2014-2015 Grand Jury Response Packet

Retirement Costs and Obligations in Santa Cruz County

Santa Cruz County Board of Supervisors

Findings

Finding 1: Continually rising retirement costs and obligations put funding of jurisdictions' services and projects at risk.

__ **AGREE**
__ **PARTIALLY DISAGREE** - explain disputed portion below
_X_ **DISAGREE** - explain below

Response explanation (required for responses other than "Agree"):

The County has taken significant and impactful steps that have contained, and in some cases capped, rising costs. The Grand Jury Report vastly understates the savings to the County resulting from the many changes mandated by AB340, the Public Employees Pension Reform Act of 2013 (PEPRA), and ignores several other County measures designed to reduce and stabilize pension and retiree healthcare costs. The Report also makes inaccurate assumptions regarding future retirement contribution levels.

PEPRA-Related Savings:

- Pensionable Compensation Cap. The PEPRA caps pensionable salaries at 100% of the Social Security Contribution and Benefit Base for employees who participate in Social Security and at 120% of that amount for employees who do not. These caps are well below the previous IRS cap and will result in on-going long term savings.

- Increased Employee Contributions/Employee "Pick Up" of Employer Contributions. The Grand Jury Report ignores the PEPRA's provisions on retirement contributions by classic (existing) members. While the PEPRA only requires new employees to contribute at least 50 percent of normal cost, it sets that contribution rate as the standard expected of all employees and permits employers to unilaterally impose that contribution rate as of January 2018. The PEPRA also lets employers and employees agree to share the cost of the employer contribution, previously only allowed if tied to a past benefit enhancement.

  Based on these changes, the County has negotiated increased pension contributions for all employees, not just those hired after January 2013, as well as several employee "pick-ups" of part of the employer contribution. Since the implementation of the PEPRA, the County has negotiated the following contribution changes with the General Representation Unit, representing approximately 70% of the County's workforce:

- Since September 2014, Miscellaneous Tier 1 and Tier 2 employees (who previously did not contribute toward their retirement benefit) have contributed 3.5% toward retirement. Employees in Tiers 1 and 2 of the County Peace Officer plan increased their contribution to 9.5% (a 0.5% increase). This increase constituted an employee "pick-up" toward the employer contribution, and would not have previously been allowed.
- In September 2015, employees in Miscellaneous Tiers 1 and 2 will double their retirement contribution to 7%, while County Peace Officers in Tiers 1 and 2 will increase their contribution to 10%. The added 0.5% County Peace Officer contribution is a further employee pick up of the employer contribution, for a total employee pick up of 1%.

- In September 2015, Miscellaneous Tier 3 employees will increase their retirement contribution from 6.25% (50 percent of normal cost) to 7%. The additional .75% is an employee "pick up" toward the cost of the employer contribution.

Similar changes negotiated with most other bargaining units have already significantly reduced the County's pension contributions, and will lead to long-term savings.

- Effective Date of PEPRA Impacts & Timing of PEPRA Savings. The Report erroneously states, "These new impacts of PEPRA go into effect FY 2015/16." All PEPRA provisions listed in the Report went into effect in January 2013 and none are scheduled to go into effect during FY 2015/16. The Report's statement that "the real savings of PEPRA will come many years in the future as the percentage of PEPRA employees increases" underestimates the savings the County has already realized from PEPRA-related changes, such as increased employee pension contributions and employee pick-ups of a portion of the employer contribution. Further, the Report assumes that very few current County employees are in one of the lower retirement tiers. In fact, just two years into PEPRA, already 20 percent of County employees are subject to Tier 2 or Tier 3 retirement benefits.

Non-PEPRA-Related Cost-Saving Measures:

- Lower Pension Tier for all Employees. The Report notes that prior to the implementation of the PEPRA the County adopted a second retirement tier for Safety (aka County Peace Officer) and Sheriff's Safety employees with benefits based on the average of the highest

three consecutive years' salaries (FAE3), rather than the single highest year (FAE1), as benefit levels were previously calculated. However, the Report fails to mention that for the Miscellaneous Plan, which accounts for 85 percent of County employees, a second tier also went into effect in December 2012 for all *new* Miscellaneous employees. Miscellaneous Tier 2 employees do not qualify for full retirement until age 60 (compared to age 55 for Tier 1 employees), and their retirement benefit is based on FAE3, rather than FAE1 like their Tier 1 colleagues.

