 2022)” prepared by County of Sonoma, SCERA, and Segal, https://sonoma-county.legistar.com/View.ashx?M=F&ID=10677795&GUID=9F4DE1D6-8DCA-4A7A-9392-7B3782D88D44.

12 The County will pay off the 2003 POBs in FY2023, and is scheduled to finish paying off the 2010 bond issue by FY2030. Under an MOU related to the 2003 POBs, employees have been contributing an extra 3% of pay towards unfunded liability service, reducing the employer rate by an equivalent amount.

13 Author’s analysis of present values of 2008 unfunded liabilities from actuarial valuations and data provided in Paul Angelo and Andy Yeung, Letter to Gary J. Bei, Sonoma County Employees’ Retirement Association, “Re: Sonoma County Employees’ Retirement Association, Possible Adjustments to Fiscal Year 2010-2011 Contribution Rates to Reflect Amounts Paid Prior to Issuance of Pension Obligation Bonds,” October 15, 2010.

14 In 2015, the Government Finance Officers Association (GFOA) issued an advisory against issuing pension obligation bonds. https://www.gfoa.org/materials/pension-obligation-bonds.

15 Sonoma County Board of Supervisors, op cit.

16 Employer contribution rate is from CalSTRS Employer Directive 22-06; state contribution rate is from the 2021 CalSTRS actuarial valuation, p. 9, “Summary of Key Valuation Results,” item 8c.

17 Benefits are actuarially equivalent when their formulas are different but their present values are the same. For instance, the present value of a 2.5% @ 67 pension benefit is about the same as that of a 2% at age 62 benefit, given the same life expectancy, salary level, and discount rate.

18 Adjacent to Sonoma County and the Bay Area, the county pension system in Lake County also offers an automatic COLA.

19 San José's Federated City Employees plan Tier 2 has a graduated COLA cap from 1.25% to 2% depending on years of service, while its Police & Fire plan Tier 2 has a 2% cap on annual inflation adjustments. San Jose Federated City Employees Retirement Plan 2019 Actuarial Valuation.

20 The SCERA FY2021 actuarial valuation indicates 0.00% COLA assumption across all plans in Section 4: Actuarial Valuation Basis.

21 SCERA 2021, op cit., p. 73.

22 The mechanism through which cumulative deficits or surpluses in investment returns are tracked is the Negative Contingency Reserve. See SCERA, "Informational Session: Negative Contingency Reserve," Powerpoint presentation prepared by Paul Angelo and Todd Tauzer, August 18, 2022.

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