

# **Soaring City Pension Costs – Time for Hard Choices.**

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## SOARING CITY PENSION COSTS – TIME FOR HARD CHOICES

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### ISSUES

How high will the pension costs of cities within San Mateo County be in the next ten years and what actions can the cities take now to meet those obligations?

### SUMMARY

Public pension costs are already eating into city budgets and represent a serious threat to public services in San Mateo County's cities.

In FY 2016-2017, the 20 cities within the county of San Mateo (the Cities) spent a total of \$102 million on their pension plans, representing an average of approximately 13.6 percent of their general fund expenditures. As heavy a financial burden as this is, the Cities' pension costs are projected to double by FY 2024-2025 if new actuarial assumptions made by CalPERS - the administrator of the Cities' pension plans - prove to be correct. Many experts argue, however, that CalPERS' assumptions are unduly optimistic. If these experts are correct, increases in the Cities' pension costs could be even greater.

The most important change in CalPERS' actuarial assumptions is a lowered expectation for the Return on Investment for CalPERS' pension fund assets. Since Return on Investment is expected to pay for the majority of retiree pensions, a lower investment return means that the Cities and their employees must make up the difference by making larger payments into the pension fund. The Cities have no control over CalPERS' assumptions, and each year they must pay the amount of money required by CalPERS. In each City, the city government and employees share a "Normal Cost" of paying for future retiree benefits. These will increase as a result of the changed CalPERS's assumptions. However, each City also has an "Unfunded Liability" that represents the difference between the value of their pension fund assets and the present value of their long-term pension obligations. As a result, the Cities are required to pay "Amortization Costs" (principal plus interest) to CalPERS on their Unfunded Liabilities. Amortization Costs will also increase because of the changed CalPERS' assumptions. On average, the Cities' Normal Costs comprise 41 percent of their total pension payments to CalPERS, while Amortization Costs comprise 59 percent.

The Cities have a number of options for paying steeply rising pension costs, each of which can be implemented on its own, or in combination. First, the Cities can cut public services, reduce employee salaries and benefits, or lay off employees in order to free up additional funds. Second, the Cities can negotiate with bargaining units to increase the employees' share of pension costs. Third, the Cities can attempt to increase revenues from taxes. Fourth, the Cities can use other existing resources, if any, to pay down the Unfunded Liabilities early. The San Mateo Civil Grand Jury of 2017-2018 has found that the last choice could result in large savings for all the

Cities. In one scenario, the savings could exceed \$125 million each for the Cities of San Mateo and Redwood City.

In the course of its investigation, the Grand Jury learned that none of the Cities have adopted long-term financial plans to address their rising pension costs. Some Cities informed the Grand Jury that, while rising pension costs are important, they must be balanced against “other priorities” for new spending. While the Grand Jury understands the desire on the part of the Cities to expand their services in these times of growth and increasing property tax revenues, it is difficult to think of a more important issue for them to address than the looming pension crisis. Currently, the region enjoys unprecedented economic conditions, resulting in higher tax revenues and budget surpluses for many Cities. The Grand Jury asks: If the Cities do not address Unfunded Liabilities now, when will they ever be able to?

The Grand Jury has compiled data regarding pension costs of each of the Cities, which are set forth in Appendix A of this report, as well as aggregate information for all of the Cities. This report also provides a general overview of public pension obligations, the major variables that drive pension cost and Unfunded Liability calculations, including how these variables can understate Unfunded Liabilities. This report describes the options available to the Cities to address the looming budgetary crises they face from rising pension costs.

The Grand Jury recommends that the Cities make addressing pension costs a higher priority and that they engage residents in a discussion about the hard choices that their local governments will have to make. The Grand Jury also recommends that each City develop a financial plan to address rising pension costs. The Grand Jury does not recommend specific policies or implementation measures for the Cities to adopt, but the Grand Jury does identify a number of options for them to consider.

## **GLOSSARY**

- Agency: Any city, county, or other public entity employer that offers a pension plan to its employees through CalPERS. Each of the Cities is, accordingly, an “Agency” for purposes of this report.
- Amortization Cost: Payments by the Cities to CalPERS, to pay down their Unfunded Liability. It includes payments of (a) principal needed to pay off (amortize) the Unfunded Liability over a period of years, plus (b) interest charged by CalPERS on that liability.
- Amortization Period: The number of years over which an Unfunded Liability is to be paid off.
- Benefits or Benefits obligations: Amounts to be paid out of a pension plan’s assets to Members or their beneficiaries.

- Comprehensive Annual Financial Report or CAFR: An annual financial report issued by government entities, such as the Cities.
- CalPERS: The California Public Employees Retirement System, which administers pension plans for all of the Cities.
- County: The government of San Mateo County. The geographic area of San Mateo County is referred to as the “county.”
- Discount Rate: The interest rate used in calculating the present value of future cash flows. CalPERS determines the Discount Rate it will use to calculate each pension plan’s Total Plan Liabilities and Unfunded Liabilities. Under public pension plan accounting rules, the Discount Rate is the same as the annual Return on Investment that CalPERS projects it will earn on plan assets.
- Funded Ratio or Funded Percentage: Measures the extent to which a pension plan’s assets match the present value of its projected future pension obligations. It is the ratio that results from dividing Total Plan Assets by Total Plan Liabilities.
- GASB: The Government Accounting Standards Board. Among other things, it sets financial accounting standards for public service employee pension plans.
- Members: Current and vested former employees of the Cities, or their beneficiaries, who participate in one of the Cities’ CalPERS pension plans.
- Miscellaneous Plans: Pension plans for public service employees who do not provide safety services such as police and fire protection. Miscellaneous Plans are generally less expensive to maintain than Safety Plans.
- Normal Cost: The contribution payments Agencies and their employees make to CalPERS in order to fund the projected lifetime cost (discounted to present value) of Benefits that accrue to current employee Members during that year. It does not include Amortization Costs.
- Return on Investment or Rate of Return: The annual gain or loss on invested pension plan assets. In public pension plans, this is the same as the Discount Rate.
- Safety Plans: Pension plans for public service employees who provide safety services, such as police and fire protection.
- Cities: The 20 cities located within the San Mateo County.

- **Total Plan Assets:** The current dollar value of all assets within a pension plan (sometimes referred to in CAFRs as “Fiduciary Net Position”).
- **Total Plan Liabilities:** The present value of all future Benefit obligations under a pension plan (sometimes referred to in a CAFR as “Total Pension Liability”).
- **Unfunded Liability:** The dollar amount, if any, by which Total Plan Liabilities of a pension plan exceed its Total Plan Assets (sometimes referred to in a CAFR as “Net Pension Liability”).

## BACKGROUND

### The Cities’ Pension Plans.

Each of the Cities provides its employees with a pension plan administered by CalPERS<sup>1</sup> as an integral part of their compensation package. All of these plans are defined benefit plans<sup>2</sup> in which future Benefits are determined by a formula that is set at the outset of employment.<sup>3,4</sup> The Benefits are guaranteed by the Cities and do not depend on how well pension contributions are invested. Benefits are financed from three sources:<sup>5</sup>

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<sup>1</sup> See, the Comprehensive Annual Financial Reports (CAFRs) listed in the BIBLIOGRAPHY section below for each of the Cities.

<sup>2</sup> See, CAFRs for each of the Cities listed in the BIBLIOGRAPHY section below. CalPERS, *Comprehensive Annual Financial Report for the Year Ended June 30, 2017*, p. 7, <<https://www.calpers.ca.gov/docs/forms-publications/cafr-2017.pdf>>.

<sup>3</sup> Biggs, Andrew and Smetters, Kent, *Understanding the Argument for Market Valuation of Public Pension Liabilities*, American Enterprise Institute. May 2013, p. 1, <[http://www.aei.org/wp-content/uploads/2013/05/-understanding-the-argument-for-market-valuation-of-public-pension-liabilities\\_10491782445.pdf](http://www.aei.org/wp-content/uploads/2013/05/-understanding-the-argument-for-market-valuation-of-public-pension-liabilities_10491782445.pdf)>. Ruloff, Mark, *Defined Benefit Plans vs. Defined Contribution Plans*, Pension Section News of Society of Actuaries, January 2005 – Issue No. 57, p. 1. Money-Zine, *Defined Benefit versus Contribution Plans*, July 5, 2017, <<https://www.money-zine.com/financial-planning/retirement/defined-benefit-versus-contribution-plans/>>. Investopedia, *How does a defined benefit pension plan differ from a defined contribution plan?*, March 2015, <<https://www.investopedia.com/ask/answers/032415/how-does-defined-benefit-pension-plan-differ-defined-contribution-plan.asp>>.

<sup>4</sup> In contrast, most private companies’ retirement plans are defined contribution plans, such as 401k’s, where the amounts of future benefit payments vary depending on returns achieved on investments. Greenhut, Steven, *California Still Facing Pension Crisis Even with Good Stock Market Returns*, California Policy Center, July 14, 2017, <<http://reason.com/archives/2017/07/14/dont-let-unions-use-good-returns-to-defl>>.

<sup>5</sup> CalPERS at a Glance, *CalPERS Communications and Stakeholder Relations*, <<https://www.calpers.ca.gov/docs/forms-publications/calpers-at-a-glance.pdf>>. CalPERS 2017 CAFR, p. 47. Lin, Judy, *Retirement Debt: What’s the problem and how does it affect you?* CalMatters.org, February 21, 2018, <<https://calmatters.org/articles/california-retirement-pension-debt-explainer/>>. Nation, Joe, *Pension Math: How California’s Retirement Spending is Squeezing the State Budget*. SIEPR (Stanford Institute for Economic Policy Research). December 13, 2011, p. 23, <<http://arc.asm.ca.gov/NSR.pdf>>. Nation, Joe and Storms, Evan, *More Pension Math: Funded Status, Benefits, and Spending Trends for California’s Largest Independent Public Employee Pension Systems*. SIEPR (Stanford Institute for Economic Policy Research). February 21, 2012, p. 3, <[http://siepr.stanford.edu/sites/default/files/publications/Nation\\_More\\_Pension\\_0.pdf](http://siepr.stanford.edu/sites/default/files/publications/Nation_More_Pension_0.pdf)>. Biggs and Smetters, *Understanding the Argument for Market Valuation*, p. 3.

- Current employee contributions to CalPERS of a fixed percentage of their salaries. These contributions go towards Normal Costs and pay for approximately 13 percent of Benefits paid under CalPERS' pension plans).
- Agency (that is, employer) contributions to CalPERS of
  - (i) the Normal Cost of the pension plan for that year (less the employee contributions amounts), plus
  - (ii) if the pension plan has an Unfunded Liability (as do all of the Cities' pension plans<sup>6</sup>), the Amortization Cost (that is, the cost of paying off that Unfunded Liability, including both principal and interest, over a period of years).

These employer contributions pay for approximately 26 percent of Benefits paid under CalPERS' pension plans.<sup>7</sup>

- Return on Investment achieved by CalPERS from investing the contributions made by employees and Agencies between the time that the contributions are made and the date when Benefits payments come due. Historically, these Returns on Investment have paid for approximately 61 percent of Benefits paid under CalPERS' pension plans.<sup>8</sup>

CalPERS determines the contributions that Agencies (that is, employers) must pay to CalPERS to cover future Benefits by calculating:

- (i) Benefits amounts that will have to be paid, based on assumptions that include projected future retirement rates, inflation, wage increases and post-retirement longevity, and
- (ii) Returns on Investment CalPERS expects to earn on employee and Agency contributions.

To the extent that projected costs of Benefits increase unexpectedly, or Returns on Investment fall short of projections, pension plans will have Unfunded Liabilities. The Agencies rather than CalPERS are responsible for paying down all Unfunded Liabilities through increased contributions and the Agencies bear all the risk of CalPERS' projections being wrong.<sup>9</sup> Agencies

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<sup>6</sup> Appendix A.

<sup>7</sup> CalPERS at a Glance.

<sup>8</sup> CalPERS at a Glance.

<sup>9</sup> The Economist, Buttonwood's Notebook, *The soaring cost of old age, The real problem with pensions*, March 7, 2018, <<https://www.economist.com/blogs/buttonwood/2018/03/soaring-cost-old-age>>. Oliveira, Anthony, *The Local Challenges of Pension Reform*, Bartel Associates, May 24, 2010, p. 4, <[http://www.bartel-associates.com/docs/default-source/articles/oliveira\\_a\\_the-challenges-of-pension-reform-1.pdf?sfvrsn=2](http://www.bartel-associates.com/docs/default-source/articles/oliveira_a_the-challenges-of-pension-reform-1.pdf?sfvrsn=2)>. Andonov, Aleksander, Bauer, Rob, Cremers, Martijn, *Pension Fund Asset Allocation and Liability Discount Rates*,



have no control over CalPERS' determinations and must pay all contribution increases mandated by CalPERS.<sup>10</sup>

### **Importance of Rate of Return on Investment.**

As noted above, Returns on Investments are the primary funding source for meeting Benefits obligations. Accordingly, annual Returns on Investment achieved by CalPERS have a major impact on its ability to fund Benefits payments. As of June 30, 2017, CalPERS reported the following annualized net Returns on Investment over different periods of time:<sup>11</sup>

- Past 3 years: 4.6 percent
- Past 5 years: 8.8 percent
- Past 10 years: 4.4 percent
- Past 20 years: 6.6 percent

Even small changes in CalPERS' annual Returns on Investments over the long-term can drive substantial changes in its ability to meet Benefit obligations. For example, if a pension plan had an obligation to pay Benefits of \$150 million in 20 years and CalPERS projected that its annual Return on Investment over that time would average 7.5 percent, then CalPERS would need \$35.5 million at the outset to meet that obligation. However, if the actual Return on Investment achieved by CalPERS over that period was only 6.5 percent instead of 7.5 percent, then the pension plan would only have \$124.4 million available to pay Benefits in the 20th year,<sup>12</sup> a shortfall of more than \$35 million on the \$150 million obligation.

### **Importance of Discount Rates.**

To determine the Funded Percentage of a pension plan, CalPERS compares the value of the pension plan's assets (Total Plan Assets) to the present value of the plan's Benefits payment obligations (Total Plan Liabilities).<sup>13</sup> If the present value of the Benefits obligations is larger than the current value of pension assets, then the plan is not fully funded and has an Unfunded Liability equal to the difference.

In economic terms, the promise to make a future Benefit payment is worth less today than an immediate payment of the same amount. In order to compare the value of a promise to pay a

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March 2016, p. 1, <[http://www.icpmnetwork.com/wp-content/uploads/2016/05/Rob-Buaer\\_What-Is-the-Biggest-Challenge-Facing-Public-Plan-Sponsors\\_Optional.pdf](http://www.icpmnetwork.com/wp-content/uploads/2016/05/Rob-Buaer_What-Is-the-Biggest-Challenge-Facing-Public-Plan-Sponsors_Optional.pdf)>.

<sup>10</sup> Interviews by Grand Jury.

<sup>11</sup> CalPERS, *Investment & Pension Funding Facts at a Glance for Fiscal Year 2016-17*, <<https://www.calpers.ca.gov/docs/forms-publications/facts-investment-pension-funding.pdf>>.

<sup>12</sup> The formula for the 7.5 percent Return on Investment example is: \$150 million / ((1.0 + 0.075)<sup>20</sup>) = \$35,311,972. The formula for the 6.5 percent Return on Investment example is: \$35,311,972 x (1.065<sup>20</sup>) = \$124,426,856.

<sup>13</sup> Biggs and Smetters, *Understanding the Argument for Market Valuation*, p. 1.

Benefit in the future to the value of plan assets today, the value of the promise to make a future payment must first be discounted to its present value. As explained by Messrs. Biggs and Smetters:

“Discounting is a process similar to compound interest. While compound interest begins with a current dollar amount and adds interest to determine the future value, discounting begins with the future value and subtracts interest each year until a present value is arrived at.”<sup>14</sup>

Even small changes in the annual interest to be subtracted from the future value (that is, the Discount Rate), significantly impact present value and, consequently, a plan’s Unfunded Liability.<sup>15</sup> See, the section of this report entitled “Increase in Unfunded Liabilities and Decrease in Funded Percentages if a Lower Discount Rate is Used” at p. [16] for an example of the impact on the Cities of a drop of just one percentage point in the Discount Rate. As a result, the Discount Rate selected for this calculation matters a great deal.

### **Debate Over CalPERS’ Discount Rates and Projected Rates of Return.**

Discount rates are set based on CalPERS’ projections for long-term Returns on Investment.<sup>16</sup> The higher the projected Return on Investment, the higher the Discount Rate and the lower the Unfunded Liability. That is often referred to as the “assumed return approach”.<sup>17</sup> Although GASB mandates this method of setting public pension plan Discount Rates,<sup>18</sup> it is controversial.<sup>19</sup> Many economists, academics and commentators claim it understates the size of Unfunded Liabilities.<sup>20</sup> They argue that the present value of future Benefit obligations should be

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<sup>14</sup> Ibid., p. 4.

<sup>15</sup> Nation, *Pension Math* 2011, pp. 9 and 11.

<sup>16</sup> GASB Statement No. 68, Paragraph 64,

[http://www.gasb.org/jsp/GASB/Document\\_C/DocumentPage?cid=1176160220621&acceptedDisclaimer=true](http://www.gasb.org/jsp/GASB/Document_C/DocumentPage?cid=1176160220621&acceptedDisclaimer=true). Mixon, Peter, *Estimating Future Costs at Public Pension Plans: Setting the Discount Rate*. Pensions & Investments, April 29, 2015, p. 1, <http://www.pionline.com/article/20150429/ONLINE/150429853/estimating-future-costs-at-public-pension-plans-setting-the-discount-rate>. Brewington, Autumn, *Making Sense of the Mathematics of California’s Pension Liability*, Hoover Institution, August 21, 2012, <https://www.hoover.org/research/making-sense-mathematics-californias-pension-liability>. Biggs and Smetters, *Understanding the Argument for Market Valuation*, p. 4.

<sup>17</sup> U.S. Government Accountability Office, *Pension Plan Valuation: Views on Using Multiple Measures to Offer a More Complete Financial Picture*, September 30, 2014, p. 2, <https://www.gao.gov/products/GAO-14-264> and <https://www.gao.gov/assets/670/666287.pdf>. Mixon, *Estimating Future Costs at Public Pension Plans*, p. 1. Turner, John, Godinez-Olivares, Humberto, McCarthy, David, del Carmen Boado-Penas, Maria, *Determining Discount Rates Required to Fund Defined Benefit Plans*, Society of Actuaries, January 2017, p. 6, [www.actuaries.org/oslo2015/papers/PBSS-Turner&GO&McC&B-P.pdf](http://www.actuaries.org/oslo2015/papers/PBSS-Turner&GO&McC&B-P.pdf).

<sup>18</sup> GASB Statement No. 68, Paragraph 64.

<sup>19</sup> Angelo, Paul, *Understanding the Valuation of Public Pension Liabilities – Expected Cost versus Market Price*, In the Public Interest, January 2016, p. 9, <https://www.soa.org/library/newsletters/in-public-interest/.../ip-2016-iss12-angelo.aspx>.

<sup>20</sup> Mixon, *Estimating Future Costs at Public Pension Plans*, p. 1. U.S. Government Accountability Office, p. 2. Bui, Truong and Randazzo, Anthony, *Why Discount Rates Should Reflect Liabilities: Best Practices for Setting Public Sector Pension Fund Discount Rates*, Reason Foundation, September 2015, p. 4, <https://reason.org/wp->

based on a Discount Rate that reflects the value of those Benefits payments to the beneficiaries (that is, the amount an investor would pay today in exchange for the right to receive that future cash flow). Noting that obligations to pay Benefits in the future are similar to obligations to make future payments on municipal bonds, they argue that yield rates on municipal bonds having a duration and risk of non-payment similar to pension Benefits obligations are the best yardstick for establishing the value of those Benefit obligations and, accordingly, the Discount Rate.<sup>21</sup> This approach is sometimes referred to as the “bond-based approach” or “market-based method.”<sup>22</sup>

However, other experts, particularly actuarial professionals, argue that this bond or market-based approach does not provide useful information to the Agency sponsoring a pension plan about the cost to that Agency of funding future benefit obligations. They point out that, for purposes of calculating contribution rates, the expected costs of meeting future Benefit obligations are the only relevant consideration and that such costs are best calculated based on “assumed rates of return.”<sup>23</sup> Yet other experts believe that a variation on the assumed rate of return method in which the risk that future additional amortization payments will be necessary is factored into the Discount Rate offers the most useful information.<sup>24</sup>

This debate has important implications because CalPERS’ assumed Return on Investment (7.5 percent per year from 2012 to the present) is significantly greater than municipal bond yield rates.<sup>25</sup> Since CalPERS’ projected Return on Investment exceeds that of municipal bonds yields, the result is greater Discount Rates and smaller present values of Benefit payment obligations and Unfunded Liabilities.

Other experts do not engage in the debate between proponents of the assumed return approach and the bond or market-based approach but focus instead on concerns that CalPERS’ new projection of a 7.0 percent annual Return on Investment – approved in December 2016 but not

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[content/uploads/files/pension\\_discount\\_rates\\_best\\_practices.pdf](#)>. Biggs and Smetters, *Understanding the Argument for Market Valuation*, pp. 2-5. American Academy of Actuaries. *Measuring Pension Obligations: Discount Rates Serve Various Purposes*. American Academy of Actuaries Issue Brief, November 2013, <[http://www.actuary.org/files/IB\\_Measuring-Pension-Obligations\\_Nov-21-2013.pdf](http://www.actuary.org/files/IB_Measuring-Pension-Obligations_Nov-21-2013.pdf)>.

<sup>21</sup> Bui and Randazzo, *Why Discount Rates Should Reflect Liabilities*, p. 2. U.S. Government Accountability Office, p. 2. Biggs and Smetters, *Understanding the Argument for Market Valuation*, p. 5. American Academy of Actuaries, p. 2.

<sup>22</sup> Mixon, *Estimating Future Costs at Public Pension Plans*, p. 2. U.S. Government Accountability Office, p. 2.

<sup>23</sup> American Academy of Actuaries, p. 2. Angelo, *Understanding the Valuation of Public Pension Liabilities*, pp. 9, 11-12. Mixon, *Estimating Future Costs at Public Pension Plans*, p. 2. See also, Nation, *Pension Math* 2011, p. 12, for a chart outlining the arguments for and against public pension systems using high Discount Rates.

<sup>24</sup> Turner, *Determining Discount Rates*, p. 3.

<sup>25</sup> Boyd, Donald, Kiernan, Peter, *Strengthening the Security of Public Sector Defined Benefit Plans*, The Blinken Report, The Nelson A. Rockefeller Institute of Government. January 2014, pp. 38-39, footnote 12, <[www.rockinst.org/pdf/government\\_finance/2014-01-Blinken\\_Report\\_One.pdf](http://www.rockinst.org/pdf/government_finance/2014-01-Blinken_Report_One.pdf)>. Angelo, *Understanding the Valuation of Public Pension Liabilities*, p. 10. U.S. Government Accountability Office, pp. 2-3.

yet implemented<sup>26</sup> – is unrealistically high. They claim that a more reasonable projection would be 6.0 - 6.5 percent.<sup>27</sup> Wilshire Consulting, CalPERS' general consultant, has advised CalPERS' board that it expects the CalPERS' Return on Investment over the next ten years to be just 6.2 percent.<sup>28</sup> It should be noted, however, that CalPERS makes Discount Rate decisions based on projected Returns on Investments over 60-year periods, not 10. CalPERS' projected 60-year Returns on Investment are in line with its new 7 percent Discount Rate.<sup>29</sup>

As noted above, if Discount Rates and projected Returns on Investment are too high, then they understate the size of the Cities' Benefit payment obligations and Unfunded Liabilities.

### **Importance of Amortization Periods.**

If a pension plan has Unfunded Liabilities, CalPERS requires the sponsoring Agency to pay off (amortize) that Unfunded Liability, together with interest accrued at a rate equal to CalPERS' projected Rate of Return,<sup>30</sup> through higher annual contribution payments over the Amortization Period. Historically, CalPERS' standard Amortization Period for investment gains and losses

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<sup>26</sup> League of California Cities, *CalPERS Stays the Course, Adopts a 7 Percent Assumed Rate of Return*, December 22, 2017, <<https://www.cacities.org/Top/News/News-Articles/2017/December/CAIPERS-Stays-the-Course.-Adopts-a-7-Percent-Assum>>.

<sup>27</sup> Nation, *Pension Math* 2011, p. 13. Lin, *Retirement Debt*. Munnell, Alicia, *Appropriate discount rate for public plans is not simple*, MarketWatch, October 5, 2015, <<https://www.marketwatch.com/story/appropriate-discount-rate-for-public-plans-is-not-simple-2016-10-05>>.

<sup>28</sup> Rose-Smith, Imogen, *How Low Can CalPERS Go?* Institutional Investor.com, November 30, 2016, <<https://www.institutionalinvestor.com/article/b14z9p7tw9pdz0/how-low-can-calpers-go>>. Kasler, Dale, *With investments soft, CalPERS eyes higher contribution rates. What does that mean for workers?* Sacramento Bee, November 21, 2016, <[www.sacbee.com/news/business/article116331443.html](http://www.sacbee.com/news/business/article116331443.html)>. Kasler, Dale, *CalPERS moves to slash investment forecast. That means higher pension contributions are coming.*, Sacramento Bee, December 21, 2016, <<http://www.sacbee.com/news/business/article122088759.html>>. League of California Cities, *CalPERS Stays the Course*.

<sup>29</sup> Diamond, Randy, *CalPERS considers 4 asset allocation options; local officials prefer avoiding major changes*, November 14, 2017, p. 2, <<http://www.pionline.com/article/20171114/ONLINE/171119918/calpers-considers-4-asset-allocation-options-local-officials-prefer-avoiding-major-changes>>. CNBC.com, *CalPERS's sees 5.8 percent return with new allocation; below 7 percent goal*, February 8, 2017, <<https://www.cnbc.com/2017/02/08/calpers-sees-58-percent-return-with-new-allocation-below-7-percent-goal.html>>. See also, League of California Cities, *League of California Cities Retirement System Sustainability Study and Findings*, January 2018, p. 29, <[https://www.cacities.org/Resources-Documents/Policy-Advocacy-Section/Hot-Issues/Retirement-System-Sustainability/League-Pension-Survey-\(web\)-FINAL.aspx](https://www.cacities.org/Resources-Documents/Policy-Advocacy-Section/Hot-Issues/Retirement-System-Sustainability/League-Pension-Survey-(web)-FINAL.aspx)>, in which the authors note that CalPERS' determines its Discount Rate based on expectations for returns on investment over a 60 year period.

<sup>30</sup> Interviews by Grand Jury. Mendel, Ed, *Old cause of pension debt gets new attention*, Calpensions, July 10, 2017, p. 1, <<https://calpensions.com/2017/07/10/old-cause-of-pension-debt-gets-new-attention/>>. City of La Palma, *CalPERS Update and Additional Payment Discussion*, February 20, 2018, slide 22, <<https://www.cityoflapalma.org/ArchiveCenter/ViewFile/Item/2374>>. Eastman, Becky, *Report on status of Belvedere's employee pension funds*, May 13, 2013, p. 6, <<http://www.cityofbelvedere.org/DocumentCenter/View/1425>>.

was 30 years,<sup>31</sup> but an Agency could elect a shorter Amortization Period.<sup>32</sup> Like home loan repayment terms, the longer the Amortization Period, the lower the annual payment, but the larger the accrued interest costs. Examples of the cost of accrued interest to four of the Cities over different Amortization Periods are given in Table No. 5.

### **Public Employees Pension Reform Act of 2013 (PEPRA).**

In response to soaring public pension Unfunded Liabilities, the California Legislature adopted the California Public Employees Pension Reform Act of 2013 (PEPRA), which imposed significant reductions on state and local government pension benefits, primarily for employees hired after January 1, 2013 (referred to as “New Members”). Employees hired prior to that date are termed “Classic Members.”<sup>33</sup> Classic Members who change public employers retain their “Classic” status.<sup>34</sup> Thus, to date, the impact of PEPRA on public pension liabilities has been small.<sup>35</sup> However, it will increase over time as Classic Members retire and are replaced by New Members.

Some of the most important changes mandated by PEPRA include:

- Reduced pension benefit formulas for New Members. For New Member employees with Miscellaneous Plans, PEPRA requires a “2 percent at age 62” benefit formula, that is, a New Member retiring at age 62 is entitled to a pension equal to his number of years of

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<sup>31</sup> League of California Cities, *CalPERS Board Reduces Amortization Policy*, February 14, 2018, <<https://www.cacities.org/Top/News/News-Articles/2018/February/CalPERS-Board-Reduces-Amortization-Policy>>. Lowe, Stephanie and Rogers, Frances, *CalPERS Reduces Amortization Period with Impacts to Employer Contribution Rates*, California Public Agency Labor & Employment Blog, Liebert Cassidy Whitmore), March 1, 2018, <<https://www.calpublicagencylaboremploymentblog.com/retirement/calpers-reduces-amortization-period-with-impacts-to-employer-contribution-rates/>>. CalPERS Actuarial Office, *Finance and Administration Committee, Agenda Item 7a, Amortization Policy (Second Reading)*, February 13, 2018, <[https://www.calpers.ca.gov/docs/board-agendas/201802/financeadmin/item-7a-00\\_a.pdf](https://www.calpers.ca.gov/docs/board-agendas/201802/financeadmin/item-7a-00_a.pdf)>. Jacobius, Arleen, *CalPERS shortens amortization period to 20 years*, Pensions & Investments, February 14, 2018, <<http://www.pionline.com/article/20180214/ONLINE/180219934/calpers-shortens-amortization-period-to-20-years>>.

<sup>32</sup> Interviews by Grand Jury. However, if an Agency selects a shorter Amortization Period, CalPERS does not permit it to reverse that election later. Interviews by Grand Jury.

<sup>33</sup> CalPERS, *Summary of Public Employees Pension Reform Act of 2013 and Related Changes to Public Employees' Retirement Law*, November 27, 2012, pp. 1-2, <[http://www.counties.org/sites/main/files/file-attachments/calpers\\_summary.pdf](http://www.counties.org/sites/main/files/file-attachments/calpers_summary.pdf)>.

<sup>34</sup> Ibid. CalPERS, *A Guide to CalPERS: When You Change Retirement Systems*, p. 3, <<https://www.calpers.ca.gov/docs/forms-publications/change-retirement-systems.pdf>>.

<sup>35</sup> League of California Cities, *2018 Retirement System Sustainability Study*, pp. 2 and 5. Hutchings, Dane, *Closing the Pension Funding Gap*, League of California Cities, slide 4, <[https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwj4wYnghL7bAhUPJ3wKHeqPCW0QFggpMAA&url=https%3A%2F%2Fwww.cacities.org%2FResources-Documents%2FPolicy-Advocacy-Section%2FHot-Issues%2FRetirement-System-Sustainability%2FPension\\_Gap\\_Public.aspx&usg=AOvVaw2C02vB9pPOI9v\\_n\\_zbeA38](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwj4wYnghL7bAhUPJ3wKHeqPCW0QFggpMAA&url=https%3A%2F%2Fwww.cacities.org%2FResources-Documents%2FPolicy-Advocacy-Section%2FHot-Issues%2FRetirement-System-Sustainability%2FPension_Gap_Public.aspx&usg=AOvVaw2C02vB9pPOI9v_n_zbeA38)>. Redwood City, *Report – FY 2017-18 Mid-Year Budget Study Session and Proposed Process for Development of the FY 2018-19 Budget*, February 26, 2018, p. 10, <<https://www.redwoodcity.org/home/showdocument?id=14650>>.

service, times 2 percent, times his average salary.<sup>36</sup> A New Member retiring before age 62 would have a pension that is further reduced. For instance, at age 55, a New Member is entitled to a pension equal to his years of service, times 1.3 percent, times his average salary.<sup>37</sup> Many Classic Members are entitled to more generous Benefits. For example, many City of San Carlos Classic employees under Miscellaneous Plans have pensions calculated according to a “2.7 percent at 55” formula.<sup>38</sup> Such an employee with 30 years of government service is entitled to a pension equal to 81 percent of their salary at age 55.<sup>39</sup> By comparison, a New Member with 30 years of government service would be entitled to a pension equal to just 39 percent of salary at that same age,<sup>40</sup> or less than 50 percent of what a Classic Member would receive. PEPRAs specifies similar but more complex reductions for New Members under Safety Plans.<sup>41</sup>

- Caps on annual salary basis for calculation. PEPRAs also caps the amount of annual salary that can be used to calculate pensions for New Members at \$113,700 (if Social Security is also offered) plus cost of living adjustments (COLAs), or \$136,440 (if Social Security is not offered) plus COLA.<sup>42</sup> These caps are less than the salaries of many middle and upper management government employees.<sup>43</sup> Classic Members are not subject to salary caps in calculating their pensions.<sup>44</sup>
- Averaging of salaries for calculation. PEPRAs requires, in calculating the annual salary used to calculate pensions, that New Members use the average of the three highest consecutive years salary.<sup>45</sup> In contrast, some public agencies allow Classic Members to use just their highest salary year.
- Prohibition on “spiking” salaries. PEPRAs also prohibits “spiking” salaries used to calculate pensions by including overtime, bonuses, cash payouts for unused vacation or sick leave, severance pay and the like.<sup>46</sup>

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<sup>36</sup> CalPERS, *Summary Public Employee Reform Act*, p. 2.