Under the PEPRA, a person who became a member of CalPERS or a reciprocal retirement program before January 1, 2013 and subsequently joins a different CalPERS agency with less than a six month break in service is a "classic" employee who qualifies for the retirement benefit that was in effect at the new agency on December 31, 2012. The December 2012 implementation of a lower tier of benefits for Miscellaneous employees precludes "classic" employees from other CalPERS or reciprocal agencies from qualifying for Tier 1 benefits at the County of Santa Cruz.

Savings from the implementation of the Tier 2 benefit formula for all bargaining units is anticipated to total $9.7 million in the first ten years, $37 million over 20 years, and $93.5 million over 30 years.

Reduced Retiree Healthcare Costs through Structural Reform. The County provides pay-as-you-go health benefits to retirees. The value of benefits to be paid in the future and how much of that value remains unfunded is known as the Unfunded Actuarial Accrued Liability (UAAL). Since 2007, the County has implemented several structural changes that have reduced both the pay-as-you-go costs and the UAAL:

- Cafeteria plan and cap on retiree health benefits. The 2007-08 implementation of a cafeteria plan and cap on retiree health benefits reduced the UAAL from $216 million, in January 2007, to $181.5 million, by January 2009.

- Retiree health longevity schedule. In January 2012 the County implemented a retiree health longevity schedule that links the level of benefits to years of County service and age at retirement. Before then, the County's retiree medical benefit for most employees was $507/month for single, $557 with one dependent, and $613 with

more than one dependent. As of 2012, retirees with five or fewer years of service qualify for only the "PEMHCA minimum," which is currently $112/month. Depending on years of County service and age at retirement, retirees may receive up to a "cap" of $507/month single or $557/month with any number of dependents.

- Reduced healthcare contributions to Medicare-eligible retirees. In 2012, the County reduced its contributions when retirees attain Medicare eligibility and qualify for lower cost health premiums. Even if a person qualifies for the maximum $507/month contribution based on years of service and age at retirement, when that person qualifies for Medicare, the County's contribution is reduced by 25% to $380/month.

As a result of these structural reforms, the County's pay-as-you-go benefit payments, estimated in 2009 to hit $12.5 million by 2019, are now projected to reach only $7 million by then and the UAAL has been reduced by an additional $36.5 million to $145 million.

Inaccurate Assumptions Regarding Future Retirement Contribution Levels. The Grand Jury indicated that, "Employer and employee contribution levels are **expected to continue to increase** unless exceptional investment returns are experienced…" and footnotes this comment to a November 2014 CalPERS report. The report referenced in the footnote actually reads, "Contribution rates are expected to **remain high for an extended period** unless there is a period of exceptional returns in the markets." In this context, there is a notable difference between the words "remaining high" and "increasing." The rates will remain high for approximately four to five years because PERS has recently implemented conservative demographic, amortization, and investment assumptions designed to complement the PEPRA's structural benefit reductions. After the initial phase-in period, rates are expected to decline.

Finding 2: A clear and complete statement of the total retirement costs and obligations has not been provided in the budget narrative for either the public or elected officials.

_X_ **AGREE**
___ **PARTIALLY DISAGREE** - explain disputed portion below
___ **DISAGREE** - explain below

Response explanation (required for responses other than "Agree"):

In accordance with the Governmental Accounting Standards Board, these obligations are reported in great detail in the Comprehensive Annual Financial Report (CAFR). In the budget documents, costs are disclosed on Schedule 9 for each department under Salaries & Benefits. Pension costs are provided on the "PERS" line item; retiree health benefit costs (OPEB) are included with active employee health benefit costs in the "Employee Insurance and Benefits" line item.

Finding 3: Enrollment in the CalPERS Employers Retiree Benefit Trust Fund reduces employer contributions, prevents retiree health obligations from becoming a significant budget liability, and contributes to a positive credit rating.

