Funded for the Future?

Retirement Costs and Obligations in Santa Cruz County

Summary

Public pension costs and retirement obligations have been a major topic in the news due to the increasing costs to governments and public agency employees. The California legislature and Governmental Accounting Standards Board have formulated new standards and reporting for retirement obligations. The Grand Jury investigated the past, current and future retirement costs of six jurisdictions in Santa Cruz County and identified what measures have been taken to manage or reduce costs. The Grand Jury investigated the cities of Capitola, Santa Cruz, Scotts Valley, Watsonville, the county of Santa Cruz and the Soquel Creek Water District.

Costs of retirement obligations are projected to continue increasing for the next five years.[1] The ratio of retirees to the number of employed active members is increasing statewide. More retirees and fewer employees mean retirement costs are spread over fewer people. The goal of the pension program is to have sufficient assets to completely cover (fund) all retirement obligations. Currently the funded ratio range is between 64.9-80.6% for the public agencies in this report. A clear understanding of the total retirement obligation is necessary for both the general public and for the governing bodies tasked with making budgetary decisions.

The Grand Jury found the following:

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

The Grand Jury makes the following recommendations:

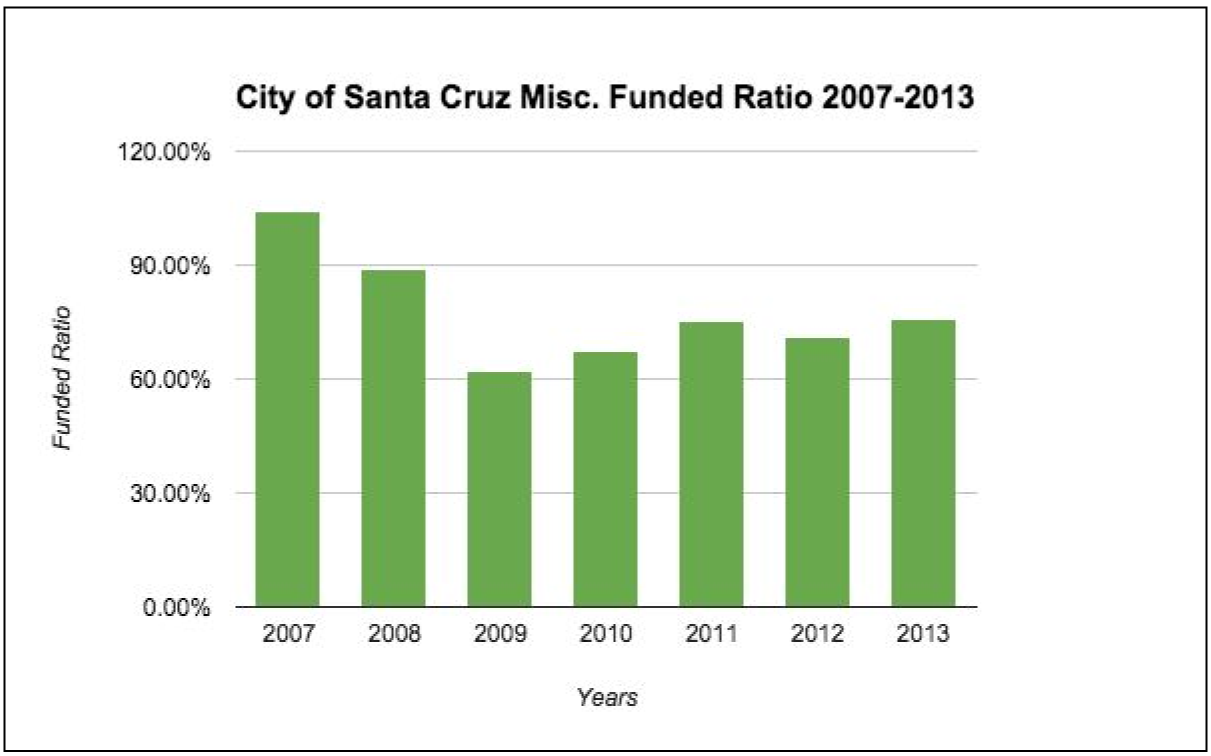
- To prevent reductions in public services, each of the six public agencies studied in this report should increase, and make public, their efforts to manage and reduce retirement costs and obligations.
- Each of the six public agencies studied in this report should provide, in language understandable to the public, the totality of retirement obligations in their annual budget narratives beginning with the fiscal year 2015/16 budget.

- 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.

Background

Public pension costs have been a major topic of discussion due to the increasing costs to local governments and recent State legislation reforming pensions in California. This legislation, Public Employees' Pension Reform Act of 2013 (PEPRA), became effective January 1, 2013.[2] The Santa Cruz County Business Council commissioned a study titled "*Unfunded Pension and Retiree Health Care Liabilities in Santa Cruz County, October 2012,"* which identified the high costs of retirement obligations.[3]

In the last eight years, the six public agency pension plans in Santa Cruz County have declined from over 100% funded to as low as 59.9% funded. The primary cause of the drop in funding level was the fact that public pension investments suffered significant losses in fiscal years 2008 and 2009. In those years the California Public Employees Retirement System (CalPERS) had a net negative rate of return of -2.9% and -23.6%, respectively. This resulted in an approximate $69.9 billion loss of assets.[4]



Source: City of Santa Cruz Annual Valuation Reports

As an example, the chart above shows that the City of Santa Cruz miscellaneous member plan (for employees who are not police or fire) was funded at 104% in 2007 and declined to 75.9% in 2013.[5] The ratio of assets to accrued liabilities is the primary indicator of the health of the pension fund and determines the fiscal health of the plan or risk pool. A funded ratio greater than 100% means the plan or risk pool has more assets than liabilities and a ratio less than 100% means liabilities are greater than assets.

California Public Employees Retirement System (CalPERS)

CalPERS is an independent State agency with sole authority to:

- Administer the retirement funds of contracting public agencies
- Collect both employee and employer annual required contributions (ARCs)
- Manage the investment of funds
- Conduct an annual actuarial valuation of each agency's funds in order to determine the benefit plan contribution level.

CalPERS is the largest public-sector pension system in the United States, serving over 1.7 million members, 3,094 school districts and public agencies, and managing investments of over $300.3 billion (as of February 2015).[4]

Each jurisdiction has an individual contract with CalPERS. CalPERS offers a defined benefit plan which provides benefits calculated using a defined formula. When a public agency chooses a defined benefit plan (CalPERS) for its employees, it incurs an obligation to pay employee pensions and provide additional money if the prior contributions invested in CalPERS are insufficient to cover the promised payments. This liability remains with the jurisdiction and is not insured by any third party.

Retirement benefits are calculated using a member's years of service credit, age at retirement and final compensation averaged over a defined period of employment. There are a variety of retirement formulas that are determined by the member's employer, occupation group, and the specific provisions in the contract between CalPERS and the employer. Employees hired after January 1, 2013 are governed by the new PEPRA requirements.

CalPERS manages the public agencies' funds. Funding for retirees comes from three sources:[4]

1. 67% from investment earnings
2. 21% from employers
3. 12% from employees.

Over the last 30 years, CalPERS investments have earned an average of 9.4% per year. During the last 10 years (2005-2014) investments have earned an average of 7.4%, with an annual high of 18.8% in fiscal year (FY) 2005 and an annual low of -23.6% in FY 2009. CalPERS investments lost $69.9 billion in value during the recession of FY's 2008 and 2009.[4]

CalPERS investments lost 26.5% of portfolio value or $69.9 billion in fiscal years 2008 and 2009 combined.

Each year CalPERS conducts an actuarial study for each jurisdiction and determines the next year's contribution rates as a percentage of payroll. This information is transmitted to each public agency in October of each year. The following principal assumptions are currently used (last evaluated 2 years ago) by CalPERS to determine the funding status of each plan:[6]

1. Inflation rate of 2.75%
2. Payroll growth of 3%
3. Investment return rate of 7.5%.

CalPERS determines the total employer contribution rate as a percentage of payroll. To fund employee pensions, the jurisdiction and its employees make contributions over the course of the employees' careers as a percent of salary. These contributions, with the investment earnings through CalPERS, are expected to pay all retiree pension benefits. Employee contributions are established by memoranda of understanding that are negotiated between the local public agencies and their employee groups (bargaining units such as safety, police, clerical workers etc.) and by state law.

Each public agency has multiple employee plans created and administered by CalPERS. Each plan has an actuarial study conducted annually by CalPERS. The actuarial study determines the public agency's contribution rate for the following year and a projection for the subsequent year. The following shows the number of plans that CalPERS has designated for the six jurisdictions in this report:

City of Capitola	3 plans
City of Santa Cruz	5 plans
City of Scotts Valley	3 plans
City of Watsonville	6 plans
County of Santa Cruz	3 plans
Soquel Creek Water District	3 plans

The employee contribution is determined through negotiations between the employee bargaining units and governing bodies of each public agency. The employer/employee payments are submitted to CalPERS every two weeks by the employer.

In some situations, if assets are not equal to liabilities, side funds are created by CalPERS. Side funds are debts which represent the differences between assets and liabilities. Side fund debts are treated as loans from CalPERS and have an interest rate of approximately 7.75%. Public agencies have the option to issue, at lower interest rates from 3-6%, pension obligation bonds to pay off their side fund debts.

What is the Public Employees' Pension Reform Act (PEPRA)?

The Public Employees' Pension Reform Act (PEPRA) became effective January 1, 2013. PEPRA affects both classic (existing) and new members (hired after January 1, 2013).[2] The intent of California's legislature was to overhaul the state public employee retirement law. Major changes of the Public Employees' Pension Reform Act include:

- Increasing retirement age by two years or more for all new public employees
- Capping pensionable salaries (salary used by employer to calculate pension) at $113,700 with Social Security and $136,440 without Social Security
- Eliminating numerous abuses such as pension or salary spiking (inflating compensation in the years immediately preceding retirement to receive larger pensions)
- Requiring state employees and all new employees hired after January 1, 2013 to pay more toward their own retirement.

The effect of PEPRA was to close all existing active plans to new employees and create new plans for those hired after January 1, 2013. These new impacts of PEPRA go into effect FY 2015/16.

PEPRA creates a new defined benefit plan and formulas for all California state employees, most public agencies and local government employees hired after January 1, 2013. PEPRA is projected to save $42-55 billion over the next 30 years.[7] However, the real savings of PEPRA will come many years in the future as the percentage of PEPRA employees increases.

Additional Changes to CalPERS Assumptions

In April 2013 CalPERS approved new actuarial policies that are aimed at returning the pension system to fully-funded status in 30 years. The new policies include a rate-smoothing method with a 30-year fixed amortization period for gains and losses. The amortization would have a five-year ramp-up of rates at the start and a five-year ramp-down at the end. As a result, unfunded liabilities will be paid off faster because contribution rates will rise in the short term. This will also help avoid large increases in employer contribution rates in extreme years, while maintaining a reasonable level of change in normal years. These changes go into effect FY 2015/16.[8]

In 2014 CalPERS concluded a 2-year asset study and approved several changes to the demographic assumptions that more accurately reflect actual experience. The most significant of these is an increase in employee life expectancies. These new assumptions will be used in the FY 2016/17 employer contribution rates.[8]

Other Post Employment Benefits (OPEBs)

OPEBs are benefits (other than pension wages) that an employee will begin to receive at the start of retirement. These may include life insurance premiums, death benefits and health care premiums. Retiree health care premiums comprise the majority of costs of OPEBs. OPEBs are optional and are negotiated between employees and governing bodies. OPEBs may be increased, reduced or eliminated by an employer based on the language in the memorandum of understanding between the employer and employee.

