City of Larkspur

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July 17, 2013

Richard Treadgold, Foreperson
Marin County Grand Jury
3501 Civic Center Drive, Room #275
San Rafael, CA 94903

SUBJECT: Response to Grand Jury Report, *Marin's Retirement Health Care Benefits: The Money Isn't There*

Dear Foreperson Treadgold:

At its regular meeting on July 17, 2013, the City Council reviewed the above-referenced report, dated May 22, 2013. The Council applauds the Grand Jury for tackling this important topic. The report calls for a response from the City of Larkspur to all Findings (F) and recommendations (R). The Council's responses are provided below.

F1. We find that many of Marin's local governments and special districts are failing to pre-fund future costs for retired employees by making investments to cover promised benefits for active employees. This jeopardizes the certainty that retiree health care benefits promised to current employees will be paid.

The City Council agrees.

F2. The failure of the majority of entities studied in this investigation to begin an investment program to provide a portion of the needed funds to pay for retiree health care benefits leads to generation shifting of the payment responsibility. Thus it appears to be, at the least unethical, and even a breach of fiduciary responsibility.

While the City Council agrees that the failure to invest in an "Other Post Employment Benefits" (OPEB) trust effectively shifts costs forward, we strongly disagree with the characterization of this decision as unethical. When adopting a budget, a local government agency makes difficult choices about addressing a variety of short- and long-term liabilities and obligations. Making such decisions is not, in and of itself, unethical. The Council does agree that consciously deciding to never prefund promised retiree benefits could be characterized as unethical. But the Larkspur City Council is aware of no local government in Marin County that has made such a decision. Most local agencies are in the process of determining the best strategy to address this liability in a manner that minimizes the impact on local service provision.

F3. *The extreme 30-year amortization period used by most entities minimizes the annual cost of funding the liability gap and further defers to future generations the compensation owed to present employees who provide services to present taxpayers and customers. Shorter amortization periods should be required for reasons of equity and to ensure that the promised benefits will be provided.*

The Council acknowledges that with any debt or liability a shorter amortization period is generally preferable because it results in lower total costs over time. However, as with any debt or liability, local governments must schedule payments that are manageable over the amortization period. For each jurisdiction, the amortization schedule should reflect the specific fiscal realities of that agency.

F4. *By capping retiree health care benefits, the City of San Rafael has reasonable certainty as to what those costs are. Other entities studied here that promise to pay for future retiree health care with uncertain and likely rapidly increasing costs are accepting an unknown and potentially very costly risk*

The City Council agrees.

F5. *Because a few Marin County cities and other entities studied provide very limited benefits yet still appear able to meet community service needs, and because providing such benefits is increasingly rare in the private sector, such benefits appear to be unnecessary for attracting and retaining employees. Accordingly, for active and newly hired employees, the benefits should be trimmed and costs should be shared between the employees and their employee.*

The City Council strongly supports providing a compensation package that is competitive and sustainable. It is incumbent upon all government employers to work closely with their employee groups to adjust packages to ensure that commitments to active and retired employees can be met while providing the greatest breadth of community services possible.

F6. *Marin entities using "Pay-Go" funding are paying only the current year health care benefits of those already retired. This ignores the reasonably known rising costs to cover future retirees who are already heading for retirement.*

> *Some actuarial valuation reports the Grand Jury studied provide those future "Pay-Go" estimates year-by-year, so they should be readily available from the actuary's valuations.*
>
> *Estimates of those annual costs for each of the next 10 years should be provided to the public so that those who will incur the costs can know those costs.*

The City Council agrees that the public deserves as much transparency about OPEB liability as possible.

F7. Employers studied for this report should include an age-60, or even later, date for retiree health care benefits to commence in future negotiations with employees and their representatives.

For agencies such as Larkspur, which obtain health care benefits through California Public Employees Retirement System (CalPERS) under the Public Employees Medical Care and Hospital Act (PEMCHA), legislative change is required to change the age that retiree health care benefits begin. Currently, this age is tied to the qualification of the retiree as an annuitant of the CalPERS. This finding was effectively implemented statewide for those non-safety public employees that are a "new member" of CalPERS (as defined in Government Code Section 722.04(f)), as the retirement age for such employees is 62.