___ **AGREE**
_X **PARTIALLY DISAGREE** - explain disputed portion below
___ **DISAGREE** - explain below

Response explanation (required for responses other than "Agree"):

Enrollment in the California Employers' Retiree Benefit Trust (CERBT), or any Other Post-Employment Benefits (OPEB) trust, in and of itself will not have any impact on contributions for current or future retirees. Contributions to the trust would not reduce current year benefit ("Pay-Go") costs for retired annuitants. Depending upon the total amount accumulated in the trust and the investment returns realized, reductions to the portion of the Annual Required Contribution (ARC) attributable to amortization of the unfunded liability could be achieved. Prefunding OPEB would be viewed favorably by rating agencies and could positively impact the County's long-term debt rating. If, however, the County had to borrow funds in order to pre-fund the OPEB liability, there could be negative impacts to the County's short-term debt rating which could increase the interest rate associated with the annual Tax Revenue Anticipation Note (TRAN) financing. If one-time money could be identified for funding an OPEB trust, there would be no associated negative impacts on the short-term debt rating.

Recommendations

Recommendation 1: To prevent reductions in public services, each of the six public agencies studied in this report should increase, and make public, their efforts to manage and reduce retirement costs and obligations.

_X_ **HAS BEEN IMPLEMENTED**
___ **HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE** - indicate timeframe below
___ **REQUIRES FURTHER ANALYSIS** - explain scope and timeframe below (not to exceed six months)
___ **WILL NOT BE IMPLEMENTED** - explain below

Response summary, timeframe or explanation:

Beginning in 2007, with the anticipated implementation of GASB45, the County took aggressive steps to manage rising costs associated with pension and retiree health benefits. Since the implementation of SB1129, all steps taken to reduce obligations, including estimates of the anticipated savings, have been taken to the Board in open session, and placed on the regular agenda, affording ample opportunity for review and input by the public.

Recommendation 2: Each of the six public agencies studied in this report should provide, in language understandable to the public, the totality of retirement obligations in their annual budget narratives beginning with the fiscal year 2015/16 budget.

___ **HAS BEEN IMPLEMENTED**
___ **HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE** - indicate timeframe below
___ **REQUIRES FURTHER ANALYSIS** - explain scope and timeframe below (not to exceed six months)
_X_ **WILL NOT BE IMPLEMENTED** - explain below

Response summary, timeframe or explanation:

The County will continue to adhere to the Governmental Accounting Standards Board (GASB) guidelines for reporting pension and OPEB obligations, and in accordance with GASB reports the obligations in the CAFR which is available to the public on the County's webpage under "*Budget and Financial Reports.*" The budget documents will disclose costs on Schedule 9 for each department under Salaries & Benefits. Pension costs are provided on the "PERS" line item; retiree health benefit costs (OPEB) are included with active employee health benefit costs in the "Employee Insurance and Benefits" line item. It's anticipated that the County will begin

issuing an Annual Report in FY 2015-16 and could provide some narrative of the OPEB and Pension liabilities there.

Recommendation 3: The Board of Supervisors and the City Councils of Santa Cruz, Scotts Valley and Watsonville should enroll in the California Employers Retiree Benefit Trust Fund (CalPERS Trust Fund) to pre-fund retiree health obligations and unfunded liabilities.

__ **HAS BEEN IMPLEMENTED**
_X_ **HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE** - indicate timeframe below
__ **REQUIRES FURTHER ANALYSIS** - explain scope and timeframe below (not to exceed six months)
__ **WILL NOT BE IMPLEMENTED** - explain below

Response summary, timeframe or explanation:

Staff has evaluated establishment of an Other Post-Employment Benefits (OPEB) Trust for the purposes of prefunding OPEB obligations. While there are numerous OPEB Trust providers, staff has met with two: CalPERS, to learn more about their CERBT, and Public Agency Retirement Services (PARS), both of which offer trusts for prefunding OPEB. At present the County General Fund does not have sufficient cash reserves to make a contribution equal to the Annual Required Contribution (ARC) as defined in the OPEB Actuarial Report; therefore initial prefunding would likely be for the annual benefit payment amount. It's anticipated that the OPEB trust's investment portfolio would generate a better rate of return than the treasury rate earnings on General Fund balances. It's anticipated that staff will be making a recommendation to the Board of Supervisors to establish an OPEB Trust during FY 2015-16 and initially prefund the estimated annual benefit payment amount in FY 2016-17.