All public agencies in this report use a pay-as-you-go financing method for funding OPEB programs. Two jurisdictions, the City of Capitola and the Soquel Creek Water District, are enrolled in the California Employers Retiree Benefit Trust (CERBT) program.

CERBT is a separate CalPERS irrevocable trust fund dedicated to pre-funding employer OPEB liabilities.[9]

Frequently Used Pension Terms

- **Basic retirement funding equation:** Contributions (employer/employee) + Investment income = Expenses + Benefits Paid
- **Normal costs** are the total benefits and expenses that have accrued during the year and are expected to accrue annually.
- **Accrued Liability** is the amount of money needed to pay for benefits based on current members' years of service. This amount is amortized to build the necessary assets over time to cover liabilities.
- **Fully funded** means the assets equal or exceed the liabilities.
- **Funded Ratio** is the market value of assets over the pension obligation.
- **Unfunded Liability** is the unfunded obligation for prior benefits, measured as the difference between the accrued liability and plan assets.
- **Unfunded accrued liabilities** occur when the value of assets is less than the accrued liability.
- **Unfunded actuarial accrued liability** (UAAL) is created when past actuarial assumptions have not occurred.

What is Considered to be an Adequately Funded Pension Program?

An adequately funded pension program is not simply or easily defined. CalPERS current contribution patterns are designed to attain a funded ratio of 100% within 30 years.[1]

Each pension plan is designed to accumulate sufficient funds to support member's defined retirement benefits. The amount of anticipated funds required to support a member's retirement benefit minus the funds currently available is the accrued liability. A plan that is currently on track to create assets equal to the accrued liability is on schedule. A plan whose assets will not meet the accrued liability is behind schedule or is said to have an unfunded liability and must temporarily increase contributions to get back on schedule. Events such as plan amendments and investment or demographic gains or losses can change a plan's funding status from year to year.

The funded status of a pension plan is defined as the ratio of assets to a plan's accrued liabilities based on the market value of those assets. As of June 30, 2013, after reflecting the new assumptions adopted by CalPERS, the funded status range for all jurisdictions being studied was between 64.9 and 80.6%. The funded ratio is the primary means of determining the health of a pension program.[10]

Interviewees had varying responses to the question of what is considered adequate funding for a pension program, including:

- 80% of the funded ratio
- 100% of the funded ratio
- Not too concerned because the funded ratio is cyclic

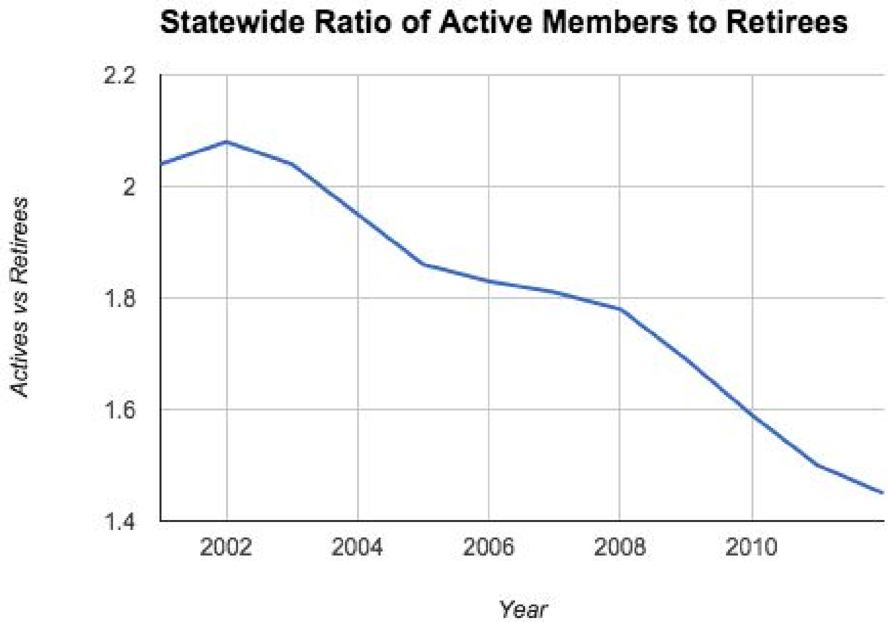
Interviewees expressed concern about the increased costs of retirement obligations on the budget and potential impact to the credit rating of the public agency.

Why are Pension Costs Increasing?

Even with the changes in the retirement law with the passage of PEPRA, retirement obligations are becoming an increasing financial obligation for jurisdictions for the following reasons:

1. In 2002 the statewide ratio of active members to retirees was 2 to 1. By 2012, the statewide ratio had declined to 1.45 to 1. Currently there are about 1.5 active members' payroll to spread the risk associated with each retiree's benefits instead of the 2 to 1 ratio of a decade ago. The CalPERS projected ratio for 2037 is between 0.6 and 0.8 active member to one retiree (see the chart below).[1]
2. Increases in benefits to existing employees raises costs, e.g.
    a. Past negotiated retirement age reductions resulted in longer benefit terms and therefore higher costs.
    b. Increased retirement amount from 2.5% to 3% at 60 years of age for every year employed.
3. Retiree health costs continue to increase.
4. The CalPERS investment rate of return is unpredictable and changes from year to year.
5. The actuarial assumptions are not constant. Recently, CalPERS changed several assumptions related to rate-smoothing and demographics. The most significant demographic change, greater life expectancies, has increased the required employer contributions.[6]
6. Investment returns suffered significant losses in FY 2008-2009 of -26.5% ($69.9 billion) compared to the projected assumption of a 7.5% annual rate of return. These funds still have not recovered.

Due to the declining ratio of active to retired employees, unless funding levels rise to 100%, retirees represented in the later years will be essentially funding their own retirements.



Employer and employee contribution levels are expected to continue to increase unless exceptional investment returns are experienced.[1] When investment returns fail to meet expectations, employer and employee contributions must increase to fund the difference. In addition to rising CalPERS costs, a public agency which has significant unfunded liabilities and debt levels may receive a lower credit rating, making any new or refinanced debt more expensive.

A public agency which has significant unfunded liabilities and debt levels could receive a lower credit rating, making any new or refinanced debt more expensive.

According to CalPERS representatives, the three primary reasons for unfunded liabilities are the following:

1. 70% of the unfunded liabilities are attributable to market performance.
2. 15% of the unfunded liabilities are attributable to retroactive benefit enhancements (e.g. lowering retirement age, revising retirement salary determination from a three year average to a one year average).
3. 15% of the unfunded liabilities are attributable to other actuarial assumption changes.[11]

Laws, Regulations and Standards for Pensions

The laws, regulations and standards for retirement programs are located in Appendix L.

Scope

The Grand Jury investigated and evaluated the retirement obligations of six Santa Cruz County jurisdictions: the four incorporated cities, Capitola, Santa Cruz, Scotts Valley and Watsonville, the county of Santa Cruz and the Soquel Creek Water District. All of these public agencies contract with the California Public Employees Retirement System (CalPERS) to provide retirement benefits to employees.

This investigative report focuses on identifying relevant data from the following areas for the six public agencies:

1. The total pension costs for the last five years
2. The percentage of pension costs of the total operating and personnel budgets
3. Employee and employer contribution rates for each pension plan
4. The unfunded liability for each pension plan
5. The steps taken to manage and reduce pension costs

Retirement obligations in this report include the following:

1. Post-retirement wages (pension) paid to employees and/or beneficiaries
2. Other Post Employment Benefits (OPEBs) including life insurance premiums, death benefits and health benefits for retirees
3. Social Security benefits, if the public agency has elected to be in the program
4. Public Agency Retirement System (PARS)
5. Pension obligation bonds
6. Unfunded liabilities for pensions and OPEBs

This report does not evaluate the public agency health plans for active employees.

Interviews were conducted from October 2014 to March 2015 with representatives from each of the public agencies and an actuary from CalPERS. The primary sources of information for this report were interviews, Comprehensive Annual Financial Reports (CAFRs), budgets, the CalPERS website, requested information from interviewees and Annual Actuarial Valuation Reports from CalPERS for each jurisdiction. This report does not compare pension plans between public agencies.

Investigation

The Grand Jury interviewed administrative personnel from the cities of Capitola, Santa Cruz, Scotts Valley, Watsonville, the county of Santa Cruz, Soquel Creek Water District and a CalPERS actuary, all of whom are familiar with pension and/or retirement issues. As part of the interview process, each individual was also given a list of requested information relating to pension issues.

All recent budgets and budget narratives were reviewed to find basic information concerning retirement obligation costs.[12][13][14][15][16][17] As the following table indicates, the budget and budget narratives of all six public agencies failed to provide a clear and understandable breakdown of retirement obligations.

Summary of Annual Pension Data from the Budget or Budget Narrative

	Total Annual CalPERS Retirement Costs	***Total Annual Retiree Health Insurance (OPEB) Costs***	***Total Annual Pension Obligation Bond Costs***	***Total Annual Social Security Costs***	***Unfunded Pension Liability***	***Unfunded OPEB Liability***	***Funded Ratios***
City of Capitola	No	No	Yes	N/A*	No	No	No
City of Santa Cruz	No	No	Yes	N/A	No	No	Yes
City of Scotts Valley	No	No	Yes	No	No	No	No
City of Watsonville	No	No	N/A	No	No	No	No
County of Santa Cruz	No	No	N/A	No	No	No	No
Soquel Creek Water District	Yes	No	N/A	N/A	No	No	No

*N/A means not applicable

Total retirement costs include the pension contribution, retiree health costs, Social Security (if applicable), pension obligation bonds (if applicable), Public Agency Retirement System (if applicable), unfunded pension liability and unfunded retiree health liability (OPEBs).

The Grand Jury believes the public and each governing body should have a clear understanding of the total costs and cost trends of retirement obligations before an annual budget is approved. Comprehensive annual financial reports (CAFRs) have the most information about retirement obligations. However in the CAFR, the information is contained in an audit of previously approved budgets, which do not present an account of the total retirement costs in a clear and understandable format. A good example of an understandable budget narrative is listed in Appendix D.

Recent Changes to Reporting Other Post Employment Benefits

In May 2014, the Governmental Accounting Standards Board (GASB) issued a draft on Accounting and Financial Reporting for Post Employment Benefits Other Than Pensions. This document makes changes on how OPEBs are reported in the financial statements (CAFRs) of employers. One of the key provisions of the changes is that every government entity will be required to report its OPEB net liability in their government-wide and proprietary fund financial statements. Currently, employers only report liability if they fail to fully fund their annual contribution.[18] The following table summarizes general information about retirement plans from each of the six public agencies.

