

# **MORGAN HILL UNIFIED SCHOOL DISTRICT**

## **VALUATION OF RETIREE HEALTH BENEFITS**

### **REPORT OF GASB 75 ACTUARIAL VALUATION AS OF JUNE 30, 2019**

**Prepared by: North Bay Pensions LLC  
December 4, 2020**

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## Actuarial Certification

This report presents the determination of benefit obligations under **Statement No. 75 of the Governmental Accounting Standards Board (GASB 75)** as of June 30, 2019 for the retiree health and welfare benefits provided by the Morgan Hill Unified School District. I was retained by the District to perform these calculations.

GASB Statement 75, "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions", was issued to provide standards for governmental employers to record expense for **Other Postemployment Benefits (OPEB)**.

The information contained in this report was based on a participant census as of June 30, 2019 provided to me by the District. The actuarial assumptions and methods used in this valuation were selected by the District after consultation with me. I believe the assumptions and methods are reasonable and appropriate for purposes of actuarial computations under GASB 75.

Actuarial computations under GASB 75 are for purposes of fulfilling employer accounting requirements. The calculations reported herein have been made on a basis consistent with my understanding of GASB 75. Determinations for purposes other than meeting employer financial accounting requirements may be significantly different from the results reported herein. Due to the limited scope of my assignment, I did not perform an analysis of the potential range of future measurements.

To the best of my knowledge, this report is complete and accurate. This valuation has been conducted in accordance with generally accepted actuarial principles and practices. The undersigned is a Fellow of the Society of Actuaries, a Fellow of the Conference of Consulting Actuaries, and a Member of the American Academy of Actuaries, and meets their continuing education requirements and qualification standards for public statements of actuarial opinion relating to retirement plans. In my opinion, I am qualified to perform this valuation.



12-4-2020

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## Summary of Results

### Background

The District maintains a program which pays part or all of monthly medical insurance premiums on behalf of retired former employees, provided that the employee has satisfied certain requirements. As of June 30, 2019, the District continues to fund the benefits on a pay-as-you-go basis.

GASB Statement No. 75, "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions", often referred to as **GASB 75**, requires governmental entities to (1) record annual expense for their OPEB and (2) disclose certain information in their year-end financial statements.

The District has requested this actuarial valuation to determine what its OPEB obligations under the program are, and what the impact of GASB 75 will be for the 2019-2020 year. This report also includes GASB 75 results that were accrued and disclosed by the District during the 2018-2019 year.

**A significant change has been made to the negotiated benefits for MHCEA (classified) employees.** MHCEA employees who retire after December 31, 2019 are only eligible to receive the PEMHCA minimum, and do not qualify for the \$9,000 benefit.

### Actuarial Present Value of Projected Benefit Payments

The Actuarial Present Value of Projected Benefit Payments (APVPBP) for all current and former employees, as of June 30, 2019, is **\$61,654,500**. This is the amount the District would theoretically need to set aside at this time to fully fund all those future benefits.

The total value of \$61,654,500 is the sum of these amounts:

Future benefits of current employees	\$ 43,336,055
Future benefits of current retirees	<u>18,318,445</u>
APVPBP	\$ 61,654,500

This figure may be compared to the APVPBP of \$64,363,802 that was shown in the 2017 valuation report. We would have expected the APVPBP to be approximately \$65,885,000 by 2019 as employees continue working and benefits are paid to retirees. The difference between the 2017 figure of \$64,363,802 and this year's figure of \$61,654,500 is due to:

• Expected change in the APVPBP since 2017	\$ 1,520,865
• Changes in assumptions	3,822,876
• Change in MHCEA benefits	(1,983,996)
• Medical premiums different than expected	(4,590,816)
• Miscellaneous other experience gains and losses	(1,478,231)
Total of changes	\$ (2,709,302)

The assumption changes are explained below under “Actuarial Assumptions”. The change in benefits for MHCEA employees is described below under “Changes in Benefits”. The experience gain (i.e. reduction) of \$1,478,231 is due mainly to normal demographic effects (deaths, terminations and retirements different than anticipated).