<sup>37</sup> CalPERS, *Retirement Formulas and Benefit Factors: Your Benefits / Your Future What You Need to Know About Your CalPERS Local Miscellaneous Benefits*, p. 28, <<http://www.reedley.ca.gov/departments/administrative/pdfs/CalPERS%202016-01-01%20Local%20Miscellaneous%20Pub%208.pdf>>.

<sup>38</sup> City of San Carlos, Teamsters Group – Benefits Summary 2018, p. 3.

<sup>39</sup> CalPERS, *Retirement Formulas and Benefit Factors*, pp. 32-33.

<sup>40</sup> *Ibid.*, pp. 28-29.

<sup>41</sup> CalPERS, *Summary Public Employee Reform Act*, p. 2.

<sup>42</sup> *Ibid.*, p. 3.

<sup>43</sup> Interviews by Grand Jury.

<sup>44</sup> CalPERS, *Summary Public Employee Reform Act*, p. 3.

<sup>45</sup> *Ibid.*, pp. 9-10.

<sup>46</sup> *Ibid.*, pp. 8-9.

- Prohibition on purchases of “airtime”. PEPRA also prohibits employees from purchasing nonqualified service time (“airtime”), which allows Members to boost their pensions by buying up to five years of additional service credit.<sup>47</sup>

As discussed below, PEPRA may have intended to apply some of these prohibitions to both Classic and New Members. However, whether these provisions apply to Classic Members is currently before the California Supreme Court.

### “California Rule”.

A major obstacle to reducing the pension Benefits to be earned by Classic employees in the future is the so-called “California rule,” an interpretation of a 1955 state Supreme Court decision<sup>48</sup> that public employee pension Benefits, once granted, can never be modified, even for future work, without providing “comparable new advantages,” and that also still leave employees with a “reasonable” pension.<sup>49</sup> However, in 2016, a Court of Appeal ruled that, under the Supreme Court’s decision, employees only have a vested right to “a ‘reasonable pension’ – not an immutable entitlement to the most optimal formula of calculating the pension.”<sup>50</sup> At issue in that case was the prohibition on “spiking” discussed above at p. 11. A few months later, another Court of Appeal reached a similar conclusion in upholding a prohibition on the purchasing of “airtime” discussed above at p. 12.<sup>51</sup> However, a third Court of Appeal recently reached a different conclusion, finding that detrimental changes to pension benefits of Classic Members would only be upheld as “reasonable” if supported by “compelling evidence that the required changes ‘bear a material relation to the theory ... of a pension system’ and its successful operation.”<sup>52</sup> The California Supreme Court is currently considering appeals of all three Court of

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<sup>47</sup> Ibid., pp. 7-8.

<sup>48</sup> *Allen v. City of Long Beach*, 45 Cal.2d 128 (1955), <<https://scocal.stanford.edu/opinion/allen-v-city-long-beach-26585>>.

<sup>49</sup> *Allen v. City of Long Beach*, 45 Cal.2d 128 at 131. Beyerdorf, Brian, *The Fate of Public Employee Pensions: Marin’s Revision of the ‘California Rule’*, California Law Review Online, September 2017, p. 1, <[www.californialawreview.org/wp-content/uploads/2017/09/Beyersdorf-02-formatted-62-72.pdf](http://www.californialawreview.org/wp-content/uploads/2017/09/Beyersdorf-02-formatted-62-72.pdf)>. Walters, Dan, *Jerry Brown, nearing end of terms, defies unions on pensions*, San Francisco Chronicle, November 28, 2017, <<https://www.sfchronicle.com/news/article/Jerry-Brown-nearing-end-of-term-defies-unions-12389814.php>>.

<sup>50</sup> *Marin Association of Public Employees v. Marin County Employees Retirement Association*, 2 Cal. App. 5th 674 at 680 (1st Dist. 2016), <<https://www.leagle.com/decision/incaco20160817007>>.

<sup>51</sup> *Cal Fire Local 2881 et al., v. California Public Employees’ Retirement System et al.*, 7 Cal. App. 5th 115 (1st Dist. 2016), <<https://www.eastbaytimes.com/wp-content/uploads/2017/01/123016-appellate-court-ruling.pdf>>.

<sup>52</sup> *Alameda County Deputy Sheriff’s Association, et al. v. Alameda County Employees’ Retirement Assn., et al.*, Case No. A141913, filed January 8, 2018, as modified February 5, 2018, <<https://www.gmsr.com/wp-content/uploads/2018/04/scw-A141913M.pdf>>. Rogers, Frances and Overby, Brett, *California Court of Appeal Issues A Contrary Decision Addressing “Vested Rights” of Public Employees in the Aftermath of PEPRA: Where will the Supreme Court Land?*, California Public Agency Labor & Employment Blog (Liebert Cassidy Whitmore), January 10, 2018, <<https://www.calpublicagencylaboremploymentblog.com/pension/california-court-of-appeal-issues-a-contrary-decision-addressing-vested-rights-of-public-employees-in-the-aftermath-of-pepra-where-will-the-supreme-court-land/>>.

Appeal rulings.<sup>53</sup> Acceptance of the “reasonable pension” standard enunciated in the first two Court of Appeal cases could have significant implications for future pension reform efforts, as well as eliminate the pension “spiking” and “air time” practices for both Classic and New Members.

### **CalPERS’ changes.**

CalPERS administers pension plans for Agencies throughout California. CalPERS’ system-wide Funded Percentage (that is, value of current assets divided by the present value of future Benefit payments) is only 68 percent.<sup>54,55</sup> As discussed below in the section entitled “Unfunded Liabilities and Funded Percentages of the Cities” at p. 16, among private sector pension plans, a Funded Percentage of 80 percent is the threshold below which a plan’s solvency is considered “at risk”.<sup>56</sup> CalPERS’ reported 68 percent Funded Percentage is based on a Return on Investment and Discount Rate assumption of 7 percent. CalPERS has been criticized in the past for inaccurate assumptions made in its calculations of future Benefits obligations and Returns on Investment.<sup>57</sup> The May 2017 Roeder Survey of California public pension plans ranked CalPERS a poor 34<sup>th</sup> out of 37 California public pension plans rated for “funding assumptions.”<sup>58</sup> However, CalPERS has begun taking actions to strengthen its pension system.

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<sup>53</sup> Webster, Keeley, *More briefs ask State Supreme Court to weaken California rule on pensions*, The Bond Buyer, February 27, 2018, <<https://www.bondbuyer.com/news/more-briefs-ask-state-supreme-court-to-weaken-california-rule-on-pensions>>. GMSR Appellate Lawyers, *California Supreme Court Watch*, #18-49, <<https://www.gmsr.com/18-49-alameda-county-deputy-sheriffs-assn-v-alameda-county-employees-retirement-assn-s247095-a141913-19-cal-app-5th-61-mod-19-cal-app-5th-945a-contra-costa-county-superior/>>.

<sup>54</sup> Terando, Scott, *Strategies for Managing the New Reality*, CalPERS, September 15, 2017, slide 8, <<https://www.cacities.org/Resources-Documents/Education-and-Events-Section/Annual-Conference/2017-Handouts/Strategies-for-Managing-the-New-Reality-of-CalPERS>>. CalPERS 2017 CAFR, p. 27. CalPERS, *CalPERS Reports Preliminary 11.2 Percent Investment Return for Fiscal Year 2016-17*, July 14, 2017, p. 1, <<https://www.calpers.ca.gov/page/newsroom/calpers-news/2017/preliminary-fiscal-year-investment-returns>>.

<sup>55</sup> A Funded Percentage of 68 percent is low compared to CalPERS’ historic Funded Percentages over the last 25 years. For a chart showing these percentages since 1993, see, Fox, Kelly, *CalPERS Update and Path Forward*, December 13, 2017, p. 16, <<https://www.cacities.org/Resources-Documents/Education-and-Events-Section/Fire-Chiefs/2017-Session-Materials/CalPERS-History-and-Pension-Updates>>.

<sup>56</sup> Nation, *Pension Math* 2011, p. 17. Financial analyst Rick Roeder notes that a public pension plan with a Funded Percentage in the 80-90 percent range is considered “reasonably well funded.” Roeder, Rick, Roeder Financial, *California Pension Systems: Ranking their Funding Assumptions*, May 2017, p. 2, <<http://roederfinancial.com/ramblings.php?ramble=42>>.

<sup>57</sup> See, for example, the following: Ring, Edward, *Did CalPERS Use Accounting “Gimmicks” to Enable Financially Unsustainable Pensions?*, California Policy Center, January 24, 2018, <<https://californiapolicycenter.org/calpers-use-accounting-gimmicks-enable-financially-unsustainable-pensions/>>. Dolan, Jack, *How a pension deal went wrong and cost California taxpayers billions*, Los Angeles Times, September 18, 2016, <<http://www.latimes.com/projects/la-me-pension-crisis-davis-deal/>>. Malanga, Steven, *The Pension Fund that Ate California*, The City Journal, <<https://www.city-journal.org/html/pension-fund-ate-california-13528.html>>.

<sup>58</sup> Roeder, Rick, Roeder Financial, *California 2017 Funding Assumption Survey*, May 2017, <<http://roederfinancial.com/RoederSurvey2017.html>>.



CalPERS' reduction of Discount Rate from 7.5 to 7 percent.

In late 2016, CalPERS decided to lower its Discount Rate from 7.5 to 7.0 percent.<sup>59</sup> This will have the effect of significantly increasing the size of CalPERS' Unfunded Liabilities and, accordingly, the contribution amounts Agencies must pay. One expert has estimated that, for every one quarter percentage point decrease in the Discount Rate, Agency contribution rates (that is, the size of their contribution payments as a percentage of total payroll) go up by approximately 2.5 percentage points.<sup>60</sup> A 5 percentage point increase in the contribution rate would represent a large increase in payments by the Cities as their average contribution rate in FY 2017-2018 was 27.3 percent.<sup>61</sup> In order to give Agencies time to prepare for these increased costs, CalPERS intends to phase in the change in its Discount Rate from 7.5 to 7 percent over a three-year period as follows<sup>62</sup>:

- FY 2018-2019: 7.35%
- FY 2019-2020: 7.25%
- FY 2020-2021: 7.00%

To further ease the impact on Agencies of these Discount Rate reductions, CalPERS plans to phase in the resulting contribution payment increases over an additional 5 years.<sup>63</sup> As a result, the full cost of the Discount Rate decreases to 7 percent will not be felt by Agencies until approximately FY 2024-2025.<sup>64</sup> This phasing-in process comes at a cost, however, as it allows interest to continue to accrue on Unfunded Liabilities for a longer time, thereby increasing total costs that the Cities will eventually have to pay.

In late 2017, CalPERS considered lowering its Discount Rate even further, down to 6.75 or even 6.5 percent.<sup>65</sup> Agencies objected because of the increased contribution costs this would impose on them and CalPERS decided not to lower the Discount Rate below 7 percent.<sup>66</sup> However, one expert has projected that it is "likely" CalPERS' Discount Rate will be lowered, in a series of steps, down to 6 percent over the course of the next 20 years or so.<sup>67</sup>

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<sup>59</sup> CalPERS, *CalPERS to Lower Discount Rate to Seven Percent Over the Next Three Years*, December 21, 2016, <<https://www.calpers.ca.gov/page/newsroom/calpers-news/.../calpers-lower-discount-rate>>.

<sup>60</sup> Nation, *Pension Math* 2011, pp. 25-26.

<sup>61</sup> Appendix A.

<sup>62</sup> CalPERS, *CalPERS to Lower Discount Rate to Seven Percent*. Terando, *Strategies for Managing the New Reality*, slide 6.

<sup>63</sup> Mendel, *Old cause of pension debt*, p. 3.

<sup>64</sup> League of California Cities, *CalPERS Stays the Course*.

<sup>65</sup> Diamond, *CalPERS considers 4 asset allocation options*, p. 1.

<sup>66</sup> Ibid. League of California Cities, *CalPERS Stays the Course*.

<sup>67</sup> Lin, Bianca and Childs, Matthew, *City of Pacifica Miscellaneous and Safety Plans, CalPERS Actuarial Issues – 6/30/15 Valuation Preliminary Results*, Bartel Associates LLC, September 18, 2017, slide 3, <<http://www.cityofpacific.org/civicax/filebank/blobdload.aspx?BlobID=13378>>. Lin, Bianca and Yam, Wai Man, *City of Menlo Park Miscellaneous and Safety Plans, CalPERS Actuarial Issues – 6/30/15 Valuation Preliminary Results*, Bartel Associates LLC, May 2, 2017, slide 10, <<https://www.menlopark.org/DocumentCenter/View/14392/D2-MenloPark-17-05-02-CalPERS-Misc-Safety>>. Lin,

### CalPERS' adoption of new mortality rate assumptions.

In 2014, CalPERS adopted new mortality rate assumptions reflecting the fact that retirees are expected to live longer. These assumption changes were projected to have the effect of increasing Agencies' pension contribution costs.<sup>68</sup>

### CalPERS' reduction of Amortization Period.

In February 2018, CalPERS reduced its standard Amortization Period from 30 to 20 years.<sup>69</sup> To “avoid undue disruption” to Agency budgets, CalPERS proposes to implement the new period prospectively only, starting with amortization bases established by its June 30, 2017 valuation. Amortization bases established prior to that date would continue as scheduled under current policy.<sup>70</sup> Although this change will decrease the Cities' pension costs over the long run (see, Table No. 5 below for examples of such savings), in the near term shortened Amortization Periods will increase their contribution payments.

## **DISCUSSION**

### **Why are Unfunded Liabilities and Funded Percentages so important?**

The Grand Jury chose to study public pension costs and Unfunded Liabilities because they represent a serious threat to public services county-wide and are already eating into public agency budgets.<sup>71</sup> The League of California Cities recently warned:

“Rising pension costs will require cities over the next seven years to nearly double the percentage of their general fund dollars they pay to CalPERS...[U]nder current law, cities have two choices – attempt to increase revenue or reduce services. Given that police and fire services comprise a large percentage of city general fund budgets, public safety, including response time, will likely be impacted.”<sup>72</sup>

The effects of increasing pension costs are clear:

- As payments consume a larger share of cities' budgets, it becomes more difficult to maintain, much less improve, public services.

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Bianca and Yang Kevin, *Redwood City Miscellaneous and Safety Plans, CalPERS Actuarial Issues – 6/30/15 Valuation Preliminary Results*, Bartel Associates LLC, February 13, 2017, slide 7.

<sup>68</sup> Bartel Associates, LLC, *New CalPERS Assumptions Will Increase Rates*, February 23, 2014, <<http://www.bartel-associates.com/news/2014/02/23/new-calpers-assumptions-will-increase-rates>>.

<sup>69</sup> Lowe and Rogers, *CalPERS Reduces Amortization Period*. CalPERS, *Agenda Item 7a, Amortization Policy*, p. 1..

<sup>70</sup> *Ibid.*, p. 4.

<sup>71</sup> Nation, *Pension Math: Public Pension Spending and Service Crowd Out in California, 2003-2030*, October 2, 2017, p. xi, <<https://siepr.stanford.edu/research/publications/pension-math-public-pension-spending-and-service-crowd-out-california-2003>>. League of California Cities, *2018 Retirement System Sustainability Study*, p. 5.

<sup>72</sup> League of California Cities, *2018 Retirement System Sustainability Study*, p. 1.

- As Unfunded Liabilities increase, cities’ municipal bond ratings may be hurt, which could increase the cost of other public improvement projects that require bonds.
- Public employees may face reduced compensation, reduced COLAs, or layoffs.
- Retired employees may find the security of their pensions threatened (obligations “guaranteed” by the state constitution have been voided in situations of bankruptcy)<sup>73</sup>.
- Residents may be asked to raise taxes; a difficult “sell” in the present political climate when the reason is to pay for legacy pension costs and not current services.<sup>74</sup>

**The Cities’ Pension Costs and Unfunded Liabilities Today.**

Appendix A shows each City’s pension costs, Funded Percentage and Unfunded Liabilities for FY 2016-2017 (the most recent year for which information is available), together with a comparison to each of the two immediately preceding fiscal years. A review of Appendix A data on a consolidated basis (shown at the bottom of Appendix A) is also revealing. A discussion of that consolidated data for the Cities follows.

Unfunded Liabilities and Funded Percentages of the Cities.

Two important measures of the health of pension plans are the size of their Unfunded Liabilities and their Funded Percentages. Table No. 1 (below) shows, based on the 7.5 percent Discount Rate then being used by CalPERS, that the Cities’ aggregate Unfunded Liabilities increased by 10.7 percent from FY 2014-2015 to FY 2015-2016 and by another 22.2 percent from FY 2015-2016 to FY 2016-2017. Funded Percentages correspondingly decreased, at an accelerating rate, over these 3 years.

<b>Table No. 1 - Increasing Unfunded Liabilities and Decreasing Funded Percentages</b>			
<b>(\$000)</b>			
	Unfunded Liabilities	Percent Increase in Unfunded Liabilities	Funded Percentage
2016-2017	\$1,215,465	22.2%	70.5%
2015-2016	\$994,535	10.7%	75.1%
2014-2015	\$898,036		76.8%

(See, Appendix A.)

As noted previously, among private sector pension plans, a Funded Percentage of 80 percent is the threshold below which a plan’s solvency is considered “at risk”.<sup>75</sup> Table No. 1 shows that the Funded Percentage for the Cities’ pension plans, while slightly higher than CalPERS’ system-wide Funded Percentage of 68 percent, has dropped to 70.5 percent, almost 10 percentage points below this 80 percent “at risk” threshold. The Funded Percentages in Table No. 1 would be significantly lower, and the Unfunded Liabilities correspondingly higher, if a lower Discount Rate were applied. This difference is shown in Table No. 2, below.

<sup>73</sup> Ang, Kimberly, *What Happens to Public Employee Retirement Benefits When Municipalities Go Bankrupt?*, United States Common Sense, March 10, 2016, p. 3, <<http://govrank.org/research/researchText/45>>.

<sup>74</sup> Interviews by Grand Jury.

<sup>75</sup> Nation, *Pension Math* 2011, p. 17.

Increase in Unfunded Liabilities and Decrease in Funded Percentages if a Lower Discount Rate is Used.

The Cities' Unfunded Liabilities and Funded Percentages in Table No. 1 were calculated using CalPERS then-applicable Discount Rate of 7.5 percent. If, however, the Discount Rate had been just one percentage point lower, the Cities' Unfunded Liabilities for FY 2016-2017 would have been approximately 44 percent larger (as shown in Table No. 2) and the corresponding Funded Percentage that year would have been 62.4 percent rather than 70.5 percent, almost 18 percentage points below the 80 percent Funded Percentage standard.

<b>Table No. 2 - Increased Pension Unfunded Liabilities and Decreased Funded Percentages if Discount Rate is Reduced By 1 percentage point</b>				
<b>(\$000)</b>				
<b>Fiscal Year</b>	<b>Unfunded Liabilities based on 7.5 % Discount Rate</b>	<b>Unfunded Liabilities based on 6.5 % Discount Rate</b>	<b>Funded Percentages based on 7.5 % Discount Rates</b>	<b>Funded Percentages based on 6.5 % Discount Rates</b>
2016-2017	\$1,215,465	\$1,755,047	70.5%	62.4%
2015-2016	\$994,535	\$1,515,521	75.1%	66.5%
2014-2015	\$898,036	\$1,399,702	76.8%	68.0%

(See, Appendix A.)

Applying its new Discount Rate of 7 percent (which will be implemented in stages over the three fiscal years ending FY 2020-2021), CalPERS states that its current, system-wide Funded Percentage is 68 percent.<sup>76</sup> However, if long-term Returns on Investment decrease, or are projected to decrease, below 7 percent, then CalPERS' Funded Percentage (and corresponding Discount Rate) would drop even lower. For example, at a Discount Rate of 6.2 percent, it has been estimated that CalPERS' Funded Percentage would drop by almost 10 percentage points, from 68 to 58.3 percent.<sup>77</sup>

Increasing Pension Contribution Payments.

Increasing Unfunded Liabilities result in larger contribution payment costs. Table No. 3 shows how the Cities' contribution costs have risen from FY 2014-2015 through FY 2016-2017 and how the percentages of cities' payroll and general fund spending consumed by contribution payments have been increasing.

<b>Table No. 3 - Increasing Pension Contribution Payments</b>			
<b>(\$000)</b>			
<b>Fiscal Year</b>	<b>Total Contribution Payments</b>	<b>Contributions as a percent of covered payroll</b>	<b>Contributions as a percent of general fund spending</b>
2016-2017	\$104,986	27.3%	13.6%
2015-2016	\$95,987	27.4%	13.2%
2014-2015	\$85,335	25.5%	12.8%

(See, Appendix A.)

<sup>76</sup> Terando, *Strategies for Managing the New Reality*, slide 8. CalPERS 2017 CAFR, p. 27. League of California Cities, *2018 Retirement System Sustainability Study*, p. 1.

<sup>77</sup> Nation, *2011 Pension Math*, p. vii.

The average, statewide percentage of Agencies' general fund budgets projected to be paid to CalPERS in FY 2017-2018 is 11.2 percent.<sup>78</sup> In comparison, the Cities' pension costs in FY 2016-2017 represented an average of 13.6 percent of their general fund spending.

Percentage of Employer Contribution Paid for Amortization Costs.

All of the Cities have substantial Unfunded Liabilities<sup>79</sup> and a significant and increasing portion of their contribution payments go to paying Amortization Costs (that is, payments required to pay off Unfunded Liabilities, including accrued interest). Table No. 4 (below) shows that well over half of the Cities' contribution payments in FY 2017-2018 have been applied to payment of Amortization Costs.

<b>Table No. 4 - Percentage of Cities' FY 2017-18 Pension Costs that are Amortization Costs</b>			
<b>(\$000)</b>			
City	2017-2018 Normal Costs	2017-2018 Amortization Costs	% of 2017-2018 Total Contribution Costs for Amortization
Belmont	\$1,473	\$2,046	58.1%
Brisbane	\$989	\$912	48.0%
Burlingame	\$2,552	\$3,183	55.5%
Daly City	\$6,281	\$7,184	53.4%
East Palo Alto	\$1,024	\$635	38.3%
Half Moon Bay	\$174	\$654	79.0%
Menlo Park	\$2,841	\$2,915	50.6%
Millbrae	\$783	\$2,907	78.8%
Pacifica	\$2,084	\$2,043	49.5%
Redwood City	\$8,767	\$12,479	58.7%
San Bruno	\$3,334	\$4,070	55.0%
San Carlos	\$715	\$2,565	78.2%
City of San Mateo	\$6,750	\$11,239	62.5%
South San Francisco	\$5,872	\$9,171	61.0%
	Total	Total	Weighted Average
	\$43,637	\$62,001	58.7%

California Policy Center, *CalPERS Actuarial Report Data – Cities (\$=M)*, <<http://californiapolicycenter.org/wp-content/uploads/2018/02/CalPERS-Actuarial-Report-Data-Cities-and-Counties-w-totals.xlsx>>. The California Policy Center provides pension cost data for 14 of the 20 Cities. Data for Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside was not provided.

<sup>78</sup> League of California Cities, *2018 Retirement System Sustainability Study*, p. 4.

<sup>79</sup> Appendix A.

Interest Charges on Unfunded Liabilities.

CalPERS charges interest on Unfunded Liabilities at an annual rate equal to the then-current Discount Rate.<sup>80</sup> Accordingly, the 30-year Amortization Period historically used by CalPERS to amortize Unfunded Liabilities results in interest payments that make up a large percentage of total Amortization Costs. Table No. 5 (below) shows, by way of example, that more than 50 percent of the Amortization Costs paid by South San Francisco, Redwood City, the City of San Mateo, and Daly City go to interest payments. It also shows that, if the Amortization Periods were shortened to 20 years, or even 15, those Cities would realize large savings on interest. Most notably, the City of San Mateo would save \$56 million under a 20-year Amortization Period and \$126 million with a 15-year period. Redwood City would save \$55 million by switching to a 20-year Amortization Period and \$134 million with a 15-year period.

Table No. 5 - Interest payment savings where shorter Amortization Periods are applied							
(\$000)							
City	Interest over 30 years			Interest over 20 years		Interest over 15 years	
	Total payments over 30-years (using 30-year Amortization Period).	Interest payments over 30-years.	Percent of 30-year. Amortization Cost payments consisting of interest payments.	Interest payments over 20-years (using 20-year Amortization Period).	Savings compared to 30-year period.	Interest payments over 15-years (using 15-year Amortization Period).	Savings compared to 30-year period
South S.F. <sup>81</sup>	\$390,708	\$206,436	52.8%	\$185,162	<b>\$20,574</b>	\$127,457	<b>\$78,979</b>
Redwood City <sup>82</sup>	\$553,787	\$305,671	55.2%	\$250,256	<b>\$55,415</b>	\$171,616	<b>\$134,055</b>
City of San Mateo <sup>83</sup>	\$502,874	\$280,510	55.8%	\$224,282	<b>\$56,228</b>	\$153,805	<b>\$126,706</b>
Daly City <sup>84</sup>	\$371,749	\$201,920	54.3%	\$171,295	<b>\$30,625</b>	\$117,468	<b>\$84,452</b>

Shortening the Amortization Period is only one way that savings on interest can be achieved. Savings can also be made by reducing the size of the Unfunded Liabilities through supplemental

<sup>80</sup> Interviews by Grand Jury. Mendel, *Old cause of pension debt*, p. 1. City of La Palma, slide 22. Eastman, p. 6. City of Daly City, *Comprehensive Biennial Operating and Capital Budget, Fiscal Years 2017 and 2018*, p. 25.

<sup>81</sup> CalPERS, *Actuarial Valuation – June 30, 2016 Miscellaneous Plan of the City of South San Francisco*, p. 17, <<https://www.calpers.ca.gov/docs/actuarial-reports/2016/south-san-francisco-city-miscellaneous-2016.pdf>>. CalPERS, *Actuarial Valuation – June 30, 2016 Safety Plan of the City of South San Francisco*, p. 17, <<https://www.calpers.ca.gov/page/.../actuarial.../public-agency-actuarial-valuation-reports>>.

<sup>82</sup> CalPERS, *Actuarial Valuation – June 30, 2016 Miscellaneous Plan of the City of Redwood City*, p. 17, <<https://www.calpers.ca.gov/docs/actuarial-reports/2016/redwood-city-miscellaneous-2016.pdf>>. CalPERS, *Actuarial Valuation – June 30, 2016 Safety Plan of the City of Redwood City*, p. 17, <<https://www.calpers.ca.gov/docs/actuarial-reports/2016/redwood-city-safety-2016.pdf>>.

<sup>83</sup> CalPERS, *Actuarial Valuation as of June 30, 2016 for the Miscellaneous Plans of the City of San Mateo*, p. 17, <<https://www.calpers.ca.gov/docs/actuarial-reports/2016/san-mateo-city-miscellaneous-2016.pdf>>. CalPERS *Actuarial Valuation as of June 30, 2016 for the Safety Plans of the City of San Mateo*, p. 17, <<https://www.calpers.ca.gov/docs/actuarial-reports/2016/san-mateo-city-safety-2016.pdf>>.

<sup>84</sup> CalPERS *Actuarial Valuation as of June 30, 2016 for Miscellaneous Plans of Daly City*, p. 17, <<https://www.calpers.ca.gov/docs/actuarial-reports/2016/daly-city-miscellaneous-2016.pdf>>. CalPERS *Actuarial Valuation as of June 30, 2016 for Safety Plans of Daly City*, p. 17, <<https://www.calpers.ca.gov/docs/actuarial-reports/2016/daly-city-safety-2016.pdf>>.

payments to CalPERS beyond the required contribution amounts. This can be done through a commitment by the Cities to make additional payments on a regular basis that is reflected in the annual budget, and/or by the Cities making additional payments as funds become available, as when there is a budget surplus or non-recurring revenue source. The process is similar to the experience of a credit card holder. If the holder only pays the minimum monthly balance, long-term interest expenses are higher than if the holder pays more than the minimum per month in order to work down the principal amount.

### **What does the future hold? The Impact of Increasing Pension Costs on the Cities.**

Rising Unfunded Liabilities will generate increasing pension costs. A “Key Finding” of the League of California Cities’ January 2018 report is that “City pension costs will *dramatically increase to unsustainable levels*” (emphasis added).<sup>85</sup> The League reports that the average percentage of its 426-member cities’ general fund spending on CalPERS pension plans will almost double between FY 2006-2007 and FY 2024-2025 (from 8.3 percent to 15.8 percent).<sup>86</sup>

CalPERS projects that the \$3.1 billion in pension costs being paid by member cities in FY 2017-2018 will almost double (to \$5.8 billion) by FY 2024-2025.<sup>87</sup> The Cities’ projected future pension costs, as estimated by CalPERS, are also projected to almost double during that period,<sup>88</sup> and some experts project even larger increases.<sup>89</sup> Table No. 6 sets out CalPERS’ projections for increasing pension costs for 15 of the Cities from FY 2017-2018 through FY 2024-2025 and shows that they will have to pay pension costs that are rising by an average of 13.3 percent per year.

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<sup>85</sup> League of California Cities, *2018 Retirement System Sustainability Study and Findings*, p. 2.

<sup>86</sup> *Ibid.*, pp. 1 and 4.

<sup>87</sup> Ring, Edward, *Did CalPERS Use Accounting “Gimmicks ...?”*

<sup>88</sup> California Policy Center, *CalPERS Actuarial Report Data – Cities (\$=M)*,

<https://californiapolicycenter.org/CalPERS-Actuarial-Report-Data-Cities-and-Counties/>. This source provides pension cost data for 15 of the 20 Cities in the County. Data for Atherton, Colma, Foster City, Hillsborough and Woodside is not included. The weighted average percent increase in costs for these 15 Cities from FY 2017-18 to FY 2024-25 is 92.7 percent.

<sup>89</sup> See, discussion following Table No. 6 about higher projections by Bartel Associates, LLC and Table Nos. 7.1, 7.2 and 7.3 (below).

Table No. 6 - Increasing Pension Costs for Cities					
(\$000)					
City	2017-2018 Total Pension Costs	2024-2025 Total Projected Pension Costs	Percent Increase from 2017-2018 to 2024-2025	Average Annual Total Pension Cost Increase	Average Annual Percent Increase
Belmont	\$3,518	\$6,039	71.7%	\$360	10.2%
Brisbane	\$1,901	\$3,851	102.6%	\$279	14.7%
Burlingame	\$5,735	\$11,435	99.4%	\$814	14.2%
Daly City	\$13,464	\$28,579	112.3%	\$2,159	16.0%
East Palo Alto	\$1,658	\$2,873	73.3%	\$174	10.5%
Half Moon Bay	\$828	\$1,519	83.5%	\$99	11.9%
Menlo Park	\$5,756	\$11,258	95.6%	\$786	13.7%
Millbrae	\$3,690	\$6,828	85.0%	\$448	12.1%
Pacifica	\$4,127	\$8,899	115.6%	\$682	16.5%
Redwood City	\$21,246	\$39,955	88.1%	\$2,673	12.6%
San Bruno	\$7,404	\$14,695	98.5%	\$1,042	14.1%
San Carlos	\$3,280	\$5,407	64.8%	\$304	9.3%
City of San Mateo	\$17,988	\$33,178	84.4%	\$2,170	12.1%
South San Francisco	\$15,043	\$28,960	92.5%	\$1,988	13.2%
	Total	Total	Weighted Average	Total	Weighted Average
	\$105,638	\$203,477	92.6%	\$13,977	13.2%

California Policy Center, *CalPERS Actuarial Report Data – Cities (\$=M)*, <<http://californiapolicycenter.org/wp-content/uploads/2018/02/CalPERS-Actuarial-Report-Data-Cities-and-Counties-w-totals.xlsx>>. The California Policy Center provides pension cost data for 14 of the 20 Cities. Data for Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside was not provided.