Summary of Retirement Plans/Number of Employees and Retirees

	CalPERS	***Social Security for Regular Employees***	***Number of Current Employees 6/30/13***	***Number of Retirees 6/30/13***	***Ratio of Current Employees to Retirees***
City of Capitola	Yes	No	65	92	1 to 1.41
City of Santa Cruz	Yes	No	777	882	1 to 1.13
City of Scotts Valley	Yes	Yes	60	26	1 to 0.43
City of Watsonville	Yes	Yes	361	328	1 to 0.91
County of Santa Cruz	Yes	Yes	2,350	2,428	1 to 1.03
Soquel Creek Water District	Yes	No	47	46	1 to 0.98

Sources: 2014 Comprehensive Annual Financial Reports, Soquel Creek WD response to comments 12/30/14, Scotts Valley Budget 2014/15.

Specific retirement cost totals paid and contribution rates for each jurisdiction are included in the following Appendices:

- City of Capitola — Appendix F
- City of Santa Cruz — Appendix G
- City of Scotts Valley — Appendix H
- City of Watsonville — Appendix I
- County of Santa Cruz — Appendix J
- Soquel Creek Water District — Appendix K

The following table shows the total unfunded liabilities for each public agency.

Total Unfunded Liabilities for Pensions and OPEBs FY's 2011 and 2013

Agency	***FY 2011***	***FY 2013***
City of Capitola	$13,288,347	$14,890,582
City of Santa Cruz	$108,374,540	$130,957,078
City of Scotts Valley	$14,208,845	$16,274,061
City of Watsonville	$51,385,033	$53,556,361
County of Santa Cruz	$381,187,830	$479,192,624
Soquel Creek Water District	$8,642,212	$9,000,989

Sources: CAFR's for the cities of Capitola, Santa Cruz, Scotts Valley, Watsonville, County of Santa Cruz and the Soquel Creek Water District Annual Valuation Report as of June 30, 2013

Unfunded liabilities and funded ratios for all public agencies are found in Appendix C.

Options for Managing Retirement Costs

With input from public agencies, and by reviewing budgets, Comprehensive Annual Financial Reports, actuarial studies and other information, the Grand Jury identified some options for managing retirement obligations:

- Increase revenue. Without increased revenue to the agencies, the increases in retirement obligations will reduce funding for other projects and services.

- Permanently reduce workforce. Outsource or contract for services. This needs to be evaluated on a case by case basis to determine if cost reductions are real.
- Develop a trust or reserve fund for pension contribution rate increases to minimize the impacts of future contribution rate increases.
- Utilize the CalPERS California Employers' Retiree Benefit Trust Fund to pre-fund OPEB (retiree health) costs.
- Negotiate an increase of the employee contribution to CalPERS.
- Negotiate a decrease in the amount paid by the employer for retiree health insurance premiums.
- Develop new hiring tiers for workforce.
- Evaluate a discontinuance of Employer Payment of Member Contributions (EPMC), if applicable.
- Pay off CalPERS pension side funds, if applicable.
- Investigate unfunded accrued liability (UAL) lump sum prepayments.
- Evaluate issuing a Pension Obligation Bond.
- Terminate the CalPERS contract. In order to terminate the contract, the unfunded termination liability must be paid, which can be extremely expensive. Public agencies would be required to pay approximately the following amounts for termination:[5][19][20][21][22][23]

City of Capitola	$ 53,381,934
City of Santa Cruz	$ 417,035,407
City of Scotts Valley	$ 42,109,974
City of Watsonville	$ 185,390,950
County of Santa Cruz	$1,023,685,680
Soquel Creek Water District	$ 19,916,389

Because of the costs, paying termination fees is not a viable or reasonable option.

The public agencies we investigated have taken a number of steps to more efficiently manage retirement costs (See Appendices F, G, H, I, J and K).

CalPERS Unfunded Liabilities

The unfunded liability is the expected amount due for pensions and retiree health care promised in future years. There must be a balance between contributions to the pension fund and investments to benefits paid and administrative expenses. To illustrate:

Contributions + Investment income = Benefits paid + Administrative expense[24]

In Santa Cruz County, the range of total unfunded liability for the six jurisdictions ranges from approximately $8 million to $480 million.[25][26][27][28][29][30] The unfunded actuarial accrued liability (UAAL) occurs because past assumptions have not been realized.

In the CalPERS "Annual Review of Funding Levels" dated November 18, 2014, numerous conclusions are stated which identify a significant amount of risk being taken in the funding of the statewide CalPERS pension plan. The purpose of the report was to assist CalPERS Board of Administration in assessing the funded status of the retirement system and its overall soundness and sustainability. The primary conclusion of this report is:

> ***. . .there is a significant amount of risk being taken in the funding of the (CalPERS pension) system. The probability that the system will face a period of severe stress is still at a level that may be unacceptable.***

The full report conclusions are listed in Appendix M.

Investigative Facts Summary

The following major facts were found during the preparation of the Grand Jury report:

1. The totality of retirement obligations (pension, retiree health, social security, pension obligation bonds, unfunded pension liability and unfunded OPEB costs) are not included in any of the six public agencies' annual budget narratives or budgets.
2. Mandated CalPERS employer contribution rates have increased in the last 2 years.
3. CalPERS predicts increased pension contributions for the next 5 years.[1]
4. Other Post Employment Benefit costs have increased in the last 2 years.
5. The CalPERS statewide ratio of employees to retirees has fallen from:
    - 2001: 2.04 to 1
    - 2012: 1.45 to 1
    - 2037: 0.6 to 1 (projected).[1]
6. The employee to retiree ratio in the six public agencies in Santa Cruz County is falling (more retirees compared to employees).
7. Employer contribution rates for the jurisdictions range between 6.25% to 36.6%. Generally, police and fire plans have the highest contribution levels because of the early retirement of safety employees. CalPERS reports that agencies throughout California with contribution levels over 40% are putting a strain on local budgets.[1]
8. The total paid retirement cost has increased in the last two years for every agency except the Soquel Creek Water District.

Findings

F1. Continually rising retirement costs and obligations put funding of jurisdictions' services and projects at risk.

Response from the Santa Cruz County Board of Supervisors:

DISAGREE - 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.

<u>PEPRA-Related Savings:</u>

- <u>Pensionable Compensation Cap</u>. 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.
- <u>Increased Employee Contributions/Employee "Pick Up" of Employer Contributions</u>. 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-asyou-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.

Response from the Capitola City Council:

PARTIALLY DISAGREE - As with any projected expenditure increase, the City agrees that rising pension costs will either have to be offset with future revenue increases or reductions in services or projects.

The City partially disagrees with the finding as the City has taken a number of proactive steps to address this issue. For example this fiscal year the City established a PERS Contingency Fund. The Fund was set up to help stabilize the City's finances and to help manage future increases in PERS contributions.

In addition, current long-term projections show the City with a balanced budget position in future years, due to current fiscal policies, increased revenue, and the payoff of Pension Obligation Bonds. However, given the potential for an economic downturn or other revenue contractions, these projections must be consistency analyzed and monitored and City services levels evaluated in the face of changing economic conditions.

Response from the Santa Cruz City Council:

AGREE

Response from the Scotts Valley City Council:

PARTIALLY DISAGREE - Rising retirement costs do put pressure on the budget, but it is not the only factor. Personnel costs in general are 80% of the City's General Fund budget. Retirement costs are a part (13%) of that overall cost. The City needs to stay competitive with salaries to keep qualified employees. Salaries are a much larger part of the budget at 42%.

The economy is another large factor to having the resources to provide services. The City has endured two economic downturns in the last 10 years. These were prior to the latest increase in retirement costs. The City needed to take measures during those time periods to maintain its budget. The City will continue to take necessary steps in the future due to any factors affecting its budget.

Response from the Watsonville City Council:

AGREE - The City recognizes the risk rising costs of retirement obligations in the short term and in the long term. Budget and Financial presentations made as part of Public Hearings to the City Council each budget year have emphasized this issue as one which needs addressing and planning into the future. Examples of these presentations can be found in the City's website.

- February 10, 2015, Audited Statements Financial Presentation to City Council (see pages 11 and 12 of this document). In addition, the full audited financial report was provided to the City Council as part of that public hearing. The financial audit contains information related to the unfunded liability and its status on pages 82 through 84. The document was also made available to the public

for review. [accessable 9/15/015]
http://cityofwatsonville.org/download/City_Council/City_Council_Documents/2015/021015/Item%206.2a%20Mid%20Year%202014-15%20Budget%20Report.pdf

- May 26, 2015, Budget Study Session Presented to City Council (refer to pages 7 and 8 of the report). The report highlights the challenge to continue funding continually rising retirement costs and obligations in the current year and future years. [accessable 9/15/015]
http://cityofwatsonville.org/download/City_Council/City_Council_Documents/2015/052615/Item%208.3%20Proposed%20Budget%202015-16%20&%202016-17%20Report.pdf

- June 9, 2015, Budget Public Hearing conducted by the City Council (refer to pages 9 and 10 of the report). The report highlights the challenge to continue funding continually rising retirement costs and obligations in the current year and future years. [accessable 9/15/015]
http://cityofwatsonville.org/download/City_Council/City_Council_Documents/2015/060915/Item%206.2a%20Budget%20Summary%20Report.pdf

Response from the Board of Directors, Soquel Creek Water District:

PARTIALLY DISAGREE - The Soquel Creek Water District's total Unfunded Liability (UL) for pension and OPEB as of June 30, 2013 was $9 million. Required employer contributions are estimated at $682,000 for the 2015/16 fiscal year and projected to rise over four more years before flattening out. If the District pays according to CalPERS amortization schedule, the pension UL costs would total $14.9 million over 30 years.

This is the first year that small employers in the mandated CalPERS risk pools have the ability to effectively manage their pension liabilities. The Fiscal Year 2015/16 Budget adopted by the Board on June 16, 2015 includes funding for accelerated payment of the UL. The smaller liability associated with the Second Tier plan will be paid off and the District intends to pay down the liability for the First Tier plan in ten years instead of thirty in order to achieve significant long term savings.

Retirement costs certainly contribute to the District's financial pressures. However, as noted in the 2015 Ten-Year Finance Plan (Attachment 1), the District faces financial challenges on a number of fronts that combined, put significant upward pressure on future water rates. Future anticipated projects and costs include:

- $80 million (in escalated $) to develop a supplemental water supply project. New and ongoing annual maintenance costs to operate the project once it's placed into service are estimated to be $1.3 million starting in 2022/23.
- $70 million (in escalated $) of water system capital needs in the current and next ten years, along with $1 million to $2 million each year for capital outlay, studies, and planning efforts.
- The District will be required to issue additional debt, which will increase debt service payments, in order to fund the supplemental supply project.

- $875,000 for Conservation Program expenses in 2015/16 increasing annually to $1.3 Million in 2024/25 depending upon the degree of implementation.
- $350,000 starting in 2017/18 in ongoing annual operational costs for hexavalent chromium treatment.

The District is currently operating in an environment of declining water sales and will need to raise rates to meet its financial obligations and ensure long term financial stability. Retirement costs must be acknowledged and properly managed but are not the District's sole source of financial pressure. To state that these costs alone put services and projects at risk is not a fair and accurate assessment of the District's overall financial outlook.

F2. 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.

Response from the Santa Cruz County Board of Supervisors:

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.

Response from the Capitola City Council:

AGREE - The City agrees with this finding. The City believes we have previously included detail of pension costs in several different areas of the budget but the City agrees that having the information in one section would improve the transparency of the City's Budget. A new chart showing the total retirement costs, along with funding ratios and funded status will be included in the Final Fiscal Year 2015-16 Budget and all future budget documents.