The \$4,590,816 decrease due to changes in medical premiums deserves a bit of explanation. One of the things the accounting profession requires us to compute is the value of “subsidized premiums”, sometimes called the “implicit rate subsidy”. The true cost of medical claims increases as people get older, but the insurance companies charge the same monthly medical premium to all employees, young and old. In a sense, the younger employees are subsidizing the higher cost of medical claims for older employees. The accounting rules require us to include the value of this subsidy (the part that relates to retired employees) in our GASB 75 liabilities. The \$4.6 million decrease mentioned above represents the change in the value of subsidized premiums in all future years, as a result of this year’s medical premiums being lower than was anticipated.

These figures are computed by (1) estimating the OPEB benefits that will be paid to each current and former employee and their beneficiaries (if applicable), upon the employee’s retirement from the District, (2) estimating the likelihood that each payment will be made, taking into consideration the likelihood of remaining employed until retirement age and the likelihood of survival after retirement, and (3) discounting each expected future payment back to the present date at an assumed rate of investment return.

### **Net OPEB Liability**

The **Total OPEB Liability** (TOL) is the portion of the APVPBP which has been “earned” by employees based on past years of service (i.e. benefits allocated to past years of service).

The **Plan Fiduciary Net Position** (FNP) is equal to the value of assets that have been accumulated in an irrevocable trust for these benefits.

The **Net OPEB Liability or Asset** (NOL) is the excess of the Total OPEB Liability over the Plan Fiduciary Net Position. At the end of each fiscal year, beginning June 30 2018, the District must show a liability equal to the NOL.

At June 30, 2018 and June 30, 2019, these amounts are:

	<u>June 30, 2018</u>	<u>June 30, 2019</u>
Present value of benefits for employees	\$ 34,014,133	\$ 28,024,903
Present value of benefits for retirees	<u>16,762,832</u>	<u>18,318,445</u>
Total OPEB Liability	\$ 50,776,965	\$ 46,343,348
Accumulated assets	<u>\$ 0</u>	<u>\$ 0</u>
Plan Fiduciary Net Position	\$ 0	\$ 0
Total OPEB Liability	\$ 50,776,965	\$ 46,343,348
Plan Fiduciary Net Position	<u>(0)</u>	<u>(0)</u>
Net OPEB Liability	\$ 50,776,965	\$ 46,343,348

### **OPEB Expense under GASB 75**

GASB 75 requires that the annual change in the TOL be recognized as OPEB expense, except for certain specific changes which are to be recognized over different periods of time. Changes in actuarial assumptions, and experience gains and losses, are to be recognized over the average of the expected remaining service lives of all employees. This average for District employees is 8.8 years. The unrecognized remaining amounts of assumption changes, experience gains/losses and investment earnings differences are called “deferred outflows and inflows of resources relating to OPEB” (see Exhibit 5).

The OPEB Expense for the fiscal year ending June 30, 2019 was **\$3,109,145**. For the year ending June 30, 2020, the OPEB Expense is **\$1,086,406**. Derivations of these amounts are shown in Exhibit 4.

### **Disclosure Information as of June 30, 2019 and June 30, 2020**

Amounts to be disclosed in the footnotes to the District’s audited financial statements as of June 30, 2019 and as of June 30, 2020 are shown in Exhibits 2 through 6 of this report. Numbers labelled as “June 30, 2018” are to be disclosed at June 30, 2019. Numbers labelled as “June 30, 2019” are to be disclosed at June 30, 2020. For GASB 75 reporting, we use a one-year “lookback” which is the reason for the differences in dates.

Exhibit 7 shows estimated retiree benefits and OPEB expense for the 9 years after that.

### **Actuarial Assumptions**

All actuarial assumptions are unchanged from the July 1, 2017 valuation, except as described below. The assumptions are described in detail in Exhibit 9.

The discount rate has been changed from 3.13% to 2.79%. The discount rate for an unfunded plan is required to be based on a 20-year index of high-quality bonds. The

District has elected to use the S&P Municipal Bond 20 Year High Grade Rate Index, which was 3.13% as of June 30, 2017; 2.98% as of June 30, 2018; and 2.79% as of June 30, 2019. Changing the discount rate had the effect of increasing the APVPBP by \$4,547,186.

The probabilities of mortality, turnover and retirement for classified employees have been changed from the 2014 CalPERS assumptions to the 2017 CalPERS assumptions. This change had the effect of decreasing the APVPBP by \$724,310.