Bartel Associates, LLC<sup>90</sup> projects even larger increases in pension costs than CalPERS. For example, as shown in Table Nos. 7.1, 7.2 and 7.3, Bartel projected in 2017 that pension costs for Redwood City, Menlo Park and Pacifica will more than double from FY 2016-2017 through FY 2024-2025 (which is substantially greater than CalPERS’ projections for those Cities shown in Table 6) and are projected to continue to increase substantially thereafter through FY 2027-2028.<sup>91</sup>

<sup>90</sup> The public pension actuarial consulting firm of Bartel Associates, LLC reports having served as consultants to over 400 public sector clients since 2012 including, within the San Mateo county alone, the Cities of Belmont, Burlingame, Daly City, East Palo Alto, Foster City, Menlo Park, Millbrae, Pacifica, Redwood City, San Bruno, San Carlos, San Mateo, South San Francisco, and the Town of Hillsborough. See, Bartel website, <<http://www.bartel-associates.com/about-us/client-list>>.

<sup>91</sup> It should be noted that the Bartel Associates, LLC projections on which Table Nos. 7.1, 7.2 and 7.3 rely were set forth in reports dated February 17, 2017, May 2, 2017 and September 18, 2017, respectively. They were based on CalPERS numbers as of June 30, 2015. Last summer, CalPERS issued updated its numbers as of June 30, 2016 and it is expected to issued June 30, 2017 numbers again this summer. Were the Bartel projections to be re-run based on the most recent CalPERS data, they would be somewhat different from those reflected in Table Nos. 7.1., 7.2 and 7.3. Source: Grand Jury interviews.



Table No. 7.1 - Redwood City's projected increases in pension contribution costs from FY 2016-2017 to FY 2024-2025 and FY 2027-2028 <sup>92</sup>								
(\$000)								
	Miscellaneous Plans				Safety Plans			
	Pension Costs as a Percent of Payroll (Projected)	Annual Pension Costs (Projected)	Increase in Annual Pension Costs since FY 2016-2017	% Increase in Annual Pension Costs since FY 2016-2017	Pension Costs as a Percent of Payroll (Projected)	Annual Pension Costs (Projected)	Increase in Annual Pension Costs since FY 2016-2017	% Increase in Annual Pension Costs since FY 2016-2017
FY 2027-2028	37.3%	\$16,764	\$8,691	107.7%	67.2%	\$24,771	\$13,246	114.9%
FY 2024-2025	42.7%	\$17,530	\$9,457	117.1%	65.6%	\$22,148	\$10,623	92.2%
FY 2016-2017	26.3%	\$8,073			42.9%	\$11,525		

Table No. 7.2 – Menlo Park's projected increases in pension contribution costs from FY 2016-2017 to FY 2024-2025 and FY 2027-2028 <sup>93</sup>								
(\$000)								
(Before <sup>94</sup> taking into account any employee cost sharing.)								
	Miscellaneous Plans				Safety Plans			
	Pension Costs as a Percent of Payroll (Projected)	Annual Pension Costs (Projected)	Increase in Annual Pension Costs since FY 2016-2017	% Increase in Annual Pension Costs since FY 2016-2017	Pension Costs as a Percent of Payroll (Projected)	Annual Pension Costs (Projected)	Increase in Annual Pension Costs since FY 2016-2017	% Increase in Annual Pension Costs since FY 2016-2017
FY 2027-2028	33.9%	\$7,190	\$4,140	135.7%	60.5%	\$5,389	\$3,285	156.1%
FY 2024-2025	34.5%	\$6,695	\$3,645	119.5%	58.4%	\$4,756	\$2,652	126.0%
FY 2016-2017	21.2%	\$3,050			32.3%	\$2,104		

<sup>92</sup> Data in Table No. 7.1 is derived from Lin, Bianca and Yang Kevin, *Redwood City Miscellaneous and Safety Plans, CalPERS Actuarial Issues – 6/30/15 Valuation Preliminary Results*, Bartel Associates LLC, February 13, 2017, slides 17, 18, 29 and 30.

<sup>93</sup> Data in Table No. 7.2 is derived from Lin, Bianca and Yam, Wai Man, *City of Menlo Park Miscellaneous and Safety Plans, CalPERS Actuarial Issues – 6/30/15 Valuation Preliminary Results*, Bartel Associates LLC, May 2, 2017, slides 23, 24, 39 and 40, <https://www.menlopark.org/DocumentCenter/View/14392>.

<sup>94</sup> Menlo Park's projected Miscellaneous Plan annual pension costs in Table No. 7.2 would be approximately 15 percent lower than shown if employee cost sharing were taken into account and its Safety Plan pension costs would be 5 - 9 percent lower. Lin, Bianca and Yam, Wai Man, *City of Menlo Park Miscellaneous and Safety Plans, CalPERS Actuarial Issues – 6/30/15 Valuation Preliminary Results*, Bartel Associates LLC, May 2, 2017, slides 25, 28, 40 and 41.

Table No. 7.3 – City of Pacifica’s projected increases in pension contribution costs from FY 2016-2017 to FY 2024-2025 and FY 2027-2028 <sup>95</sup>								
(\$000)								
(Before <sup>96</sup> taking into account any employee cost sharing.)								
	Miscellaneous Plans				Safety Plans			
	Pension Costs as a Percent of Payroll (Projected)	Annual Pension Costs (Projected)	Increase in Annual Pension Costs since FY 2016- 2017	% Increase in Annual Pension Costs since FY 2016- 2017	Pension Costs as a Percent of Payroll (Projected)	Annual Pension Costs (Projected)	Increase in Annual Pension Costs since FY 2016- 2017	% Increase in Annual Pension Costs since FY 2016- 2017
FY 2027-2028	36.3%	\$4,435	\$2,992	207.3%	71.8%	\$6,186	\$3,910	171.8%
FY 2024-2025	34.4%	\$3,846	\$2,403	166.5%	69.0%	\$5,428	\$3,152	138.5%
FY 2016-2017	16.7%	\$1,443			34.6%	\$2,276		

**Pension Information Provided by the Cities Could be Substantially Improved.**

Clear information about the Cities’ current and projected pension costs, as well as their plans for meeting these rising expenses in the future, is not readily found in the Cities’ CAFRs, nor (with a few notable exceptions<sup>97,98,99</sup>) in their most recent budgets published in the finance section of

<sup>95</sup> Data in Table No. 7.3 is derived from Lin, Bianca and Childs, Matthew, *City of Pacifica Miscellaneous and Safety Plans, CalPERS Actuarial Issues – 6/30/15 Valuation Preliminary Results*, Bartel Associates LLC, September 18, 2017, slides 8, 9, 18 and 19, <http://www.cityofpacifica.org/civicax/filebank/blobdload.aspx?BlobID=13378>.

<sup>96</sup> Pacifica’s projected Miscellaneous Plan annual pension costs in Table No. 7.3 would be approximately 15, 7.3 and 7 percent lower in FY 2016-17, FY 2024-25 and FY 2027-28 respectively than shown if employee cost sharing were taken into account and its Safety Plan pension costs would be approximately 11, 5.6 and 5.4 percent lower in FY 2016-17, FY 2024-25 and FY 2027-28 respectively. Lin, Bianca and Childs, Matthew, *City of Pacifica Miscellaneous and Safety Plans, CalPERS Actuarial Issues – 6/30/15 Valuation Preliminary Results*, Bartel Associates LLC, September 18, 2017, slides 11, 12, 20, 21, 29, 30.

<sup>97</sup> Redwood City’s FY 2017-18 Adopted Budget provides projections of projected future pension costs through FY 2030-31, together with a description of steps the city is taking to begin addressing these costs. City of Redwood City, *Report - FY 2017-18 Mid-Year Budget Study Session*. See also, City of Redwood City, *Fiscal Year 2018-2019 Recommended Budget*, pp. 13 and 14, <<http://www.redwoodcity.org/home/showdocument?id=15124>>.

<sup>98</sup> The City of San Mateo’s FY 2017-18 Adopted Budget includes a table showing how the City’s pension costs will increase from FY 2017-18 through FY 2027-28. City of San Mateo, *Adopted 2017-18 Budget*, p. 11, <<https://www.cityofsanmateo.org/DocumentCenter/View/60043/Adopted-2017-18-Budget>>. The City’s proposed 2018-20 Business Plan also includes annual pension cost projections through FY 2028-29. City of San Mateo, *Proposed 2018-20 Business Plan*, pp. 9, 11, and 65, <<https://www.cityofsanmateo.org/DocumentCenter/View/64801/Proposed-FY-2018-20-Business-Plan>>.

<sup>99</sup> Menlo Park’s FY 2017-18 budget shows total pension costs for each of the next 10 years. City of Menlo Park, *Adopted Budget, Fiscal Year 2017-18*, p. 48.

their websites.<sup>100,101,102,103</sup> Appendix B’s guide to locating pension information in CAFRs shows that a certain level of specialized knowledge and concerted effort is required to extract information about pension costs from CAFRs. While the Cities’ published budgets often refer to growing budgetary challenges faced by pension costs, the information provided about costs, especially projected future costs and descriptions of how the Cities are planning to meet them, is generally not set out in a systematic way. The information falls far short of what it should be given the importance and growing urgency of the subject matter.

## **What can the Cities do About Their Rising Pension Costs?**

### Develop a Financial Plan.

As with any challenge, the first step is to acknowledge the problem. In the case of pensions, this requires an analysis of future obligations, under various scenarios, over at least a 10-year time horizon. The second step is for each City to develop a long-term financial plan over at least a 10-year time period to address rising costs. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years and maintaining the City’s share of Normal Costs at “n” percentage of payroll
- Policies to achieve these objectives, such as making supplemental contributions to CalPERS, making annual contributions to a reserve or IRS Section 115 trust (described below) for the purpose of meeting unanticipated future pension costs, keeping salary increases below the actuarially assumed increase rate, or negotiating cost-sharing

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<sup>100</sup> The City of Burlingame provides information about its plans for addressing rising pension costs in Staff Reports and proposed budgets. See for example, Augustine, Carol, Staff Report to Burlingame City Council, July 3, 2017, <<http://burlingameca.legistar.com/gateway.aspx?M=F&ID=145f1c47-afe4-48e6-8c90-7af86841c428.docx>>; Augustine, Carol, Staff Report to Burlingame City Council, March 14, 2018, pp. 11, 12, 27, 28 and 48, <<http://burlingameca.legistar.com/gateway.aspx?M=F&ID=8bf430f2-6a90-46f4-a5e8-bc50ad710524.docx>>; Augustine, Carol, Staff Report to Burlingame City Council, May 9, 2018, <<http://burlingameca.legistar.com/gateway.aspx?M=F&ID=68ce413d-4c73-4e2b-abf2-d2e04b1dde86.docx>>.

<sup>101</sup> The Town of Hillsborough’s FY 2018-19 Proposed Budget notes that annual pension costs are projected to double over the next ten years (from \$2.4 to \$5.7 million. The Town also provides a 10-year forecast of expenditures that incorporates data regarding projected pension costs, but the actual pension costs themselves are not broken out. Town of Hillsborough, *FY 2018-19 Proposed Budget*, pp. 27 and 96, <<https://www.hillsborough.net/ArchiveCenter/ViewFile/Item/212>>.

<sup>102</sup> Foster City’s preliminary budget for FY 2018-19 states that, between FY 2017-18 and FY 2022-23, the City’s Miscellaneous Plan contribution rate will rise from 27.9 to 40.8 percent and its Safety Plan contribution rate will rise from 45.2 to 70.4 percent. City of Foster City, *Preliminary Budget Fiscal Year 2018-2019*, p. 10, <[https://www.fostercity.org/sites/default/files/fileattachments/financial\\_services/page/3521/fy\\_2018-2019\\_preliminary\\_budget\\_published.pdf](https://www.fostercity.org/sites/default/files/fileattachments/financial_services/page/3521/fy_2018-2019_preliminary_budget_published.pdf)>. The proposed budget does not include more specific information about dollar amounts represented by these percentages.

<sup>103</sup> The City of Belmont’s 2018 Budget includes a chart showing increasing pension contribution rates over the next 4 years. City of Belmont, *FY 2018 Budget*, p. 18, <<https://www.belmont.gov/home/showdocument?id=15433>>.

agreements with employees that cap the Cities' share of Normal Costs (which are described below in "Specific Measures for the Cities to Consider")

- Specific measures to implement the policies
- A process to monitor progress in implementing the measures and in achieving the objectives
- Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's Return on Investment assumptions are not met in future years.

Finally, tough decisions need public support. This cannot be achieved without the public being informed about the issue at every step. The Cities' plans should include a public awareness component.

The Cities' CAFRs and budget documents published by the Cities in the finance section of their websites that were reviewed by the Grand Jury show that none of them has adopted a long-term financial plan with all of the components described above.<sup>104,105,106,107</sup>

#### Specific Measures for the Cities to Consider.

There are a number of measures that can be taken to meet objectives that might be included in the Cities' long-term financial plans. Some of these are summarized below. Most have been employed by one or more Cities, although not necessarily in a systematic way. Not every City will be in a financial position to take aggressive action now, but there are options, including the following nine:

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<sup>104</sup> The City of San Mateo states that it has a plan for eliminating its Unfunded Pension Liabilities; it intends to achieve this by 2050. City of San Mateo, *Adopted 2017-18 Budget*, p. 20.

<sup>105</sup> The City of Foster City plans to "[i]dentify and implement pension sustainability strategies to reduce the City Unfunded Accrued Liability and improve the City funded status with CalPERS" in FY 2018-19. City of Foster City, *Preliminary Budget Fiscal Year 2018-2019*, p. 188.

<sup>106</sup> It should be noted, however that the City of Redwood City does have a five-year plan that provides for supplemental payments to CalPERS (beyond required contributions) of \$0.5 million per year; it has funded a Section 115 pension trust (described below) with an initial \$10.5 million and plans to make additional contributions to the trust of \$1.1 million per year over the next five years, and employee cost sharing. Redwood City also adopted a lower tier, less expensive, pension plan even before the passage of PEPR. See, "Specific Measures for the Cities to Consider" below for references to Redwood City's actions.

<sup>107</sup> In 2014 San Carlos published annual pension cost projections through FY 2035-36. City of San Carlos, *Long-Term Financial Plan*, November 5, 2014, pp. 21 and 22, <<http://www.cityofsancarlos.org/Home/ShowDocument?id=700>>. The City also published a graph showing pension costs through FY 2047-48. City of San Carlos, *City Council Staff Report*, Item 7.b of March 12, 2018 Agenda Packet, p. 117, <<http://sancarlosca.iqm2.com/Citizens/FileOpen.aspx?Type=1&ID=2699&Inline=True>>.

(1) Make Supplemental Contributions to CalPERS.

By making supplemental contributions to CalPERS beyond the required payments, the Cities can reduce the amounts on which they are paying interest. The Cities generally cannot earn returns on their reserves equal to the interest rates CalPERS will be charging,<sup>108</sup> so using reserves to make supplemental contributions can result in substantial net savings over the long-term.

Although not a subject of this report,<sup>109</sup> actions taken by the County to reduce its pension costs are instructive. In FY 2011-2012 and FY 2012-2013, the County paid “supplemental contributions” to SamCERA (the plan administrator for the County’s pension plans) to reduce its Unfunded Liability. These were in addition to its Annual Required Contribution (ARC)<sup>110</sup> payments.<sup>111</sup> However, these supplemental contributions were applied to the entire SamCERA system, not the County alone.<sup>112</sup> Then, in November 2013, SamCERA and the County signed a Memorandum of Understanding (MOU) to formalize a plan to pay supplemental contributions.<sup>113</sup> Under the MOU, the County made two commitments. First, it agreed to pay supplemental contributions in a lump sum of \$50 million in the initial fiscal year (FY 2013-2014) and then to pay an additional \$10 million in each of the following nine years. Second, the County stated that it intended to maintain a minimum average employer contribution rate of 38 percent of payroll during the 10-year period. Since the ARC would otherwise decrease each year, as the Unfunded Liability is reduced, maintaining a contribution rate higher than the ARC would provide a second source of supplemental payments. For its part, SamCERA committed to establish a Supplemental Contribution Account to receive the supplemental contributions, which would be credited just to the County, rather than all three SamCERA employers. If SamCERA’s actuarial assumptions are met, the County’s supplemental contributions are expected to eliminate the Unfunded Liability within 10 years (FY 2022-2023).<sup>114</sup>

The MOU includes language stating that the County’s supplemental contributions are not legally binding. However, as of June 30, 2017, the MOU had been implemented on schedule. The

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<sup>108</sup> City of Menlo Park, *Adopted Budget, Fiscal Year 2017-18*, p. 48, <<https://www.menlopark.org/ArchiveCenter/ViewFile/Item/6273>>.

<sup>109</sup> Progress made by the County of San Mateo in planning for and reducing its pension costs is the subject of the Grand Jury’s report for 2017-2018, entitled “County Pension Costs – Hard Choices Paying Off.” San Mateo County Civil Grand Jury 2017-2018 report, “County Pension Costs – Hard Choices Paying Off.”

<sup>110</sup> Annual Required Contribution (ARC) is the sum of an Agencies’ share of Normal Cost and, if any, the Amortization Cost. ARC is the amount an Agency is legally required to pay to the plan administrator in order to fund a pension plan. See, Brainard, Keith and Brown, Alex, *The Annual Required Contribution Experience of State Retirement Plans, FY01 to FY13*, National Association of State Retirement Administrators, March 2015, p. 2, <[https://www.nasra.org/files/JointPublications/NASRA\\_ARC\\_Spotlight.pdf](https://www.nasra.org/files/JointPublications/NASRA_ARC_Spotlight.pdf)>.

<sup>111</sup> Referred to by SamCERA as the annual “statutory contribution rate.” SamCERA, *2017 Comprehensive Annual Financial Report for the Fiscal Year Ended on June 30, 2017*, p. 49, <[https://www.samcera.org/sites/main/files/file-attachments/2017cafr\\_final.pdf](https://www.samcera.org/sites/main/files/file-attachments/2017cafr_final.pdf)>.

<sup>112</sup> County Pension Costs – Hard Choices Paying Off, p. 6.

<sup>113</sup> Memorandum of Understanding Between the County of San Mateo and the San Mateo County Employees’ Retirement System Funding, November 19, 2013.

<sup>114</sup> County Pension Costs – Hard Choices Paying Off., p. 7.

County's supplemental contributions, including payments made before the MOU, as well as payments made pursuant to the MOU, total nearly \$139 million, through June 30, 2017.<sup>115</sup>

In theory, without supplemental contributions, the Unfunded Liability would be paid off at the end of the 15-year Amortization Period used by SamCERA. The benefit of making supplemental contributions to pay off the Unfunded Liability early is to reduce the interest payments that are included in the Amortization Cost. This is substantial. Prior to adoption of the MOU, the County Manager estimated the cumulative savings at \$304 million.<sup>116</sup> In 2017 the County Manager reported that the County could expect annual savings approaching \$90 million to \$100 million in principal and interest payments, beginning in FY 2023-2024, assuming the Unfunded Liability has been paid off by that date.<sup>117</sup>

It should be noted that the County was fortunate in having a non-recurring gain of about \$50 million from the 2014 sale of the County-owned Circle Star Plaza, which helped fund its capital plan.<sup>118</sup> The County general fund benefitted from passage of Measure A in 2012, which adds a one-half cent countywide sales tax for 10 years, through April 2023, as well as Measure K (2016) which extended the sales tax through 2043.<sup>119</sup>

Among the Cities, Redwood City's Preliminary Five-Year Forecast calls for additional payments to CalPERS of \$500,000 per year beyond the required contribution amounts.<sup>120</sup> As discussed below in "Establish IRS Section 115 non-revocable trusts," at p. 29, Redwood City's Preliminary Five-Year Forecast also calls for the city to annually contribute additional amounts to an irrevocable fund for the purposes of paying pension costs.

In April 2018, the City of San Carlos approved making an additional payment to CalPERS of \$5 million, beyond the required contribution, to pay down a portion of the City's Unfunded Liability.<sup>121</sup> The City estimates that this payment will result in \$4.3 million of net savings over the long-term.<sup>122</sup>

The City of San Mateo made additional payments to CalPERS of \$1.375 million in FY 2016-17 and \$1.4 million in FY 2017-18. The City's proposed 2018-20 budget recommends continued additional payments to CalPERS out of the general fund in the amounts of \$1.625 million in FY 2018-19 and an additional \$14 million thereafter over the course of approximately the next 10

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<sup>115</sup> Ibid.

<sup>116</sup> Ibid., pp. 7-8.

<sup>117</sup> Ibid., p. 8.

<sup>118</sup> Torres, Blanca, *San Mateo County cashes in with sale of Circle Star Plaza for \$90.1 million*, The San Francisco Business Times, May 20, 2014, <<https://www.bizjournals.com/sanfrancisco/blog/real-estate/2014/05/circle-star-plaza-griffin-capital-san-mateo-county.html>>.

<sup>119</sup> Ballotpedia, *San Mateo County Sales Tax Increase, Measure A (November 2012)*, <[http://ballotpedia/San\\_Mateo\\_County\\_Sales\\_Tax\\_Increase,\\_Measure\\_A\\_\(November\\_2012\)](http://ballotpedia/San_Mateo_County_Sales_Tax_Increase,_Measure_A_(November_2012))>. Ballotpedia, *San Mateo County Sales Tax Increase, Measure K (November 2016)*, <[https://ballotpedia.org/San\\_Mateo\\_County,\\_California,\\_Sales\\_Tax,\\_Measure\\_K\\_\(November\\_2016\)](https://ballotpedia.org/San_Mateo_County,_California,_Sales_Tax,_Measure_K_(November_2016))>.

<sup>120</sup> Redwood City Report - FY 2017-18 Mid-Year Budget Study Session, pp. 20 and 21. Grand Jury Interviews.

<sup>121</sup> Interviews by Grand Jury. San Carlos, *City Council Staff Report*, Item 9.a of April 9, 2018 Agenda Packet, <<http://sancarlosca.igq2.com/Citizens/FileOpen.aspx?Type=1&ID=2707&Inline=True>>.

<sup>122</sup> Ibid.

years.<sup>123</sup> The City does not indicate how much savings is expected to result from these additional payments.

The City of Foster City's preliminary budget for FY 2018-19 calls for an additional payment to CalPERS of \$2.1 million, representing 4.3% of its projected general fund operating expenditures budget that year.<sup>124</sup>

## (2) Make Contributions to a Reserve.

In the current good financial times, most of the Cities have experienced rising revenues and should be able to set their general fund budgets to yield a surplus of revenues over expenses and put the difference into a general fund reserve to be applied in their discretion against future unanticipated, special, or one-time expenses.<sup>125</sup> A portion of such reserves could be used to manage or smooth payments to CalPERS, consistent with budgetary needs. However, since the Cities retain the right to use these reserves as they deem appropriate, there is no guarantee that these reserves will be applied to pension costs.<sup>126</sup> Payments into a reserve do not reduce the Amortization Costs charged by CalPERS.

Several of the Cities have established reserves out of their general fund budgets that are earmarked for future increased pension contributions.

Menlo Park. The City has established a "Strategic Pension Funding reserve" which, as of June 30, 2017, held assets of \$3.2 million. That represents approximately 7 months of its annual pension contribution costs of \$5.56 million.<sup>127</sup> Menlo Park's policy is to assign 25 percent of any general fund operating budget surpluses to this pension reserve.<sup>128</sup> Based on its expected general fund operating budget surplus of approximately \$2.5 to \$3.5 million in FY 2017-2018, this policy will add another \$625,000 to \$875,000 to the reserve.<sup>129</sup> However, the Strategic Pension Funding reserve currently represents only approximately 10 percent of the City's total general fund reserves<sup>130</sup> and, even assuming continued growth in the Strategic Pension Funding reserve similar to FY 2017-2018, would only modestly help pay for increases in the City's expected pension costs over the next 10 years.<sup>131</sup>

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<sup>123</sup> City of San Mateo, *Proposed 2018-20 Business Plan*, pp. 58 and 67.

<sup>124</sup> City of Foster City, *Preliminary Budget Fiscal Year 2018-2019*, p. 50.

<sup>125</sup> See, for example, City of Menlo Park, *Adopted Budget, Fiscal Year 2017-18*, pp. 8, 33 – 38; City of San Mateo, *Adopted 2017-18 Budget*, pp. 6, 32, 36; City of Foster City, *Preliminary Budget Fiscal Year 2018-2019*, pp. 47 – 48; City of Belmont, *FY 2018 Budget*, p. 16, 22; City of Brisbane, *Fiscal Years 2016-2017 & 2017-2018, Adopted Two Year Operating Budget*, p. 11, <[http://www.brisbaneca.org/sites/default/files/City%20of%20Brisbane\\_1.pdf](http://www.brisbaneca.org/sites/default/files/City%20of%20Brisbane_1.pdf)>; Town of Portola Valley, *Adopted Budget, Fiscal Year 2017-2018*, p. 4, <<http://www.portolavalley.net/home/showdocument?id=10921>>; Town of Hillsborough, *FY 2017-18 Adopted Budget*, p. 26; Town of Hillsborough, *FY 2018-19 Proposed Budget*, p. 95.

<sup>126</sup> Interviews by Grand Jury.

<sup>127</sup> Appendix A.

<sup>128</sup> City of Menlo Park, *Adopted Budget, Fiscal Year 2017-18*, p. 48.

<sup>129</sup> Interviews by Grand Jury.

<sup>130</sup> City of Menlo Park, *Adopted Budget, Fiscal Year 2017-18*, p. 49.

<sup>131</sup> Menlo Park expects its pension costs to almost double to \$10.14 million per year by FY 2027-28. City of Menlo Park, *Adopted Budget, Fiscal Year 2017-18*, p. 48.

Half Moon Bay. The City has established a pension stabilization fund.<sup>132</sup> As of June 30, 2017, the City reported having approximately \$1 million in the fund<sup>133</sup> and its FY 2017-2018 budget provides for the transfer of another \$0.51 million into the fund.<sup>134</sup> This would bring the fund total to slightly more than \$1.5 million by the end of FY 2017-2018. When compared to Half Moon Bay's pension costs of \$0.59 million in FY 2016-2017,<sup>135</sup> a \$1.5 million pension stabilization fund represents a reasonable start to the city's preparations for rising pension costs. It compares favorably to Menlo Park's pension reserve, which holds only approximately 7 months' worth of pension costs.<sup>136</sup> In contrast, Half Moon Bay's fund holds the equivalent of well over 2 years of pension costs.

The City of San Mateo. The city's long-term budget calls for funding an \$8.95 million pension cost reserve, with \$1.4 million to be contributed in FY 2017-2018 and additional annual amounts thereafter equal to 50 percent of certain budget surpluses.<sup>137</sup> The City of San Mateo's annual pension costs were over \$17.5 million in FY 2016-2017,<sup>138</sup> so this reserve amount for pension costs is modest.

South San Francisco. The city reports that it established a "CalPERS Stabilization Reserve" with an initial amount of \$3.99 million in FY 2015-2016. It funded this reserve with another \$509,104 in FY 2016-2017 and projects funding it with an additional \$586,968 in FY 2018-2019, for a combined total of approximately \$5.1 million.<sup>139</sup> This \$5.1 million total would represent 27.3 percent of the City's \$18.7 million in unassigned reserves as of June 30, 2017<sup>140</sup> and roughly 5 months' worth of its FY 2016-2017 pension costs of \$13.3 million.<sup>141</sup>

Brisbane. The City of Brisbane reports having adopted a policy of allocating 40 percent of unanticipated ending fund balance to be used to be set aside to pay for unfunded pension and OPEB obligations.<sup>142</sup>

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<sup>132</sup> City of Half Moon Bay, *FY 2017-18 Adopted Operating Budget*, pp. 68, 71 and 224, <<https://www.half-moon-bay.ca.us/DocumentCenter/View/940>>.

<sup>133</sup> City of Half Moon Bay, California, Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 2017, p. 102, <<https://www.half-moon-bay.ca.us/DocumentCenter/View/1341>>.

<sup>134</sup> City of Half Moon Bay, *FY 2017-18 Adopted Operating Budget*, pp. 69 and 71.

<sup>135</sup> Appendix A.

<sup>136</sup> Menlo Park's pension costs in FY 2016-17 were approximately \$5.6 million. Appendix A.

<sup>137</sup> City of San Mateo, *Adopted 2017-18 Budget*, pp. 54 and 117, <<https://www.cityofsanmateo.org/DocumentCenter/View/60043>>.

<sup>138</sup> Appendix A.

<sup>139</sup> South San Francisco, Letter from City of South San Francisco to Grand Jury, dated June 11, 2018. City of South San Francisco, *FY 2018-19 Addendum to Adopted FY 2018-19 Biennial Operating Budget*, p. B-5. City of South San Francisco, *FY 2018-19 Operating Budget Study Session*, May 23, 2018, p. 28. City of South San Francisco, *Adopted Biennial Operating Budget and Capital Improvement Program Fiscal Years 2017-19*, p. D-5, <<http://www.ssf.net/home/showdocument?id=2027>>.

<sup>140</sup> City of South San Francisco, Letter from South San Francisco to Grand Jury, dated June 7, 2018.

<sup>141</sup> Appendix A.

<sup>142</sup> Brisbane, Letter from City of Brisbane to Grand Jury, dated June 11, 2018. The City's letter does not disclose the estimated amounts that might be set aside as a result of this policy.



(3) Establish IRS Section 115 non-revocable trusts.

The Cities can also put reserves that are set aside for pension costs into non-revocable trusts under Section 115 of the Internal Revenue Code. Contributions to Section 115 trusts are voluntary and can be made as city budgets allow. Funds in such trusts can only be used to pay pension costs.<sup>143</sup> As with ordinary reserves, the Cities can use funds in Section 115 trusts to manage or smooth payments to CalPERS, consistent with their budgetary needs.<sup>144</sup> The non-revocable feature assures employees, retirees and taxpayers that the funds will be used for pension costs. Another advantage of Section 115 trusts is that they offer different investment choices and risk profiles<sup>145</sup> which can yield higher rates of Return on Investments than the rates available to the Cities for their general fund reserves.<sup>146</sup> Payments into a reserve do not reduce the Amortization Costs charged by CalPERS.

In January 2018 Redwood City deposited \$10.5 million into a Section 115 trust,<sup>147</sup> representing approximately 7 months of its annual pension costs of \$17.7 million in FY 2016-2017.<sup>148</sup> Redwood City's finance group has recommended that the City deposit \$1.1 million per year from general fund reserves into the Section 115 trust over the 5-year period from and including FY 2018-2019 through FY 2022-2023.<sup>149</sup> This \$1.1 million per year would represent slightly less than 50 percent of the estimated \$2.5 million per year increase in pension costs that Redwood City is likely to experience.<sup>150</sup> In FY 2016-2017, the Redwood City Council adopted a general fund reserve policy, where the unreserved portion of the general fund's balance would be 15 percent of anticipated general fund revenues. Any excess balance above a 15 percent reserve threshold would be utilized to fund a Section 115 Trust Account to help pay pension expenses.<sup>151</sup>

In October 2017 Burlingame contributed \$3.7 million into a Section 115 trust for the purpose of paying pension obligations and, approximately six months later, an additional \$1 million.<sup>152</sup> The

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<sup>143</sup> CalPERS, Finance and Administration Committee, *Proposed California Employers' Pension Prefunding Trust (CEPPT) Legislation*, February 17, 2016, pp. 1-2, 4, <<https://www.calpers.ca.gov/docs/board-agendas/201602/financeadmin/item-6a-00.pdf>>.

<sup>144</sup> Ibid.

<sup>145</sup> Ibid.

<sup>146</sup> The City of Menlo Park notes that, if it moves funds in its Strategic Pension Funding reserve into a Section 115 trust, it would expect to earn returns on those assets of approximately 4 percent per year, as compared to the approximately 1 percent per year it earns on general fund reserves to due restrictions imposed on available investments for general fund reserves. City of Menlo Park, *Adopted Budget, Fiscal Year 2017-18*, p. 48.