Response from the Santa Cruz City Council:

PARTIALLY DISAGREE - Already contained in the May 12, 2015 Proposed Fiscal Year 2015 Budget was a description of the total unfunded retiree obligations (see the Finance Director's Overview within the Budget in Brief summary, attached). This discussion portrayed the total obligations as compared to funding levels and detailed the benefit levels provided for retiree health.

An additional financial schedule was added to the Adopted (final) Fiscal Year 2015 Budget that provides the details of the total annual costs and total obligation for retiree obligations.

Response from the Scotts Valley City Council:

AGREE - The City does provide more information in its annual financial statements as required disclosures directed by the Governmental Accounting Standards Board. The budget provides budgeted line items for each department, but also provides a General Fund recap of total amounts for each budget line item, including retirement.

The budget is primarily a document for that fiscal year's budgeted revenues and expenditures, but information regarding future costs could be incorporated into the narratives.

Response from the Watsonville City Council:

PARTIALLY DISAGREE - Budget and Financial presentations made as part of Public Hearings to the City Council each budget year have emphasized this issue as one which needs addressing and planning into the future. Examples of these presentations can be found in the City's website.

- February 10, 2015, Audited Statements Financial Presentation to City Council (see pages 11 and 12 of this document). In addition, the full audited financial report was provided to the City Council as part of that public hearing. The financial audit contains information related to the unfunded liability and its status on pages 82 through 84. The document was also made available to the public for review. [accessable 9/15/015] http://cityofwatsonville.org/download/City_Council/City_Council_Documents/2015/021015/Item%206.2a%20Mid%20Year%202014-15%20Budget%20Report.pdf
- May 26, 2015, Budget Study Session Presented to City Council (refer to pages 7 and 8 of the report). The report highlights the challenge to continue funding continually rising retirement costs and obligations in the current year and future years. [accessable 9/15/015] http://cityofwatsonville.org/download/City_Council/City_Council_Documents/2015/052615/Item%208.3%20Proposed%20Budget%202015-16%20&%202016-17%20Report.pdf
- June 9, 2015, Budget Public Hearing conducted by the City Council (refer to pages 9 and 10 of the report). The report highlights the challenge to continue funding continually rising retirement costs and obligations in the current year and future years. [accessable 9/15/015] http://cityofwatsonville.org/download/City_Council/City_Council_Documents/2015/060915/Item%206.2a%20Budget%20Summary%20Report.pdf

The City will enhance what is already being presented to make a more complete statement about the retirement costs and obligations of the City.

Response from the Board of Directors, Soquel Creek Water District:

PARTIALLY DISAGREE - At the April 21, 2015 regular meeting of the Board of Directors, Staff presented an informational report on California Public Employees' Retirement System (CalPERS) Risk Pool Changes (Attachment 2). The report provided an overview of the District's retirement benefits under its contract with CalPERS and information regarding revisions to the risk pool that affect benefits costs. A clear and complete statement of pension retirement costs and obligations was presented. The report was intended to serve as a resource for the discussion and development of funding strategies during May's budget discussions. Staff released the information ahead of the budget discussions to allow time for the

Board (and public) to digest the information and formulate questions.

The 2015-16 Budget contains information regarding OPEB expenses but does not address the unfunded liability.

More complete information regarding retirement costs and obligations (pensions and retiree health or OPEB) is appropriately located in the District's annual audited financial statements.

F3. 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.

Response from the Santa Cruz County Board of Supervisors:

PARTIALLY DISAGREE - Enrollment in the California Employers' Retiree Benefit Trust (CERBT), or any Other PostEmployment 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 ("PayGo") 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 longterm 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.

Response from the Santa Cruz City Council:

PARTIALLY DISAGREE - We agree that enrollment in Retiree Benefit Trust Funds is a valuable and essential tool for government agencies to dedicate general funding for the restricted purpose of offsetting future retiree liabilities. However, there are other options than CalPERS that can have lower entry and maintenance Costs.

Regarding lowering employer contributions, the City would not see a reduction in employer contributions to CalPERS but rather would contribute additional general purpose funding towards unfunded obligations.

Finally, without a significant funding strategy, a Trust will have a marginal impact to mitigate future liabilities or enhance the City's credit rating.

Response from the Scotts Valley City Council:

PARTIALLY DISAGREE - Enrollment is only part of the solution. There are no mandatory contributions for this Trust Fund. Contributions can be made as the City wants or has the resources to do so. Having sufficient funds to invest in the Trust Fund is the main issue. This relates back to Finding #1 above regarding budget impacts on the City and having sufficient funds to meet the various competing needs in the budget.

Employer contributions are reduced through investment earnings from City funds invested in the Trust Fund. Without sufficient resources to invest, any meaningful reduction in employer contributions will not happen. The same holds true for preventing the retiree health obligations from becoming a significant budget liability and contributing to a positive credit rating.

Response from the Watsonville City Council:

PARTIALLY DISAGREE - The California Employers' Benefit Trust (CERBT) Fund is a Section 115 trust fund dedicated to refunding Other Post Employment Benefits (OPEB) for all eligible California public agencies. While the City of Watsonville has reported a net OPEB obligation of $4.5 million for fiscal year ending 06/30/2014; this liability will be significantly reduced in FY 2014-15 and future years due to changes made by the City to its health plan and how it segregates the costs and premiums associated with retirees.

The City offers employees who have retired from service the option to continue receiving health care benefits at their own cost until age sixty-five. For the retiree to be fully eligible to participate in the plan offered by the City of Watsonville, the employee must be at least 50 years of age and have at least five years of service. Retirees pay for their benefit at 105% of the active per-capita health costs, as reset by the administrator every January 1st. In the past the City self-funded this plan by paying for the actual costs of claims received under the plan. Effective July 1, 2013; the City migrated to a pooled plan which limits the liability to the City to the monthly premium paid for each participating member of the City's plan. This limits the current and future year obligations of the City for active employees and helps more closely align the cost paid for health care costs for retirees each fiscal year and their employee paid premiums. This shift will result in a significant reduction in the OPEB liability.

Recommendations

R1. 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. (F1)

Response from the Santa Cruz County Board of Supervisors:

HAS BEEN IMPLEMENTED - 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.

Response from the Capitola City Council:

REQUIRES FURTHER ANALYSIS - The City of Capitola has been proactive in addressing retirement obligations. The City issued a Pension Obligation Bond in 2007 to pay off the CalPERS side fund that CalPERS established in 2003. The POB allowed the City to reduce the interest rate charged on the side fund from 7.75 percent that CalPERS charges to 6.01 percent.

The City also implemented a cap on the City's contribution to CalPERS. The cap required that employees pay all pension costs above the cap. The City was one of very few jurisdictions in the state with essentially fixed pension costs as a percentage of payroll. The cap allowed for a predictable expenditure stream into future years.

In 2012, the City also implemented a Tier II retirement plan for new hires that required an additional five percent employee contribution towards retirement.

Unfortunately the recent changes in the CalPERS risk pooling formulas have had a significant negative impact on the City. In fact, the scale of the impact effectively made the City's cap on employer CalPERS contributions unsustainable, as it would have required employees to contribute more than 25 percent of their salary toward pension costs in coming years.

The amended employee agreements establish increasing employee retirement contributions rates, projected to be over 15 percent for safety and over 14 percent for miscellaneous upon the end of the term of the existing contracts. The City believes these employee contribution rates are among the highest in the State.

To address the larger actuarial unfunded pension liability requires further analysis. There are several possibilities the City will evaluate in Fiscal Year 2015/16. Some of the possibilities include increased payments to CalPERS to reduce the Unfunded Liability and become fully funded in fewer years, a Pension Obligation Bond to reduce, and lock in, interest rates, and a new idea to set up an irrevocable trust fund for future CalPERS payments.

Lastly, CalPERS continues to examine their long term funding challenges. The City will follow these potential changes closely, and should changes occur, develop plans to address the impacts as quickly as possible.

Response from the Santa Cruz City Council:

PARTIALLY DISAGREE - The City continues with a long-term strategy to increase its efforts to manage and reduce retirement costs and has made some efforts in highlighting those efforts. A summary of the major efforts include:

1) Permanent reduction in across-the-board compensation to all employees of at least 10% which reduced the escalation of future retirement liabilities.
2) Established a cap on Other Post-Employment Benefits (OPEB) such that there is a maximum hard-dollar cost and that retirees become ineligible upon reaching Medicare eligibility age (currently 65).

3) Issued Pension Obligation Bonds that will be paid off in 2022. They immediately reduced the City's interest costs on this Pension debt from the then 7.75% rate. Current estimated, annual savings are $190,000, based on the recently lowered 7.50% PERS discount rate.

4) In advance of statewide reform (PEPRA), proactively implemented a second tier, lower benefited pension system for all newly hired employees. For public safety employees, the plan became effective September 2011 and for all other employees, March 2012. Unlike PEPRA, that became effective June 2013, the City's second tier does not exempt any new hires from the lower benefited plan (PEPRA allows new hires from other CalPERS or similar systems to start with the original, higher cost retirement system).

5) Established in June 2013 a $2.1 million future obligation reserve to be converted into allocations for future liabilities, including establishment of a material retiree benefit trust to pre-fund future pension liabilities.

6) Implemented an annual process such that when it is financial advantageous the City makes a lump-sum prepayment to CalPERS to lower retirement costs.

7) Continued to obtain larger cost sharing by employees of their CalPERS retirement costs.

8) Continued through recent negotiations to restrict any proposals that would directly grow employee future retirement costs.

The elements of this strategy, individually and on the aggregate have been discussed in public, at City Council meetings when Council action was taken to adopt them.

Response from the Scotts Valley City Council:

HAS BEEN IMPLEMENTED - As discussed above in Finding 1, retirement costs are not the only factor in the budget. Competitive salaries and the economy also play a part in the development of a balanced budget. Most recently, the City did have an agenda item on its August 5 Council meeting to discuss the City's structural deficit in general. The City plans to have further meetings on this subject in the future. Further back, the City has discussed the actions it has taken to manage the City's budget during its budget discussion Council meetings.

Response from the Watsonville City Council:

HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - The City recognizes the risk rising costs of retirement obligations in the short term and in the long term. Accordingly, the City has presented this information in public meetings in various occasions each year. Examples of these presentations can be found in the City's website.

- February 10, 2015, Audited Statements Financial Presentation to City Council (see pages 11 and 12 of this document). In addition, the full audited financial report was provided to the City Council as part of that public hearing. The financial audit contains information related to the unfunded liability and its status on pages 82 through 84. The document was also made available to the public for review. [accessable 9/15/015] http://cityofwatsonville.org/download/City_Council/City_Council_Documents/2015/021015/Item%206.2a%20Mid%20Year%202014-15%20Budget%20Report.pdf

- May 26, 2015, Budget Study Session Presented to City Council (refer to pages 7 and 8 of the report). The report highlights the challenge to continue funding continually rising retirement costs and obligations in the current year and future years. [accessable 9/15/015] http://cityofwatsonville.org/download/City_Council/City_Council_Documents/2015/052615/Item%208.3%20Proposed%20Budget%202015-16%20&%202016-17%20Report.pdf
- June 9, 2015, Budget Public Hearing conducted by the City Council (refer to pages 9 and 10 of the report). The report highlights the challenge to continue funding continually rising retirement costs and obligations in the current year and future years. [accessable 9/15/015] http://cityofwatsonville.org/download/City_Council/City_Council_Documents/2015/060915/Item%206.2a%20Budget%20Summary%20Report.pdf

The City will enhance what is already being presented to make a more complete statement about the retirement costs and obligations of the City. This enhanced reporting will be available with the publication of the FY 2015-16 budget document.