### **Changes in Benefits**

MHCEA employees must retire no later than December 31, 2019 to qualify for the \$9,000 benefit. MHCEA employees who retire after that date are only eligible to receive the PEMHCA minimum. Eliminating the \$9,000 benefit for MHCEA employees who retire after 2019 reduced the APVPBP by \$1,983,996.

## Exhibit 1 - Actuarial Values as of June 30, 2019

The Actuarial Present Value of Projected Benefit Payments (APVPBP) as of June 30, 2019 of all future employer-paid benefits from the program, for all current and former employees, is:

	<u>Classified</u>	<u>Certificated</u>	<u>Administrative</u>	<u>Total</u>
Current employees	\$ 13,553,891	\$ 26,029,652	\$ 3,752,512	\$ 43,336,055
Retirees	<u>5,419,234</u>	<u>11,458,236</u>	<u>1,440,975</u>	<u>18,318,445</u>
Total (APVTPB)	\$ 18,973,125	\$ 37,487,888	\$ 5,193,487	\$ 61,654,500

As of June 30, 2019, the District has not accumulated any assets in an irrevocable trust toward this liability.

The Total OPEB Liability (TOL) as of June 30, 2019 is the portion of the APVPBP which has been “earned” to date by current and former employees, based on the years of service already completed:

Current employees	\$ 28,024,903
Retired former employees	<u>18,318,445</u>
Totals	\$ 46,343,348

### Number of Persons Covered

	<u>Classified</u>	<u>Certificated</u>	<u>Administrative</u>	<u>Total</u>
Current employees	162	232	40	434
Average Age	54.6	48.2	48.9	50.7
Average Service	14.5	11.7	10.7	12.6
Retired Employees	102	172	26	300
Average Age	72.2	71.2	73.3	71.7



## Exhibit 2 - Total OPEB Liability

As of June 30, 2017, June 30, 2018 and June 30, 2019 the Total OPEB Liability is:

	<u>June 30, 2017</u>	<u>June 30, 2018</u>	<u>June 30, 2019</u>
Discount rate	3.13 %	2.98 %	2.79 %
Value of benefits for employees	\$ 30,271,829	\$ 34,014,133	\$ 28,024,903
Value of benefits for retirees	<u>17,401,345</u>	<u>16,762,832</u>	<u>18,318,445</u>
Total OPEB Liability	\$ 47,673,174	\$ 50,776,965	\$ 46,343,348

The Total OPEB Liability has changed from June 30, 2017 to June 30, 2018 in this way:

Values at June 30, 2017	\$ 47,673,174
Service cost	1,818,977
Interest	1,469,226
Differences between actual and expected experience	0
Assumption changes	1,281,703
Benefit changes	0
Benefits paid to retirees	(1,466,115)
Administrative expense	0
Net changes	\$ 3,103,791
Values at June 30, 2018	\$ 50,776,965

The Total OPEB Liability has changed from June 30, 2018 to June 30, 2019 in this way:

Values at June 30, 2018	\$ 50,776,965
Service cost	1,952,843
Interest	1,497,955
Differences between actual and expected experience	(7,418,080)
Assumption changes	2,139,162
Benefit changes	(1,585,457)
Benefits paid to retirees	(1,020,040)
Administrative expense	0
Net changes	\$ (4,433,617)
Values at June 30, 2019	\$ 46,343,348

### Exhibit 3 - Sensitivity of the Total OPEB Liability

The following presents the Total OPEB Liability (TOL) as well as what the TOL would be if it were calculated using a discount rate that is 1-percentage-point higher or lower than the current discount rate, as of June 30, 2018 and June 30, 2019:

	<u>1% Decrease</u>	<u>Discount Rate</u>	<u>1% Increase</u>
	<b>1.98 %</b>	<b>2.98 %</b>	<b>3.98 %</b>
Total OPEB Liability 6-30-2018	\$ 60,730,476	\$ 50,776,965	\$ 43,075,286
	<b>1.79 %</b>	<b>2.79 %</b>	<b>3.79 %</b>
Total OPEB Liability 6-30-2019	\$ 55,734,088	\$ 46,343,348	\$ 39,133,187