<sup>147</sup> Redwood City Report – FY 2017-18 Mid-Year Budget Study Session, p. 10. City of Redwood City, *Fiscal Year 2017-2018 Adopted Budget*, Budget Message, pp. 13 and 28, <<http://webapps.redwoodcity.org/files/finance/main/1.-Redwood-City-CA-Adopted-FY-17-18-Budget-.pdf>>.

<sup>148</sup> Appendix A.

<sup>149</sup> City of Redwood City, *Fiscal Year 2018-2019 Recommended Budget*, p. 174, <<http://www.redwoodcity.org/home/showdocument?id=15124>>.

<sup>150</sup> Table No. 7.1, above shows that Redwood City's pension costs (Miscellaneous and Safety plans) are projected to increase by \$20.1 million between FY 2016-17 and FY 2024-25. \$20.1 million / 8 years = \$2.5 million in increases per year.

<sup>151</sup> City of Redwood City, 2017 CAFR, p. v of Letter of Transmittal.

<sup>152</sup> Letter from City of Burlingame to Grand Jury, dated June 7, 2018. Augustine, Carol, Staff Report to Burlingame City Council, March 14, 2018, pp. 11 and 12.

City's proposed FY 2018-19 budget recommends contributing another \$3.4 million to the Section 115 trust,<sup>153</sup> which would bring total funds in the trust to \$8.1 million. The City's five-year forecast projects ongoing annual contributions to the Section 115 trust in the amounts of \$2.7 million in FY 2019-20, \$2.1 million in FY 2020-21, \$1.5 million in FY 2021-22 and \$1.21 million in FY 202-23.<sup>154</sup> If the additional FY 2018-19 contribution of \$3.4 million is made, the \$8.1 million total Section 115 trust amount would represent 29 percent of Burlingame's projected total general fund reserves of \$28.19 million at the end of FY 2017-2018, of which \$9.15 million will be unassigned<sup>155</sup> and approximately 19 months' worth of its \$5.3 million in pension costs in FY 2016-2017.

The City of Brisbane also reports having recently established a Section 115 trust to help pay any unexpected increases in pension payment obligations. The City's financial plan calls for it to put aside funding for additional payments into the 115 trust.<sup>156</sup>

#### (4) Negotiate Cost-Sharing Arrangements with Employees.

The Cities can reduce their pension costs through cost-sharing agreements with employees under which employees agree to pay a portion of the Cities' Normal Costs. For example, the City of Menlo Park has negotiated cost-sharing agreements with non-sworn employees under which those employees will pay an additional amount equal to 50 percent of the City's future pension cost increases and agreements with sworn employees under which they will pay a portion of the City's pension costs equal to 3 percent of total payroll.<sup>157</sup> Redwood City has also negotiated cost-sharing agreements with employees under which those employees pay a portion of the City's Normal Costs,<sup>158</sup> as have Atherton,<sup>159</sup> Burlingame,<sup>160</sup> Hillsborough,<sup>161</sup> and Millbrae.<sup>162</sup>

#### (5) Pension Obligation Bonds (POBs).

Another option is to accelerate repayment of Unfunded Liabilities with the proceeds of pension obligation bonds issued by the City. Where the interest rate being charged by CalPERS on Unfunded Liabilities is higher than the interest rate on the bonds, this can result in savings for a City. For example, in FY 2003-2004, Daly City issued \$36.2 million in pension obligation bonds and applied the proceeds to reduce its Unfunded Liabilities. At the time, CalPERS was charging annual interest of 8.25 percent on Unfunded Liabilities and the interest on the bonds was only 5.973 percent. According to Daly City, the difference between the interest rate charged by

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<sup>153</sup> Burlingame, Letter from City of Burlingame to Grand Jury, dated June 7, 2018.

<sup>154</sup> Burlingame, Email from City of Burlingame to Grand Jury, dated June 9, 2018. See also, Augustine, Staff Report March 14, 2018, p. 48 for information on the portion of these payments that will be made out of the general fund.

<sup>155</sup> City of Burlingame, *Fiscal Year 2017-18 Adopted Budget*, p. xiii.

<sup>156</sup> Brisbane, Letter from City of Brisbane to Grand Jury, dated June 11, 2018. The City's letter does not disclose the amount(s) contributed into its Section 115 Trust.

<sup>157</sup> City of Menlo Park, *Adopted Budget, Fiscal Year 2017-18*, p. 48.

<sup>158</sup> Redwood City Report - FY 2017-18 Mid-Year Budget Study Session, p. 10.

<sup>159</sup> Town of Atherton, *Fiscal Year 2017/18 Operating & Capital Improvement Budget*, p. 4, <<http://www.ci.atherton.ca.us/ArchiveCenter/ViewFile/Item/2535>>.

<sup>160</sup> City of Burlingame, *Fiscal Year 2017-18 Adopted Budget*, p. xviii.

<sup>161</sup> Interviews by Grand Jury.

<sup>162</sup> City of Millbrae, Letter from City of Millbrae to Grand Jury, dated June 11, 2018.

CalPERS, and the lower rate paid to bondholders, resulted in \$7 million in net present value savings.<sup>163</sup> However, these bonds did not solve Daly City's pension problems. As of June 30, 2017, Daly City had a remaining unpaid balance of \$22.8 million on these bonds, which mature on August 1, 2022.<sup>164</sup> In evaluating Daly City's total Unfunded Liabilities and pension costs in Appendix A, the reader should take into account that Appendix A does not reflect Daly City's outstanding balance on the bonds, nor the annual costs of repayments of principal and interest on the bonds (which totaled approximately \$3.54 million in FY 2016-2017).<sup>165</sup> If these amounts were included, then Daly City's FY 2016-2017 Unfunded Liabilities in Appendix A would rise from \$139.86 million to \$162.66 million and its annual pension costs would rise from \$11.63 million to \$15.17 million. Daly City's interest payments on the bonds, however, do remain lower than the interest it would otherwise have had to pay on Unfunded Liabilities.

In 2013, the City of San Bruno issued \$13.2 million in pension obligation bonds.<sup>166</sup> The City of Brisbane issued \$4.7 million in pension obligation bonds in 2006 and took out a \$1.6 million loan in 2013 to pay off certain pension obligations,<sup>167</sup> and the City of Burlingame issued \$33 million in pension obligation bonds in 2007.<sup>168</sup>

An analysis of the risks and benefits of pension obligation bonds is beyond the scope of this report. See the Government Finance Officers Association's analysis of pension obligation bonds for an analysis of the reasons not to issue such bonds.<sup>169</sup>

#### (6) Shorten Amortization Periods.

The Cities may instruct CalPERS to shorten the Amortization Period of their Unfunded Liabilities. That would increase their contribution costs in the short-term but decrease aggregate interest costs over the long-term.<sup>170</sup> Such a decision, however, is irrevocable. Once it has shortened an Amortization Period at the request of an Agency, CalPERS will not subsequently increase it at the request of the Agency.<sup>171</sup> The City of Palo Alto, although outside the borders of the county, has stated that it is looking at this option.<sup>172</sup> In essence, asking CalPERS to shorten

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<sup>163</sup> City of Daly City, *Comprehensive Biennial Operating and Capital Budget, Fiscal Years 2017 and 2018*, p. 25, <<http://www.dalycity.org/Assets/Departments/Finance+and+Administration/Operating+Budget+2017-2018.pdf>>.

<sup>164</sup> City of Daly City, 2017 CAFR, p. 15.

<sup>165</sup> City of Daly City, 2017 CAFR, p. 53.

<sup>166</sup> City of San Bruno, *Fiscal Year 2013-14 City Council Adopted General Fund, Enterprise Funds, Internal Service Funds and Special Revenue Funds Operating Budget*, p. K-4,

<https://www.sanbruno.ca.gov/civicax/filebank/blobdload.aspx?BlobID=23046>

<sup>167</sup> City of Brisbane, 2014 CAFR, pp. 54, 55 and 59,

<<http://brisbaneca.org/sites/default/files/brisbane%20cafr%20ocr.pdf>>.

<sup>168</sup> City of Burlingame, 2010 CAFR, p. 60,

<[https://www.burlingame.org/document\\_center/Finance/Comprehensive%20Annual%20Financial%20Reports/CAFR%2009-10.pdf](https://www.burlingame.org/document_center/Finance/Comprehensive%20Annual%20Financial%20Reports/CAFR%2009-10.pdf)>. City of Burlingame, *Fiscal Year 2017-18 Adopted Budget*, p. x.

<sup>169</sup> League of California Cities, *2018 Retirement System Sustainability Study*, pp. 6 and 33.

<sup>170</sup> Lin, Bianca and Yam, Wai Man, *City of Menlo Park Miscellaneous and Safety Plans, CalPERS Actuarial Issues – 6/30/15 Valuation Preliminary Results*, Bartel Associates LLC, May 2, 2017, p. 48.

<sup>171</sup> Interviews by Grand Jury.

<sup>172</sup> Keene, James, Palo Alto City Manager, Letter to Tamara L. Davis, Deputy Manager, Jury Services, Santa Clara County Civil Grand Jury, January 30, 2017, p. 1, (Updated response to 2011-12 Santa Clara County Civil Grand

the Amortization Period is a more structured way to achieve the same goal as making supplemental contributions to CalPERS beyond the required contribution. CalPERS has announced that it will be phasing in a 20-year amortization schedule for all member Agencies.<sup>173</sup> However, Agencies remain free to elect more aggressive reductions in their Amortization Periods.

(7) Keep Salary Increases Within the Rate Assumed by CalPERS.

Calculations of future Benefit obligations are based, in part, on assumptions CalPERS makes about future salary increases by the Cities. Cities can impact the size of their contribution payments over time by ensuring that future employee salary increases do not exceed CalPERS's assumed amounts.

(8) Reduce Operating Costs.

Painful though it may be, the Cities can reduce operating costs to create additional reserves, which they could then apply to pension costs. Redwood City's finance group has warned of "future recessionary impacts that loom in the future"<sup>174</sup> and notes that, to meet these challenges, it recommends reducing operating costs by \$3.7 million in the FY 2018-2019 budget (primarily through reductions in budgeted headcount, including police and firefighters) and another \$2.3 million in FY 2019-2020.<sup>175</sup> Indeed, Redwood City's finance group stated that rising pension costs are the biggest factor driving the city's efforts to reduce operating costs.<sup>176</sup>

Daly City describes its increasing pension costs as a "major challenge for the City's budget in coming years."<sup>177</sup> It is in the process of cutting operating costs through, among other things, a freeze on filling six vacant police officer positions and eliminating nine firefighter positions through attrition. Daly City notes that its general fund has a structural budget deficit of approximately \$6 million in the biennial budget for FY 2016-2017 and 2017-2018 and that it is drawing down existing general fund reserves to close this budget gap.<sup>178</sup> The Town of Colma notes that "Rising costs of health care and pension rates are placing extraordinary pressure on the fiscal health of most California municipalities, including the Town of Colma" and, among other responses to this pressure, has elected to terminate its retiree health premium payments programs for all employees hired after January 1, 2017.<sup>179</sup>

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Jury report, *An Analysis of Pension and Other Post-Employment Benefits*,  
<[http://www.scsccourt.org/court\\_divisions/civil/cgj/2012/responses/pension/02.03.17%20Response%20-%20Palo%20Alto.PDF](http://www.scsccourt.org/court_divisions/civil/cgj/2012/responses/pension/02.03.17%20Response%20-%20Palo%20Alto.PDF)>.

<sup>173</sup> League of California Cities, *CalPERS Board Reduces Amortization Policy*. Lowe and Rogers, *CalPERS Reduces Amortization Period with Impacts to Employer Contribution Rates*. CalPERS Actuarial Office, *Finance and Administration Committee, Agenda Item 7a*. Jacobius, Arleen, *CalPERS shortens amortization period to 20 years*.

<sup>174</sup> Redwood City, *Report - FY 2017-18 Mid-Year Budget Study Session*, pp. 7 and 11.

<sup>175</sup> City of Redwood City, *Fiscal Year 2018-2019 Recommended Budget*, pp. 9, 18 and 19.

<sup>176</sup> Interviews by Grand Jury.

<sup>177</sup> City of Daly City, *Adopted Comprehensive Biennial Operating and Capital Budget, Fiscal Years 2017 and 2018*, p. 26.

<sup>178</sup> *Ibid.*, at p. 7.

<sup>179</sup> Town of Colma, *FY 2017-18 Adopted Budget*, p. 8.

(9) Seek New Revenue.

Although raising additional revenues for the purpose of paying down pension obligations may be difficult, it may still be possible for the Cities to supplement their funding of services through new revenue sources to protect them from cuts that might otherwise have to be made to pay rising pension costs. Redwood City's finance group notes that the City has increased revenues by approximately \$2 million per year through higher development fees and that it is in the process of developing a phased approach to cannabis regulation as a result of which it expects to generate at least \$0.3 million a year in additional taxes.<sup>180</sup> Redwood City is also exploring the possibility of implementing new solid waste fees to support street sweeping and parking enforcement services. The city's finance group concludes that: "Without new revenues, staff projects deficits beginning in FY 2019-20."<sup>181</sup> These deficits are projected to reach \$6.6 million per year in the general fund budget by FY 2022-2023.<sup>182</sup> In November 2016, Daly City residents voted on Measure V, a five-year supplemental parcel tax of \$162 per parcel for the purpose of restoring police and fire personnel and related operational costs. Measure V was defeated by a vote of 53 to 47 percent.<sup>183</sup>

Measures That Appear Unavailable at this Time.

Several more obvious strategies appear to be off the table at this time:

(a) Renegotiating employee pension formulas.

As described in BACKGROUND (pages 12-13), the California Rule, a California Supreme Court interpretation of the state constitution, appears to prohibit even prospective reductions in pension Benefits for existing employees. As noted, cases challenging that interpretation are currently before the California Supreme Court. In the event that the Supreme Court loosens the California Rule, local jurisdictions may be able to renegotiate pension Benefits with their employees. Under PEPRA, Benefits for "New Members" hired after January 1, 2013, are much lower than for the "Classic Members" hired prior to that date. The California League of Cities "supports a change in state law or judicial precedent to allow employers to negotiate plan changes with classic CalPERS members" and suggests "converting all currently deemed "Classic" employees to the same provisions (Benefits and employee contributions) currently in place for "PEPRA" employees for all future years of service."

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<sup>180</sup> Redwood City, *Report - FY 2017-18 Mid-Year Budget Study Session*, p. 12.

<sup>181</sup> *Ibid.*

<sup>182</sup> City of Redwood City, *Fiscal Year 2018-2019 Recommended Budget*, p. 174.

<sup>183</sup> Ballotpedia, *Daly City, California, Parcel Tax for Police and Fire Departments, Measure V (November 2016)*, <[https://ballotpedia.org/Daly\\_City,\\_California,\\_Parcel\\_Tax\\_for\\_Police\\_and\\_Fire\\_Departments,\\_Measure\\_V\\_\(November\\_2016\)](https://ballotpedia.org/Daly_City,_California,_Parcel_Tax_for_Police_and_Fire_Departments,_Measure_V_(November_2016))>.

(b) Adopting a defined contribution pension plan for new employees.

As noted in BACKGROUND (page 4), defined contribution (as opposed to defined benefit) plans such as 401k plans relieve municipalities of the risks and uncertainties of below-projected investment returns and other assumptions about the future (for example, mortality rates). A large percentage of private companies have now adopted this approach<sup>184</sup> but they may be compensating for this, at least in part, with salaries that are greater than public agency salaries. As of 2009, only 7 percent of private-sector employees had their sole pension plan in the form of a defined benefit plan, down from 62 percent in 1975.<sup>185</sup> The Cities could achieve much greater certainty with respect to future pension costs if they could switch to a defined contribution plan for new employees. However, CalPERS does not currently offer defined contribution plans as an option for its member agencies and it requires that all new employees of the member Agencies participate in CalPERS' pension plans.<sup>186</sup> As a result, the Cities could only offer defined contribution plans to new employees in addition to, rather than in place of, existing pension plans with the result that defined contribution plans would increase, rather than reduce, overall costs for the Cities. In addition, offering only defined contribution plans could put the Cities at a significant employee recruiting and retention disadvantage compared to private industry unless the Cities increased salaries to rates more competitive with private industry.

(c) Withdrawing from CalPERS.

Several cities have considered the possibility of withdrawing from CalPERS altogether in order to have more flexibility and visibility into their future pension costs. However, CalPERS' termination payment requirements are prohibitive.<sup>187</sup> The City of Palo Alto determined that, in order to leave CalPERS, it would first need to "immediately deposit" in excess of \$1 billion to the CalPERS Pension Trust, and then establish a new deferred compensation plan for employees.<sup>188</sup> A City of San Carlos official advised the Grand Jury that withdrawal from CalPERS is effectively "impossible" because of the high termination fees imposed by CalPERS.

**Conclusion.**

Most of the Cities do not yet appear to have adopted a long-term financial plan to address their rising pension costs. They have not adopted target Funded Percentages for their plans, dates for achieving them, or plans for monitoring progress against their targets. Thus far, they have not made it a priority to provide clear, regular and public disclosure to their residents of their future projected pension costs and Unfunded Liabilities, nor the cuts in services that they will make, or

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<sup>184</sup> Since 1980, when participation in defined benefits plans was at its peak in the United States, 30.1 million people participated in defined benefit plans. That number has dropped by 40 percent over the past 30 years. Money-Zine, *Defined Benefit versus Contribution Plans*, July 5, 2017, p. 2, <<https://www.money-zine.com/financial-planning/retirement/defined-benefit-versus-contribution-plans/>>.

<sup>185</sup> Nation, *Pension Math* 2011, p. 3, footnote 11.

<sup>186</sup> Interviews by Grand Jury.

<sup>187</sup> Interviews by Grand Jury.

<sup>188</sup> Keene, James, Palo Alto City Manager, Letter to Tamara L. Davis.

increases in revenues they will seek, in response to rapidly increasing pension costs. Where projected pension costs are disclosed, they are often based on CalPERS projections for returns on investment that some experts argue are optimistic, and residents are not apprised of the potential for far greater costs should another recession occur, or other CalPERS assumptions prove inaccurate.

The steps necessary to address the pension crisis are unpleasant to think about, much less implement. Indeed, some of the Cities have advised the Grand Jury that, while important, amortization of Unfunded Liabilities must be balanced against “other priorities” for new spending.<sup>189</sup> While the Grand Jury understands the desire on the part of the Cities to expand city services in these times of economic growth and increasing property tax revenues, it is difficult to think of a more important issue for the Cities to focus on than the looming pension crisis. Currently, the county enjoys good economic conditions. Its unemployment rate recently dropped to 2.1 percent.<sup>190</sup> Many of the Cities are experiencing rising revenues.<sup>191</sup> If the Cities do not address Unfunded Liabilities in a decisive way now, when will they ever be able to? The next recession may well reduce CalPERS’ Returns on Investment below their projected level, resulting in even larger Unfunded Liabilities and higher pension costs. The next recession may also reduce or eliminate the Cities’ budget surpluses, making it harder for them to cope.<sup>192</sup> Now is the time for the Cities to engage their residents in the issue and, with the residents’ support, take the difficult actions necessary to secure a bright future for their communities.

## FINDINGS

- F1. Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City’s pension plans in the amount set forth beside its name for that year in Appendix A.
- F2. Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City’s pension plans in the amount set forth beside its name for that year in Appendix A.
- F3. Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City’s pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

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<sup>189</sup> Interviews by Grand Jury.

<sup>190</sup> Glover, Mark, *California sets a new record for lowest unemployment rate*, The Sacramento Bee, January 19, 2018, <[www.sacbee.com/news/business/article/195571634.html](http://www.sacbee.com/news/business/article/195571634.html)>.

<sup>191</sup> See footnote 125 above.

<sup>192</sup> Redwood City notes that the current expansion phase of the economy has now lasted for eight years, and that, historically, expansionary cycles only last an average of five years. It cautions that the economy is in a “late stage of expansion” and that prudent long-term budgeting requires the city to “proactively prepare for future recessionary impacts that loom in the future.” Redwood City, *Report - FY 2017-18 Mid-Year Budget Study Session*, p. 11.

- F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.
- F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.
- F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.
- F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."
- F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."
- F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.)
- F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.
- F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.
- F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:



- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years or maintaining the cities’ share of Normal Costs below “n” percentage of payroll,
- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities’ share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a “Plan B,” that may be used in the event that CalPERS’ assumptions are not met in future years.

F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

## **RECOMMENDATIONS**

- R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city’s increasing pension costs and to develop a long-term plan to address them.
- R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:
- a) The City’s total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS’ actuarial assumptions are met.
  - b) The City’s total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS’ actuarial assumptions are met.
  - c) The City’s Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS’ actuarial assumptions are met.
  - d) The percentage of the City’s general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).

- e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):

- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
- Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

R4: The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years and maintaining the City’s share of Normal Costs at “n” percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a “Plan B,” that may be used in the event that CalPERS’s actuarial assumptions, especially the Discount Rate, are not met in future years.

## **REQUEST FOR RESPONSES**

Pursuant to Penal Code Section 933.05, the Grand Jury requests that the City Councils of each of the following respond to the foregoing Findings and Recommendations referring in each instance to the number thereof:

- The Town of Atherton
- The City of Belmont
- The City of Brisbane
- The City of Burlingame
- The Town of Colma
- The City of Daly City
- The City of East Palo Alto
- The City of Foster City
- The City of Half Moon Bay
- The Town of Hillsborough
- The City of Menlo Park
- The City of Millbrae
- The City of Pacifica
- The Town of Portola Valley
- The City of Redwood City
- The City of San Bruno
- The City of San Carlos
- The City of San Mateo
- The City of South San Francisco
- The Town of Woodside

In responding to the foregoing Findings and Recommendations, each city and town should understand references to “[E]ach City” as referring only to itself. No city or town should be responding as to an entity other than itself.

## **METHODOLOGY**

The Grand Jury reviewed each of the documents listed in “BIBLIOGRAPHY” below. In addition, the Grand Jury interviewed representatives of 6 of the Cities, the County, and an independent public pensions expert.

## APPENDIX A – CITIES’ PENSION DATA

(Based on the Cities’ Annual Financial Reports for FY 2014-2015, FY 2015-2016 and FY 2016-2017)

**All dollar amounts in thousands.**

CITIES	Fiscal Year	Covered Payroll	Contribution Payments	Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)	Unfunded Liability	Funded Percentage	Unfunded Liability if Discount Rate Is Reduced 1 Percentage Point	General Fund Total Expenditures	Contribution Payments as % of General Fund Total Expenditures*
Atherton	2016-2017	<b>\$4,327</b>	<b>\$1,155</b>	<b>26.7%</b>	<b>\$13,982</b>	<b>74.3%</b>	<b>\$21,344</b>	<b>\$11,437</b>	<b>10.1%</b>
	2015-2016	\$4,261	\$617	14.5%	\$10,674	80.4%	\$17,326	\$10,611	5.8%
	2014-2015	\$3,988	\$826	20.7%	\$9,253	81.9%	\$16,088	\$11,622	7.1%
Belmont	2016-2017	<b>\$15,198</b>	<b>\$3,582</b>	<b>23.6%</b>	<b>\$32,835</b>	<b>72.0%</b>	<b>\$48,680</b>	<b>\$18,344</b>	<b>19.5%</b>
	2015-2016	\$11,794	\$4,191	35.5%	\$26,626	76.2%	\$41,855	\$16,800	24.9%
	2014-2015	\$14,176	\$2,788	19.7%	\$25,059	76.7%	\$39,412	\$16,777	16.6%
Brisbane	2016-2017	<b>\$7,916</b>	<b>\$1,713</b>	<b>21.6%</b>	<b>\$18,227</b>	<b>74.8%</b>	<b>\$27,989</b>	<b>\$15,521</b>	<b>11.0%</b>
	2015-2016	\$7,101	\$883	12.4%	\$13,952	79.9%	\$23,410	\$14,850	5.9%
	2014-2015	6,152	1,153	18.7%	12,074	82.2%	\$21,119	\$13,247	8.7%
Burlingame	2016-2017	<b>\$18,617</b>	<b>\$5,294</b>	<b>28.4%</b>	<b>\$57,694</b>	<b>73.4%</b>	<b>\$86,051</b>	<b>\$49,707</b>	<b>10.7%</b>
	2015-2016	\$17,654	\$3,840	21.8%	\$46,987	77.8%	\$75,062	\$47,459	8.1%
	2014-2015	16,713	3,822	22.9%	41,762	80.1%	\$69,042	\$44,405	8.6%
Colma	2016-2017	<b>\$4,031</b>	<b>\$1,048</b>	<b>26.0%</b>	<b>\$9,449</b>	<b>74.2%</b>	<b>\$14,008</b>	<b>\$13,323</b>	<b>7.9%</b>
	2015-2016	\$3,749	\$937	25.0%	\$7,747	74.7%	\$11,969	\$13,410	7.0%
	2014-2015	\$3,604	\$939	26.1%	\$6,885	76.1%	\$10,724	\$12,948	7.3%
Daly City	2016-2017	<b>\$40,070</b>	<b>\$11,631</b>	<b>29.0%</b>	<b>\$139,861</b>	<b>75.7%</b>	<b>\$213,918</b>	<b>\$77,139</b>	<b>15.1%</b>
	2015-2016	\$42,608	\$12,081	28.4%	\$112,195	80.0%	\$185,217	\$79,062	15.3%
	2014-2015	42,226	8,862	21.0%	99,631	81.9%	\$169,965	\$72,649	12.2%
East Palo Alto	2016-2017	<b>8,464</b>	<b>1,493</b>	<b>17.6%</b>	<b>9,459</b>	<b>74.1%</b>	<b>13,750</b>	<b>\$18,109</b>	<b>8.2%</b>
	2015-2016	\$8,408	\$1,372	16.3%	\$8,112	78.4%	\$12,086	\$17,735	7.7%
	2014-2015	7,926	1,477	18.6%	7,856	70.6%	\$11,417	\$16,524	8.9%
Foster City	2016-2017	<b>\$19,875</b>	<b>\$7,209</b>	<b>36.3%</b>	<b>\$69,207</b>	<b>68.7%</b>	<b>\$98,575</b>	<b>\$36,416</b>	<b>19.8%</b>
	2015-2016	\$18,724	\$5,294	28.3%	\$56,390	76.7%	\$84,686	\$33,048	16.0%
	2014-2015	17,696	4,552	25.7%	50,458	78.2%	\$77,534	\$31,322	14.5%
Half Moon Bay	2016-2017	<b>\$2,423</b>	<b>\$594</b>	<b>24.5%</b>	<b>\$9,502</b>	<b>74.6%</b>	<b>\$14,557</b>	<b>\$10,418</b>	<b>5.7%</b>
	2015-2016	\$2,014	\$583	28.9%	\$7,319	80.1%	\$12,332	\$8,781	6.6%
	2014-2015	1,987	529	26.6%	6,736	81.6%	\$11,620	\$8,352	6.3%
Hillsborough	2016-2017	<b>\$8,661</b>	<b>\$2,158</b>	<b>24.9%</b>	<b>\$22,387</b>	<b>74.5%</b>	<b>\$34,262</b>	<b>\$21,224</b>	<b>10.2%</b>
	2015-2016	\$9,089	\$1,893	20.8%	\$17,187	80.2%	\$28,063	\$19,693	9.6%
	2014-2015	8,625	1,605	18.6%	14,770	79.8%	\$25,822	\$18,721	8.6%

\*Note: Covered Payroll amounts in CAFRs may include compensation paid to certain employees whose activities are not accounted for as part of General Fund activities, and their compensation would not be included in General Fund Total Expenditures. As a result, the percentage of General Fund Total Expenditures represented by Covered Payroll may somewhat overstate the percentage represented by General Fund Covered Payroll. Some experts have estimated that this might result in an overstatement of the percentage by 10 – 30 percent, such that a Contribution Payment as a % of General Fund Total Expenditures of 10 percent might actually be somewhere between 7 and 9 percent.

CITIES	Fiscal Year	Covered Payroll	Contribution Payments	Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)	Unfunded Liability	Funded Percentage	Unfunded Liability if Discount Rate Is Reduced 1 Percentage Point	General Fund Total Expenditures	Contribution Payments as % of General Fund Total Expenditures*
Menlo Park	2016-2017	<b>\$23,112</b>	<b>\$5,565</b>	<b>24.1%</b>	<b>\$50,993</b>	<b>74.4%</b>	<b>\$77,514</b>	<b>\$47,314</b>	<b>11.8%</b>
	2015-2016	\$19,868	\$4,747	23.9%	\$38,881	79.3%	\$64,170	\$42,565	11.2%
	2014-2015	19,969	4,228	21.2%	34,371	81.2%	\$58,596	\$40,581	10.4%
Millbrae	2016-2017	<b>\$6,165</b>	<b>\$2,335</b>	<b>37.9%</b>	<b>\$42,769</b>	<b>74.1%</b>	<b>\$62,676</b>	<b>\$25,494</b>	<b>9.2%</b>
	2015-2016	\$5,835	\$2,064	35.4%	\$34,256	78.4%	\$53,883	\$22,514	9.2%
	2014-2015	6,871	1,400	20.4%	28,989	78.6%	47,979	\$18,201	7.7%
Pacifica	2016-2017	<b>\$15,720</b>	<b>\$3,736</b>	<b>23.8%</b>	<b>\$44,400</b>	<b>77.5%</b>	<b>\$70,650</b>	<b>\$28,781</b>	<b>13.0%</b>
	2015-2016	\$15,000	\$2,749	18.3%	\$32,841	82.7%	\$56,750	\$27,358	10.0%
	2014-2015	\$14,365	\$2,739	19.1%	\$28,089	85.0%	\$52,855	\$25,354	10.8%
Portola Valley	2016-2017	<b>\$1,442</b>	<b>\$116</b>	<b>8.1%</b>	<b>\$524</b>	<b>91.8%</b>	<b>\$1,382</b>	<b>\$4,361</b>	<b>2.7%</b>
	2015-2016	\$1,072	\$84	7.8%	\$82	98.6%	\$881	\$4,303	2.0%
	2014-2015	\$993	\$1,019	102.6%	\$957	83.0%	\$1,706	\$5,587	18.2%
Redwood City	2016-2017	<b>\$62,098</b>	<b>\$17,722</b>	<b>28.5%</b>	<b>\$215,202</b>	<b>65.7%</b>	<b>\$298,653</b>	<b>\$112,142</b>	<b>15.8%</b>
	2015-2016	\$57,352	\$17,363	30.3%	\$177,937	70.1%	\$257,798	\$101,684	17.1%
	2014-2015	\$54,275	\$16,467	30.3%	\$164,149	71.6%	\$240,111	\$95,856	17.2%
San Bruno	2016-2017	<b>\$25,173</b>	<b>\$6,344</b>	<b>25.2%</b>	<b>\$78,198</b>	<b>70.7%</b>	<b>\$114,180</b>	<b>\$43,244</b>	<b>14.7%</b>
	2015-2016	\$21,315	\$4,434	20.8%	\$61,771	75.6%	\$96,281	\$38,882	11.4%
	2014-2015	\$20,532	\$4,979	24.3%	\$53,531	78.4%	\$86,637	\$36,738	13.6%
San Carlos	2016-2017	<b>\$11,047</b>	<b>\$2,134</b>	<b>19.3%</b>	<b>\$47,009</b>	<b>63.3%</b>	<b>\$64,530</b>	<b>\$33,182</b>	<b>6.4%</b>
	2015-2016	\$10,486	\$2,601	24.8%	\$40,263	67.3%	\$57,293	\$41,264	6.3%
	2014-2015	\$8,480	\$2,296	27.1%	\$27,741	75.5%	\$42,824	\$29,067	7.9%
San Mateo (City)	2016-2017	<b>\$58,645</b>	<b>\$17,537</b>	<b>29.9%</b>	<b>\$197,822</b>	<b>66.2%</b>	<b>\$271,523</b>	<b>\$103,992</b>	<b>16.9%</b>
	2015-2016	\$52,345	\$15,908	30.4%	\$168,693	70.1%	\$240,459	\$95,779	16.6%
	2014-2015	\$49,788	\$13,860	27.8%	\$159,585	71.4%	\$228,588	\$88,078	15.7%
South San Francisco	2016-2017	<b>\$48,954</b>	<b>\$13,300</b>	<b>27.2%</b>	<b>\$152,786</b>	<b>68.4%</b>	<b>\$216,103</b>	<b>\$92,367</b>	<b>14.4%</b>
	2015-2016	\$40,396	\$13,938	34.5%	\$130,042	72.2%	\$191,669	\$86,795	16.1%
	2014-2015	\$34,478	\$11,403	33.1%	\$124,085	73.2%	\$184,305	\$76,805	14.8%
Woodside	2016-2017	<b>\$1,996</b>	<b>\$323</b>	<b>16.2%</b>	<b>\$3,164</b>	<b>72.3%</b>	<b>\$4,702</b>	<b>\$6,801</b>	<b>4.8%</b>
	2015-2016	\$1,809	\$409	22.6%	\$2,578	75.8%	\$4,325	\$6,638	6.2%
	2014-2015	\$1,640	\$389	23.7%	\$2,053	79.1%	\$3,356	\$6,107	6.4%

Totals & Weighted Averages	2016-2017	<b>\$383,935</b>	<b>\$104,986</b>	<b>27.3%</b>	<b>\$1,215,467</b>	<b>70.5%</b>	<b>\$1,755,047</b>	<b>\$769,315</b>	<b>13.6%</b>
	2015-2016	\$350,879	\$95,987	27.4%	\$994,535	75.1%	\$1,515,516	\$729,230	13.2%
	2014-2015	\$334,484	\$85,335	25.5%	\$898,036	76.8%	\$1,399,702	\$668,939	12.8%

## **APPENDIX B - HOW TO FIND PENSION DATA IN THE CITIES' CAFRS**

Set forth below is a guide to where information compiled in Appendix A can be found in the Cities' CAFRs.

