

RESPONSE TO GRAND JURY REPORT FORM

Report Title: *Marin's Retirement Health Care Benefits: The Money Isn't There*

Report Date: May 22, 2013

Response by: Sausalito City Council

By: Debbie Pagliaro, City Clerk

FINDINGS

- I (we) agree with the findings numbered: F4, F5, F6, F8, F9
- I (we) disagree wholly or partially with the findings numbered: F1, F8, F10
- (I/we neither agree nor disagree with the findings numbered: F2, F3, F7)

(Comments for each of your findings are attached)

RECOMMENDATIONS

- Recommendations numbered R1, R6 have been implemented.
- Recommendations numbered R2, R3, R4, R5 have not yet been *fully* implemented, but will be implemented in the future.
- Recommendations numbered n/a require further analysis.
- Recommendations numbered n/a will not be implemented because they are not warranted or are not reasonable.

(Comments for each of your recommendations are attached.)

Date: 7-25-13

Signed: _____

Number of pages attached 6

The response of the City of Sausalito to the Findings and Recommendations of the Grand Jury report follows:

FINDINGS

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.

City of Sausalito Response:

The City of Sausalito does not have extensive knowledge of the funding practice for Other [than pensions] Post-Employment Benefits ("OPEB") of other Marin local governments. However, the City of Sausalito, has long recognized the importance of funding OPEB annual required contributions (ARC) and unfunded accrued actuarial liabilities (UAAL). Specifically:

- In FY05, the City set-aside \$50,000 in a separate internal services fund to partially offset the UAAL;
- In both FY06 and FY07, the City aside \$150,000 each year in a separate internal services fund in order to partially offset the UAAL;
- In FY08, the City Council adopted a policy through budget adoption and implementation to set aside 1% of employees salaries in a separate internal services fund in order to continue the practice to partially offset the UAAL;
- In mid FY08, after accumulating the above noted \$350,000, and adopting the policy to continue the practice of setting aside 1% of salaries into a separate internal service fund to partially offset the UAAL, the City Council's Finance Committee deliberated on the choices of (a) pre-funding OPEB liabilities in an irrevocable trust or (b) continue to set-aside monies internally.

Although, current accounting and actuarial standards do not permit monies not in an irrevocable trust as credits against UAAL, the City decided not to invest monies in an irrevocable trust with an investment strategy to achieve the 5% actuarial discount rate due to foreseen economic market weakness. In retrospect, the decision to not place the monies into an irrevocable trust was monumentally fortuitous as the equity markets plunged late 2008 and early 2009 – the City would have lost about 50% of the money it had set-aside.

- Through FY 12, the City had accumulated approximately \$1,100,000 in the separate internal services as partial offsets for OPEB Liabilities;
- In FY09, besides setting aside funds in a separate internal services fund, the City began exploring all other options for reducing OPEB ARC and UAAL including investigating feasibility of working with other cities to find

solutions, implementing a two-tier benefits system for future new hires, a dollar cap on benefits, and converting the current defined benefits plan into a defined contribution plan.

- Accordingly, and in order to provide structural balance to the City's financial position, a two-year planning effort was initiated in 2010 that manifested a comprehensive strategy to lower the cost of labor. The strategy was implemented after six months of negotiations with the City's labor force. The strategy accomplished the substantive pension, OPEB, Health Care Costs and Salary Cost reforms that will result in enhancing the City's long-term financial position. The OPEB reform accomplished the following:
 - Replaced Defined Benefit (DB)-OPEB for current employees with 3 years or less service with Defined Contribution (DC)-OPEB
 - Offered a one-time option to all employees with > 3 years services to opt out of DB-OPEB and replace with DC-OPEB
 - Eliminated all OPEB for all future employees
- The impacts from the City's OPEB reform included:
 - Eliminated DB OPEB for 14 employees with < 3 years service
 - Eliminated DB OPEB for 19 employees with > 3 years service
 - Created a closed pool of OPEB beneficiaries and accordingly justified to continue with a Pay-As-You-Go approach for OPEB funding. Specifically,
 - the annual OPEB normal cost was cut in half and now declines incrementally each year and should be entirely eliminated within 30 years;
 - Unfunded Actuarial Accrued Liabilities (UAAL) will be completely eliminated within 75 years

This information was provided to the Grand Jury in answer to their request for information. The City of Sausalito is disappointed that the Grand Jury failed to make mention in its report of the City's aggressive and significant OPEB reforms, and not recognizing the momentous implementation of their unique solution to lowering and eventually eliminating its ARC and UAAL.