F8. The results of retiree health care actuarial cost analyses are summarized if at all only in obscure notes to annual financial statements. The public is entitled to more readily accessible explanation of these costs because the public will bear those costs.

The City Council supports transparency and would only suggest that it would be best if the reporting requirements for OPEB liability were uniform across agencies.

F9. There is a wide range of retiree health care benefits offered among the entities studied in this investigation. No clear explanation for the range from minimal to extremely generous is readily available. Those entities that are promising relatively generous benefits should provide clear justifications to their citizens and customers.

Because "extremely generous" is a relative term, the City Council suggests that a reporting standard should be identified and required of all agencies.

F10. Most of the entities the Grand Jury investigated are using fairly reasonable discount rates of 4%-5% per year to bring back to today in actuarial valuations the future annual costs of retiree health care benefits. However, some are using higher and highly questionable rate assumptions that are not justified by the investments (if any) that they have made to grow and fund the future benefits. The result is to understate the total funding needed today and in future years, to pay for those future benefits.

This finding underscores a fundamental issue with comparisons of OPEB liability across multiple employers. If the underlying assumptions of the actuarial analysis are not the same, the comparative value is limited.

R1. Begin setting aside in separate investment accounts, if it is not already doing so, each year's funds for amortizing its retiree health care benefits' UAAL, in addition to its "Pay-Go" funding of those benefits for present retirees.

In 2012, the City of Larkspur established a trust fund into which it can place monies set-aside for retiree health care benefits. To date, the fund has been used to cover Pay-Go expenses. In Fiscal Year 2013-14, the City is having its OPEB liability reexamined by an actuary. Using this data, the Council and City Manager plan to develop and implement a funding strategy for this long-term liability.

R2. Begin a program to lower the amortization period for funding its retiree health care benefits UAAL from as much as 30 years presently, to approach (within 10 years), the commonly used 17-year amortization period for retiree pension funding.

As noted above, the Council acknowledges that with any debt or liability a shorter amortization period is generally preferable because it results in lower total costs over time. However, as with any debt or liability, local governments must schedule payments that are manageable over the amortization period. For each jurisdiction, the amortization schedule should reflect the specific fiscal realities of that agency.

It should be noted that the more aggressive amortization period for retiree pension funding is, in part, a reflection of the fact that pension boards enjoy what is, effectively, a guaranteed discount rate of 7.5%. When the pension fund underperforms relative to this rate, the pension system bills employers for the shortfall. No such protections exist for OPEB liability funds.

R3. Negotiate caps on the amounts it commits to pay existing and new employees for retiree health care benefits.

R5. Require active employees to make a contribution towards the cost of their retiree health care benefit.

All local government agencies should be educating their employees about OPEB liabilities and the need to ensure that promises can be met now and into the future. Through such education, employers and employees can work together to negotiate changes to retiree health benefits that make them more sustainable.

R4. Negotiate a higher retirement age than the currently applicable age for the commencement of retiree health care benefits.

For agencies such as Larkspur, which obtain health care benefits through CalPERS under PEMCHA, legislative change is required to change the age that retiree health care benefits begin. Currently, this age is tied to the qualification of the retiree as an annuitant of the CalPERS. This finding was effectively implemented statewide for those non-safety public employees that are a "new member" of CalPERS (as defined in Government Code Section 722.04(f)), as the retirement age for such employees is 62.

R6. Place a link on its website to provide the latest actuarial valuation of its AAL, its UAAL, its consequent percent funded, its discount rate (annual percentage) used to determine these values, and a projection of outlays ("Pay-Go") for retiree health care benefits for each of the current and subsequent 10 years.

The City Council supports transparency and would only suggest that it would be best if the reporting requirements for OPEB liability were uniform across agencies. Establishing such a standard would guide the City in providing a public report.

Should the members of the Grand Jury require any additional information, please contact City Manager Dan Schwarz at 415-927-5110 or dschwarz@cityoflarkspur.org.

Sincerely,

Dan Hillmer

Dan Hillmer
Mayor