Amount of Employer Contributions to Pension Plans: This information is set forth in the "Required Supplemental Information" section of the CAFR, in the "Schedule(s) of Contributions" for the pension plans. Sometimes a separate Schedule of Contribution is included for each pension plan, other times only an aggregate number for all plans is given.

Covered Payroll for Pension Plans: This information is set forth in the "Required Supplemental Information" section of the CAFR, in the "Schedule(s) of Contributions" for the pension plans. Where the CAFR has a separate Schedule of Contributions for each pension plan, it will also show the payroll specific to that plan's employees. Where plan information is aggregated, then the payroll number will also be aggregated.

Amount of Unfunded Liabilities: This information is set forth in the "Required Supplemental Information" section of the CAFR, in the "Schedule of Proportionate Share of The Net Pension Liability" as "Plan's proportionate share of the Net Pension Liability (Asset)." Note: The amounts given for "covered payroll" in this schedule should not be relied upon as they often apply to the year (either one or two years prior) in which pension assets and liabilities were last measured, rather than the fiscal year covered in the CAFR itself. For information as to covered payroll during the current fiscal year, rely only on the information is set forth in the "Required Supplemental Information" section of the CAFR, in the "Schedule(s) of Contributions" for the pension plans.

Funded Percentage of Pension Plan. This information is set forth in the "Required Supplemental Information" section of the CAFR, in the "Schedule of Proportionate Share of The Net Pension Liability" as "Plan's proportionate share of Fiduciary Net Position as a Percentage of Plan's Total Pension Liability." As used in CAFRs, "Fiduciary Net Position" refers to the total assets in the pension plan. Hence, the Funded Percentage of a pension plan is equal to its "Fiduciary Net Position" divided by "Total Pension Liability." The term, "Net Pension Liability" refers to the difference between plan assets ("Fiduciary Net Position") and plan liabilities ("Total Pension Liability"). The amounts given for "covered payroll" in this schedule should not be relied upon as they often apply to the year (either one or two years prior) in which pension assets and liabilities were last measured, rather than the fiscal year covered in the CAFR itself. For information as to covered payroll during the current fiscal year, rely only on the information is set forth in the "Required Supplemental Information" section of the CAFR, in the "Schedule(s) of Contributions" for the pension plans.

Total Assets, Total Liabilities and Total Unfunded Liabilities of Pension Plan: This information, if provided in the CAFR, is set forth in the "Required Supplemental Information" section of the CAFR, in the "Schedule of Changes in the Net Pension Liability and Related Ratios" as (i) "Plan

Fiduciary Net Position – ending (b)” with respect to plan assets, (ii) “Total Pension Liability – ending (a)” with respect to total plan liabilities, and (iii) “Net Pension Liability – ending (a) - (b)” with respect to unfunded pension liabilities. Note: In many CAFRs the amount of unfunded pension liabilities (“Net Pension Liabilities”) and the Funded Percentage of the pension plan are given, but the total assets amount (“Plan Fiduciary Net Position”) and the total liabilities amount (“Total Pension Liability”) are not given. They can, however, be calculated in the following way. To derive total liabilities, simply divide the Unfunded Liability amount (“Net Pension Liabilities”) by 1 minus the Funded Percentage for the fund. To derive total assets (“Plan Fiduciary Net Position”) simply subtract the Unfunded Liabilities amount (“Net Pension Liability”) from the amount of total plan liabilities (“Total Pension Liability”). Where the aggregate Funded Percentage of all pension plans is not given in a CAFR, it can be derived simply by dividing the sum of all of the plan asset amounts for each plan by the sum of all plan liabilities for each plan.

The following example will demonstrate the foregoing. Assume the CAFR provides the following information:

Net Pension Liability under Miscellaneous Plan is \$15 million.

Funded percentage under Miscellaneous Plan is 75%.

Net Pension Liability under Safety Plan is \$20 million.

Funded percentage under Safety Plan is 80%.

Accordingly,

Total liabilities under the Miscellaneous Plan are \$60 million ( $\$15\text{M net pension liability} / (1 - 75\% \text{ Funded Percentage}) = \$60 \text{ million}$ )

Total assets under the Miscellaneous Plan are \$35M ( $\$60\text{M total liabilities amount minus } \$15\text{M net pension liability} = \$35\text{M}$ )

Total liabilities under the Safety Plan are \$100M ( $\$20\text{M net pension liability} / (1 - 80\% \text{ Funded Percentage}) = \$100\text{M}$ )

Total assets under Safety Plan are \$80M ( $\$100\text{M total liabilities amount minus } \$20\text{M net pension liability} = \$80\text{M}$ )

Total liabilities under all pension plans are \$160M ( $\$60\text{M under Miscellaneous Plan and } \$100\text{M under Safety Plan}$ )

Total assets under all pension plans are \$105M ( $\$35\text{M under Miscellaneous Plan plus } \$80\text{M under Safety Plan}$ )



Aggregate Funded Percentage under all plans is 65.6% (\$105M aggregate total assets divided by \$160M aggregate total liabilities).

Unfunded Liabilities Where Discount Rate Is Increased/Decreased by 100 Points (i.e., 1 percentage point): This information is set forth in the section of “Notes to Basic Financial Statements” describing the pension plans under the heading “Sensitivity of Proportionate Share of Net Pension Liability to Changes in the Discount Rate.” It is sometimes provided separately for each pension plan and other times only an aggregate number for all pension plans is given.

General Fund Spending by City: This information is found in the “Government Fund Financial Statements” section of the CAFR in the “Statement of Revenue, Expenditures and Changes in Fund Balances, Governmental Funds for the Year Ended \_\_\_\_\_”.

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Issued: July 17, 2018



## Town of Atherton

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September 21, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
C/O Charlene Kresevich  
Hall of Justice  
400 County Center; 2<sup>nd</sup> Floor  
Redwood City, CA. 94063-1655

SUBJECT: GRAND JURY REPORT "Soaring Pension Costs-Time for Hard Choices"

Dear Hon. V. Raymond Swope:

Attached please find the Town of Atherton's response to the above Grand Jury Report. Pursuant to California Penal Code Section 933.05, the response was considered by the City Council at a public meeting on September 19, 2018.

Should you have any questions concerning the response, please contact City Manager George Rodericks at (650) 752-0504.

Sincerely Regards,

**TOWN OF ATHERTON**

Cary West  
Mayor

## RESPONSE TO GRAND JURY REPORT

Report Title: "Soaring Pension Costs-Time for Hard Choices"

Report Date: July 19, 2018

Response by: Town of Atherton

By: Cary Wiest, Mayor

### FINDINGS:

- We agree with the findings numbers: F1, F2, F4, F5, F6, F7, F8, F9
- We somewhat agrees, disagree wholly or partially with the findings numbered: F3, F10, F11, F12, F13

### RECOMMENDATIONS:

Recommendation numbered R1, R2, R3, R4, will take under advisement and implement when feasible.

### FINDINGS

F3. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

**F3 Response: The Town of Atherton somewhat agrees with the finding that it has been required to make amortization cost payments of principal and interest to CalPERS on our unfunded liabilities. The Town however contends that the payments currently have not diverted money that could have been used to provide public services. Money set aside for pensions could always be used elsewhere.**

F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

**F10 Response: The Town of Atherton agrees somewhat with the finding. There will be increases in contribution payments to CalPERS in the short term. The Town cannot attest to the likelihood that the costs will be more than double by 2024-2025. It is dependent on the actual rate of return of the pension plans each year.**

F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

**F11 Response: The Town of Atherton agrees with the finding that principal and interest payments on the Agency Unfunded liabilities could possibly impair provision of public services, impair the security of employee salary and pension benefits. The Town agrees that paying down unfunded liabilities early results in large savings and we have done so in the past.**

F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:

- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

**F12 Response: The Town of Atherton somewhat disagrees partially with the finding. The Town over the years through its Finance Committee has explored long term financial plans to provide opportunities the City Council can consider to pay down pension liabilities and mitigate investment volatility. Every year we review the CalPERS pension actuarials and risk analysis tools to estimate the Town Contributions payments toward unfunded liabilities, Employer normal cost rates, and an outlook on paying down liabilities.**

**The Town has explored the following:**

- **Consideration of additional contributions to CalPERS beyond required UAL to lower our payroll normal costs. This will accelerate funding based on alternative amortization schedules in the valuation reports;**
- **Decision to accumulate reserves and establish an Internal Service Fund to make a singular significant contribution to CalPERS when the Town sees prudent;**

➤ **The Town this fall is considering to establish an Irrevocable Supplemental Trust that can be used to reimburse for CalPERS contributions or make payments directly to CalPERS;**

➤ **Setting of a funding target for unfunded liabilities versus continuing pay as we go based on CalPERS valuation reports.**

F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

**F13 Response: The Town of Atherton disagrees partially with the finding. During our budget study sessions and review of the CalPERS actuarials, we discuss the future annual projections of the pension rate normal cost and potential future unfunded liabilities. The Town will take under advisement of providing specific annual projections of future pension contributions in the Town published budget document on our website.**

### **RECOMMENDATIONS**

R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

**R1 Response: The Town does already reviews its pension cost every year in public meetings with the Town Finance Committee. The pension liabilities are also reviewed during budget study sessions, its annual audit, and presentation of financials statement at City Council. Paying down of long term liabilities is a Town core strategy of maintaining financial stability as the Town has taken steps to address pension costs in the long term.**

R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each

City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:

a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.

b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.

c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.

d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).

e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

**R2 Response: Town supports reviewing pension obligations annually and projecting costs in future fiscal years in a matter that is feasible and allows the Town to identify opportunities to pay down its pension obligations.**

R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):

- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
- Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.

To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not



enhanced by “spiking,” such as by including overtime, unused vacation or sick leave, purchases of “air time,” and the like.

**R3 Response: The Town supports reviewing pension obligations annually and projecting costs and looking for opportunities to pay down long term liabilities. The Town has explored most of the options of policies and or implementation measures provided in the grand jury report and take under advisement where feasible. The Town follows the CalPERS contract law for Classic and PEPRA members.**

R4: The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years and maintaining the City’s share of Normal Costs at “n” percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a “Plan B,” that may be used in the event that CalPERS’s actuarial assumptions, especially the Discount Rate, are not met in future years.

**R4 Response: The Town already has discussions about these topics and will take under advisement the recommendation of developing and publishing a long term financial plan to deal with rising pension costs and update the plan annually. As mentioned in Finding 12 (F12), the Town over the years through its Finance Committee has explored long term financial plans to provide opportunities the City Council can consider to pay down pension liabilities and mitigate investment volatility. The Town will continue to review the CalPERS pension actuarials and when appropriate make recommendations to implement measures to setting aside additional funding in paying down long term pension liabilities.**



**CITY OF EAST PALO ALTO**  
**OFFICE OF THE CITY MAYOR**  
2415 UNIVERSITY AVENUE  
EAST PALO ALTO, CA 94303

Ruben Abrica, Mayor  
Lisa Gauthier, Vice Mayor  
Council Members:  
Larry Moody  
Carlos Romero  
Donna Rutherford

October 5, 2018

Hon. V. Raymond Swope  
Judge of the Superior Court  
C/o Charlene Kresevich  
Hall of Justice  
400 County Center; 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

Re: Grand Jury Report: Soaring City Pension Costs – Time for Hard Choices

Dear Judge Swope,

On behalf of the City of East Palo Alto, I am responding to the above referenced report. The City Council approved this response at its meeting of October 2, 2018.

As outlined in the report, East Palo Alto is among several municipalities faced with increasing California Public Employees' Retirement System (CalPERS) pension costs. In 2015, the City Council of East Palo Alto initiated a long-term, comprehensive process to address the City's fiscal challenges and improve fiscal resiliency. The first phase of the process was to implement resource strategies to address projected General Fund cost increases and funding gaps. Those efforts resulted in reinstatement of the City's Sponsoring Entity Loans of approximately \$12M, passage of a one-half cent local transaction and use tax, a business license tax on rental properties, and numerous efforts to gain efficiencies and increase existing tax compliance.

More recently, the City Council initiated the second – or policy - phase of the process and has conducted an informational session on the City's CalPERS obligations and funding options, as well as, a study session on City reserves and the use of reserves for comprehensive risk mitigation. The end of the second phase ultimately will result in a number of policies addressing and strengthening the City's fiscal environment. Further study and implementation of a CalPERS funding strategy is a significant piece of the overall, comprehensive discussion of City risks and risk mitigation strategies.

The City's responses largely agree with the finding outlined in the Grand Jury report. Many of the recommendations are in process to some extent, or will be further considered. The City fully recognizes a significant aspect of the City's long-term fiscal sustainability is predicated upon taking prudent and meaningful actions to address the City's pension obligations. As discussed, the City has already taken steps towards this goal, and staff will work with the City Council to consider the recommendations contained in the Grand Jury report.

Below are the City Council's specific responses to the findings and recommendations in the report.

### **FINDINGS**

- F.1 Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016, and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

*Response: The City agrees with this finding pertaining to the City of East Palo Alto data.*

- F.2 Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016, and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth besides its name for that year in Appendix A.

*Response: The City agrees with this finding pertaining to the City of East Palo Alto data.*

- F.3 Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016, and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

*Response: The City primarily agrees with this finding, and further notes that actual versus assumption differences are expected when dealing with the potential variables in a defined benefit plant. The City is in agreement that CalPERS amortization costs ought to be result of utilizing actuarial parameters that reflect prudent assumptions of future events in order to minimize the magnitude and duration of significant unfunded costs.*

*The finding language is further suggestive of the concept that Amortization Costs, if not paid, otherwise could have been utilized for additional public services or to increase fund reserves. Given that the City of East Palo Alto's resource structure is such that salary and benefit are typically below market averages; an alternate possibility is that the City would have been seeking to achieve improved market parity and paid approximately the same amount for total personnel expenditures in those years. Therefore, while we tend to agree with a simple interpretation of the finding; the span of possible outcomes is more complex.*

- F.4 Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

*Response: The City agrees with this finding pertaining to the City of East Palo Alto data.*

- F.5 Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

*Response: The City agrees with this finding pertaining to the City of East Palo Alto data.*

- F.6 Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported General Fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

*Response: The City agrees with this finding pertaining to the City of East Palo Alto data. The City further notes significant capital funding transferred during those years which is not reflected in the reported expenditures.*

- F.7 In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's General fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

*Response: The City agrees with this finding pertaining to the City of East Palo Alto data, and further notes to the extent employees are directly charged to other City funds, those funds bear the related pension costs. For the City of East Palo Alto, approximately 4% of payroll is charged to non-General funds annually – effectively reducing the General Fund contribution payment percentage by approximately 0.5% for each year disclosed.*

- F.8 In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."

*Response: The City agrees with this finding pertaining to the City of East Palo Alto data presented in the referenced CAFRs.*

- F.9 In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4 (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.)

*Response: The City partially agrees with this finding pertaining to the City of East Palo Alto data. In FY 2017-18, the City opted to prepay the total Amortization Cost of \$634,916 at the beginning of the year. This prepayment resulted in a savings of \$22,548 for an actual Amortization Cost of \$612,368 in FY 2017-18.*

- F.10 As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

*Response: The City primarily agrees with this finding pertaining to the City of East Palo Alto. The City of East Palo Alto rates are expected to increase approximately 70% through 2024-25; however, internal City projections assume a doubling of rates due to local labor trends since the most recent actuarial valuation, and to provide a higher level of confidence that projected and actual future rates are similar.*

- F.11 Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

*Response: The City agrees with this finding and further notes a multi-pronged approach to managing accumulated unfunded liabilities is required. The City faces a number of risks and liabilities requiring the City's attention, study, and consideration for resource allocation. The City recently presented a study of projected CalPERS' rate increases conducted by Bartel Associates LLC, and also initiated public discussion regarding current reserve balances and the use of reserve balances to mitigate a number of identified risks, including those risks associated with CalPERS' unfunded liabilities. The Council plans to consider CalPERS' funding strategy options together with a comprehensive risk study and a long-term forecast. The City will be considering strategies and opportunities for early payment of the Unfunded Liability.*

- F.12 The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising normal costs and amortization costs that includes each of the following:
- objectives such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
  - policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below that actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
  - measures to implement such policies,
  - processes to monitor progress in implementing the measure, and

- alternative financial strategies, or a “Plan B,” that may be used in the event that CalPERS’ assumptions are not met in future years.

*Response: The City mostly agrees with this finding. The City typically develops a five-year forecast with each adopted budget; however, recently delayed a strategy to adopt a long-term forecast in order to implement a ballot tax aimed at addressing local affordable housing and job training resources. The City plans to implement a stand-alone forecast through 2024-2025 as this time period addresses the most significant rate “ramp up” as a result of recent CalPERS funding policy and assumption changes.*

- F.13 Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, The City of Belmont and the City of Menlo Park) includes specific, annual projection of future pension contributions costs in their budgets published in the finance section of their websites.

*Response: The City mostly agrees with this finding pertaining to the City of East Palo Alto. During the last formal adoption of the five-year forecast, the City disclosed projected PERS contributions over the forecast period. We agree with the finding due to the fact that the preparation of a long-term forecast was strategically delayed to address Council priorities regarding affordable housing and job training resources. As noted above, the City intends to publish a stand-alone forecast in December 2018; and, also, is planning further public discussion of CalPERS’ Unfunded Liabilities and funding strategies.*

## **RECOMMENDATIONS**

- R.1 The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the City’s increasing pension costs and to develop a long-term plan to address them.

*Response: The City agrees with the recommendation, but the recommendation will be implemented within a timeframe extending through the FY 2019-2020 budget cycle. The City has taken steps to address City risks comprehensively, and the CalPERS’ Unfunded Liability is identified as a significant risk requiring further study, public engagement, and discussion. The City currently has excess general reserves and, over the ensuing months, will consider the allocation of those reserves to either mitigate existing risks, or fund additional one-time projects/programs – including one-time pay-down of unfunded liabilities. In May 2018, Council conducted an information session regarding projected CalPERS’ rate increases and options for addressing unfunded liabilities. The City plans to conduct further public meetings specifically on CalPERS’ Unfunded Liabilities and funding strategies.*

- R.2 The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:

- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- b) The City's total Unfunded Liabilities under all plans, also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- d) The percentage of the City's General Fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of General Fund expenditures in future fiscal years).
- e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

*Response: The City agrees with the recommendation to provide annual website information pertaining to the City's pension obligations. The City will consider the data requested and, also, comprehensively consider which data points effectively communicate the City's pension obligations. As mentioned, the City currently does not produce 10-year forecast data, and the current strategy is to produce a forecast through FY 2025-26. The City is unable to meet the recommended deadline of December 31, 2018 for the data points suggested, but will post historical and available forecast information available by that date.*

- R.3 The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):
- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of the Unfunded Liabilities.
  - Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
  - Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
  - Issuing pension obligation bonds.
  - Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
  - Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.

- Reductions in General Fund operating costs other than pension.
- Seeking additional General Fund revenues that can be applied directly to paying pension costs or that can offset General Fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchased of "air time," and the like.

*Response: The City agrees with the recommendation to evaluate options to address pension costs and hold public hearings every year or every other year to discuss such. The City held an informational session in May 2018, and will be engaging in discussions on this topic by December 31, 2018. The City of East Palo Alto typically engages in a strategic planning and budgeting cycle beginning approximately mid-January to mid-June of each year.*

*This year, the City will prepare a General Fund forecast through an extended period, in order to address the CalPERS rate projections specifically. This process is in tandem with extensive study and discussion, initiated in September 2018, regarding the City's overall risk environment and developing policies and strategies to address and mitigate those risks comprehensively. The City will be considering a number of the options considered to be in the best interest of the City of East Palo Alto.*

- R.4 The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:
- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
  - Policies to achieve these objectives.
  - Specific measures to implement the policies.
  - A process to monitor progress in implementing the measures and in achieving the objectives.
  - Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS' actuarial assumptions, especially the Discount Rate, are not met in future years.

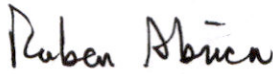


*Response: The City will be developing and publishing an extended financial plan, and will further consider the suggestions for policy and monitoring listed above. The City has the following plan in place and will continue with its intended goal of improving fiscal resiliency:*

- *May 15, 2018: City Pension Obligations and Funding Options*
- *September 4, 2018: General Reserves Study Session (including risk assessment and mitigation)*
- *October 16, 2018: Update of General Reserves Study Session – Consider GFOA Risk Based Reserve Analysis (if bid available)*
- *December 18, 2018: General Fund Forecast Report FY2018-19 to FY2025-26*
- *January 2019: Council Strategy and Planning Sessions*
- *February 2019: Present GFOA Risk Reserve Analysis (if approved)*
- *February – June 2019: Establish Council Reserve Policy, initiate CalPERS funding strategies, hold public meetings regarding risk mitigation – including CalPERS funding options and strategies.*

Thank you for allowing us to respond to your report and share our perspective.

Respectfully,



Ruben Abrica, Mayor

c: East Palo Alto Council Members  
Carlos Martinez, City Manager

October 1, 2018

Hon. V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center; 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655



Dear Judge Swope,

Thank you for the opportunity to respond to the Grand Jury report entitled “Soaring City Pension Costs – Time for Hard Choices”. The City of Belmont’s required responses, which were approved by the City Council on September 25, 2018, are listed below:

**Grand Jury Findings:**

- F1. Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City’s pension plans in the amount set forth beside its name for that year in Appendix A.
- F2. Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City’s pension plans in the amount set forth beside its name for that year in Appendix A.
- F3. Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City’s pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.
- F4. Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City’s pension plans in the amount set forth beside its name for that year in Appendix A.
- F5. Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City’s pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.
- F6. Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.



- F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."
- F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."
- F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not included data for them.)
- F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.
- F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.
- F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:
- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
  - policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
  - measures to implement such policies,

- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a “Plan B,” that may be used in the event that CalPERS’ assumptions are not met in future years.

F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

### **City of Belmont Response to Findings F1-F13:**

With respect to F1 – F8, the City disagrees with the findings and provides the following response:

As was previously reported to the Grand Jury, the City was unable to trace all amounts shown in Appendix A to its CAFR. It appears in some instances the results of the separate Belmont Fire Protection District were included, such as in the case of column titled, “Unfunded Liability if CalPERS’ Discount Rate is Reduced 1 Percentage Point” and in other instances it was not, such as in the case of the column titled “Covered Payroll”. For comparison purposes, the City had suggested to the Grand Jury to only include the results of the City of Belmont.

With respect to F9, the City partially disagrees with the finding, as it does not verify the veracity of information published by third parties with whom it has no business relationship.

With respect to F10, the City partially disagrees with the finding. Based on the actuarial valuations provided by CalPERS, which are a public document, the City believes the comment, “...*which are likely to more than double by FY 2024-2025*” is an overstatement.

With respect to F11, the City partially disagrees with this finding. The City has projected the increases in its long term forecast and believes the comment “...will increasingly impair Belmont’s provision of public services, impair the security of employee salary and pension Benefits...” is an overstatement. The City prepared a 7-year Trend and Projection for the City’s General Fund and the Belmont Fire Protection District. The pension contribution payments over the next five fiscal years were assumed in these projections and were based on the projected PERS Rate increases for FY 2019 to 2023 derived from actuary reports provided by CalPERS. No service impairment was noted in the forecast. The City concurs with the balance of the statement.

With respect to F12, the City disagrees with this finding. The statement above incorrectly leaves the impression that the City does not perform long-term financial planning, when, in fact, the City’s forecasting is modelled on and follows GFOA’s Best Practice Long-Term Financial Planning. GFOA specifically states that a plan should look at least five to ten years into the future, which is consistent with the City’s time horizon used in the budget forecast provided in the budget document.

With respect to F13, the City agrees with this finding.

**Grand Jury Recommendations requiring City of Belmont response:**

R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:

- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
- e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):

- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
- Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.

- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

R4: The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.

**City of Belmont Response to Recommendations R1-R4:**

The City of Belmont is acutely aware of this issue and has been proactively managing pension costs for decades. For instance, the City's Tier 1 CalPERS pension (2% at 55) is modest as compared to other municipalities within the County. The City provides the following responses:

With respect to R1, this recommendation has been implemented. On June 12, 2018, the City held a public meeting titled "CalPERS Unfunded Accrued Liability (UAL) Funding Options", which was open to the residents. At that meeting, the City's actuary discussed options for pension liability funding. At the conclusion of the meeting, the City Council directed that the discussion be

continued, further analysis be performed, and that the matter be brought back to the City Council for deliberation. The City is currently preparing this analysis with its actuary and is committed to continuing this discussion in a public forum.

With respect to R2, this recommendation will not be implemented because it is not warranted or reasonable. The recommendation includes forecasting 10 years of pension obligations, which is not a generally accepted accounting principle (GAAP). The City has a long history of issuing financial statements that are in compliance with GAAP, receiving unmodified opinions from its external auditors (highest level of assurance) and awards for Outstanding Excellence in Financial Reporting. Should the Governmental Accounting Standards Board (GASB) or Government Finance Officers Association (GFOA) promulgate GAAP requiring forecasting of pension obligations or making such forecasting a best practice, the City intends to follow such practice.

With respect to R3, this recommendation requires further analysis. As stated in the City's response to R1 above, the City Council directed that the discussion on pension liability funding options be further analyzed. The City Council considered a variety of options to address its pension obligation, but instructed staff to specifically focus on modeling supplemental payments to CalPERS which would accelerate the amortization of unfunded liabilities, including making regular or irregular payments with the objective of mimicking a 20-year amortization period. The City is in the midst of performing this analysis with its actuary and, as such, cannot commit to the Grand Jury's implementation date of December 31, 2018, however, the City is committed to continuing this discussion in a public forum.

With respect to R4, this recommendation has been implemented. As noted in the Grand Jury's Finding #13 ("*Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.*"), the City's General Fund Balance 7-Year Trends and Projections already incorporates future anticipated pension contributions, including components for normal costs, unfunded liabilities and discretionary additional pension contribution, if any. The City Council has expressed an interest in achieving fully-funded status on its existing unfunded actuarial liabilities premised on CalPERS' 20-Year Actuarial Amortization Policy (approved February 14, 2018). The anticipated outcome of the City Council's direction, if implemented, is that existing unfunded actuarial liabilities should be fully amortized in 20 years as long as CalPERS' actuarial assumptions are met and the City makes its annual required contributions. The City will continue its best practice of preparing its long-term financial forecast, monitoring its results and making corrective actions as necessary in order to maintain fiscal responsibility.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Thomas Fil', is written over the typed name.

Thomas Fil  
Finance Director



## CITY OF BRISBANE

50 Park Place  
Brisbane, California 94005-1310  
(415) 508-2100  
Fax (415) 467-4989

September 12, 2018

Hon. V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center  
Redwood City, CA 94063-1655

Dear Hon. V. Raymond Swope:

Below is the City's response to the Grand Jury Report: Soaring City Pension Costs- Time for Hard Choices. The responses were reviewed and approved by the City Council at their September 6, 2018 meeting.

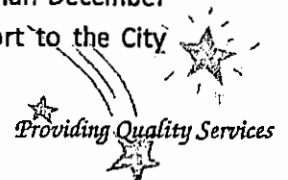
Recommendation 1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

RESPONSE: The City has held a public meeting concerning the rising cost of our pension plan as part of the 2018/20 budget process. The long-term plan was established by setting up a 115 Trust and contributing to it annually as well as planning for the increase in pension costs as part of our long-term financial planning scenarios.

Recommendation 2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. It goes on to list a number of items suggested to be in the report.

RESPONSE: It would make more sense to publish this type of report along with the City's budget in July or August of each year. The City contracts with GovInvest for PERS projections. The software is able to show the projected unfunded liability for the next 10 years by Plan so it has the ability to show the unfunded liability and the funded percentage. Without this software it would not be possible to show this information without getting a separate actuarial report which would be cost prohibitive. If the City was to show what would happen if PERS underperformed projections by 1% it would make sense to show what would happen if it over performed by 1% as well. The projected performance is the expected rate of return of over a twenty year period. In any given year PERs can underperform or over perform. Both cases are equally as likely.

Recommendation 3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City





Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider options no less than every other year. The report then listed 12 different strategies that could be reviewed.

RESPONSE: The City discussed the impact of pension on the City's ability to provide services for the City with its budget which is the time frame that the City Council can best decide on an overall strategy. The City does two year budgeting and will continue to have these discussions at this time. If the City Council was to discuss PERs options outside of the budget process, it would not have the same context to make the most informed decisions.

Recommendation 4 The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. The Grand Jury listed 5 items it recommends the plan include.

RESPONSE: The City will continue to review its Pension obligations alongside its budget every two years. Identifying a funded percentage by year may not be in the best interest of the City. There are years where PERs is able to outperform expectations. During these times the City should not deviate from its long-term financial objectives to take advantage of the short-term return on the market. It was thinking like this that enabled City's to provide additional benefits to its employees when PERs was above 100% funded. When there is a short-fall in returns the City should not reduce services which may be difficult to resurrect for short-term financial issues.

If there are any questions concerning the City's response please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read 'Stuart Schillinger', with a long horizontal line extending to the right.

Stuart Schillinger  
Administrative Services Director/Deputy City Manager



MICHAEL BROWNRIGG, MAYOR  
DONNA COLSON, VICE MAYOR  
EMILY BEACH  
ANN KEIGHRAN  
RICARDO ORTIZ

## The City of Burlingame

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September 17, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

Subject: City of Burlingame's response to 2017-2018 Civil Grand Jury Report entitled "Soaring City Pension Cost – Time for Hard Choices"

Dear Judge Swope:

After reviewing the 2017-2018 Grand Jury report entitled "Soaring City Pension Cost – Time for Hard Choices", the following are the City of Burlingame's responses to the Grand Jury's findings:

**F1. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016, and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR. The City of Burlingame has not reviewed any other City's CAFR.

**F2. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR. The City of Burlingame has not reviewed any other City's CAFR.

**F3. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR, with one clarification: pension payments in general represent costs incurred in the provision of public services. The principal payments on unfunded pension liabilities represent payment for the prior years' costs of providing public services.

The City agrees that every effort should be made to reduce the interest expense on these past liabilities, pay down the principal amount of these obligations, and (as with all operating costs) control increases in the future cost of employee pensions.

- F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR. The City of Burlingame has not reviewed any other City's CAFR.

- F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016, and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR. The City of Burlingame has not reviewed any other City's CAFR.

- F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR. The City of Burlingame has not reviewed any other City's CAFR.

- F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR. The City of Burlingame has not reviewed any other City's CAFR.

- F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR. The City of Burlingame has not reviewed any other City's CAFR.

- F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.)**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR, with one clarification: the City of Burlingame's cost shown was partially offset by employees making a portion of the City's required contribution.

- F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR. The City of Burlingame has not reviewed any other City's CAFR.