The following presents the TOL as well as what the TOL would be if it were calculated using healthcare cost trend rates that are 1-percentage-point higher or lower than the current healthcare cost trend rates, as of June 30, 2018 and June 30, 2019:

	<u>1% Decrease</u> <b>3%</b>	<u>Trend Rate</u> <b>4%</b>	<u>1% Increase</u> <b>5%</b>
Total OPEB Liability 6-30-2018	\$ 42,963,596	\$ 50,776,965	\$ 61,047,927
Total OPEB Liability 6-30-2019	\$ 39,382,495	\$ 46,343,348	\$ 55,403,676

## **Exhibit 4 - OPEB Expense for the Fiscal Year Ending June 30, 2020**

**For the year ending June 30, 2019**, the District recognized OPEB expense of **\$3,109,145**, computed as follows:

Service cost	\$ 1,818,977
Interest	1,469,226
Expected investment return	0
Administrative expense	0
Change in TOL due to changes in benefits	0
Recognition of difference between actual and expected experience	0
Recognition of changes in assumptions	(179,058)
Recognition of difference between projected and actual earnings on investments	<u>0</u>
<b>Total</b>	<b>\$ 3,109,145</b>

**For the year ending June 30, 2020**, the District will recognize OPEB expense of **\$1,086,406**, computed as follows:

Service cost	\$ 1,952,843
Interest	1,497,955
Expected investment return	0
Administrative expense	0
Change in TOL due to changes in benefits	(1,585,457)
Recognition of difference between actual and expected experience	(842,964)
Recognition of changes in assumptions	64,029
Recognition of difference between projected and actual earnings on investments	<u>0</u>
<b>Total</b>	<b>\$ 1,086,406</b>

## Exhibit 5 - Deferred Outflows and Inflows of Resources

The values of deferred outflows and inflows of resources related to OPEB as of June 30, 2018, **to be reported as of June 30, 2019**, are:

	<b><u>Deferred Outflows of Resources</u></b>	<b><u>Deferred Inflows of Resources</u></b>
Differences between expected and actual experience	\$ 0	\$ 0
Changes of assumptions	1,182,346	3,034,728
Net difference between projected and actual earnings on OPEB plan investments	0	0
District contributions subsequent to the measurement date	<u>1,020,040</u>	<u>0</u>
Total	\$ 2,202,386	\$ 3,034,728

Amounts reported as deferred outflows and inflows of resources related to OPEB as of June 30 2018, **to be reported as of June 30, 2019**, will be recognized in OPEB expense as follows:

Year Ended June 30	
2020	\$ (179,058)
2021	(179,058)
2022	(179,058)
2023	(179,058)
2024	(179,058)
Thereafter	(957,092)

The values of deferred outflows and inflows of resources related to OPEB as of June 30, 2019, **to be reported as of June 30, 2020**, are:

	<b><u>Deferred Outflows of Resources</u></b>	<b><u>Deferred Inflows of Resources</u></b>
Differences between expected and actual experience	\$ 0	\$ 6,575,116
Changes of assumptions	2,979,064	2,756,313
Net difference between projected and actual earnings on OPEB plan investments	0	0
District contributions subsequent to the measurement date	<u>UNKNOWN</u>	<u>0</u>
Total		\$ 9,331,429

“UNKNOWN” is the total contributed by the District during the 12 months ending June 30, 2020 to retirees’ benefits. This is the sum of (1) actual cash benefits paid to or on behalf of retirees, plus (2) the subsidized benefits for the year (which is \$670,357).

Amounts reported as deferred outflows and inflows of resources related to OPEB as of June 30 2019, **to be reported as of June 30, 2020**, will be recognized in OPEB expense as follows:

Year Ended June 30	
2021	\$ (778,935)
2022	(778,935)
2023	(778,935)
2024	(778,935)
2025	(778,935)
Thereafter	(2,457,690)

