



**SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
STAFF REPORT
FINANCE DIVISION**

DATE: February 23, 2016
TO: BUSINESS AND GOVERNANCE COMMITTEE
FROM: Ted LaSalvia, Controller
SUBJECT: Presentation of the FY 2017 SDCERS Budget

Summary

The SDCERS' FY 2017 proposed budget demonstrates a continued emphasis on support and resources for the business, yet balanced with prudent cost controls.

- Administrative expenses in FY 2017 are budgeted at \$13.6 million
 - Down \$0.7 million (4.7%) from the FY 2016 budget
 - Down \$0.1 million (0.5%) from the FY 2016 projection
- Investment Management expenses in FY 2017 are budgeted at \$33.4 million
 - Down \$1.1 million (3.3%) from the FY 2016 budget
 - Up \$2.6 million (8.6%) from the FY 2016 projection
- Total proposed FY 2017 spending is \$46.9 million
 - Down \$1.8 million (3.7%) from the FY 2016 budget
 - Up \$2.6 million (5.8%) from the FY 2016 projection

The FY 2017 decrease of \$0.7 million in Administrative expense over the FY 2016 budget is the result of decreases in outside legal fees, salary and fringe costs, and actuary services. The \$0.1 million Administrative expense decrease over the FY 2016 projection is primarily due to decreases in outside legal counsel associated with ongoing purchase service credit litigation, actuary services and depreciation offset by increases in salaries and fringe expenses for positions that were open for much of FY 2016.

FY 2017 Investment Management expenses are projected to increase over the FY 2016 projection related to increases in assets under management, and incremental investments in real estate, private equity and infrastructure. FY 2017 expenses will be lower than the FY 2016 budget reflecting an improved methodology to calculate expected real estate fees for funds in the disposition phase offset by increases in assets under management. The FY 2017 basis points for the portfolio are 44 bps compared to the FY 2016 budget of

46 bps; the FY 2017 decrease reflects the improved real estate fee methodology and the fair value growth in private equity.

Below is a summary comparison of the FY 2017 Proposed Budget compared to the FY 2016 Budget and FY 2016 Projection, and a discussion of each category (amounts are subject to rounding and may not sum):

(In millions)

Category	FY 2016 Budget	FY 2016 Projection	FY 2017 Budget	Increase/ (Decrease) to FY 2016 Budget	Increase/ (Decrease) to FY 2016 Projection
Administrative Expenses	\$14.2	\$13.6	\$13.5	\$(0.7)	\$(0.1)
				(4.7)%	(0.5)%
Investment Management Expenses	\$34.5	\$30.7	\$33.4	\$(1.1)	\$2.6
				(3.3)%	8.6%
Total	\$48.7	\$44.3	\$46.9	\$(1.8)	\$2.6
				(3.7)%	5.8%

Administrative Expenses

1. Salaries and Personnel

The total cost for salaries and benefits is projected to decrease \$172,000 (2.2%) from the FY 2016 budget and increase \$264,000 (3.7%) from the FY 2016 projection. FY 2017 salaries have decreased by \$136,000 (2.9%) over the FY 2016 budget and increased \$185,000 (4.2%) over the FY 2016 projection. The increase in projected-to-budget wages reflects a fully staffed organization for FY 2017. Operational efficiencies associated with the implementation of the IRIS pension system have been realized in FY 2016, allowing SDCERS to leave open four positions that became vacant this year. Accordingly, the FY 2017 budgeted headcount is reduced to 54 from the FY 2016 budgeted level of 58. No provision has been made for a general salary increase.

Fringe expense accounts for \$25,000 of the Salaries and Personnel budget-to-budget decrease and \$79,000 of the increase over the FY 2016 projection. The FY 2017 fringe expense of \$2.9 million is a pass-through cost from the City, primarily composed of pension benefits, health benefits, taxes and changes in the City's FY 2017 ADC payment and may change based upon the completion of City's annual budget; any significant fringe rates changes from the City will be communicated to the SDCERS Board at the May Board meeting.

2. Information Technology

The FY 2017 budget for Information Technology increased \$32,000 (1.6%) from the FY 2016 budget, and \$31,000 (1.6%) from the FY 2016 projection. The slight increases for technical support labor and pension system support are related to year-over-year contractual increases. FY 2017 network services, licensing and support, professional services, computer hardware supplies and citywide costs are on par with the FY 2016 budget and FY 2016 projection.