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.

City of Sausalito Response:

The ethics and fiduciary responsibility of intergenerational equity are difficult concepts and the City of Sausalito neither agrees nor disagrees with this finding.

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.

City of Sausalito Response:

There are many funding approaches to pay off the UAAL including: level dollar 10, 17, 20 or 30 years (or any number in-between), and level percent of payroll 10, 17, 20 or 30 years (or any number in-between). The level dollar options are more expensive at the beginning of funding years than the level percent of payroll options. The level percent of payroll 30 years is consistent with the CalPERS retirement funding. The City of Sausalito neither agrees nor disagrees with the Grand Jury's finding and believes that future GASB and actuarial standards should prevail on the appropriate amortization periods.

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.

City of Sausalito Response:

The City of Sausalito agrees that retiree health care costs that are capped provide more reasonable certainty than uncapped retiree health care costs.

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 employer.

City of Sausalito Response:

The City of Sausalito has implemented a two-tiered system that caps/eliminates retiree health care costs for future hires.

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.

City of Sausalito Response:

The City of Sausalito agrees that 10 year forecasts of the actuarial estimates of the "Pay-Go" annual retiree health care costs should be included in the valuations.

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.

City of Sausalito Response:

Finding #7 reads more like a recommendation than a finding; the City of Sausalito neither agrees nor disagrees with the statement above.

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.

City of Sausalito Response:

The City of Sausalito agrees that the public is entitled to readily accessible retiree health care costs and liabilities information; the City disagrees that its notes to the financial statements are obscure; and the City is not aware of the practice of other city's disclosure of retiree health care cost and liability information.

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.

City of Sausalito Response:

The City of Sausalito agrees that all entities should provide clear justification for all public spending to their citizens and customers.

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.

City of Sausalito Response:

The City of Sausalito uses a 5% discount rate in its actuarial valuations, an amount deemed reasonable in regards to its OPEB actuarial valuation.

RECOMMENDATIONS

The Grand Jury recommends that each Marin County local government, special district and school district:

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.

City of Sausalito Response:

The City of Sausalito has been regularly setting aside funds to partially offset its UAAL since FY05, and by budget policy is continuing to do so.

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.

City of Sausalito Response:

The City of Sausalito will consider lowering the amortization period for funding its retiree health care costs and liabilities, with a policy of maintaining consistency with standards promulgated by GASB and other actuarial standard setting bodies

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

City of Sausalito Response:

The City of Sausalito will consider negotiating ceilings for retiree health care benefits for existing employees in future labor negotiations. As discussed above, the City eliminated OPEB for future employees.

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

City of Sausalito Response:

The City of Sausalito will consider negotiating higher retirement ages than the currently applicable age for the commencement of retiree health care benefits for

existing employees in future labor negotiations. As discussed above, the City eliminated OPEB for future employees.

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

City of Sausalito Response:

The City of Sausalito will consider requiring active employees to make a contribution towards the cost of their retiree health care benefit in future labor negotiations. As discussed above, the City eliminated OPEB for future employees.

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.

City of Sausalito Response:

The City of Sausalito has placed a link on its website providing the most recent and complete, comprehensive actuarial valuation with all required information.



CITY OF SAUSALITO

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July 25, 2013

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

RE: Grand Jury Response – “Marin’s Retirement Health Care Benefits:
The Money Isn’t There”

Dear Mr. Treadgold:

At their meeting of July 9, the Sausalito City Council reviewed and approved the response to the Grand Jury Report “Marin’s Retirement Health Care Benefits: The Money Isn’t There”.

Enclosed you will find our response. By copy of this letter, Judge Ritchie will also receive one copy of the report.

If you have any questions, please feel free to contact me.

Respectfully,

Debbie Pagliaro
City Clerk

cc: Judge James Ritchie

FAX NUMBERS:

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