- F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.**

Response: The City of Burlingame agrees with this finding with respect to the City of Burlingame's CAFR, with the clarification that any pay down of the unfunded liability must be done in the context of the City's other budgetary considerations.

- F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:**

- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

Response: Although not totally familiar with steps other cities in the County have taken to address rising pension costs, the City of Burlingame has for many years made the identification and funding of long-term liabilities a priority, as an essential element in the maintenance of fiscal sustainability. Accordingly, the City Council directed the issuance of Pension Obligation Bonds (POBs) in 2006. Most of this \$32,975,000 issuance served to reduce the unfunded liability associated with the City's Safety and Miscellaneous plans. Since that time, rising pension costs due to the reduction of amortization periods and updated actuarial assumptions have always been considered in the City's five-year forecasts. Mindful of growing pension costs, the City has been very judicious in its consideration of additional staffing. With the most recent discount rate reductions (7.5% to 7% over three years), Burlingame's City Council directed staff to establish a §115 trust account for the exclusive purpose of funding pension obligations. A presentation was developed for all City employees, and three information and discussion sessions were held in July 2017 to explain to employees the impact of the CalPERS changes on the City's future pension costs. (The presentation and tutorial were also made available on the City's intranet.) The City made an initial contribution of \$3.7 million to the §115 trust account in October 2017. The fund was augmented by \$1 million in March 2018 with the analysis presented as part of the City's Mid-year Report. The 2018-19 budget includes nearly \$3.4 million in contributions to the fund.

Though not containing all the specific elements of the financial document described in the Grand Jury's finding, the City of Burlingame's plan to address rising pension costs is shown in the FY 2018-19 budget document under the

section entitled "Key Budget Assumptions", under the subtitle "Pension Liability Strategy"(page 25). In addition, the City is continually examining its options to fund these pension obligations in order to protect its ability to provide reliable municipal services into the future. To avoid frequent and significant changes in its funding plan, the City has not committed to a specific measure or outcome. Rather, in response to projected increases in Required Employer Contributions to CalPERS, the City plans to pay the required amounts each fiscal year, and fund the §115 trust account at a higher threshold rate, to provide for future year payments to CalPERS, until these rates level off and gradually subside. To the extent market conditions and other assumptions vary, the City will alter its contributions to the trust fund as prudently as possible and in the context of other demands on the City's fiscal resources. Alternative financial strategies are continuously analyzed, because actuarial assumptions are continuously adjusted to more accurately reflect the most current environment. The City includes "worse case" scenarios in its analysis of pension projections, which are reviewed annually by the Council in a public setting.

- F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.**

Response: The City agrees with this finding with respect to the City of Burlingame's CAFR. The City of Burlingame has not reviewed any other City's CAFR. The discussion of the City of Burlingame's future pension projections is included in the FY 2018-19 Budget Transmittal Letter in the section entitled "Citywide Budget Issues", under the subtitle "Controlling the Increasing Costs of Employee Benefits" (beginning on page xvii).

The following are the City of Burlingame's responses to the Grand Jury's recommendations:

- R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.**

The recommendation has been implemented. All discussions regarding the City's pension costs have been made during noticed, public City Council meetings, and the public is encouraged to provide comment on each topic presented at these meetings. In addition, the annual budget report, including a discussion of pension obligations and other long-term liabilities, requires a formal budget hearing. (The Grand Jury has included the links to the City's public pension discussions in footnote 100.) The City will have a comprehensive update of its pension plans on a Council agenda again prior to December 31, 2018.

- R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:**
- a. The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
  - b. The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
  - c. The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**

- d. The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
- e. In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

Response: The recommendation will not be implemented, as the City does not believe its analysis and discussion of pension costs should follow a specific frequency, format, or content. The City annually publishes its Comprehensive Annual Financial Reports (audited) and Budgets on its website. These reports contain information and discussion on all fiscal topics, concerns, and initiatives of the City. All City Council discussions, including decisions and plans regarding the funding of long-term liabilities, are held at public meetings where public comment is invited.

- R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):
- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
  - Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
  - Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
  - Issuing pension obligation bonds.
  - Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
  - Establishing Section 15 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
  - Reductions in general fund operating costs other than pensions.
  - Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
  - Keeping employee salary increases at or below the levels assumed by CalPERS.
  - Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
  - Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
  - To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

Response: The recommendation has been implemented. The City of Burlingame has considered and implemented many of the measures suggested in the Grand Jury's recommendation in the past, and will continue to explore all options within the context of its overall operating budget.

However, it should be noted that the City has in the past worked closely with its employee groups to reduce the cost of the long-term liabilities associated with employment and to control the cost of employee benefits: The City negotiated significant reductions in retiree health benefits for newer employees (hired after 2012, dependent on bargaining unit). Coupled with contributions to a trust fund account for the purpose of funding prior-year liabilities for retiree health insurance, this unfunded actuarially accrued liability for retiree health coverage has been greatly reduced. Employees now not only pay a portion of the cost of their health insurance coverage, but also pay a portion of the employer's required contribution for pension benefits with CalPERS (contribution rates vary from 1.5% to 4% depending on bargaining unit). The City continues to have good relations with its bargaining units; negotiates benefits in good faith; and is transparent in all its dealings with both represented and unrepresented employee groups. The City will not propose contracts it sees as too costly to the City or would jeopardize the cooperative nature of future employee negotiations.

Also of note: The City has never practiced "spiking", which generally refers to including excess compensation in the final year of employee pay. The Public Employees' Pension Reform Act (PEPRA), which took effect on January 1, 2013, bans the purchase of "air time", and eliminated many forms of pay (above base pay) that can be included in pensionable compensation.

**R4. The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:**

- **Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.**
- **Policies to achieve these objectives.**
- **Specific measures to implement the policies.**
- **A process to monitor progress in implementing the measures and in achieving the objectives.**
- **Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.**

Response: This recommendation has been implemented. The City of Burlingame has a plan in place to assist it in meeting its pension obligations through years of high pension costs until the employer required contribution rates return to current levels or below. See pages 30-31 of the Grand Jury report. By funding a \$115 Trust established specifically for this purpose, the City will smooth out the *rate* (as a percentage of payroll) for the amounts dedicated to its pension obligations.

The Burlingame City Council approved this response letter at its public meeting on September 17, 2018.

Sincerely,

  
Michael Brownrigg  
Mayor



## TOWN OF COLMA

1198 El Camino Real • Colma, California • 94014-3212  
Tel 650.997.8300 • Fax 650.997.8308

September 12, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center; 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

Re: Grand Jury Report: "Soaring City Pension Costs – Time for Hard Choices."

Dear Judge Swope;

The City Council received the San Mateo Civil Grand Jury report titled, "Soaring City Pension Costs – Time for Hard Choices."

The Town was requested to submit comments regarding the findings and recommendations within 90 days and no later than October 16, 2018. The Town of Colma's response to both the findings and recommendations are listed below.

The Grand Jury instructed all agencies in San Mateo County including the County to respond to findings 1-13 (F1-F13) and for Cities to respond to recommendations 1-4 (R1-R4).

For the "findings", the Town was to indicate one of the following;

1. The respondent agrees with the finding.
2. The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefore.

Additionally, for each Grand Jury "recommendation", the Town was requested to report one of the following actions;

1. The recommendation has been implemented, with a summary regarding the implemented action.
2. The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.
3. The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or director of the agency or department being investigated or

Raquel P. Gonzalez, Mayor  
Joanne F. del Rosario, Vice Mayor  
John Irish Goodwin, Council Member • Diana Colvin, Council Member • Helen Fisicaro, Council Member  
Brian Dossey, City Manager



reviewed, including the governing body of the public agency when applicable. This time frame shall not exceed six months from the date of publication of the Grand Jury report.

4. The recommendation will not be implemented because it is not warranted or reasonable, with an explanation therefore

**The following are responses to findings 1-13:**

**F1.** Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City’s pension plans in the amount set forth beside its name for that year in Appendix A.

**Town Response:** The Town disagrees with this finding. The correct pension data for the Town of Colma is stated below. This is the same data provided in the June 7, 2018 Grand Jury request.

Fiscal Year	Covered Payroll	Contribution Payments	Contribution Rates	Unfunded Liability	Funded Percentage	Unfunded Liability @ 1% Disc Rate	General Fund Total Expenditures	% of Contribution to Total GF Expenditures
2016-2017	\$ 4,031	\$ 1,139	28.3%	\$ 9,449	73.9%	\$ 14,008	\$ 13,323	8.5%
2015-2016	\$ 4,219	\$ 1,048	24.8%	\$ 7,747	74.7%	\$ 11,969	\$ 13,410	7.8%
2014-2015	\$ 3,209	\$ 982	30.6%	\$ 6,884	76.0%	\$ 10,724	\$ 12,948	7.6%

**F2.** Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City’s pension plans in the amount set forth beside its name for that year in Appendix A.

**Town Response:** The Town disagrees with this finding. The corrected pension data is summarized under Town Response for F1.

**F3.** Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City’s pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

**Town Response:** The Town disagrees with this finding. The corrected pension data is summarized under Town Response for F1. While annual pension contributions increase, the Town has been maintaining an excess of \$20.0 million in general fund reserves during the last several years. Service fee increases are related to equability and sustainability. The Town plans to establish and implement a long-range financial strategy to ensure future fiscal stability.

**F4.** Each City’s CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City’s pension plans in the amount set forth beside its name for that year in Appendix A.

**Town Response:** The Town disagrees with this finding. The corrected pension data is summarized under Town Response for F1.

**F5.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

**Town Response:** The Town disagrees with this finding. The corrected pension data is summarized under Town Response for F1.

**F6.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

**Town Response:** The Town disagrees with this finding. The corrected pension data is summarized under Town Response for F1.

**F7.** In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

**Town Response:** The Town disagrees with this finding. The corrected pension data is summarized under Town Response for F1.

**F8.** In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."

**Town Response:** The Town disagrees with this finding. The corrected pension data is summarized under Town Response for F1.

**F9.** In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.)

**Town Response:** Not applicable to the Town of Colma.

**F10.** As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

**Town Response:** The Town agrees with this finding.

**F11.** Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

**Town Response:** The Town agrees with this finding but is cautious in only focusing on unfunded pension liability. Supplemental contributions will reduce overall interest payments, resulting in substantial savings. It, however, also reduces the Town's ability to meet other obligations and community needs.

**F12.** The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:

- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

**Town Response:** The Town agrees with this finding. The Town has not published a 10-year financial forecast specifically addressing the rising pension cost. A 5-year financial forecast is included in the budget document.

**F13.** Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

**Town Response:** The Town agrees with this finding. The 5-year financial forecast mentioned under F12 includes rising pension cost but did not separately highlight pension cost.

**The following are responses to recommendations 1-4:**

**R1:** The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them

**Town Response:** This recommendation has not yet been implemented, but the Town is scheduled to discuss unfunded pension liability, along with other unfunded liabilities, during the September 26 City Council meeting. The discussion will include an initial funding plan and ongoing funding strategy.

**R2:** The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:

- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
- e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

**Town Response:** This recommendation has not yet been implemented, but the Town will implement it by December 31, 2018.

**R3:** The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):

- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
- Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.

- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the level assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRAs Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

**Town Response:** This recommendation has not been implemented and requires further analysis. The initial pension costs discussion is planned for the September 26 City Council meeting.

**R4:** The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.

- Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS' actuarial assumptions, especially the Discount Rate, are not met in future years.

**Town Response:** The recommendation has not yet been implemented, but the Town will implement this as part of the annual reporting process, with the 2018-19 plan by December 31, 2018.

Sincerely,

A handwritten signature in cursive script that reads "Raquel P. Gonzalez". The signature is written in black ink and includes a long, sweeping tail on the letter "z".

Raquel P. Gonzalez  
Mayor



# CITY OF DALY CITY

333 - 90TH STREET

DALY CITY, CA 94015-1895

PHONE: (650) 991-8000

Sent Via Email: [grandjury@sanmateocourt.org](mailto:grandjury@sanmateocourt.org)

August 17, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

Re: 2017-2018 County of San Mateo Civil Grand Jury Report "Soaring City Pension Costs – Time for Hard Choices"

Dear Judge Swope:

We are in receipt of the Grand Jury's final report "Soaring City Pension Costs – Time for Hard Choices". Pursuant to your July 17, 2018 request for response, the Daly City, City Council held a public meeting on August 13, 2018 and approved this response. The City of Daly City responds to the Grand Jury's findings, conclusions and recommendations as follows:

## **Findings:**

F1. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F2. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F3. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

**Response:** The City agrees with the finding.

- F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

**Response:** The City agrees with the finding.



F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."

**Response:** The City agrees with the finding.

F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not included data for them.)

**Response:** The City agrees with the finding.

F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

**Response:** The City agrees with the finding.

F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

**Response:** The City agrees with the finding.

F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:

- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,

- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

**Response:** The City agrees with the finding.

- F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

**Response:** The City agrees with the finding.

**Recommendations:**

- R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

**Response to Recommendation 1:**

The recommendation has been implemented.

All the City Council meetings are conducted openly in compliance with the Brown Act, and its records are maintained publicly in compliance with the Public Records Act.

At the City Council budget study sessions in April 2018, pension information included pension obligation bonds, CalPERS actuarial assumptions change and its impact to the City budget, unfunded pension liabilities, funded ratio, projected CalPERS employer contribution rates and projected employer contribution for miscellaneous and safety members over the next 10 years, were presented to the City Council and the public.

In addition, the City has retained an outside consultant to assist with the development of a Long-Term Financial Plan. The long-term financial forecast through Fiscal Year 2028 including pension costs and recommended actions were presented to the City Council in June 2018.

- R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:
- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
  - e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

**Response to Recommendation 2:**

The recommendation has not yet been implemented, but will be implemented by July 2019.

The City engages an outside consultant to prepare the pension actuarial report for the miscellaneous and safety members every two years. The actuarial reports will include projection over a 10-year horizon and other information requested by the Grand Jury. The next actuarial report will be completed by July 2019.

- R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):
- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
  - Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.

- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

**Response to Recommendation 3:**

The recommendation has been implemented.

Funding for the pension costs and Council priorities were presented to the City Council at the budget study sessions in April 2018 when the City put together the biannual budget.

In addition, the long-term financial forecast through Fiscal Year 2028 including pension costs and recommended actions were presented to the City Council in June 2018.

The City has prudently taken actions to manage its pension liabilities. In 2004, the City issued Pension Obligation Bonds (POBs) and proceeds were delivered to CalPERS to prepay pension unfunded liabilities.

The City is committed to pay down pension unfunded liabilities due to CalPERS actuarial assumptions change. The City has implemented a multi-pronged approach to address

long-term fiscal and pension challenges and to ensure the sustainability of the City's finance into the future.

1. Maintain General Fund unassigned fund balance equal to 15% of annual budgeted expenditures. Prior year surpluses of revenues over expenditures will be used to reduce unfunded liabilities for pension or other post-employment benefits.
2. Participated in Section 115 Trust Program to pre-fund pension unfunded liabilities.
3. Develop Workforce Management Strategies to reduce operating costs, evaluate alternative service delivery models to maximize efficiency, and align staffing with service demand.
4. Identify potential voter-approved taxes and other revenues.

R4: The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.

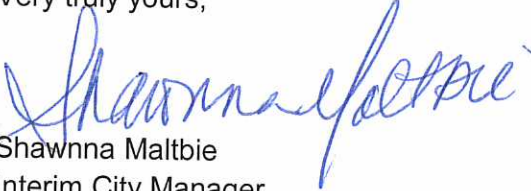
**Response to Recommendation 4:**

The recommendation has not been implemented, but will be implemented by June 30, 2019.

The City of Daly City appreciates the opportunity to provide written responses to the San Mateo County Civil Grand Jury Report "Soaring City Pension Costs – Time for Hard Choices."

Should you or the Grand Jury require any additional information, please contact me directly at (650) 991-8127.

Very truly yours,

A handwritten signature in blue ink, appearing to read "Shawna Maltbie".

Shawna Maltbie  
Interim City Manager

cc: City Council

Annette Hipona, City Clerk

Rose Zimmerman, City Attorney



# City of Foster City

## ESTERO MUNICIPAL IMPROVEMENT DISTRICT

610 FOSTER CITY BOULEVARD  
FOSTER CITY, CA 94404-2222

August 20, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center; 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

**RE: Response of the City of Foster City/Estero Municipal Improvement District to the Grand Jury Report "Soaring City Pension Costs – Time for Hard Choices"**

Honorable Judge Davis:

Thank you for the opportunity to review and comment on the above-referenced Grand Jury Report issued on July 17, 2018. The City of Foster City/Estero Municipal Improvement District's response to both the findings and recommendations are only for Foster City/EMID itself (hereinafter "City"), and are listed below.

### **Responses to Grand Jury Findings:**

F1. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

#### Response to F1:

The City's data differs slightly with the Grand Jury for fiscal year 2015-2016 as indicated below.

#### **Covered Payroll (in thousands):**

Fiscal Year	Per Foster	Per Grand
	City	Jury
2016-2017	19,875	19,875
<b>2015-2016</b>	<b>18,697</b>	<b>18,724</b>
2014-2015	17,696	17,696

F2. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.

Response to F2:

The City agrees with the finding.

F3. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

Response to F3:

The City agrees with the finding.

F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

Response to F4:

The City's data differs slightly with the Grand Jury as indicated below.

Funded Percentage	Funded Percentage	
	Per Foster	Per Grand
Fiscal Year	City	Jury
2016-2017	68.8%	68.7%
2015-2016	76.3%	76.7%
2014-2015	77.9%	78.2%

F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

Response to F5:

The City agrees with the finding.

F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

Response to F6:

The City agrees with the finding.



- F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

Response to F7:

The City agrees with the finding with the caveat that not all contribution payments to CalPERS are made by the City's General Fund (e.g. the City's Water and Wastewater Funds makes contribution payments for its applicable portion).

- F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."

Response to F8:

The City agrees with the finding.

- F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.)

Response to F9:

Not applicable

- F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

Response to F10:

The City faces increasing pension contribution payments to CalPERS and estimates that it may increase between 85 to 95 percent by FY 2024-2025.

- F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

Response to F11:

The City agrees with the finding.

- F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising

Normal Costs and Amortization Costs that includes each of the following:

- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

Response to F12:

The City agrees with the finding. However, the City does have a 5-year financial plan in its annual budget that identifies and addresses increases in overall City costs, including pension costs.

- F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

Response to F13:

The City agrees with this finding. However, City staff notes that as part of the City's annual budget (which can be found in the Finance section of the City's website), there is a 5-year financial plan which incorporates the effects of rising pension costs and unfunded liabilities into its forecasted employee services cost structure.

- R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

Response to R1:

The City agrees with this recommendation. The City will strive to schedule a public hearing on this important matter by December 2018. However, given that the City will have two new City Councilmembers at the conclusion of the November 6, 2018 election, the City may need to push the meeting out to January 2019 so that the two new City Councilmembers are present to provide policy direction on this important issue.

- R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:
- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
  - e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

Response to R2:

The City agrees with this recommendation to the extent that CalPERS is able to provide 10-year information to the City. Otherwise, the City plans to provide projected future amounts based on CalPERS' latest Annual Valuation Report.

- R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):
- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
  - Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.

- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

Response to R3:

The City agrees with this recommendation subject to policy direction from the City Council after the November 6, 2018 election. As stated in the response to R2, given that the City will have two new City Council members at the conclusion of the November 6, 2018 election, the City may need to push the meeting out to January 2019 so that the two new City Council members are present to discuss and consider policy options on pension costs.

- R4. The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:
- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
  - Policies to achieve these objectives.
  - Specific measures to implement the policies.
  - A process to monitor progress in implementing the measures and in achieving the objectives.
  - Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.

Response to R4:

The City agrees with this recommendation and plans to seek formal City Council policy direction on this matter by June 30, 2019.

Pursuant to Penal Code Section 933.05 and the Brown Act, this response to the Grand Jury was approved by Minute Order at a public meeting on August 20, 2018.

Respectfully,

A handwritten signature in blue ink, appearing to read "Sam Hindi".

Sam Hindi  
Mayor, City of Foster City  
President, Estero Municipal Improvement District

*Enclosure*

# MINUTE ORDER

No. 1559

OFFICE OF THE CITY CLERK  
FOSTER CITY, CALIFORNIA

Date: August 22, 2018

Attention: City Council/EMID Board  
Jeff Moneda, City Manager  
Edmund Suen, Finance Director  
Ann Ritzma, HR Director  
Fiti Rusli, Assistant Finance Director

City Council/EMID Board of Directors Meeting Date: August 20, 2018

Subject: Response to the San Mateo County Civil Grand Jury Report, Dated July 17, 2018,  
Entitled "Soaring City Pension Costs: Time for Hard Choices"

Motion by Councilmember Perez, seconded by Councilmember Bronitsky, and carried unanimously by roll call vote, 5-0-0, IT WAS ORDERED approving the response letter to the Honorable V. Raymond Swope, Judge of the Superior Court, pertaining to the San Mateo County Civil Grand Jury Report, dated July 17, 2018.

  
\_\_\_\_\_  
CITY CLERK/DISTRICT SECRETARY  
BY YELENA CAPPELLO, DEPUTY CITY CLERK



# CITY OF HALF MOON BAY

501 Main Street  
Half Moon Bay, CA 94019

October 17, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

**RE: San Mateo County Civil Grand Jury Report: “Soaring City Pension Costs – Time for Hard Choices”**

Honorable Judge Swope:

The City of Half Moon Bay hereby submits this letter in reply to your request for responses to the San Mateo Grand Jury Report, “Soaring City Pension Costs – Time for Hard Choices”. Pursuant to Penal Code Section 933.05 and the Brown Act, this response was approved by the City Council at the October 16, 2018 public meeting.

**Findings.** The City of Half Moon Bay reviewed all 13 Findings in the Grand Jury report. Since the Findings are based on information collected by the Grand Jury from all agencies in San Mateo County, the City assumed that the general information is accurate, and therefore agrees with the Findings 1-11. The City has additional comments related to Findings 12-13.

**F12: The financial documents for each city reviewed by the Grand Jury show that no city has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:**

- Objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years or maintaining the cities’ share of Normal Costs below “n” percentage of payroll;
- Policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities’ share of Normal Costs, reducing operational costs or increasing revenue;
- Measures to implement such policies;
- Processes to monitor progress in implementing the measures; and
- Alternative financial strategies, or a “Plan B”, that may be used in the event that CalPERS’ assumptions are not met in future years.

Response: The City partially agrees with the finding. The City has recently engaged in the independent actuarial study to evaluate various scenarios and develop a pension funding policy. The Finance staff is currently working with the actuarial consultant to finalize the analysis of assumptions and effects for additional contribution towards the unfunded liability, including the long-term implications of sending the contribution to CalPERS vs. funding it in a Section 115 supplemental fund. This includes 20-year projections of CalPERS contribution rates under both scenarios, including PEPRAs changes, discount rate changes and risk mitigation, recently adopted amortization policy and investment return volatility.

As the first step in developing the long-term plan, the City has already established the reserve fund or unrestricted Pension Stabilization Internal Service Fund to set aside funds to offset the costs of pension liabilities and smooth out future fluctuations driven by changes in funding policy and actuarial assumptions. As of June 30, 2017, the balance in this fund was \$1,035,404, and as part of FY 2018-19 Budget, City Council authorized an on-going annual contribution of \$100,000 to the Pension Stabilization Fund in addition to employer normal cost and payment of unfunded liability calculated by PERS.

Also, the City has previously established an irrevocable Section 115 Trust with PARS to fund other post-employment benefits (OPEB). In October, 2016, City Council approved creating another tax-exempt irrevocable trust to fund pension obligation and stabilize pension costs in a Pension Rate Stabilization Program (PRSP) with PARS. Given that the City's OPEB obligations are now fully-funded, this creates a unique flexibility to draw down on OPEB trust overfunded assets to reallocate available resources into the pension trust fund, which will be included in the greater pension funding policy discussion with the City Council in February, 2019.

**F13: Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each city, no city (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contributions costs in their budgets published in the finance section of their websites.**

Response: The City of Half Moon Bay partially disagrees with the finding. During the budget preparation and study sessions, staff reviewed the CalPERS actuarial reports and discussed the future annual projections of the pension normal cost and unfunded liabilities. The FY 2018-19 Adopted Budget includes annual projections of both the normal cost and future pension contributions. While these are not specifically called out as separate line items, they are included in the assumptions, which can be found in the salaries and benefits totals on each department page and in a 5-year General Fund forecast which incorporates the effects of rising pension cost and unfunded liabilities in future cost structure. Additionally, City Council approved an on-going annual contribution of \$100,000 to the Pension Stabilization Fund and directed staff to prepare for funding strategy and policy options discussion to address the rising pension liability. Staff will be bringing this item to the Council agenda after the November elections when the new Council is seated to weigh in on this important decision.



Once the pension liability funding policy is adopted by City Council, staff will take under advisement of providing annual projections for future pension contributions in the City's published budget document.

#### **Responses to Recommendations.**

City staff offers the following responses to the Grand Jury's four four recommendations:

**R1: By December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.**

**Response:** The City has not yet implemented the recommendation to schedule public hearings, but will implement it in the future with anticipated hearings at regularly scheduled City Council meetings. The above-mentioned independent actuarial study is currently underway and once completed and reviewed, it will be presented to the City Council at a public hearing as part of development of a long-term pension funding plan. However, given that the City will have three new Councilmembers after the November 6, 2018 election, staff recommends pushing this meeting to February, 2019 and present it in conjunction with the mid-year budget review, so the new Councilmembers may provide policy direction on this important issue and any additional funding authorization.

**R2: By December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:**

- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
- b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
- c) The City's Funded Percentage under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
- d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years.)**
- e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be represented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.**

Response: The City has not yet implemented this recommendation, but anticipates implementation of this recommendation with the delivery of the independent actuary's report as outlined in response to F12 and R1 above.

**R3: By December 31, 2018, and annually thereafter, each city instruct its staff to deliver a report to the City Council in connection with the city's financial plan evaluating available options to address pension costs and that each city hold public hearings to discuss and consider such options no less than every other fiscal year.**

Response: As noted above, the City has not yet implemented this recommendation but will direct the City's independent actuary to provide analysis and guidance on the various options outlined above and present those options to the City Council at a public meeting in conjunction with presenting the independent actuarial report described in the City's response to F12 and R1. As mentioned above (F12), the City has already implemented a number of options to mitigate the impact of rising pension costs. As suggested in response to R1, after the November 6, 2018 election, the City will develop and bring the pension funding policy for Council's consideration to be adopted in conjunction with the mid-year budget review to allow new Councilmembers to weigh in on this important policy decision and authorize any related budget amendments.

**R4: By June 30, 2019, each city develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:**

- **Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll;**
- **Policies to achieve these objectives;**
- **Specific measures to implement the policies;**
- **A process to monitor progress in implementing the measures and in achieving the objectives;**
- **Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.**

Response: The City of Half Moon Bay will work with our actuarial consultant and legal counsel to review this recommendation further. Each actuarial report includes an amortization schedule to pay off the liabilities. However, since the City has no control over how CalPERS ultimately calculates our Unfunded Liabilities based on CalPERS investments and assumptions, those amounts and dates are subject to change on the annual basis.

In order to maintain the City's share of Normal Costs at a given rate, the recommendation implies that it will require re-negotiating those rates with our labor unions, which would require re-opening the City's labor contract. Staff will take this recommendation under advisement to

present as a policy option when we bring the pension funding plan to the City Council's consideration in February, 2019.

In closing, the City of Half Moon Bay thanks the Grand Jury for its efforts to address one of the biggest challenges that face local governments throughout the state and we appreciate the opportunity to share our perspective.

Sincerely,

A handwritten signature in blue ink, appearing to read "Deborah Penrose". The signature is fluid and cursive, with a large initial "D" and "P".

Deborah Penrose, Mayor  
City of Half Moon Bay

Resolution No. C-2018-116

**A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF HALF MOON BAY ACCEPTING THE FINDINGS AND RECOMMENDATIONS FROM THE SAN MATEO COUNTY GRAND JURY REPORT, ENTITLED, "SOARING PENSION COSTS – TIME FOR HARD CHOICES"**

**WHEREAS**, On July 17, 2018, the San Mateo County Civil Grand Jury issued a report entitled "Soaring Pension costs – Time for Hard Choices";

**WHEREAS**, that Grand Jury Report included a request to the City of Half Moon Bay to respond to the report findings and recommendations by October 17, 2018," and

**WHEREAS**, at the regular City Council meeting on October 16, 2018, the City Council of Half Moon Bay reviewed this report, its findings and recommendation, and gave direction to City Staff to respond, as required under Penal Code § 933.05(b).

**NOW, THEREFORE, BE IT RESOLVED THAT** the City Council of the City of Half Moon Bay hereby accepts the findings and recommendations from the San Mateo County Grand Jury Report, entitled "Soaring Pension Costs – Time for Hard Choices".

\*\*\*\*\*

I, the undersigned, hereby certify that the foregoing Resolution was duly passed and adopted on the 16<sup>th</sup> day of October, 2018 by the City Council of Half Moon Bay by the following vote:

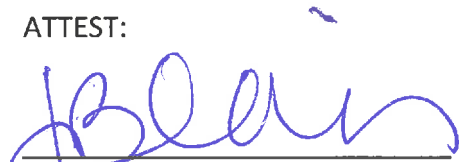
AYES, Councilmembers: Eisen, Ruddock, Rarback, Penrose

NOES, Councilmembers:


ABSENT, Councilmembers:

ABSTAIN, Councilmembers:

ATTEST:

  
\_\_\_\_\_  
Jessica Blair, City Clerk

APPROVED:

  
\_\_\_\_\_  
Deborah Penrose, Mayor



**HILLSBOROUGH**  
*California*

October 9, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

Re: Civil Grand Jury Report: “Soaring City Pension Costs – Time for Hard Choices”

Dear Judge Swope:

This letter is the Town of Hillsborough’s response to the Civil Grand Jury letter dated July 17, 2018. These responses were approved by the City Council at the October 8, 2018 meeting.

RESPONSE TO FINDINGS:

F1-F8. Cities pension data in Appendix A

*The Town of Hillsborough agrees with the findings. The data presented for the Town of Hillsborough on Appendix A-1 is accurate for the Town of Hillsborough.*

F9. In FY 2017-2018, each City has paid CalPERS for its Normal Costs and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (Hillsborough was not included in Table No. 4 because the source for that table did not include data for Hillsborough.)