3. Legal/External

The outside Legal budget of \$550,000 is comprised of litigation counsel (\$200,000), fiduciary counsel (\$160,000), tax/general counsel (\$135,000), and disability counsel (\$55,000). The FY 2017 budget has been reduced by \$427,000 (43.7%) from the FY 2016 budget, and \$187,000 (25.4%) from the FY 2016 projection. The Purchase Service Credit (PSC) litigation cases up on appeal are expected to be completed in FY 2016. FY 2017 budgeted amounts reflect a general provision for potential litigation. Projected outside fiduciary counsel costs are also included in the FY 2017 legal budget; the fiduciary budget is \$160,000, which reflects a minor increase in consultations with fiduciary counsel compared to the FY 2016 budget. The budget for tax/general includes estimates for work related to Unified Port District's determination letter, IRS private letter ruling, industrial disability ruling and day-to-day tax questions. The FY 2017 budget for disability counsel decreased from the FY 2016 budget by \$15,000 due to a decrease in disability applications and associated hearing-related costs.

4. General Operations

The General Operations budget reflects an overall decrease of \$104,000 (2.9%) from the FY 2016 budget, and a \$174,000 decrease (4.7%) from the FY 2016 projection. The FY 2017 savings compared to the FY 2016 budget and FY 2016 projection result from a \$100,000 decrease in actuary services reflecting the completion of an experience study in FY 2016, lower fiduciary insurance rates, and decreased depreciation expense. Office operations expense increases \$86,000 over the FY 2016 budget resulting from temporary labor to support an electronic filing/scanning project underway, and a provision for a competitive benchmarking study comparing SDCERS to like-sized pension systems. The office operations expense decrease of \$88,000 over the FY 2016 projection reflects more limited use of temporary labor while recruiting to fill open budgeted positions. Lastly, a contractual increase in rent adds \$32,000 to the FY 2017 budget.

Investment Management

Investment management fees are budgeted based on assets under management, the projected growth in the investment portfolio, and the investment of assets according to the allocations as approved by SDCERS' Board. The annual growth in assets under management is based on SDCERS' actuarially assumed rate of 7.125%. The asset growth projection is applied to the current contractual fee schedules of SDCERS' investment managers and is calculated on projected average assets of approximately \$6.9 billion for FY 2017.

FY 2017 Investment Management expenses are expected to decrease over FY 2016 budget by \$1.1 million (3.3%) and to increase over FY 2016 projections by \$2.6 million or (8.6%). Fees as a percentage of market value are projected to decline to 44 basis points for FY 2017 from 46 basis points for the FY 2016 budget. This reflects the use of an improved and more accurate methodology to calculate expected real estate fees for funds in the disposition phase and the projected fair value growth in private equity.

Compared to the FY 2016 budget, Public Market fees are expected to decrease \$0.3 million (2.1%) reflecting a reduction in the allocation to public markets as the result of the continued investment in Private Equity and a reclassification of Real Estate Opportunity Fund investments to the Real Estate budget. Real Estate fees decrease by \$2.4 million (18.7%) as a result of an improved methodology to estimate management fees for funds in the wind-down phase, representing 9 out of 23 funds. Private Equity and Infrastructure fees are anticipated to increase \$1.3 million (24.7%) largely as a result of a new private equity series. Investment consulting fees are up \$52,000 (7.3%) reflecting the hiring of an independent contractor to review Custodial banking services and fees. Legal fees increase \$115,000 due to anticipated new investment contract reviews and a legal review of Investment Division policies.

Compared to the FY 2016 projection, Public Market fees increase \$1.1 million (8.0%) due to assumed market growth and new Opportunity Fund investments. Real Estate expenses are projected to increase \$0.9 million (9.2%) due to three new fund investments and the inclusion of Opportunity Fund real estate investments. Private Equity and Infrastructure fees are expected to be up \$0.5 million (7.5%) due to the new private equity series; reflecting the anticipated funding of this series, only half the fees are projected to be paid in the FY 2016 projection, while a full year of fees are included in the FY 2017 budget.

Capital Spending

SDCERS' capital spending is projected at \$100,000 for FY 2017, an increase of 11.1% from the \$90,000 budgeted in FY 2016 and a \$307,000 decrease from the FY 2016 projection. The FY 2016 projection of \$407,000 reflects an IRIS pension system final phase payment of \$140,000 that was previously scheduled for payment in FY 2015 and a \$250,000 increase in the Board Room HD Video upgrade project that will be funded by Public, Educational and Government (PEG) funds provided through the City of San Diego. The entire video upgrade project is eligible for these funds and will allow SDCERS to recover the project costs in FY 2016. In FY 2017, projects include an upgrade to the SIRE Board Agenda and Voting software, and computer hardware replacements.

Conclusion

Ten years ago, SDCERS spent \$19.1 million in Administrative expenses, while now ten years later the FY 2017 budget is \$13.6 million . . . a 29% reduction. Headcount for SDCERS peaked in 2009 at 65 people, while the FY 2017 budget is 54 people . . . 17% fewer people. In 2007, SDCERS Administrative expenses were 47% of the total budget (Investment Management fees being the other 53%). In FY 2017, Administrative expenses will be just 29% of the budget. These trends are all in the right direction!