Response from the Board of Directors, Soquel Creek Water District:

HAS BEEN IMPLEMENTED - The Soquel Creek Water District has a history of proactively managing, to the extent possible, its retirement costs and obligations. Actions taken to date include:

Retirement

- 2005: Negotiated a contract change to discontinue certain benefits to newly hired employees
- 2011: Paid off, eight years ahead of schedule, the CalPERS side fund which was accruing interest at 7.75%
- 2013: Negotiated a contract change to discontinue the Employer Payment of Member Contributions (EPMC)
- 2015: Adopted the Fiscal Year 2015-16 Budget which includes funding to pay off the unfunded liability for the Second Tier plan and to make a payment in excess of what is owed on the First Tier plan with the intention of paying down the unfunded liability in ten years instead of thirty years in order to achieve significant long term savings

Other Post Retirement Benefits (OPEB)

- 2011: Enrolled in the CalPERS Employers Retiree Benefit Trust Fund (CERBT) and began pre-funding retiree health benefits

- 2013: Negotiated a contract change whereby certain eligible retirees pay 10% of the health premium until they are eligible for Medicare. The District pays 100% of the Supplemental Medicare Premium
- 2013: Negotiated a contract change lengthening the number of years of District service AND the age requirement necessary to earn full retirement health benefits

District staff will continue to monitor retirement costs and obligations on an on-going basis and seek ways in which to achieve savings and minimize the impact on District finances.

R2. 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. (F2)

Response from the Santa Cruz County Board of Supervisors:

WILL NOT BE IMPLEMENTED - 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.

Response from the Capitola City Council:

HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - This recommendation will be included in the Final Fiscal Year 2015/16 Budget Document. The City agrees that the City's Budget document should provide readers with the totality of the retirement obligations. The City will include the below chart [see their response] in its Final Fiscal Year 2015/1[6] Budget Document:

Response from the Santa Cruz City Council:

HAS BEEN IMPLEMENTED - Please see the response to Finding 2.

In addition, we have historically included similar schedules detailing total retiree obligations, including a description of the benefit levels, in our audited, Comprehensive Annual Financial Report (CAFR) (attached).

Response from the Scotts Valley City Council:

HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - The budget document for the 2015-16 fiscal year had already been prepared by the time this Grand Jury report was received by the City. More information will be provided in next year's budget document.

The City does provide information on its retirement plan and retiree medical plan in its annual financial statements. The annual financial statements are normally available in December after the June 30 fiscal year end date. The information provided is according to the disclosure requirements of the Governmental Accounting Standards Board.

Response from the Watsonville City Council:

HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - The City will enhance what is already being presented to make a more complete statement about the retirement costs and obligations of the City. This enhanced reporting will be available with the publication of the FY 2015-16 budget document.

Response from the Board of Directors, Soquel Creek Water District:

HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - The District will include expanded language regarding retirement obligations in the annual budget narratives beginning with the Fiscal Year 2016-17 Budget. Additionally, the April 21, 2015 financial report on pensions (referenced above in Finding 2) will be posted as a supplementary budget document to the District's website in the Transparency Center under Finance and Budgets. Staff will add information regarding the funded status of the plans to the report and make the document available on the website no later than July 30, 2015. The report will be updated annually.

As noted in the Grand Jury report, the District pre-funds Other Post-Employment Benefits (OPEB) through the California Employers' Retiree Benefit Trust Program (CERBT). All plan participants are required to perform an actuarial valuation every two years. The District's last actuarial report is as of June 30, 2013 and Staff has arranged for actuarial work to begin this summer. Once the study is complete; sometime in October, the results will be presented to the Board at a regularly scheduled public meeting. Staff will utilize the information in the 2015 actuarial report to develop a comprehensive OPEB report similar to the one on pensions that will also be updated annually and posted to the District's website as a supplementary Budget document.

R3. 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. (F3)

Response from the Santa Cruz County Board of Supervisors:

HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - 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.

Response from the Santa Cruz City Council:

HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - As a continuation of the development of our $2.1 million unfunded obligations reserve, we will be building into our FY2017 budget development (1) a funding mechanism to build our reserve; (2) the establishment of a Retiree Trust with a provider yet to be determined (as stated in response to Finding #3, there are providers other than CalPERS to be considered); and (3) the process by which contributions are made to the Trust.

Response from the Scotts Valley City Council:

HAS NOT BEEN IMPLEMENTED BUT WILL BE IMPLEMENTED IN THE FUTURE - At the City Council's August 5, 2015, meeting, Council decided that the City should set aside reserves for retiree medical obligations. The City will enroll in the CalPERS Trust Fund by the end of the calendar year and will fund it in accordance with direction from Council.

Response from the Watsonville City Council:

WILL NOT BE IMPLEMENTED - The California Employers' Benefit Trust (CERBT) Fund is a Section 115 trust fund dedicated to prefunding Other Post-Employment Benefits (OPEB) for all eligible California public agencies. While the City of Watsonville has reported a net OPEB obligation of $4.5 million for fiscal year ending 06/30/2014; this liability will be significantly reduced in FY 2014-15 and future years due to changes made by the City to its health plan and how it segregates the costs and premiums associated with retirees.

The City offers employees who have retired from service the option to continue receiving health care benefits at their own cost until age sixty-five. For the retiree to be fully eligible to participate in the plan offered by the City of Watsonville, the employee must be at least 50 years of age and have at least five years of service. Retirees pay for their benefit at 105% of the active per-capita health costs, as reset by the administrator every January 1st. In the past the City self-funded this plan by paying for the actual costs of claims received under the plan. Effective July 1, 2013; the City migrated to a pooled plan which limits the liability to the City to the monthly premium paid for each participating member of the City's plan. This limits the current and future year obligations of the City for active employees and helps more closely align the cost paid for health care costs for retirees each fiscal year and their employee paid premiums. This shift will result in a significant reduction in the OPEB liability.

Responses Required

Respondent	***Findings***	***Recommendations***	***Respond Within/ Respond By***
Capitola City Council	F1, F2	R1, R2	90 Days 9/10/2015
Santa Cruz City Council	F1, F2, F3	R1, R2, R3	90 Days 9/10/2015
Scotts Valley City Council	F1, F2, F3	R1, R2, R3	90 Days 9/10/2015
Watsonville City Council	F1, F2, F3	R1, R2, R3	90 Days 9/10/2015
County of Santa Cruz Board of Supervisors	F1, F2, F3	R1, R2, R3	90 Days 9/10/2015
Soquel Creek Water District Board of Directors	F1, F2	R1, R2	90 Days 9/10/2015

Definitions

- **Actuary**: A professional who analyzes the financial consequences of risk.
- **ARC**: *Annual Required Contribution* - The annual required contribution is the amount the employer is required to contribute to a defined benefit pension fund, based on an actuarial formula, to fund current and future retirement benefits and liabilities. The ARC is determined by multiplying the employer contribution rate by the payroll reported to CalPERS. If this contribution is fully prepaid in a lump sum, then the dollar value of the ARC is equal to the lump sum prepayment. It is the amount needed to payout the benefits of future retirees.
- **AVA**: *Actuarial Value of Assets* - The value of a pension plan investments and other property. AVA is used by the actuary for the purpose of an actuarial valuation (sometimes referred to as valuation assets). Actuaries often select an asset valuation method that smoothes the effects of short-term volatility in the market value of assets.
- **Bargaining Units**: Local groups designated to represent the individuals (fire, police, miscellaneous employees, etc.) to negotiate with the local governing body regarding wages and benefits.
- **CalPERS**: *California Public Employees Retirement System -* The State agency responsible for managing public agency retirement funds through contracts with local agencies.
- **CAFR**: *Comprehensive Annual Financial Report* - A CAFR is a set of U.S. government financial statements comprising the financial report of a public agency that complies with the accounting requirements promulgated by the Governmental Accounting Standards Board (GASB) and is required by the State of California (Government Code 12460). GASB provides standards for the content of a CAFR in its annually updated publication, *Codification of Governmental Accounting and Financial Reporting Standards.* A CAFR is compiled by public agency staff and audited by an external American Institute of Certified Public Accountant (AICPA) certified accounting firm utilizing GASB requirements.
- **Classic member**: A member of CalPERS hired prior to January 1, 2013.
- **Employer Normal Cost**: Employer normal costs are the total benefits and expenses that have accrued during the year and are expected to accrue annually.
- **Funded Status**: The funded status is the ratio of assets to a plan's accrued liabilities. A ratio of over 100% means the plan or risk pool has more assets than liabilities. A ratio less than 100% means liabilities are greater than assets. A funded ratio based on the Actuarial Value of Assets (AVA) indicates the progress toward fully funding the plan using the actuarial cost methods and assumptions. A funded ratio based on the Market Value of Assets (MVA) indicates the short-term solvency of the plan.
- **Hiring Tiers:** Tiers created for new employees with associated benefits.
- **Miscellaneous Employees:** Miscellaneous employees are employees of a public agency other than fire, police or sheriff.
- **MVA**: *Market Value of Assets* - Market value of assets is the price of an asset in the current market.

- **OPEB**: *Other Post Employment Benefits* - Other post employment benefits are benefits that an employee will begin to receive at the start of retirement other than pension wages. Other post employment benefits that a retiree can be compensated for are life insurance premiums, health care premiums and death benefits.
- **PARS**: *Public Agency Retirement System* - PARS is a defined retirement system covering part-time, temporary or seasonal employees and all employees not covered by another retirement plan. The plan is sponsored and paid for by employees and employer contributions.
- **PEPRA**: *Public Employees' Pension Reform Act of 2013 -* California Pension reform legislation which became effective January 1, 2013.
- **PERF**: *Public Employees' Retirement Fund -* PERF is the account established for retirement benefits of members administered by the California Public Employees Retirement System.
- **PERL**: *Public Employment Retirement Law -* PERL is the California State regulation governing public pensions or retirement systems.
- **Plans**: Groups of CalPERS active members (Safety, Police, Miscellaneous, PEPRA, etc.) which CalPERS establishes actuarial reports and determines local contribution rates.
- **Retirement Obligations**: Retirement obligations include pensions, retiree health care costs, pension obligation bonds, Social Security costs, unfunded liability for pension and unfunded liability for retiree health care (OPEB).
- **Risk Pool**: Risk pooling is the process of combining assets and liabilities across employers to produce large risk sharing pools. Such risk sharing pools dramatically reduce or eliminate the large fluctuations in an employer's retirement contribution rate caused by unexpected demographic events. Participation in risk pools is mandated for all rate plans with less than 100 active members on any valuation date.
- **Side Fund**: Loans that public agencies initiate to cover the difference between CalPERS assets and liabilities. These loans are in addition to the normal or annual required contribution.
- **Smoothing**: A statistical technique for removal of short term irregularities in order to improve the value of the financial forecast.
- **Totality of retirement costs**: Includes the pension, other post employment benefits, social security, pension obligation bonds, Public Agency Retirement System (PARS), unfunded pension liabilities and unfunded other post employment benefit liabilities.
- **UAL**: *Unfunded Accrued Liabilities -* When a plan or pool's actuarial value of assets is less than its accrued liability, the difference is the plan or pool's unfunded liability. If the unfunded liability is positive, the plan or pool will have to pay contributions exceeding the normal cost.
- **UAAL**: *Unfunded Actuarial Accrued Liabilities* - The unfunded actuarial accrued liability is the difference between accrued liabilities and the value of assets accumulated to finance an obligation.