*The Town of Hillsborough agrees with the finding. Table 4 on page 18 of the Grand Jury report does not include the Town of Hillsborough as the source used by the Grand Jury, the California Policy Center, did not include this data.*

F10. As a result, among other things, of CalPERS’ decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

*The Town of Hillsborough agrees with the finding. An actuarial report dated February 5, 2018, commissioned by the Town of Hillsborough and published by Bartel and Associates calculates the Town of Hillsborough’s contributions at \$2.4 million for Safety and*

*Miscellaneous Plans in Fiscal Year 2017-2018 and \$5.7 million for Safety and Miscellaneous Plans in Fiscal Year 2024-2025.*

- F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

*The Town of Hillsborough partially agrees with the finding. The Town of Hillsborough disagrees with the conclusion that increased interest and principal payments will impair services or compensation or require revenue increases. These costs alone may not impair services or require revenue increases but will be one of many factors that may influence budget funding. In addition, the achievement of substantial savings is relative to how much of the Unfunded Liability is paid down and when.*

- F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:
- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
  - policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
  - measures to implement such policies,
  - processes to monitor progress in implementing the measures, and
  - alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

*The Town of Hillsborough disagrees with the finding. While a separate financial plan document is not published as a standalone report, the Town discloses pension information in its existing budget and Comprehensive Annual Financial Report (CAFR) documents. The Town of Hillsborough's adopted FY 2018-2019 budget document includes a long-range projection, which discusses the rising pension costs, and includes a Town Goal to study the pension impacts and strategy. The Town's CAFR outlines pension data and analysis in compliance with GASB 68. Both documents reflect the Government Finance Officers Association (GFOA) requirements to the award program, which is considered best practices for local governments. In addition, the Town has held public discussions and implemented strategies related to pensions. The Town of Hillsborough is currently evaluating the impacts of CalPERS discount rate/policy changes and cost mitigation strategies that are most beneficial for the Town. The Town of Hillsborough hired an independent actuary to provide a projection and pension analysis report. In August 2017, the City Council and the Financial Advisory Committee at a public Study Session reviewed the results of the report. In March 2018, the Financial Advisory Committee reviewed mitigation strategies at its public meeting and provided recommendations for additional analysis. In July 2018, a Request for Proposal process for a Section 115 pension trust provider was issued and is estimated to conclude in October 2018.*

*Over the past decade, the Town of Hillsborough has implemented several strategies to mitigate the long-term cost of pensions. These strategies have included paying off \$9.9 million of side fund liabilities, collaborating with employees to pay a share of the employer's contribution, implementing an additional tier with a lower pension formula for miscellaneous plan employees and replacing employees who have retired with employees who are on the PEPPRA plan, where applicable.*

- F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

*The Town of Hillsborough disagrees with the finding. Hillsborough shows the pension costs in the long-range projection on page 96 of the FY 2018-2019 Adopted Budget published on the Town's website. The Town of Hillsborough has received the Government Finance Officers Award for fifteen years. The GFOA guidelines are considered the best practice for governments in displaying business plans, budgets, and policies.*

*In addition, the Town of Hillsborough publishes pension related disclosures in its Comprehensive Annual Financial Report in compliance with GASB 68. The CAFR is available to the public on the Town of Hillsborough's website.*

#### RESPONSE TO RECOMMENDATIONS:

- R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

*The recommendation has not been implemented but will be implemented as soon as possible with a goal of completing by December 31, 2018. As stated earlier in response to F12, the long-term plan is in the process of being developed. To date, the City Council commissioned an actuarial study and reviewed the long-term pension projections and an overview of cost mitigation strategies in a Joint City Council/Financial Advisory Committee public meeting in August 2017. In addition, at its March 20, 2018 public meeting, the Financial Advisory Committee reviewed long-term pension cost mitigation strategies and requested further investigation on the merits of an IRS Section 115 pension trust. A Request for Proposal (RFP) process was issued for Section 115 Pension Trust Services in June 2018.*

- R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:

a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.

b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.

c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.

d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).

e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

*The recommendation will not be implemented because it is not reasonable and would require considerable expense to provide a standalone annual report with the specified data on an annual basis, and some of the information would also be redundant with information that is already published in the CAFR and budget documents. In addition, not all of the data specified by the Grand Jury's recommendation is available in the annual actuarial valuations provided by CalPERS to the Town and therefore would require the Town to hire an outside actuary to prepare the annual report every year. The Town annually reports pension data in compliance with GASB 68 guidelines in its audited CAFR. The CAFR is available to the public on the Town's website. The GASB 68 pension reporting guidelines provide readers with many key financial metrics on pensions, which spans six pages in the Town's CAFR. In general, the CAFR disclosures provide a three-year historical view but do not provide the ten-year forward projection that the Grand Jury specified. The CalPERS actuarial valuations provide projections (not always ten years) for some of the items listed by the Grand Jury. These annual actuarial reports for each plan and member agency are provided to the Town on an annual basis. These reports outline information that CalPERS, as the administrator of the pension plan, deems to be important information and disclosures for the pension plans.*

R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. *(See list of options on page 39 of the Grand Jury report.)*

*The recommendation has not been implemented but will be implemented as soon as possible with a goal of completing by December 31, 2018. As stated in response R1, the long-term financial strategy is under way and will be presented in a public meeting. The funding of pension mitigation measures is best reviewed in conjunction with the annual budget process at a public study session and/or public hearing. The strategy will be documented in an existing format such as a budget document rather than a separate standalone report.*



- R4: The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:
- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years and maintaining the City’s share of Normal Costs at “n” percentage of payroll.
  - Policies to achieve these objectives.
  - Specific measures to implement the policies.
  - A process to monitor progress in implementing the measures and in achieving the objectives.
  - Consideration of alternative policies and measures, or a “Plan B,” that may be used in the event that CalPERS’s actuarial assumptions, especially the Discount Rate, are not met in future years.

*The recommendation will not be implemented because it is not reasonable and cost effective. The Town will continue to review its pension obligations and funding alongside the annual budget process, where funding can be determined in the context of the overall budget. The Town has already implemented several actions including paying off \$9.9 million of side fund liabilities within the past eight years, partnering with employees to pay a share of the employer’s contribution, implementing a new lower pension formula tier for miscellaneous plan employees and replacing employees who have retired with employees who are on the PEPPA plan, where applicable. The Town is currently reviewing long-term strategies and will continue to review funding strategies in the annual budget process.*

Sincerely,



Marie Chuang  
Mayor  
Town of Hillsborough



September 11, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

**RE: Civil Grand Jury Report: "Soaring Pension Costs – Time for Hard Choices"**

Dear Judge Swope:

The City Council of the City of Menlo Park (City) voted at its public meeting on September 11, 2018 to authorize this response to the San Mateo County (SMC) Civil Grand Jury Report "Soaring Pension Costs – Time for Hard Choices" released on July 17, 2018.

Responses to Findings

**F1.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response:** *The City agrees.*

**F2.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response:** *The City agrees.*

**F3.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

**Response:** *The City agrees.*

**F4.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response:** *The City agrees.*

**F5.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

**Response:** *The City agrees.*

**F6.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

**Response:** *The City agrees.*

**F7.** In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

**Response:** *The City agrees.*

**F8.** In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."

**Response:** *The City agrees.*

**F9.** In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not included data for them.)

**Response:** *The City agrees.*

**F10.** As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-

2025.

**Response:** *The City agrees.*

**F11.** Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

**Response:** *The City disagrees partially with this finding. The City included Unfunded Liabilities according to the current CalPERS 30-year amortization schedule in its 10-year forecast and does not anticipate an impairment to the City's provision of public services, security of employee salary or pension benefits, or the need for revenue increasing measures beyond those which comply with longstanding City policies such as cost recovery targets. The City agrees with the finding that the nominal amount paid would be lower by paying down Unfunded Liabilities early and has previously made concrete steps such as the paying down of the Safety Side Fund in Fiscal Year 2010-11 and saving approximately \$2.2-\$3.6 million in interest.*

**F12.** The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:

- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

**Response:** *The City agrees that it has not developed a long-term financial plan targeted at Normal Costs and Amortization Costs, though disagrees that these factors should be considered independently from a holistic long-term financial plan incorporating all City revenues, resources, and requirements.*

**F13.** Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

**Response:** *The City agrees with the finding that rising pension costs and Unfunded Liabilities are a concern and, as noted, has acted to include these costs in its annual budgeting process.*

#### Responses to Recommendations

**R1.** The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

**Response:** *The City has not yet implemented the recommendation to schedule public hearings, but will implement it on November 13, 2018. The City has a past practice of retaining an independent actuary to provide a report to the City Council once every two to three years. With the recent release of the valuation as of June 30, 2017, the City has acted to retain the independent actuary to conduct the necessary analysis and make a report to the City Council at the public meeting scheduled for November 13, 2018. In addition to retaining the services of an independent actuary, the City has implemented a number of strategies to address pension costs. Steps taken include both ongoing cost-reduction strategies and the use of strategic opportunities. Steps which have already been taken are:*

1. *The implementation of multiple retirement tiers for "classic" members, which reduces the future cost of newly-hired CalPERS "classic" employees, as these new hires receive a lower pension formula.*
2. *Cost-sharing provisions in each Memorandum of Understanding with regular City staff, which includes a reduction in City cost of 3% for "classic" Safety employees who pay an additional member contribution, a minimum contribution for PEPRA Safety members which is above the statewide PEPRA minimum contribution, and an uncapped 50% cost-share for miscellaneous employees when the CalPERS rates rise above a threshold.*
3. *Adoption of a General Fund Reserve Policy which dedicates a portion of any operating surplus toward strategic pension funding opportunities, including a contribution in Fiscal Year 2017-18 of \$1.0 million which is expected to be a larger amount than specified in the policy. This reserve has an estimated balance of \$4.30 million, pending final audited numbers following Fiscal Year 2017-18. The City will direct the independent actuary to identify potential uses for this reserve, including options such as a Section 115 trust.*
4. *Pre-funding of other post-employment benefits (OPEB) of \$10.4 million in Fiscal Year 2007-08, fully meeting the City's actuarially accrued liability. While not directly related to pension funds, OPEB obligations are earned benefits which must be met by the City and monies used to meet these obligations would be unavailable to pay pension liabilities. As such, the pre-funding of OPEB reduced the competition for City monies in a way that few other agencies have done.*
5. *Paying off the City's Safety side fund of \$7.2 million in Fiscal Year 2010-11 and reducing the interest payments which would have been required in the future by between \$2.2 million and \$3.6 million, demonstrating the City's dedication to identifying and seizing opportunities for strategic investments.*

*Prior to the City Council meeting on November 13, 2018, the City will consult with the independent actuary to identify any other specific pension funding alternatives that are available and incorporate them into a comprehensive long-term financial plan.*

**R2.** The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:

- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
- e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

**Response:** *The City has not yet implemented this recommendation, but anticipates implementation of this recommendation with the delivery of the independent actuary's report as outlined in response to R1 above.*

**R3.** The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):

- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
- Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.

- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

**Response:** *The City has not yet fully implemented the recommendation but will direct the City's independent actuary to provide analysis and guidance on the various options outlined above as well as present those options to the City Council at a public meeting in conjunction with the report described in the City's response to R1. The City has already implemented the following recommendations:*

- *Establishment of substantial reserves, estimated at \$4.30 million pending final audited financial statements for Fiscal Year 2017-18.*
- *Reduced General Fund operating costs other than pensions by pre-funding OPEB obligations with a \$10.4 million payment in Fiscal Year 2007-08 and fully meeting the City's actuarial obligation.*
- *Negotiated cost-sharing agreements with employees in which "classic" Safety members pay a 3% additional member contribution, PEPRA Safety members pay a minimum contribution greater than the statewide PEPRA minimum, and miscellaneous employees pay a 50% cost-share when the CalPERS rate rises above a certain threshold.*

*The City will continue to evaluate potential opportunities, their relative effectiveness, and conformity with other City policies and goals and incorporate them into the annual budgeting process as appropriate.*

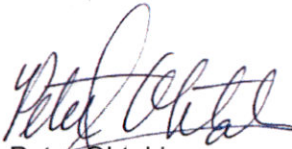
**R4.** The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years and maintaining the City’s share of Normal Costs at “n” percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a “Plan B,” that may be used in the event that CalPERS’s actuarial assumptions, especially the Discount Rate, are not met in future years.

**Response:** *The City has partially implemented this recommendation by including pension costs in the long-range forecast used in the annual budget process. The City will direct the independent actuary to address each of these points in its report scheduled for November 13, 2018 and the City will fully implement the recommendation in the future by incorporating recommended plan elements into the annual budgeting process by June 30, 2019.*

*In addition to each of the preceding responses to findings and recommendations, the City urges the Grand Jury to encourage Cities to lobby CalPERS for additional retirement options, such as those suggested by the City’s Finance and Audit Committee. For instance, defined contribution plans such as 457(b) or 401(a) plans instead of defined benefit plans which would mitigate the scope and volatility of future pension obligations. While an individual member agency’s suggestion may not carry a great deal of weight, a coordinated effort has a greater likelihood of receiving a response and change from CalPERS.*

Sincerely,



Peter Ohtaki  
Mayor





# City of Millbrae

621 Magnolia Avenue, Millbrae, CA 94030

GINA PAPAN  
Mayor

WAYNE J. LEE  
Vice Mayor

ANN SCHNEIDER  
Councilmember

ANNE OLIVA  
Councilmember

REUBEN D. HOLOBER  
Councilmember

September 25, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

Subject: City of Millbrae's Response to 2017 – 2018 Civil Grand Jury Report entitled "Soaring Pension Costs – Time for Hard Choices"

Honorable Judge Swope:

The City of Millbrae has reviewed the 2017-2018 Grand Jury report entitled "Soaring City Pension Costs – Time for Hard Choices." The City has the following responses to the Civil Grand Jury's findings and recommendations:

### Responses to Findings

- F1: Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016, and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.
- R1: With respect to the City of Millbrae, the City agrees with this finding. The City has not reviewed the CAFR's for other Cities.
- F2: Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.
- R2: With respect to the City of Millbrae, the City agrees with this finding. The City has not reviewed the CAFR's for other Cities.
- F3: Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.
- R3: With respect to the City of Millbrae, the City agrees with this finding but notes that the Amortization Cost is the cost of providing public services in prior years. The City agrees that it is important to reduce the interest expense on these liabilities, pay down the principal and control future increases in

City Council/City Manager/City Clerk  
(650) 259-2334

Building Division/Permits  
(650) 259-2330

Community Development  
(650) 259-2341

Finance  
(650) 259-2350

Fire  
(650) 558-7600

Police  
(650) 259-2300

Public Works/Engineering  
(650) 259-2339

14883674-1  
Recreation  
(650) 259-2360

employee pensions. The City notes that many of these costs are based on agreements negotiated in prior years when investment returns were significantly higher and, therefore, the City's costs of these long term benefits was expected to be significantly lower.

- F4: Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.
- R4: With respect to the City of Millbrae, the City agrees with this finding with the following correction: For Fiscal Year, 2015, the City's Funded Percentage was reported as 79.8%. The City has not reviewed the CAFR's for other Cities.
- F5: Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016, and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.
- R5: With respect to the City of Millbrae, the City agrees with this finding. The City has not reviewed the CAFR's for other Cities.
- F6: Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.
- R6: With respect to the City of Millbrae, the City agrees with this finding. The City has not reviewed the CAFR's for other Cities.
- F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."
- R7: The City of Millbrae agrees with this finding but notes that Contribution Payments are made from funds other than the General Fund. The City of Millbrae has not reviewed this information for other Cities.
- F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."
- R8: The City of Millbrae agrees with this finding but notes that Contribution Payments are made from funds other than the General Fund. The City of Millbrae has not reviewed this information for other Cities.
- F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.)

- R9: The City of Millbrae agrees with this finding but notes that City employees contribute 5.5% of the Employer Normal Cost Share offsetting over 60% of the total Normal Cost. The City has not reviewed this information for other Cities.
- F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.
- R10: The City of Millbrae agrees with this finding. The City has not reviewed this information for other Cities.
- F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.
- R11: The City of Millbrae agrees with this finding but notes that paying down unfunded liabilities must be done in the context of the City's other budgetary challenges and goals. The City has not reviewed this information for other Cities.
- F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:
- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
  - policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
  - measures to implement such policies,
  - processes to monitor progress in implementing the measures, and
  - alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.
- R12: The City has insufficient information to assess the actions taken by other Cities. The City agrees with the finding that the above items are not included in an existing financial document but notes that the City has taken a number of proactive steps to reduce this liability in the long term including:
- Contracting services such as police and fire as well as professional services. In general, contracted services result in a fixed cost that will not have ongoing liability. (Note that for public safety services contracted to other public agencies, pension and OPEB costs are included in the annual contract cost.)
  - Adjusting employee benefits including negotiating with employee groups so that Classic members pay the full employee share of CalPERS Normal Costs and 5.5% of the City (employer) share of CalPERS Normal Costs. For fiscal year 2019, that has meant that employees pay

approximately 13.5% of salary towards CalPERS Normal Costs while the City pays approximately 7.6%.

- Reducing the cost of other long term liabilities such as retiree medical.

The City notes that these actions are weighed in the context of the need to provide good service to our constituents, maintain services, and support actions that will improve the revenue situation for the City (such as development projects). The City continues to discuss this issue regularly including through the budget process and is in the process of developing a longer term financial plan.

- F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.
- R13. With respect to the City of Millbrae, the City agrees with this finding. The City addressed long term pension liabilities through a separate staff report to Council in March, 2018 and in the budget presentation for Fiscal Years 2018 – 2019 and 2019 – 2020. The City has not reviewed the budget documents for other cities.

### **Responses to Recommendations**

Following are the City of Millbrae's responses to the Grand Jury's recommendation:

- Rec1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.
- R1. The recommendation has been implemented. The City addressed long term pension liabilities through a separate staff report to Council in March, 2018 and in the budget presentation for Fiscal Years 2018 – 2019 and 2019 – 2020. The City has an additional public presentation planned in September 2018. Public Comment is invited at all City Council meetings.
- Rec2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:
- a. The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - b. The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - c. The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.

- d. The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
- e. In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CaIPERS' then-current Discount Rate.

R2. The City has implemented this recommendation through inclusion of this information in its Comprehensive Annual Financial Report (CAFR) which is posted on the City's website annually.

Rec3: The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):

- Regular supplemental payments to CaIPERS (beyond those required by CaIPERS) to accelerate the amortization of their Unfunded Liabilities.
- Irregular supplemental payments to CaIPERS (beyond those required by CaIPERS), as when a City has a budget surplus or receives special non-recurring revenues.
- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CaIPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CaIPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension benefits of Classic Members in line with PEPRAs Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

R3. The City has implemented this recommendation through the following actions:

- Early payment of Unfunded Actuarial Liability (UAL) reducing the interest cost
- Issuance of Pension Obligation Bond in 2004
- Establishment of a Section 115 trust for Other Post-Employment Benefits (OBEB) or retiree medical significantly reducing the long term liability associated with this cost. The City has also significantly reduced this benefit for employees hired after June 1, 2013.
- Ongoing prudent management of general fund (and all fund) operating costs
- Contracting of services where possible to meet the public need while providing good customer service
- Negotiated cost sharing of pensions with employee groups. Employees consider Classic members pay 5.5% of the Employer Share of Normal Costs in addition to the Employee Share of Normal Costs. For fiscal year 2019, that has meant that employees pay approximately 13.5% of salary towards CalPERS Normal Costs while the City pays approximately 7.6%.
- Limiting growth in annual salaries.

The City will continue to routinely explore all options available to reduce the costs of long term liabilities. Some of the above referenced limitations are subject to state law.

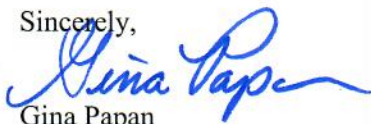
Rec 4. The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.

R4. This recommendation will be implemented where possible. The City is currently in the process of developing a long term financial plan to include the known increases in pension costs annually. Due to fluctuations in both the CalPERS estimates and in other City revenues and expenses, specific measures tend to occur through the regular budget process.

The City Council approved this response letter at its public meeting on ~~September 25, 2018~~ *November 13, 2018 E.S.*. Thank you for this opportunity to respond to the Grand Jury Report.

Sincerely,

  
Gina Papan  
Mayor

cc: City Council  
City Manager  
City Attorney



Scenic Pacifica  
Incorporated Nov. 22, 1957

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## CITY OF PACIFICA

170 Santa Maria Avenue • Pacifica, California 94044-2506  
[www.cityofpacifica.org](http://www.cityofpacifica.org)

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**MAYOR**  
John Keener

**MAYOR PRO TEM**  
Sue Vaterlaus

**COUNCIL**  
Sue Digre  
Mike O'Neill  
Deirdre Martin

September 24, 2018

Honorable V. Raymond Swope, Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2nd Floor  
Redwood City, CA 94063-1655

**Re: Grand Jury Report: "Soaring City Pension Costs"**

Honorable Judge Swope:

Thank you for the opportunity to review and comment on the above referenced Grand Jury Report filed on June 28, 2018. The City of Pacifica's response to both the findings and recommendations are listed below.

**Response to Grand Jury Findings:**

- F1. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response to F1:** The City agrees with this finding.

- F2. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response to F2:** The City agrees with this finding.

- F3. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

**Response to F3:** The City agrees with this finding.

- F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans the amount set forth beside its name for that year in Appendix A.

**Response to F4:** The City agrees with this finding.

- F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

**Response to F5:** The City agrees with this finding. However, we would like to note that the amount in Appendix A for FY 2015-16 should be \$58,424, instead of \$56,750.

- F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

**Response to F6:** The City agrees with this finding.

- F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

**Response to F7:** The City agrees with this finding.

- F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."

**Response to F8:** The City agrees with this finding.



F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No.4 because the source for that table did not include data for them.)

**Response to F9:** The City agrees with this finding.

F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

**Response to F10:** The City agrees with this finding.

F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

**Response to F11:** The City understands that increasing unfunded liabilities can impair City services if not adequately planned for and addressed within the City's financial plans. The City also understands that paying down unfunded liabilities early can result in savings if the financing arrangement is structured effectively.

F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:

- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,

- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

**Response to F12:** The City agrees with this finding.

- F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

**Response to F13:** The City agrees with this finding.

**Response to Grand Jury Recommendations:**

- R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

**The City accepts this recommendation and will schedule a public hearing, as specified, by December 31, 2018.**

- R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:
- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.

- b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
- e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

**The City accepts this recommendation and will publish a report on its website detailing its pension obligations, as specified, by December 31, 2018, and annually thereafter.**

R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):

- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
- Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.

- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and /or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRAs Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

**The City accepts this recommendation and will deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs by no later than December 31, 2018 and annually thereafter and hold public hearings to discuss and consider such options no less than every other fiscal year.**

- R4. The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.

**The City accepts this recommendation and will develop and publish a long-term financial plan to deal with rising pension costs by June 30, 2019, and update that plan annually thereafter.**

Sincerely,

A handwritten signature in blue ink, appearing to read "Kevin Woodhouse".

KEVIN WOODHOUSE  
City Manager

cc: Pacifica City Council



# TOWN of PORTOLA VALLEY

Town Hall: 765 Portola Road, Portola Valley, CA 94028 Tel: (650) 851-1700 Fax: (650) 851-4677

October 25, 2018

Hon. V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center  
Redwood City, CA 94063

Dear Judge Swope,

Thank you for the opportunity to respond to the Grand Jury report entitled "Soaring City Pension Costs – Time for Hard Choices".

Below are the Town's responses to the report's findings and recommendations.

## **Findings**

***F1.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.*

Response: The Town agrees with this finding.

***F2.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.*

Response: The Town partially agrees with this finding, in that in 2015 the Town made an approximately \$900,000 one-time payment to CalPers to lower its pension liability, which is shown in the large contribution payment in the "2014-2015" column in Appendix A.

***F3.** Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.*

Response: The Town partially agrees with this finding. The Town agrees that reported unfunded liabilities for the Town's pension plans are represented in Appendix A, but does not necessarily agree that such a payment impacted any service provision budgeted for that or a future year.

*F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.*

Response: The Town agrees with this finding.

*F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.*

Response: The Town agrees with this finding.

*F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.*

Response: The Town agrees with this finding.

*F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."*

Response: The Town agrees with this finding.

*F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."*

Response: The Town agrees with this finding.

*F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and*

*Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not included data for them.)*

Response: Not applicable to the Town of Portola Valley

**F10.** *As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.*

Response: The Town partially disagrees with this finding. Although the Town anticipates increases in its pension contributions, we cannot at this time determine that such costs "are likely to more than double by FY 2024-2025" given factors such as market conditions, fund performance, future potential reforms, and other unknown factors. PEPR implementation has also assisted in lowering the long-term impacts of pension liabilities.

**F11.** *Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.*

Response: The Town partially disagrees with this finding. The Town agrees that the payment of unfunded liabilities early can potentially save substantial dollars. The 2015 pension payment made by the Town has not subsequently affected the provision of public service or had any other appreciable impact, and given that the Town is nearly 90% funded, it is not anticipated that in the short to medium term there will be any such impacts.

**F12.** *The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following: 2017-2018 San Mateo County Civil Grand Jury 38 • objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll, • policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue, • measures to implement such policies, • processes to monitor progress in implementing the measures, and • alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.*



Response: The Town agrees with this finding as it relates to its own pension liabilities.

**F13.** *Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.*

Response: The Town disagrees with this finding as it relates to its own pension liabilities. The Town has proactively managed its pension liabilities and is reviewing options to further strengthen the Town's position using trust funds.

### **Recommendations**

**R1.** *The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.*

Response: The Town has implemented this recommendation. The Town provides such information at regularly-scheduled meetings on this topic, including budget presentations. The last discussion of the Town's pension costs was on June 13, 2018, during the 2018-19 budget presentations. The Finance Committee has also discussed these issues at their regularly-held meetings in 2018.

**R2.** *The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following: a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met. b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met. c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met. d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years). 2017-2018 San Mateo County Civil Grand Jury 39 e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.*

Response: The Town will work its Finance Committee and its actuary to determine the best opportunities to implement such a plan. The Finance Committee is meeting in October 2018 and will discuss this issue, among others.

**R3.** *The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):*

- *Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.*
- *Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.*
- *Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.*
- *Issuing pension obligation bonds.*
- *Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.*
- *Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.*
- *Reductions in general fund operating costs other than pensions.*
- *Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.*
- *Keeping employee salary increases at or below the levels assumed by CalPERS.*
- *Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).*
- *Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.*
- *To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.*

Response: The Town has already implemented this recommendation, as such information is presented during the annual budget process, which includes a discussion of pension liabilities, various fiscal strategies, and potential future payments to lower the Town's obligations and remain a responsible fiduciary body. The last such meeting was held on June 13, 2018.

**R4:** *The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:*

- *Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.*
- *Policies to achieve these objectives.*
- *Specific measures to implement*

*the policies. • A process to monitor progress in implementing the measures and in achieving the objectives. • Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.*

Response: The Town will work its Finance Committee and its actuary to determine the best opportunities to implement such a plan. The Finance Committee is meeting in October 2018 and will discuss this issue, among others.

Thank you,

A handwritten signature in black ink, consisting of a large, stylized 'J' followed by a series of loops and a final 'S' shape.

John Richards  
Mayor, Town of Portola Valley

Mayor Ian Bain  
Vice Mayor Diane Howard

Council Members  
Alicia C. Aguirre  
Janet Borgens  
Jeffrey Gee  
Shelly Masur  
John D. Seybert



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September 11, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2nd floor  
Redwood City, CA 94063-1655

**Re: Grand Jury Report: Soaring City Pension Costs – Time for Hard Choices**

Dear Judge Swope:

On behalf of the City Council of Redwood City, I am responding to the above referenced report. The City Council approved this response at its meeting of September 10, 2018.

As outlined in the report, Redwood City is not alone in facing increasing California Public Employee Retirement System (CalPERS) pension costs. In fact, this is a challenge for municipalities across the state. The City Council of Redwood City has taken a forward-thinking and prudent approach to addressing the City's fiscal challenges by adopting a Financial Sustainability Plan as part of the FY 2017-18 Adopted Budget. This plan includes reducing operating costs by approximately \$6 million and increasing revenue by approximately \$6 million in order to balance the City's budget over the next five years and pay down long-term financial obligations.

The City has reduced operating costs by \$3.7 million in the current FY 2018-19 adopted budget, and additional reductions of \$2.3 million will occur in FY 2019-20. In addition, the City Council has voted to place two revenue measures on the November 2018 ballot in an effort to increase revenues. The revenue measures include a half-cent sales tax increase and a cannabis excise tax.

The City has provided a great deal of public disclosure about our pension challenges and our use of key strategies. We have provided a significant amount of information to the public during the mid-year budget update and budget adoption, as well as during the approval of a Section 115 pension trust account, and when the City Council approved the upcoming two revenue measures. The City also maintains a "Fiscal Update" webpage, and has posted data and Frequently Asked Questions about our pension challenge for the public to review.

In addition to implementing the Financial Sustainability Plan, the City has taken the following steps to mitigate increasing pension costs, including:

- Implemented a second tier pension in 2011

- Negotiated employee cost-sharing agreements where current employees pay between 8 percent and 18 percent of salary towards their pension costs
- Established a Section 115 Pension Trust Account, with an initial deposit of \$10.5 million, to pre-fund the City's pension obligations over time
- Maximized fees charged to developers
- Developed and implemented a plan to pay down the City's unfunded actuarial liability
- Budgeted for additional direct payments to CalPERS above and beyond the required annual pension contribution, in addition to budgeting annual payments towards the Section 115 pension trust
- Changed service delivery methods and sought greater efficiencies through partnerships and shared service models

The City's responses largely agree with the findings outlined in the Grand Jury report. In fact, there are numerous instances in the report where the City's sound financial practices are cited as examples of how other cities can proactively address rising pension costs.

The long-term fiscal sustainability of the City is based upon taking prudent, meaningful, and swift actions to address the City's pension obligations. As discussed, the City has already taken many significant steps towards this goal, and staff will work with the City Council's Finance and Audit Committee to consider the recommendations contained in the Grand Jury report and take additional steps towards addressing the City's pension costs.

Below are the City Council's specific responses to the findings and recommendations in the report.

## **FINDINGS**

- F1. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

*Response: The City agrees with this finding as pertaining to the City of Redwood City data.*

- F2. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.

*Response: The City agrees with this finding as pertaining to the City of Redwood City data.*

- F3. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016, and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

*Response: The City agrees with this finding as pertaining to the City of Redwood City data. While it is true that the City has been required to make amortization cost payments of principal and interest on the unfunded pension liability, these are normal costs associated with a long-term liability. In recent years, when revenue has exceeded expenditures at fiscal year-end, and*

*the City's reserve has been at or above the General Fund reserve level, the City has made additional payments toward unfunded liabilities.*

- F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

*Response: The City agrees with this finding as pertaining to the City of Redwood City data.*

- F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

*Response: The City agrees with this finding as pertaining to the City of Redwood City data.*

- F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

*Response: The City agrees with this finding as pertaining to the City of Redwood City data.*

- F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

*Response: The City agrees with this finding as pertaining to the City of Redwood City data.*

- F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."

*Response: The City agrees with this finding as pertaining to the City of Redwood City data.*

- F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.)

*Response: The City partially agrees with this finding. The City has reviewed the City of Redwood City data reported in Table 4 and agrees with the \$8.767 million reported as Normal Cost, but disagrees with the \$12.479 million reported as Amortization Cost. All cities are given an option*

by CalPERS to prepay the annual Amortization Cost at the beginning of each fiscal year, which will result in a discount and a lower amount due. For FY 2017-18, the City prepaid \$12.036 million of Amortization Cost, for a savings of \$443, 000. This savings was used to fund a supplemental payment directly to CalPERS in June 2018.

- F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

*Response: The City agrees with this finding. A majority of the increase in the pension contribution payments are attributable to the decrease in the discount rate from 7.5 to 7.0 percent. The City's pension contribution payments are expected to double from FY 2017-18 to FY 2027-28.*

- F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

*Response: The City agrees with this finding. Although it is true that there are savings that would result in paying down the unfunded liabilities early, there are other approaches to managing pension costs. The City has negotiated with employees to pay more towards their pensions and has implemented a second retirement tier to manage costs. During FY 2017-18, the City began the process of reshaping service delivery for the future in order to fund upcoming costs and long-term liabilities. As previously mentioned, the City's Financial Sustainability Plan seeks to protect essential City services and address fiscal challenges that exist, due in large part to increasing pension costs. Operating cost reductions of approximately \$3.7 million will occur in FY 2018-19 and additional reductions of \$2.3 million will occur in FY 2019-20. In addition to cost reductions, the City is placing two revenue measures on the ballot in November 2018. The City has also established a Section 115 Pension Trust Account and has funded that account with an initial deposit of \$10.5 million. This account acts as a reserve fund and provides greater flexibility and control by the City. It also offers higher investment returns than the City's investment portfolio and does not limit the City's pension investment to one agency (CalPERS). The City believes the shared approach of funding a Section 115 Trust Account, along with supplemental payments directly to CalPERS, offers the City the greatest flexibility and best opportunity to pay down the unfunded liability early.*

- F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising normal costs and amortization costs that includes each of the following:
- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
  - policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially

assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,

- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

*Response: The City partially agrees with this finding. Every year, the City develops a robust and comprehensive 5-year forecast for the City's General Fund, which is included in the FY 2018-19 Adopted Budget. Staff will be working with the City Council's Finance and Audit Committee this fall to make recommendations on the feasibility of developing a plan with a longer horizon.*

- F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

*Response: The City agrees with this finding. These specific annual projections are included in the City's FY 2018-19 Adopted Budget.*

## **RECOMMENDATIONS**

- R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

*Response: The City agrees with this finding. Staff will be collaborating with the City Council's Finance and Audit Committee to develop a community engagement strategy during the City's annual budget planning process.*

- R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:

- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
- d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general



fund expenditures in future fiscal years).