## Exhibit 6 - Schedule of Changes in the Total OPEB Liability

Reporting date	<u>6/30/2019</u>	<u>6/30/2020</u>
<b>Total OPEB liability</b>		
Service cost	\$ 1,818,977	\$ 1,952,843
Interest	1,469,226	1,497,955
Changes of benefit terms	0	(1,585,457)
Differences between actual and expected experience	0	(7,418,080)
Changes of assumptions	1,281,703	2,139,162
Benefits paid to retirees	<u>(1,466,115)</u>	<u>(1,020,040)</u>
<b>Net change in Total OPEB liability</b>	3,103,791	(4,433,617)
<b>Total OPEB liability – beginning</b>	<u>47,673,174</u>	<u>50,776,965</u>
<b>Total OPEB liability – ending</b>	\$ 50,776,965	\$ 46,343,348
 Covered-employee payroll	 \$ 37,446,273	 \$ 46,129,632
Total OPEB liability as a percentage of covered-employee payroll	135.60 %	100.46 %

## Exhibit 7 - Ten-Year Projection of Costs

Shown below are estimates of (a) the benefits expected to be paid to retirees, and (b) the amounts the District is expected to accrue as GASB 75 OPEB expense, for the next ten years. For these estimates, it is assumed that all actuarial assumptions and the size of the workforce will remain unchanged, that the promised benefits will remain the same, that the District will continue paying benefits to retirees each year, and that there are no experience gains or losses.

Fiscal Year Ending:	Employer-Paid Retiree Payments	Projected Implicit Rate Subsidy Payments	GASB 75 OPEB Expense
2020	\$ 868,000	\$ 670,357	\$ 1,086,406
2021	847,000	710,484	2,504,000
2022	818,000	723,000	2,613,000
2023	804,000	730,000	2,726,000
2024	780,000	719,000	2,845,000
2025	797,000	808,000	2,970,000
2026	810,000	758,000	3,099,000
2027	829,000	777,000	3,233,000
2028	870,000	790,000	3,493,000
2029	934,000	805,000	4,117,000

## Exhibit 8 - Summary of Benefit Provisions

There are four different employee groups for which post-retirement medical benefits are provided.

1. **Certificated (MHFT):** Certificated employees who retire on or after age 55 with at least 10 years of service are entitled to benefits. The district will provide the retiree with \$9,000 per year for not more than 10 years or until the retiree turns 65. This will be interpreted as the end of the month in which the retiree turns 65, and will be in effect until all other agreements with MHUSD employee units who have retirement benefits receive prorated benefits that end at the retiree's 65th birth month. If the retiree worked part-time, the annual amount is pro-rated. After age 65, the monthly portion of the premium (PEMHCA minimum) is paid for as long as the retiree lives and is covered by a CalPERS health plan.

2. **Classified (MHCEA):** Classified employees who retire after age 55 and with at least 10 years of service no later than December 31, 2019 are entitled to a maximum benefit of \$9,000 annually for 10 years or until the year the retiree attains age 65 whichever comes first. If the retiree worked part-time, the annual amount is pro-rated. Benefits are only paid if the retiree is covered by a CalPERS health plan. After age 65, the monthly portion of the premium (PEMHCA minimum) is paid for as long as the retiree lives and is covered by a CalPERS health plan. The PEMHCA minimum applies also to employees who retire after 2019.
3. **Administrative (MHELA):** Administrative employees who retire on or after age 55 with at least 10 years of service are entitled to benefits. The benefits are the same as those paid to retiring certificated employees.
4. **Individual Contracts:** Two persons (a former Superintendent and a former Deputy Superintendent) have employment contracts providing for lifetime health, dental, and vision benefits after retirement. In one contract, the benefit is capped; in the other contract, the benefit is uncapped.
5. **PEMHCA Minimum.** The PEMHCA minimum benefit is \$136 per month in 2019, \$139 in 2020, increases each year thereafter. The PEMHCA minimum benefit is not pro-rated if the retiree did not work full-time.
6. **PEPRA Employees.** PEPRA employees (initial California public employment after December 31, 2012) are not eligible to receive benefits.

## **Exhibit 9 - Summary of Actuarial Assumptions**

**Actuarial Assumptions:** The following assumptions as of June 30, 2019 were selected by the District in accordance with the requirements of GASB 75. These assumptions, in my opinion, are reasonable and appropriate for purposes of determining OPEB costs under GASB 75.

**20-Year Bond Rate:** The District has chosen to use the “S&P Municipal Bond 20 Year High Grade Rate Index” as its 20-year bond rate. That Index was 2.98% at June 30, 2018, and 2.79% at June 30, 2019.