Sources

References

1. CalPERS. 2014. "Annual Review of Funding Levels and Risks, November 18, 2014." Accessed 1/13/15. http://www.calpers.ca.gov/eip-docs/about/pubs/employer/2014-report.pdf.

2. CalPERS. 2014. "Summary of Public Employees' Pension Reform Act and Related Changes to the Public Employees' Retirement Law" Accessed 3/3/15. http://www.calpers.ca.gov/eip-docs/employer/program-services/summary-pension-act.pdfl.

3. Nation, Joe, *"Unfunded Pension and Retiree Health Care Liabilities in Santa Cruz County."* 10/15/12.

4. CalPERS. 2015. "Facts at a Glance, March 2015." Accessed 3/7/15. http://www.calpers.ca.gov/eip-docs/about/facts/calpers-at-a-glance.pdf.

5. CalPERS. 2014. "City of Santa Cruz Annual Valuation Reports as of June 30, 2013" Accessed 12/2/14. http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=2&q=santa-cruz-city.

6. CalPERS. 2014. "Comprehensive Annual Financial Report, Fiscal Year ended June 30, 2014." Accessed 12/15/14. http://www.calpers.ca.gov/eip-docs/about/pubs/cafr-2014.pdf.

7. CalPERS. August 31, 2012. "Actuarial Cost Analysis, California Public Employees' Pension Reform Act of 2013" Accessed 1/23/15 http://www.calpers.ca.gov/eip-docs/about/pubs/cost-analysis.pdf.

8. CalPERS. 2013. "CalPERS Board Approves New Actuarial Policies" Accessed 3/24/1515. http://www.calpers.ca.gov/index.jsp?bc=/about/newsroom/news/2013/actuarial-policies.xml.

9. CalPERS. 2013. "GASB 45 & California Employers' Retiree Benefit Trust Fund" Accessed 3/14/15. https://www.calpers.ca.gov/index.jsp?bc=/employer/retiree-ben-trust/overview.xml

10. American Academy of Actuaries. 2012. *"The 80% Pension Funding Standard Myth"* http://www.actuary.org/files/80_Percent_Funding_IB_071912.pdf.

11. Santa Clara County Grand Jury Report 2011-2012. 2012. “An Analysis of Pension and Other Post Employment Benefits." Accessed 12/12/14. http://www.scscourt.org/court_divisions/civil/cgj/2012/pension.pdf.

12. City of Capitola. 2014. “2014-15 Adopted Budget” Accessed 1/7/15. http://www.cityofcapitola.org/sites/default/files/fileattachments/Finance/page/2415/adopted_budget_fy_14-15_reduced_size_090814.pdf.

13. City of Santa Cruz. 2014. “FY 2015 Adopted Budget." Accessed 1/8/15. http://www.cityofsantacruz.com/departments/finance/city-budget/fiscal-year-2015-budget.

14. City of Scotts Valley. 2014. “2014/2015 Preliminary Budget." Accessed 1/8/15. http://www.scottsvalley.org/downloads/finance/PrelimBgt14-15.Section1.pdf.

15. City of Watsonville. 2014. “Final Revised Biennial Budget FY 2014-15." Accessed 12/15/14. http://cityofwatsonville.org/download/Finance/city_of_watsonville_budget/budget_fy_13-15/revised%20budget%20master%2014_15%20(1)(2).pdf.

16. County of Santa Cruz. 2014. “Adopted Budget 2014-2015." Accessed 1/10/15. http://sccounty01.co.santa-cruz.ca.us/AuditorBudget/2014-2015/County_Budget_Table_of_Contents.pdf.

17. Soquel Creek Water District. 2014. “2014-15 Budget." Accessed 1/24/15. http://www.soquelcreekwater.org/sites/default/files/documents/Reports/financial/BUDGET%202014-15_FINAL.pdf.

18. Government Finance Officers Association. 2014. “GASB Moves toward Major Changes in Accounting for OPEB” Accessed 4/1/15. http://www.gfoa.org/sites/default/files/GFROct1454_0.pdf.

19. CalPERS. 2014. “City of Capitola Annual Valuation Reports as of June 30, 2013” Accessed 2/15/15. http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=2&q=capitola-city.

20. CalPERS. 2014. “City of Scotts Valley Annual Valuation Reports as of June 30, 2013” Accessed 12/14/14. http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=2&q=scotts-valley-city.

21. CalPERS. 2014. “City of Watsonville Annual Valuation Reports as of June 30, 2013” Accessed 12/14/14. http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=2&q=watsonville-city.

22. CalPERS. 2014. “County of Santa Cruz Annual Valuation Reports as of June 30, 2013” Accessed 4/1/15. http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=1&q=santa-cruz-county.

23. CalPERS. 2014. “Soquel Creek Water District Annual Valuation Reports as of 6/30/13” Accessed 4/1/15. http://www.calpers.ca.gov/index.jsp?bc=/about/forms-pubs/calpers-reports/actuarial-reports/browse-results.xml&strCatId=3&q=soquel-creek-water-district.

24. Florida Public Pension Trustees Association. 2011. “Understanding Public Pension Plans Unfunded Liability” Accessed 6/04/15. http://www.houstontx.gov/finance/11_07_2011_FPPTA_%20UAL_%20Report.pdf

25. City of Capitola. 2014. “Comprehensive Annual Financial Report 2014” Accessed 3/15/15. http://www.cityofcapitola.org/sites/default/files/fileattachments/Finance/page/2416/city_of_capitola_2014_cafr.pdf.

26. City of Santa Cruz. 2014. “Comprehensive Annual Financial Report 2014” Accessed 3/15/15. http://www.cityofsantacruz.com/home/showdocument?id=41833.

27. City of Scotts Valley. 2014. “Comprehensive Annual Financial Report 2014” Accessed 3/15/15. http://www.scottsvalley.org/downloads/finance/CAFR2014Intro.pdf.

28. City of Watsonville. 2014. “Comprehensive Annual Financial Report 2014” Accessed 3/15/15. http://cityofwatsonville.org/download/Finance/Comprehensive_Financial_Reports/CAFR%20FY%202013-2014.pdf.

29. County of Santa Cruz. 2014. “Comprehensive Annual Financial Report 2014” Accessed 10/31/14. http://www.co.santa-cruz.ca.us/Portals/0/County/auditor/cafr14/CAFR_2014.pdf.

30. Soquel Creek Water District. 2014. “Annual Financial Report 2013-2014” Accessed 3/15/15. http://www.soquelcreekwater.org/sites/default/files/images/SQCWD%20Financial%20Statements%202014.pdf.

Appendix A

Brief Summary of PEPRA

PEPRA defines a new member as:

1. A new hire who is brought into CalPERS membership for the first time on or after January 1, 2013 and has no other membership in any other California public retirement system, or
2. A new hire who is brought into CalPERS membership for the first time on or after January 1, 2013 and who is not eligible for reciprocity with another California public retirement system, or
3. A member who established CalPERS membership prior to January 1, 2013 and who is hired by a different CalPERS employer after January 1, 2013 after a break in service of greater than six months. [Section 7522.04 (F) of Public Employees' Retirement Law].

The final compensation used to calculate the benefits paid to a new member is defined as the highest average annual pensionable compensation earned over the last 36 consecutive months prior to retirement. What is “pensionable compensation”?

> *"The normal monthly rate of pay or base pay for services rendered pursuant to publicly available pay schedules" (Section 7522.34 of CalPERS Public Employees' Retirement Law).*

PEPRA caps the annual salary that can be used to calculate final compensation for all new employees (except judges) at $113,700.00 for employees that participate in Social Security or $136,440.00 (120% of the 2013 contribution and benefit base) for those employees that do not participate in Social Security. Adjustments to the caps are permitted annually based on changes to the Consumer Price Index (CPI) for All Urban Consumers.

PEPRA has reduced benefit formulas and increased retirement ages:

1. Non-safety members have a new defined benefit formula of 2% at age 62 with an early retirement age of 52 and a maximum benefit factor of 2.5% at age 67.
2. Safety members have new defined benefit formulas consisting of the normal retirement formula of 2% at age 50 and a maximum benefit factor of 2.7% at age 57 (Section 20516 CalPERS Public Employees' Retirement Law).

PEPRA applies to most public agencies and State employee retirement systems in California whether the plan is a defined benefit plan, a contribution plan governed by Section 401 of the Internal Revenue code, or a tax sheltered annuity 403 (B) plan.

PEPRA permits public agencies and school employers to agree to share the cost of the employer contribution rate with or without a change in benefits to employees. However, by January 1, 2018 the employee contribution rate may only be increased up to 8% for miscellaneous members, a 12% contribution rate for local police officers, local firefighters and county peace officers, or an 11% contribution rate for all other local safety members.

PEPRA excludes certain types of pay from being reported as pensionable compensation; including bonuses,overtime outside normal working hours, cash payouts for unused leave(vacations, annual sick leave and severance pay.)

PEPRA prohibits purchase of additional retirement service credit, known as "air time" (Section 7522.46 of CALPERS Public Employees' Retirement Law).

Public officials forfeit their pensions if they are convicted of a felony in carrying out their elected official duties (Section 7522.72 and 7522.74 of CalPERS Public Employees' Retirement Law).

PEPRA also requires a 180 day waiting period before any retiree can return to work for a CalPERS employer without reinstatement from retirement. This does not generally apply to public safety officers or firefighters (Section 7522.56 of CalPERS Public Employees' Retirement Law).

Because PEPRA effectively closed all active risk pools to new employees, as such it is no longer appropriate to assume that the payroll of the risk pools for the classic formulas will continue to grow at 3% annually. Funding the promised pension benefits as a percentage of payroll would lead to the underfunding of the plans. In addition the current

allocation of the existing unfunded liabilities based on payroll would create equity issues for employers within the risk pools. Furthermore the declining payroll of the classic formula risk pools will lead to unacceptable levels of employer rate volatility.