- e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

*Response: The City agrees with this finding. Staff will be collaborating with the City Council's Finance and Audit Committee this fall to make recommendations on a pension obligation report. In addition, the City's annual budget documents and Comprehensive Annual Financial Reports are located on the City's website and contain much of the recommended information. The City also has a "Fiscal Update" link on the front page of the City's website that directs visitors to financial information, budgets, mid-year budget updates, pension presentations and data, CalPERS information, and the League of California Cities special report on pensions.*

- R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):

- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
- Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRAs Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

*Response: The City partially agrees with this finding. The City has already implemented a number of the recommendations above. Options the City has implemented include:*

- *Negotiating cost-sharing agreements where employees pay between 8 and 18 percent of salary towards their pension benefit*
- *Maintaining COLAs at or below the CalPERS rates*
- *Making supplemental payments to CalPERS in FY 2016-17 and FY 2017-18, budgeting for additional supplemental payments to CalPERS in the City's 5-year forecast.*
- *Establishing and funding a Section 115 pension trust account in January 2018 with an initial deposit of \$10.5 million. Also included in the 5-year forecast are supplemental contributions to the City's Section 115 Pension Trust Account in annual amounts ranging from \$1.1-1.6 million.*
- *Reducing operating expenditures by an estimated \$3.7 million in FY 2018-19 and an additional \$2.3 million in FY 2019-20.*
- *Maintaining a General Fund reserve of 15%. It should be noted that these reserves provide one-time funding to be used in case of a crisis, such as an economic crash or a catastrophic event (earthquake or other natural disaster) that would require emergency funds to rebuild critical infrastructure. Reserves should not be used for ongoing obligations such as rising pension costs and/or accelerating amortization of unfunded liabilities. .*
- *Seeking additional General Fund revenues through a half-cent sales tax increase and a cannabis excise tax on the ballot for the November 2018 election.*

*The City does not believe that issuing Pension Obligation Bonds would be in the best interest of the City. The Governmental Finance Officers Association has issued an Advisory recommending that state and local governments do not issue pension obligation bonds for the following reasons:*

- *The invested proceeds might fail to earn more than the interest rate owed over the term of the bonds, leading to increased overall liabilities for the government.*
- *Pension obligation bonds (POB) are complex instruments that carry considerable risk. POB structures may incorporate the use of guaranteed investment contracts, swaps, or derivatives, which must be intensively scrutinized as these embedded products can introduce counterparty risk, credit risk, and interest rate risk.*
- *Issuing taxable debt to fund the pension liability increases the jurisdiction's bonded debt burden and potentially uses up debt capacity that could be used for other purposes. In addition, taxable debt is typically issued without call options or with "make-whole" calls, which can make it more difficult and costly to refund or restructure than traditional tax-exempt debt.*
- *POBs are frequently structured in a manner that defers the principal payments or extends repayment over a period longer than the actuarial amortization period, thereby increasing the sponsor's overall costs.*
- *Rating agencies may not view the proposed issuance of POBs as credit positive, particularly if the issuance is not part of a more comprehensive plan to address pension funding shortfalls.*

R4: The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years and maintaining the City’s share of Normal Costs at “n” percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a “Plan B,” that may be used in the event that CalPERS’s actuarial assumptions, especially the Discount Rate, are not met in future years.

*Response: The City agrees with this finding. The City has already developed and implemented a 5-year forecast for the City’s General Fund, which is included in the FY 2018-19 Adopted Budget. Staff will be working with the City Council’s Finance and Audit Committee to make recommendations on the feasibility of developing a plan with a longer horizon, which could include the suggested components.*

Thank you for allowing us to respond to your report and share our perspective.

Respectfully,



Ian Bain, Mayor

cc: Redwood City Council Members  
Melissa Stevenson Diaz, City Manager



Rico E. Medina  
Mayor

CITY OF SAN BRUNO  
OFFICE OF THE MAYOR

October 9, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center; 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

**Subject:** Response of the City of San Bruno to the Grand Jury Report "Soaring City Pension Costs – Time for Hard Choices."

Dear Judge Swope,

Thank you for the opportunity to respond to the Grand Jury report titled "Soaring City Pension Costs – Time for Hard Choices." The City of San Bruno's response to both the findings and recommendations are listed below.

**Responses to Grand Jury Findings:**

**F1. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.**

*Response:*

The City of San Bruno agrees.

**F2. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.**

*Response:*

The City of San Bruno agrees.

**F3. Each City's CAFR for the fiscal year ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.**

*Response:*

The City of San Bruno agrees that it has been required to make the Amortization Cost payments reflected in its CAFR; however, these payments, which are legally required to be made, have not been "diverted" from other segregated funds or discretionary City programs.

**F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.**

*Response:*

The City of San Bruno agrees.

**F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.**

*Response:*

The City of San Bruno agrees that changes in the Discount Rate would have a corresponding effect on the amount of the Unfunded Liabilities.

**F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.**

*Response:*

The City of San Bruno agrees.

**F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."**

*Response:*

The City of San Bruno agrees.

**F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."**

*Response:*

The City of San Bruno agrees.

**F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.)**

*Response:*

The City of San Bruno agrees.

**F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.**

*Response:*

The City of San Bruno generally agrees that if the assumptions stated above are incorporated into CalPERS' calculations of pension contributions, and if other countervailing assumptions are not incorporated, the City would experience increases in required pension contributions. The City cannot estimate the amount of such increases without a detailed, independent analysis.

**F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.**

*Response:*

The City of San Bruno generally agrees but would require a detailed, independent analysis conducted before understanding the financial impact.

**F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:**

- Objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
- Policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
- Measures to implement such policies,
- Processes to monitor progress in implementing the measures, and
- Alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

*Response:*

The City of San Bruno agrees.

**F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.**

*Response:*

The City of San Bruno agrees.

**Responses to Grand Jury Recommendations:**

**R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.**

*Response:*

The City has partially implemented this recommendation. Over the years, the City has contracted with an actuarial consultant to perform an independent analysis of the City's unfunded pension liability, the reports and recommendations of which have been incorporated into the budget process and comprehensive annual financial reports (CAFRs) in prior years. The City plans to engage with an actuarial consultant in the coming months to perform a comprehensive, independent analysis of the City's unfunded liability position. A report including recommendations will be delivered, and staff will develop a plan and schedule to present the report and recommendations to the City Council by March 31, 2019. The City anticipates requiring up to 6 months in order to bring an experienced actuarial firm on board, adequately scope the project, provide relevant data, prepare and review draft reports and deliver a final report including recommendations.

As part of the budget study sessions and budget adoption process, the City has discussed the increase in pension costs during public meetings and public hearing. The City will continue to engage the community with anticipated hearings at regularly scheduled City Council meetings in upcoming months.

**R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:**

- a) **The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
- b) **The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
- c) **The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
- d) **The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).**
- e) **In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.**

*Response:*

The City has not implemented this recommendation, but plans to implement by March 31 2019. The City plans to engage with an actuarial consultant in the coming months to perform a comprehensive, independent analysis of the City's unfunded liability position. A report including recommendations will be delivered, and staff will develop a plan and schedule to present the report and recommendations to the City Council by March 31, 2019. The City anticipates requiring up to 6 months in order to bring an experienced actuarial firm on board, adequately scope the project, provide relevant data, prepare and review draft reports and deliver a final report including recommendations.

**R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):**

- **Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.**

- Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

*Response:*

The City has already implemented some of the options discussed in the Civil Grand Jury report. During each annual budget process, the Council is provided an update on pension costs and unfunded liabilities, and City staff will continue to do so in future budget sessions. Staff will direct the independent actuary to provide analysis and guidance on the various options outlined in this recommendation as well as present those options to the City Council at a public meeting in conjunction with the report described in the City's response to R1 and R2.

The FY18-19 adopted budget can be found here on the City's website:

<https://www.sanbruno.ca.gov/civicax/filebank/blobdload.aspx?BlobID=29504>

**Budget Overview:** As indicated in the FY18-19 adopted budget, employee retirement benefits total \$7,191,763, or 35% of the cost of employee salaries. This amount represents an increase of \$984,901 compared to the FY17-18 amount. The City continues to experience significant impacts from increasing costs for retirement benefits through the CalPERS system. Beginning in FY18-19, CalPERS is reducing the Discount Rate which is its expected earnings on all investments. The only revenues available to the CalPERS system to fund employee pension costs comes from three sources: investment earnings, employee contributions and employer contributions. As a result, the reduction of available revenue in the investment earnings category must be made up from increases to employer contributions.

As a strategy to address this problem, State legislation implementing pension reform and changes to retirement benefits through CalPERS took effect in 2014 and reduced the defined benefits available to employees who are new to the system. The City is regularly hiring new employees who will receive the reduced pension benefits (i.e. PEPRA members). However, the City will not see a tangible effect on the City's retirement benefits costs for several more years until a substantial number of Classic or tenured CalPERS members have retired and been replaced by new employees. For San Bruno, CalPERS costs are expected to reach 45% of total salaries by FY20-21.

**Pension Obligation Bond:** The City issued a Pension Obligation Bond (POB) for \$13,175,000 in 2013 with the intent of reducing pension liability due to the expected higher rate of return that is expected to be achieved which would be greater than the interest owed. The City has achieved a very high or the highest credit rating on the POB and other issued bonds over the past 3 years. The purpose of the POB was to refund the outstanding side



**Grand Jury Response “Soaring City Pension Costs – Time for Hard Choices.”**

**October 9, 2018**

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fund obligation of the City's Safety Plan to the California Public Employees' Retirement System (CalPERS). The bond has a 14 year term, will mature in 2027 and carries an interest rate of 4.05%. The outstanding principal as of July 1, 2018 is \$8,820,000 and is paid from the City's General Fund.

**Bargaining Units' Negotiated Agreements:** The City has 6 employee bargaining unit agreements in place with agreements expiring on December 31, 2019 and on December 31, 2020. As part of managing costs, the City will continue to negotiate various cost-sharing provisions related to health and welfare benefits and retirement benefits to manage costs.

**General Fund Reserve:** The City maintains a healthy reserve in the General Fund which can be used to help the City weather the next recession. The 4 key objectives of the City's reserve policy include:

1. Ensuring financial stability in the event of significant economic downturn or catastrophic events;
2. Providing resources in an emergency situation;
3. Creating a funding source for general capital improvement projects and one-time initiatives; and
4. Establishing reserves for unfunded liabilities, including facilities replacement, accrued leave balances and other post-employment benefits.

The City has a General Fund Reserve policy that states that the General Fund Reserve Fund balance shall not fall below 15% of General Fund operating expenditures except in a declaration of emergency. The policy also states that the target fund balance should be 25% of the budgeted General Fund expenditures. The General Fund Contingency Fund shall have a goal of maintaining a target fund balance of \$1.5 million, and the City has been able to achieve this target fund balance in recent years. The City also has reserve policies for emergency disasters, capital improvements, central garage, building and facilities, equipment and technology. The table below shows the General Fund reserve as a percent of expenditures from FY12-13 to FY16-17. The City has achieved a general fund reserve percent higher than the minimum of 15%, as stated in the policy, and the percent has increased each year. In FY16-17, the general fund reserve percent exceeded the 25% target for the first time. The City may use any surplus remaining in the General Fund Operating Budget at year-end to manage and/or smooth payments to CalPERS in the coming years.

	<b>FY12-13</b>	<b>FY13-14</b>	<b>FY14-15</b>	<b>FY15-16</b>	<b>FY16-17</b>
General Reserve	\$7,994,030	\$8,675,145	\$9,302,476	\$10,002,044	\$10,578,092
General Fund - Operating Expenditures	\$38,884,350	\$37,511,315	\$39,989,795	\$41,082,655	\$41,284,185
<b>General Fund Reserve as % of Expenditures</b>	<b>20.6%</b>	<b>23.1%</b>	<b>23.3%</b>	<b>24.3%</b>	<b>25.6%</b>

**Revenue Enhancements:** Although not directly intended to reduce the unfunded pension liability, the City is exploring revenue enhancements with the City Council in order to continue to fund existing, on-going expenditures, potential new initiatives and alleviate the pressure on existing General Fund revenues. These measures include a potential sales tax measure on an upcoming ballot, transfer and transient occupancy tax changes, short-term rental fees, development impact fees and adjustments to the City's existing application and permit fees to ensure fees being collected cover the cost of City staff to perform required work.

**Expenditure Control:** As considered and prioritized during each budget cycle, all department heads are directed to thoroughly review their line item expenditure budget and consider and recommended expenditure reductions. The City's budget including personnel staffing is very lean and demand for City services continue to increase, so opportunities for further expenditure reduction may not be possible.

The City has and will continue to report to the City Council a revenue and expenditure projection at least once every fiscal quarter as well as presenting General Fund reserve position at each fiscal year end. Other unfunded pension liability measures will be considered during the upcoming FY19-20 budget process.

R4. The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- **Specific objectives, such as identifying a target funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.**
- **Policies to achieve these objectives.**
- **Specific measures to implement the policies.**
- **A process to monitor progress in implementing the measures and in achieving the objectives.**
- **Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS' actuarial assumptions, especially the Discount Rate, are not met in future years.**

*Response:*

The City plans to analyze and consider at least 2 out years of revenues and expenditures, at a high level, to better understand the reasons for and the magnitude of any potential shortfalls and develop budget balancing solutions to address the potential issues. The City will likely need to consult with a financial firm in order to develop a framework to prepare a long-term financial plan by June 30, 2019.

Sincerely,



Rico E. Medina  
Mayor



September 10, 2018

Honorable V. Raymond Swope, Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

**RE: 2017-18 San Mateo County Civil Grand Jury Report “Soaring City Pension Costs – Time for Hard Choices” Response**

Dear Judge Swope:

In reply to your request for responses to the above referenced report, the City of San Carlos hereby submits this letter, which was approved by the City Council via resolution at the September 10, 2018 Council meeting.

**Findings.**

The City of San Carlos reviewed all 13 of the Findings in the Grand Jury report. Since the Findings are based on information collected by the Grand Jury from of all agencies in San Mateo County, the City must assume the general information is accurate, and therefore agrees with the Finding 1 – 11. The City has additional comments related to Findings 12-13.

**Finding 12: The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:**

- **Objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years or maintaining the cities’ share of Normal Costs below “n” percentage of payroll,**
- **Policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities’ share of Normal Costs, reducing operational costs or increasing revenue,**
- **Measures to implement such policies,**
- **Processes to monitor progress in implementing the measures, and**
- **Alternative financial strategies, or a “Plan B”, that may be used in the event that CalPERS’ assumptions are not met in future years.**

Response: The City adopted a long-term financial plan in January 2015 which looked at the City’s General Fund revenues and expenditures over a 20-year horizon. Included in this long-term plan, was a review of our long-term obligations as they related to pensions. The long-term plan included a recommendation to keep our workforce at sustainable levels while

acknowledging the fact that the City has already instituted several changes to our benefit structure to help contain long-term cost increases, including the establishment of multiple CalPERS tiers. The City has been following that recommendation.

Prior to adoption of the long-term plan, the City established an Unfunded Liabilities Reserve in October 2012. This reserve was created to offset the costs of pension and other pension related liabilities. The reserve is evaluated every year as part of the annual audit and is funded from prior year savings. As of June 30, 2017, the balance was \$7,750,000 and on April 9, 2018, the City Council directed staff to use \$7,000,000 of this reserve to pay-down our unfunded pension obligations. The City will continue to utilize this reserve as a way to fund the pension obligations from prior year savings.

**Finding 13: Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contributions costs in their budgets published in the finance section of their websites.**

Response: The City does include annual projections of both the normal cost and future pension contributions in the budget. While these are not specifically called out as separate line items, they are included in the assumptions which can be found in the salaries and benefits totals on each department page.

#### **Recommendations.**

The City of San Carlos reviewed the four Recommendations in the Grand Jury report.

**Recommendation 1: By December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.**

Response: The City held two public meetings earlier this year on March 12, 2018 and April 9, 2018 to discuss the status of our unfunded pension liabilities and the options to reduce them.

**Recommendation 2: By December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:**

- a) **The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
- b) **The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**

- c) **The City's Funded Percentage under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.**
- d) **The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years.)**
- e) **In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be represented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.**

Response: The City will work with its Financial Advisors to compile this information. Most of this data was included in the report that went to Council on March 12, 2018 and April 9, 2018. Those reports are currently available on our website as part of the agenda packets.

**Recommendation 3: By December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year.**

Response: As noted above, the City held two public meetings earlier this year to discuss the status of our unfunded pension liabilities. At the April 9, 2018 meeting, Council approved an option to pay down our unfunded liabilities in a one-time lump sum amount of \$7 million, saving the City approximately \$650,000 per year.

The City has been and will continue to hold public meetings related to pension liabilities as part of the biennial budget process.

**Recommendation 4: By June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include: December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:**

- **Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.**
- **Policies to achieve these objectives.**
- **Specific measures to implement the policies.**
- **A process to monitor progress in implementing the measures and in achieving the objectives.**
- **Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.**

Response: The City will work with our Financial Advisors and legal counsel to review this recommendation further. Each actuarial report includes an amortization schedule to pay off the liabilities. However, since the City has no control over how CalPERS ultimately calculates our Unfunded Liabilities based on their investments and assumptions, those amounts and dates could be subject to change. In addition, in order to maintain the City's share of Normal Costs at a given rate, it will require negotiating those rates with our labor unions.

The City of San Carlos appreciates the opportunity to comment on the Grand Jury report.

Best Regards,



Bob Grassilli, Mayor



September 17, 2018

Hon. V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center; 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

**RESPONSE TO GRAND JURY REPORT: "Soaring City Pension Costs – Time for Hard Choices"**

Honorable Judge Swope –

Thank you for the opportunity to review and comment on the above referenced Grand Jury Report filed on July 17, 2018. The City of San Mateo's responses to both the findings and recommendations are listed below. This response was approved by the City Council at a public meeting held on August 20, 2018.

**Response to Grand Jury Findings:**

F1. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

Response: The City of San Mateo agrees with this finding.

F2. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.

Response: The City of San Mateo agrees with this finding.

F3. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

Response: The City of San Mateo partially disagrees with this finding.

This is simply a point of clarification. The values listed for the unfunded liability for each year are actually the value of the unfunded liability, as defined by GASB 68, for the applicable measurement period, which happens to be one year earlier. For example, in our CAFR for the fiscal year ending June 30, 2017 (fiscal year 2016-17), the unfunded liability is listed as \$197,821,575. This is an accurate value, but it is attributable to the measurement period of July 1, 2015 to June 30, 2016 (fiscal year 2015-16). Ultimately, the unfunded liability numbers agree with the values in the City's CAFR; the City just wanted to clarify those unfunded liability values are attributable to a measurement period that ties to the previous fiscal year.

F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

Response: The City of San Mateo partially disagrees with this finding.

Same clarification as item F3. Otherwise, the City agrees with the finding.

F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

Response: The City of San Mateo partially disagrees with this finding.

Same clarification as item F3. Otherwise, the City agrees with the finding.

F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

Response: The City of San Mateo agrees with this finding.

F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

Response: The City of San Mateo agrees with this finding.

F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."



Response: The City of San Mateo agrees with this finding.

F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.)

Response: The City of San Mateo partially disagrees with this finding.

These values are estimates from our CalPERS valuation reports for the normal cost. Actual normal cost is a percentage of actual payroll, which will vary from CalPERS estimates. In fiscal year 2017-18, the City's required contribution for normal costs was \$7,778,823. This amount was partially offset by employees making a portion of the City's required contribution in the amount of \$884,372. For the payment on the unfunded liability, this was also the CalPERS-derived value. The City actually took the option to pre-pay its entire unfunded liability payment in July 2017, which resulted in a reduced required payment on the unfunded liability. The City also made an additional discretionary payment against its unfunded liability during the fiscal year in the amount of \$1.4 million. In total, the City of San Mateo made a \$12,218,379 payment on its unfunded liability in fiscal year 2017-18.

Thus, the City's net payment to CalPERS for its pension obligation in fiscal year 2017-18 was \$19,112,830.

F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

Response: The City of San Mateo partially disagrees with this finding.

The City agrees that contribution rates will increase significantly by fiscal year 2024-25 and that increase will be driven by many of the factors cited in the finding. However, this finding contradicts the values in Table 6 of the Grand Jury report regarding the amount of the increase. In Table 6, the report indicates San Mateo's rates are expected to increase by 84.4% by fiscal year 2024-25.

F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

Response: The City of San Mateo partially disagrees with this finding.

While the City of San Mateo has significant concerns about increasing pension costs and their impact on our overall financial position and on the provision of public services, we are not prepared at this point to conclude that the payments on the unfunded liability will, for example, “impair the security of employee salary and pension benefits.” The City’s long-term financial plan allows for the City to absorb these increased costs through a variety of strategies, including containing salary cost increases and utilizing unassigned fund balance. At this time, the City does not expect that its ability to provide salaries and benefits for its employees is in jeopardy. Potential service level reductions in targeted areas and/or revenue enhancements are considerations but must be considered within our entire budgetary context. Certainly, increasing pension costs are a driver for these considerations, but so are revenue sources that are not growing (sales tax) and revenue sources that are highly volatile (property transfer tax).

With respect to paying down the unfunded liability early, the City understands the significant cost savings that could be achieved by paying down the unfunded liability early. To that end, the City has made additional discretionary contributions for CalPERS in fiscal years 2016-17 and 2017-18, and the long-term financial plan calls for those discretionary contributions to continue annually. While relatively modest, they do result in some savings on interest costs. With that said, the City must balance the benefit of paying down the unfunded liability more aggressively with providing services to the public. There is a service provision cost to spending current resources to pay down the unfunded liability early, and in setting its discretionary CalPERS contribution at the level that it has, the City is seeking to strike that balance.

F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:

- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over “n” years or maintaining the cities’ share of Normal Costs below “n” percentage of payroll,
- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities’ share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a “Plan B,” that may be used in the event that CalPERS’ assumptions are not met in future years.

Response: The City of San Mateo partially disagrees with this finding.

While all of this information is not consolidated into one place in our budget document, the City's budget and Council financial strategies do address each of these items to some degree. Specifically, the General Fund's pension costs are incorporated into the existing long-term financial plan, which covers a period of ten years. The payment on the unfunded liability and the discretionary additional pension contribution are stand-alone line items in the financial plan. The Council has an existing priority on its strategic plan to eliminate the City's unfunded pension and OPEB liabilities by no later than 2050. Given the fact that all of our current amortization bases will be fully amortized by 2050 and that all new amortization bases will be amortized over a period of no longer than 20 years, the City's plan to eliminate its unfunded liability will be met if all actuarial assumptions have been met and the City continues to make its annual required contribution to CalPERS, which it fully intends to do. If the City continues to make an additional discretionary payment to CalPERS annually, it will be able to accelerate the elimination of the unfunded liability.

F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

Response: The City of San Mateo agrees with this finding (only as it relates to the City of San Mateo).

**Response to Grand Jury Recommendations:**

R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

Response: This recommendation has not yet been implemented but will be implemented in the future.

The City of San Mateo will have a comprehensive update of its pension plans on a Council agenda for public hearing during the current fiscal year (2018-19). In order to provide a comprehensive update of its pension plans, the most recent CalPERS actuarial valuation reports need to be published, and the City needs to have its consulting actuary perform its analysis of the plans and produce its report. The CalPERS valuation reports were available on August 3<sup>rd</sup>, and the City is currently just beginning its engagement with its consulting actuary. Given this, as well as the City Council meeting schedule late in the calendar year, the City cannot commit to the Grand Jury's recommendation of December 31, 2018. This agenda item will be scheduled to correspond with the City's mid-year financial update, which takes place in January or February.

- R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:
- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
  - e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

Response: This recommendation has not yet been implemented but will be implemented in the future.

The City will produce this information as a part of its comprehensive update pursuant to the Grand Jury's first recommendation. This information will be posted to the City's website and updated annually. As is the case for the first recommendation, the City cannot commit to the December 31, 2018 timeframe and instead expects to publish this information in January or February.

- R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):
- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
  - Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
  - Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
  - Issuing pension obligation bonds.

- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRAs Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

Response: This recommendation has not yet been implemented, but will be implemented in the future.

As a part of the comprehensive update on its pension plans, the City will include an evaluation of the various options that are directly related to addressing pension costs. As noted previously, this update will correspond with the mid-year financial update, which takes place in January or February. Specifically, these options include:

- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
- Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.
- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).

For the other items recommended for consideration such as reductions in expenditures, increased reserves, and increased revenues, those must be considered within the context of the entire City operating budget. As such, these considerations will be evaluated and incorporated into the City Manager's proposed budget. The City Manager's proposed budget is delivered to Council in May and considered during public hearings in June.

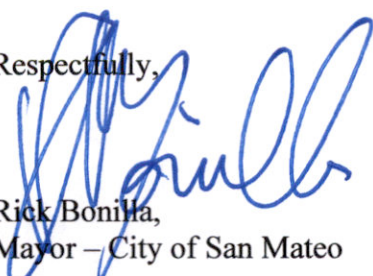
R4: The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.

Response: This recommendation has been implemented.

The General Fund's pension costs are incorporated into the existing long-term financial plan, which covers a period of ten years. The payment on the unfunded liability and the discretionary additional pension contribution are stand-alone line items in the financial plan. The Council has an existing priority on its strategic plan to eliminate the City's unfunded pension and OPEB liabilities by 2050. Given the fact that all of our current amortization bases will be fully amortized by 2050 and that all new amortization bases will be amortized over a period of no longer than 20 years, the City's plan to eliminate its unfunded pension liability will be met if all actuarial assumptions have been met and the City continues to make its annual required contribution to CalPERS, which it fully intends to do. If the City continues to make an additional discretionary payment to CalPERS annually, it will be able to accelerate the elimination of the unfunded liability. The City will continue to closely monitor its progress towards meeting its objective of eliminating the pension liabilities by no later than 2050 and will make adjustments as needed to ensure it stays on track.

Respectfully,



Rick Bonilla,  
Mayor – City of San Mateo



PO BOX 711  
400 GRAND AVENUE  
SOUTH SAN FRANCISCO, CA 94083

**CITY COUNCIL 2018**

LIZA NORMANDY, MAYOR  
KARYL MATSUMOTO, MAYOR PRO TEMPORE  
MARK ADDIEGO, COUNCILMEMBER  
RICHARD A. GARBARINO, COUNCILMEMBER  
PRADEEP GUPTA, PH.D., COUNCILMEMBER

MIKE FUTRELL, CITY MANAGER

September 27, 2018

Hon. V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center; 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

Dear Hon V. Raymond Swope

On September 22, 2018, the City Council of the City of South San Francisco ("City") approved the response contained in this letter to the San Mateo County Grand Jury Report "Soaring City Pension Costs – Time for Hard Choices" dated July 17, 2018.

**Response to Findings**

The City agrees with Findings F1, F2, F3, F4, F5, F6, F8, F9 and F11. The findings are accurate, and reflect information that is included in publicly available documents, including the City of South San Francisco's Comprehensive Annual Financial Statement (CAFR) and annual actuarial valuations from the California Public Employees' Retirement System (CalPERS).

The City disagrees partially with Finding F7. While Finding F7 is mathematically accurate, comparing annual pension contributions relative to General Fund total expenditures is not consistent with the City's method for allocating employee costs, which include the cost of pension contributions. Employee costs are allocated based on the scope of each employee's job duties. For example, the costs associated with a Laboratory Chemist from the City's Water Quality Control Plant are fully allocated to the Sewer Enterprise Fund. As such, of the \$92 million in total appropriations for payroll in the Fiscal Year (FY) 2018-19 Adopted Budget, \$80 million are allocated to the General Fund, \$9 million to the Sewer Enterprise Fund, and the remaining \$3 million to other operating funds.

The City disagrees partially with Finding F10. Based on independent actuarial analysis estimates, by 2024-25, a 6.0 percent investment juxtaposed against a 7.0 percent discount rate with the shorter amortization period, pension contributions are projected to increase by 57 percent, rather than 100 percent over the same period. At a cost of \$33 million, pension contributions are projected to reach their apex in FY 2032-33, a 96% increase compared to the current cost.

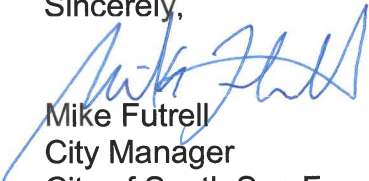
The City disagrees partially with Finding F12. The City has utilized a long-term financial forecast to support its decision-making processes since 2013, and expanded the forecast to a 10-year time horizon in 2017. However, given the sensitivity of labor negotiations, the model has been kept confidential. The City is amenable to establishing a pension funding strategy and policy to achieve funding targets, and committing to appropriating funds based on availability and priority. The City is also amenable to implementing processes to monitor the City's pension funding efforts, and establishing alternative financial strategies.

While the City agrees with Finding F13, past, present, and future pension contribution costs are available on publicly available documents. The City's Comprehensive Annual Financial Report (CAFR), available at <http://www.ssf.net/departments/finance/financial-reports/comprehensive-annual-financial-reports-cafr>, discloses pertinent pension plan information in Note 7 and the Required Supplemental Information section, including employer pension contributions and net pension liabilities. The actuarial valuation for any participating entity is available on CalPERS' website at <https://www.calpers.ca.gov/page/employers/actuarial-services/employer-contributions/public-agency-actuarial-valuation-reports>. The actuarial report provides projected pension contribution rates and sensitivity analysis.

### **Response to Recommendations**

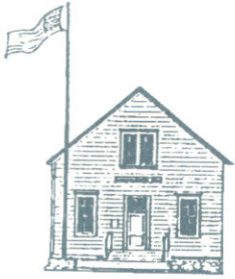
All Grand Jury recommendations will be timely implemented, specifically a public meeting will be held, engaging and informing residents; all available options will be evaluated; and a long-term plan to address rising pension costs will be developed. All staff reports and supporting information will be published in a highly visible and prominent area on the City's website.

Sincerely,



Mike Futrell  
City Manager  
City of South San Francisco





The Town of  
Woodside

October 10, 2018

The Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

**RE: 2017-18 GRAND JURY REPORT - *Soaring City Pension Costs - Time for Hard Choices***

Dear Judge Swope:

The Town Council of the Town of Woodside wishes to thank the 2017-18 Grand Jury for its service. The Town Council has reviewed the report entitled *Soaring City Pension Costs - Time for Hard Choices* and reviewed the findings and recommendations of the Grand Jury at its public meeting of October 9, 2018, and approved the following response:

**FINDINGS**

1. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

2. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

3. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

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4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

Response. Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

9. In FY 2017-18, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs and Amortization Costs in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough,

Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not include data for them.

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-21, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contributions payments to CalPERS which are likely to more than double by FY 2024-25.

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

11. Principal and interest payments on each City's Unfunded Liabilities will increasing impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

Response: The Town agrees with this finding.

12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that include each of the following:

- Objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,
- Policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operations costs or increasing revenue,
- Measures to implement such policies,
- Processes to monitor progress in implementing the measures, and
- Alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

Response: Based on the information provided in the Grand Jury Report, the Town agrees with this finding.

13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

Response: The Town disagrees with this finding. On pages 6 and 7 of the Town of Woodside's Adopted Budget for 2018-19 are the Five Year Forecast for the General Fund and the Road Program, respectively. Each Forecast has a specific projection for "PERS & Retiree Health Benefits" which includes the substantial increase expected for retiree benefits, including pension obligations.

## RECOMMENDATIONS

1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

Response: The Town will implement this recommendation, but it is unlikely prior to December 31, 2018. In November, the Town will have four new Councilmembers elected. Under its Municipal Code, the Town does not hold regular Council meetings until the elections results have been canvassed and certified. The topic of pension costs and development of a long-term plan will be taken up by the new Town Council, in conjunction with the Mid-Year Budget Review, early in 2019.

2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:
  - a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such

Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.

- d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
- e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

Response: The Town will implement this recommendation in conjunction with the community discussion planned on pension costs and a long-term plan which will be held by the newly seated Town Council in early 2019. It is anticipated that this information would be updated annually following the publication of the CalPERS annual valuation reports.

- 3. The Grand Jury recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year.

Response: The Town will implement this recommendation as part of its budget adoption process in the spring of each year.

- 4. The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:
  - Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
  - Policies to achieve these objectives.
  - Specific measures to implement the policies.
  - A process to monitor progress in implementing the measures and in achieving the objectives.
  - Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS' actuarial assumptions, especially the Discount Rate, are not met in future years.

Response: The Town will implement this recommendation as part of the budget adoption process in the spring of each year.

On behalf of the Town Council, I would like to extend our thanks for the opportunity to review and respond to the work of the 2017-18 Grand Jury.

Please do not hesitate to call Town Manager Kevin Bryant, at (650) 851-6790, should you require any further information.

Sincerely,



Chris Shaw  
Mayor