In summary, the FY 2017 budget reflects continued cost control over administrative overhead while providing the resources necessary for SDCERS to meet its mandated responsibilities.

Attachments: FY 2017 Expense Budget Proposal
FY 2017 Capital Budget Proposal

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM
EXPENSE BUDGET (in thousands)
FISCAL YEAR 2016 BUDGET, FISCAL YEAR 2016 PROJECTION AND FISCAL YEAR 2017 PROPOSED BUDGET

	2016		Proposed Budget	2017	
	Budget	Projection		Increase (Decrease) to FY2016 Budget	Projection
ADMINISTRATIVE EXPENSES					
Budgeted Staff	58	54	54	(4)	-
Salaries and Personnel					
Salary ¹	\$ 4,685	\$ 4,364	\$ 4,549	\$ (136)	\$ 185
Fringe ¹	2,951	2,847	2,926	(25)	79
Overtime	26	14	15	(11)	1
Recognition Program	10	11	10	-	(1)
Total Salaries and Personnel	\$ 7,671	\$ 7,235	\$ 7,500	\$ (172)	\$ 264
				-2.2%	3.7%
Information Technology					
Technical Support Labor	\$ 945	\$ 945	\$ 965	\$ 20	\$ 20
Pension System Support	450	450	464	14	14
Network Services	157	158	156	(2)	(2)
Licensing and Support	150	150	150	-	-
Computer Hardware Supplies	101	101	101	-	(0)
Professional Services	97	97	97	-	-
Citywide Costs	42	42	42	-	-
Total Information Technology	\$ 1,942	\$ 1,943	\$ 1,974	\$ 32	\$ 31
				1.6%	1.6%
Legal/External					
Litigation	\$ 600	\$ 400	\$ 200	\$ (400)	\$ (200)
Fiduciary	150	150	160	10	10
Legal Tax/General	158	108	135	(23)	28
Disability	70	80	55	(15)	(25)
Total Legal/External	\$ 978	\$ 738	\$ 550	\$ (427)	\$ (187)
				-43.7%	-25.4%
General Operations					
Rent	\$ 936	\$ 941	\$ 969	\$ 32	\$ 28
Depreciation Expense	899	899	851	(49)	(48)
Office Operations Expenses	423	596	509	86	(88)
Fiduciary Insurance	440	405	388	(52)	(17)
Actuary Services	450	450	350	(100)	(100)
Disability Processing	148	96	138	(10)	43
Travel & Training	118	117	121	3	4
Audit Services	133	115	118	(14)	4
Retiree Health Counseling Services	97	97	97	-	-
Total General Operations	\$ 3,645	\$ 3,715	\$ 3,541	\$ (104)	\$ (174)
				-2.9%	-4.7%
TOTAL ADMINISTRATIVE EXPENSES	\$ 14,236	\$ 13,631	\$ 13,565	\$ (671)	\$ (66)
				-4.7%	-0.5%
INVESTMENT MANAGEMENT EXPENSES					
Management Fees					
Equity & Fixed Income	\$ 15,250	\$ 13,821	\$ 14,934	\$ (316)	\$ 1,112
Real Estate	12,698	9,455	10,329	(2,370)	873
Private Equity & Infrastructure	5,377	6,239	6,707	1,330	468
Consulting	715	720	767	52	48
Legal Fees	100	148	215	115	67
Custodial Banking Services	343	320	401	58	81
Software Applications	20	20	17	(3)	(3)
TOTAL INVESTMENT MANAGEMENT EXPENSES	\$ 34,503	\$ 30,723	\$ 33,370	\$ (1,133)	\$ 2,647
				-3.3%	8.6%
GRAND TOTAL	\$ 48,739	\$ 44,354	\$ 46,935	\$ (1,805)	\$ 2,581
				-3.7%	5.8%

¹ Investment Division salary and fringe costs of are included in Salaries and Personnel expense for budgetary purposes, but are reclassified as investment expenses on the Statement of Changes in Plan Net Position as required under GASB financial reporting standards.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

CAPITAL EXPENSE BUDGET (in thousands)

FISCAL YEAR 2016 BUDGET, FISCAL YEAR 2016 PROJECTION AND FISCAL YEAR 2017 PROPOSED BUDGET

	2016		Proposed Budget	2017	
	Budget	Projection		Incr. (Decr.) to FY 2016	
				Budget	Projection
Pension Administration System Replacement - Final Phase	\$40	\$140	\$0	\$(40)	\$(140)
Call Center Voice Monitoring & Recording System	-	17	-	-	(17)
Board Room HD Video Upgrade	50	250	-	(50)	(250)
SIRE Board Agenda & Voting System Upgrade	-	-	75	75	75
Equipment Replacement	-	-	25	25	25
Total	\$90	\$407	\$100	\$10	(\$307)