In order to address these issues CalPERS approved changes to the risk pools in May 2014. All pools plans will be combined into two pools, miscellaneous and safety, effective with the 2013 valuations. In additions, two important changes are also being made which will affect employers:

1. CalPERS will collect employer contributions toward unfunded liability and side fund as dollar amounts instead of the prior method of a contribution rate, beginning with FY 2015/16. This change will address the funding issue that would still arise from the declining population of classic formula members. Although members' employers will be invoiced at the beginning of the fiscal year for their unfunded liability and side fund payments the plan's normal cost contribution will continue to be collected as a percentage of payroll.
2. The pools' unfunded liability will be allocated to each individual plan based on the plan's total liability rather than by plan individual payroll. This will allow employers to track their own unfunded liability and pay it down faster if they choose. The change in the allocation of unfunded liabilities will result in some employers paying more towards their unfunded liability and some paying less.[2]

Appendix B

Summary of Fund Status of Misc. Retirement Plans from FY 2010 to 2013

Market Value of Assets (MVA)

	Percent of Retirement Fund which is Funded as of 6/30/10	***Percent of Retirement Fund which is Funded as of 6/30/11***	***Percent of Retirement Fund which is Funded as of 6/30/12***	***Percent of Retirement Fund which is Funded as of 6/30/13***
City of Capitola	n/a	75.3%	71.0%	75.2%
City of Santa Cruz	67.2%	75.4%	69.0%	73.4%
City of Scotts Valley	n/a	69.0%	72.0%	76.2%
City of Watsonville	68.3%	76.7%	72.3%	75.4%
County of Santa Cruz	65.1%	73.3%	69.0%	73.4%
Soquel Creek Water District	n/a	76.5%	72.0%	76.2%

Sources: CalPERS Annual Actuarial Valuation Reports 2010-2013 for all jurisdictions

Appendix C

Unfunded Liabilities and Funded Ratios for Jurisdictions for FY 2012/2013

Capitola Unfunded Liabilities/Funded Ratios for FY 2012/2013

Plan	*Safety*	*Misc*	*PEPRA*	*Total*
Unfunded Pension Liabilities	$7,114,975	$7,118,107	$0	$14,233,082
Funded Ratio	77.5%	75.2%	134%	
OPEB Unfunded Actuarial Accrued Liability				$657,500

Source: CalPERS "City of Capitola Annual Valuation Reports as of June 30, 2013" and FY CAFR 2014

City of Santa Cruz Unfunded Liabilities/Funded Ratios for FY 2012/2013

Plan	*Police Tier 1*	*Police Tier 2*	*Fire Tier 1*	*Fire Tier 2*	*Misc.*	*Total*
Unfunded Pension Liabilities	$24,523,905	$11,169	$17,369,713	$14,722	$72,616,578	$114,536,087
Funded Ratio	77.5%	80.6%	77.5%	80.6%	75.9%	
OPEB Unfunded Actuarial Accrued Liability						$16,420,991

Source: CalPERS "City of Santa Cruz Annual Valuation Reports as of June 30, 2013" and FY CAFR 2014

Scotts Valley Unfunded Liabilities/Funded Ratios for FY 2012/2013

Plan	*Safety*	*Misc*	*PEPRA*	*Total*
Unfunded Pension Liabilities	$4,705,083	$6,080,149	0	$10,785,232
Funded Ratio	77.5%	76.2%		
OPEB Unfunded Actuarial Accrued Liability				$5,488,829

Source: CalPERS "City of Scotts Valley Annual Valuation Reports as of June 30, 2013 and FY 2014 CAFR

Watsonville Unfunded Liabilities/Funded Ratios for FY 2012/2013

Plan	*Fire Tier 1*	*Fire Tier 2*	*Police Tier 1*	*Police Tier 2*	*Misc*	*PEPRA*	*Total*
Unfunded Pension Liabilities	$9,164,624	$4,601	$15,275,403	$6,983	$25,516,550	0	$49,968,161
Funded Ratio	77.5%	80.6%	77.5%	80.6%	75.4%	146%	
OPEB Unfunded Actuarial Accrued Liability							$3,588,200

Source: CalPERS "City of Watsonville Annual Valuation Reports as of June 30, 2013" and FY 2014 CAFR

County of Santa Cruz Unfunded Liabilities/Funded Ratios for FY 2012/2013

Plan	***Sheriff***	***Safety***	***Misc***	***Total***
Unfunded Pension Liabilities	$45,325,971	$34,094,931	$254,758,722	$334,179,624
Funded Ratio	64.9%	76.3%	73.4%	
OPEB Unfunded Actuarial Accrued Liability				$145,013,000

Source: CalPERS "County of Santa Cruz Annual Valuation Reports as of June 30, 2013" and FY 2014 CAFR

Soquel Creek Water District Unfunded Liabilities/Funded Ratios for FY 2012/2013

Plan	***Misc. Tier 1***	***Misc. Tier 2***	***PEPRA***	***Total***
Unfunded Pension Liabilities	$5,255,480	$315,655	0	$5,571,135
Funded Ratio	76.2%	76.2%	134%	
OPEB Unfunded Actuarial Accrued Liability				$3,429,854

Source: CalPERS "Soquel Creek Water District Annual Valuation Reports as of June 30, 2013" and Annual Financial Report 2013-2014

Appendix D

Example of Retirement Obligation Information for Budget Narratives

City/County/Special District Retirement Obligations			
	FY 2012	**FY 2013**	**FY 2014**
Pension Costs	$6,786,565	$7,000,000	$7,500,000
OPEB Costs	$1,056,676	$1,134,333	$1,200,000
Pension Obligation Bond Costs	$0	$0	$0
Social Security Costs	$0	$0	$0
Total Annual Retirement Costs	$7,843,241	$8,134,333	$8,700,000
Unfunded Pension Liability	$31,343,212	$32,444,323	34,500,000
Unfunded OPEB Liability	$6,987,556	$7,100,343	$7,600,000
Funded Ratios %	71-75%	71-75%	72-77%

Appendix E

Summary of Retirement Costs as a Percentage of Operating and Payroll Budgets FY 2013/14 unless otherwise noted

	Annual Retirement Costs	***Annual Operating Budget***	***Annual Retirement Costs as a Percent of Operating Budget***	***Annual Payroll***	***Annual Retirement Costs as a Percent of Payroll FY 2012/13***	***Annual Retirement Costs as a Percent of Payroll FY 2013/14***
City of Capitola	$1,880,236	$ 13,733,777	13.7%	$7,768,290	24.7%	24.2%
City of Santa Cruz	10,961,518	$144,290,472	7.5%	$82,274,813	12.1%	13.3%
City of Scotts Valley	$1,795,078	$8,466,448	21.2%	$6,422,488	24.9%	27.9%
City of Watsonville	$5,712,953	$62,060,149	9.2%	$40,632,450	13.4%	14.1%
County of Santa Cruz	$43,480,065	$407,410,361	10.7%	$181,461,167	24.8%	23.9%
Soquel Creek Water District	$954,455	$9,489,000	10.1%	$5,206,600	30.2%	18.3%

Sources: Data from the 2012/2013 and 2013/14 annual budgets from the cities of Capitola, Santa Cruz, Scotts Valley and Watsonville, County of Santa Cruz and Soquel Creek Water District and CalPERS

Appendix F

City of Capitola

The City of Capitola has paid the following total amounts of retirement costs during the last five fiscal years ending June 30:

City of Capitola Annual Retirement Costs

Fiscal Year	*Pension Costs (A)*	*PARS (B)*	*OPEB Costs (C)*	*Pension Obligation Bond Costs (D)*	*Total Retirement Costs (A+B+C+D)*
2010	$ 768,343	$5,359	$18,058	$674,991	$1,466,751
2011	$ 836,156	$4,282	$20,597	$679,751	$1,540,786
2012	$1,020,901	$3,476	$22,891	$673,005	$1,720,273
2013	$1,059,598	$3,238	$27,292	$672,466	$1,762,594
2014	$1,132,136	$3,487	$69,900	$674,713	$1,880,236

Source: City of Capitola written communication November 3, 2014, CAFR's 2010-2014

The City of Capitola has taken the following steps to manage retirement obligations:

1. The City of Capitola implemented a cap on pension contributions in 2007. These caps are in effect through June 30, 2018.
2. In July 2007 Capitola issued a pension obligation bond (6.09%) in the amount of approximately $5 million to refinance the unfunded liability with CalPERS. The $5,040,000 pension bond will be paid off in August 2017.
3. The City implemented a higher employee contribution rate (the rate increased from 8 to 13%) for new employees in 2012.

According to the Capitola 2014 Comprehensive Annual Financial Report (CAFR):

> *The risk pool adjustment to the CalPERS risk pool structure was not confirmed until FY 13/14. The risk pool adjustment, which was unanticipated consequence of PEPRA, allocated each employer's unfunded liabilities to individual plans. Due to City's high retiree to active employee ratio, Capitola like many smaller cities were adversely impacted. Five year projections included in the actuarial report indicate that rates will most likely continue to rise through FY 20/21.*

While all labor agreements include a CPI-based Cost-of-Living-Adjustment (COLA) through the contract period, it may be challenging for employees to bear the complete cost of the increase. Capitola employees have previously foregone raises over a five-year period, deferred previously negotiated salary increases, and accepted mandatory furloughs to assist with cost-containment during difficult fiscal times. The City is in the process of meeting with bargaining groups to discuss solutions, while also reviewing long-term financial projections.

City of Capitola Employee-Employer Contribution Rates FY 2014-15

	Bargaining Unit	**Employee Contribution**	**Employer Contribution**
City of Capitola	Misc. Classic Tier 1	10.292%	16.488%
	Misc. Classic Tier 2	15.292%	11.488%
	Misc. PEPRA	6.25%	6.25%
	Safety Classic Tier 1	11.874%	28.291%
	Safety Classic Tier 2	16.874%	23.291%
	Safety PEPRA	11.50%	11.50%

Source: City of Capitola, Request for Information Response, November 3, 2014

Appendix G

City of Santa Cruz

The following chart shows the total retirement costs paid by the City of Santa Cruz for the last five fiscal years ending June 30.

City of Santa Cruz Annual Retirement Costs

Fiscal Year	***Pension Costs (A)***	***OPEB Costs(B)***	***Pension Obligation Bond Costs(C)***	***Social Security Costs (temporary employees only) (D)***	***Total Retirement Costs (A+B+C+D)***
2010	$10,070,382	$360,431	0	$117,841	$10,548,654
2011	$8,838,188	$444,442	$501,194	$127,189	$9,911,012
2012	$8,230,089	$476,411	$1,056,928	$149,003	$9,912,431
2013	$8,015,878	$554,284	$1,024,485	$171,969	$9,766,618
2014	$9,254,901	$548,627	$986,900	$171,090	$10,961,518

Source: 2010-2014 City of Santa Cruz Comprehensive Annual Financial Reports

The City of Santa Cruz has taken the following steps to manage retirement obligations:

1. In 2010, the City implemented a new, second tier, lower benefited pension for all new hires.
2. Santa Cruz has implemented, through negotiations, a higher employee contribution for retirement costs (from 7% to 19%, depending on the bargaining unit).
3. Santa Cruz has elected to prepay its annual pension payment to obtain a discounted pension payment.
4. The city has adopted an Unfunded Obligation Reserve which will be utilized to build up available resources to a level to establish a Retirement Trust fund that can maximize investment earnings to be used to decrease future pension liabilities.

In 2010 the city issued a $24.15 million dollar Pension Obligation Bond to eliminate the CalPERS side fund saving approximately $200,000 annually.

