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; 2nd 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.

Sincere Regards,

TOWN OF ATHERTON

Cary Wiest
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.