**Discount rate:** 2.98% at June 30, 2018, and 2.79% at June 30, 2019. Since the benefits are not funded, the discount rate is equal to the 20-Year Bond Rate.



**Premium Increases:** The PEMHCA minimum benefit and CalPERS medical premiums are assumed to increase 4% per year in the future. The \$9,000 cap is assumed to remain unchanged in all future years.

**Payroll Growth:** Total payroll is assumed to increase 3% per year in the future.

**Coverage Elections:** Retired employees who are covered at June 30, 2019 are assumed to remain covered for life. Retirees who are not covered at June 30, 2019 are assumed to never elect coverage. 100% of eligible current employees are assumed to elect coverage upon retirement.

**Mortality:** Mortality rates are taken from the 2017 CalPERS valuation (for classified employees) and from the 2016 valuation of Cal STRS (for certificated employees). In the 2017 valuation, mortality for classified employees was taken from the 2014 CalPERS OPEB Assumptions Model.

**Funding Method:** The Entry Age actuarial cost method has been used, with normal costs calculated as a level percentage of payroll, as required by GASB 75.

**Disability:** Incidence of disability is considered to be included in the termination and retirement rates here, so no explicit recognition of disablement has been included.

**Inflation:** Long-term inflation is assumed to be 2.75% per year.

**Age-Specific Claims:** The per person annual “true cost” of medical coverage for the 2019-2020 fiscal year has been developed from the monthly insurance premiums, the demographics of the employee population and industry norms. The annual “true cost” amounts used in this valuation were (sample rates only are shown):

Age 50	11,849
Age 55	14,612
Age 60	17,032
Age 62	17,832
Age 64	18,273

These age-specific rates were developed so as to reproduce in the aggregate the same total premium that would be paid to the carriers for all current employees and all current retirees.

**Retirement:** Retirement rates are taken from the 2017 CalPERS OPEB Assumptions Model (for classified employees) and from the 2016 valuation of Cal STRS (for certificated employees). Sample rates are:

	<u>10 Years Service</u>	<u>20 Years Service</u>	<u>30 Years Service</u>
<b>CalPERS</b>			
Age 55	4.2 %	6.9 %	8.6 %
Age 58	4.5 %	7.4 %	9.2 %
Age 61	7.2 %	11.9 %	14.9 %
Age 64	11.7 %	19.3 %	24.0 %
<b>STRS Males</b>			
Age 55	2.7 %	2.7 %	6.0 %
Age 58	2.7 %	2.7 %	12.0 %
Age 61	7.0 %	7.0 %	50.0 %
Age 64	13.0 %	13.0 %	30.0 %
<b>STRS Females</b>			
Age 55	3.5 %	3.5 %	8.0 %
Age 58	3.5 %	3.5 %	15.0 %
Age 61	9.0 %	9.0 %	50.0 %
Age 64	14.0 %	14.0 %	35.0 %

In the 2017 valuation, retirement rates for classified employees were taken from the 2014 CalPERS valuation.

**Turnover (withdrawal):** Likelihood of termination within the next year is taken from the 2017 CalPERS OPEB Assumptions Model (for classified employees) and from the 2016 valuation of Cal STRS (for certificated employees). Sample rates are:

	<u>5 Years Service</u>	<u>10 Years Service</u>	<u>15 Years Service</u>
<b>CalPERS</b>			
Age 20	12.13 %		
Age 30	12.13 %	5.26 %	3.09 %
Age 40	7.49 %	4.37 %	3.09 %
Age 50	5.99 %	2.98 %	2.03 %
<b>STRS Males</b>			
Age 20	3.50 %		
Age 30	3.50 %	1.80 %	1.20 %
Age 40	3.50 %	1.80 %	1.20 %
Age 50	3.50 %	1.80 %	1.20 %
<b>STRS Females</b>			
Age 20	3.00 %		
Age 30	3.00 %	1.80 %	1.20 %
Age 40	3.00 %	1.80 %	1.20 %
Age 50	3.00 %	1.80 %	1.20 %

In the 2017 valuation, turnover rates for classified employees were taken from the 2014 CalPERS valuation.