City of Santa Cruz Employee-Employer Contribution Rates 2014/15

	Bargaining Units	***Employee Contribution***	***Employer Contribution***
City of Santa Cruz	Misc. Tier 1	8%	16.74%
	Misc. Tier 2	8%	16.74%
	Misc. Tier 3	7.75%	16.74%
	Public Safety-Police Tier 1	14.22%	29.56%
	Public Safety-Police Tier 2	14.22%	23.07%
	Public Safety-Police Tier 3	17.47%	12.25%
	Public Safety-Fire Tier 1	12.0%	29.56%
	Public Safety-Fire Tier 2	12.0%	23.07%
	Public Safety-Fire Tier 3	15.25%	12.25%

Source: City of Santa Cruz, Request for Information Response, December 5, 2014

Employees also pick up an additional amount of the city contribution. The additional contribution depends on the bargaining unit and varies from year to year.

1. Police employee contribution rates include the base 9% required employee pickup plus additional contribution amount. Amounts shown are for the core bargaining unit. Management group rates are 15.75%, 19% and 19% for Tiers 1, 2 and 3 respectively.
2. Fire employee contribution rates include the base 9% required employee pickup plus additional contribution amount. Amounts shown are for all Fire employees.
3. Misc. employee contribution rates include the base 7% required employee pickup plus additional contribution amount. Amounts shown are for the service unit.
    a. Supervisory and Management rates are 11%, 10.75% and 10.75% for Tier 1, 2 and 3 respectively.
    b. Executive rates are 12%, 11.75% and 11.75% for Tier 1,2 and 3 respectively.

Appendix H

City of Scotts Valley

The following chart shows the total retirement costs paid by the City of Scotts Valley for the last five fiscal years ending June 30.

City of Scotts Valley Annual Retirement Costs

Fiscal Year	***Pension Costs (A)***	***OPEB Costs (B)***	***Pension Obligation Bond Costs (C)***	***Social Security Costs (D)***	***Total Retirement costs (A+B+C+D)***
2010	$962,050	$152,240	0	$337,919	$1,452,209
2011	$954,584	$197,557	0	$337,303	$1,489,444
2012	$1,174,108	$219,715	0	$342,582	$1,736,405
2013	$797,941	$245,143	$294,194	$348,611	$1,685,889
2014	$775,658	$228,394	$443,268	$347,758	$1,795,078

Source: 2010-2014 Scotts Valley Comprehensive Annual Financial Reports

The City of Scotts Valley has taken the following steps to manage retirement obligations during the last five years:

1. The city now pays the employee's portion of CalPERS in lieu of salary increases.
2. In June 2012 the city issued a pension obligation bond in the amount of $4,460,000 to pay off the City's side fund deficit. The city was paying 7.75% on the side fund deficit to CalPERS. The weighted average interest rate of the bond was 3.06%.

City of Scotts Valley Employee-Employer Contribution Rates 2014-15

	Bargaining Unit	**Employee Contribution**	**Employer Contribution**
City of Scotts Valley	Misc. Safety	8% 9%	15.701% 26.881%

Source: City of Scotts Valley, Request for Information Response, January 2015

Appendix I

City of Watsonville

The following chart shows the total retirement costs paid by the City of Watsonville for the last five fiscal years ending June 30.

City of Watsonville Annual Retirement Costs

Fiscal Year	***Pension Costs (A)***	***OPEB* (B)***	***Pension Obligation Bond Costs (C)***	***Social Security Costs (D)***	***Total Retirement costs (A+B+C+D)***
2010	$4,253,518	0	0	$1,500,696	$5,754,214
2011	$4,237,856	0	0	$1,397,584	$5,635,440
2012	$4,398,604	0	0	$1,054,533	$5,434,522
2013	$4,275,295	0	0	$1,035,918	$5,311,213
2014	$4,332,846	0	0	$1,380,107	$5,712,953

Source: 2010-14 Watsonville Comprehensive Annual Financial Reports (CAFR's)
*Although the city does not currently pay for retiree health costs, there is a retiree health OPEB net obligation of $4,530,800 for FY 2013/14.

The City of Watsonville has taken the following steps to manage retirement obligations during the last five years:

1. The city implemented a two tier system in 2011 so new employees would be at a lower level of benefits.
2. The city has negotiated for employees to pay the full employee share of pension costs (previously the city paid part of the employee pension costs).

The City did not pre-fund retiree healthcare costs nor did the City establish an irrevocable trust for retiree healthcare costs. The decision not to use an irrevocable trust was made because of the current national and state economic issues and the possibility that the funds may be required to provide current services.

City of Watsonville Employee-Employer Contribution Rates 2014/15

	Bargaining Unit	Employee Contribution	Employer Contribution	Employee PEPRA	Employer PEPRA
City of Watsonville	Clerical/Tech	7%	12.12%	6.25%	12.12%
	Confidential	7%	12.12%	6.25%	12.12%
	Fire Tier 1	9%	35.73%*	11.5%	11.5%
	Fire Tier 2	9%	21.37%	11.5%	11.5%
	Management	7%	12.12%	6.25%	12.12%
	Mid-Manage	7%	12.12%	6.25%	12.12%
	Police Tier 1	9%	36.64%	11.5%	11.5%
	Police Tier 2	9%	21.37%	11.5%	11.5%
	Public Works	7%	12.12%	6,25%	12.12%
	Safety (police) Mid-Management	9%	33.49%	11.5%	11.5%
			*Employee pays 7.5% of PERS Employer Rate		

Source: City of Watsonville Bargaining Unit Benefits-Updated July 1, 2014

Appendix J

County of Santa Cruz

The following chart shows the total retirement costs paid by the county of Santa Cruz for the last five fiscal years ending June 30.

County of Santa Cruz Annual Retirement Costs

Fiscal Year	*Pension Costs (A)*	*OPEB Costs (B)*	*Pension Obligation Bond Costs (C)*	*Social Security Costs (D)*	*Total Retirement Costs (A+B+C+D)*
2010	\$32,054,634	\$3,998,945	None	\$2,286,463	\$38,340,042
2011	\$31,074,807	\$4,818,714	None	\$2,236,165	\$38,129,686
2012	\$33,261,121	\$4,822,914	None	\$2,216,671	\$40,300,706
2013	\$34,365,995	\$4,591,534	None	\$2,245,272	\$41,202,801
2014	\$36,462,580	\$4,681,209	None	\$2,336,276	\$43,480,065

Source: 2010-2014 County of Santa Cruz Comprehensive Annual Financial Reports and Auditor-Controller information submitted dated January 9, 2015.

The county of Santa Cruz has taken the following steps to manage retirement obligations during the last five years:

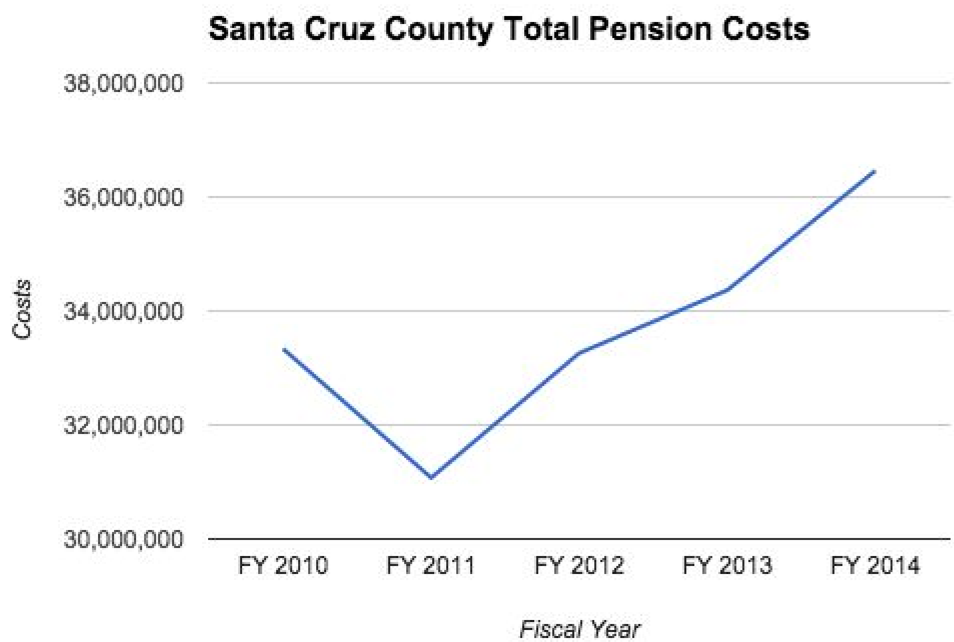
1. In February 2014, the Board of Supervisors approved changes to the retiree health benefits to physicians which reduced the Unfunded Actuarial Accrued Liability (UAAL) by \$117,000 and reduced the annual required contribution for the first year by \$22,000.
2. Negotiated a cafeteria plan and cap on retiree health benefits which was implemented in 2007-2008.
3. Safety employees hired between June 8, 2012 and January 1, 2013 will have benefits based on the highest 3 consecutive years' earnings.
4. Safety Sheriff employees hired after June 8, 2012 will have benefits based on the highest 3 consecutive years' earnings.

According to the FY 2013/14 CAFR regarding OPEB, \$4,681,209 was paid, the OPEB debt obligation increased \$7,326,833 as of June 30, 2014 with a total net OPEB obligation of \$102,743,480. During the last 3 years the net OPEB obligation increased from \$88,212,910 to \$102,743,480 (an increase of \$14,530,570 or a 14.2% increase).

County of Santa Cruz Employee-Employer Contribution Rates 2014-15

	Bargaining Units	***Employee Contribution***	***Employer Contribution***
County of Santa Cruz	Misc.	7%	16.084%
	Safety Sheriff	9%	34.020%
	Safety non-Sheriff	9%	20.292%

Source: County of Santa Cruz, Request for Information Response, January 9, 2015



Appendix K

Soquel Creek Water District

The following chart shows the total retirement costs paid by the Soquel Creek Water District for the last five fiscal years ending June 30.

Soquel Creek Water District Annual Retirement Costs

Fiscal Year	*Pension Costs (A)*	*OPEB Costs (B)*	*Pension Obligation Bond Costs (C)*	*Total Retirement Costs (A+B+C+D)*
2010	$671,045	$162,624	None	$ 833,669
2011	$675,435	$401,263	None	$1,076,698
2012	$622,212	$435,527	None	$1,057,739
2013	$615,527	$779,428	None	$1,394,955
2014	$474,355	$480,100	None	$ 954,455

Source: Soquel Creek Water District Annual Financial Reports 2010-2014

The decrease in pension costs during 2013/14 was due to negotiated agreements which transferred payment of the employee share from the District to the employee. The Soquel Creek Water District has taken the following steps to manage retirement obligations during the last five years:

1. Negotiated a contract change to discontinue the Industrial Disability Retirement Benefit for employees hired after December 18, 2005.
2. Paid off the CalPERS side fund which was accruing interest at 7.75% with 8 years left on the amortization schedule in June 2011.
3. Negotiated a contract change to discontinue the Employer Payment of Member Contributions (EPMC) benefit effective September 2013.
4. Negotiated a contract change whereby retirees who are eligible for health reimbursement pay 10% of the premium cost. Note: The cost sharing ends when an employee becomes eligible for Medicare. The District pays 100% of the Supplemental Medicare premium.
5. Negotiated a contract change lengthening the number of years of district service and age requirement to earn full retirement health benefits in 2013.
6. Began contributions to pre fund OPEB in March 2011.

For the fiscal year ended June 30, 2014, the District's ARC cost was $281,957. The District's net OPEB asset amounted to $248,286 for the fiscal year ending June 30, 2014. The District contributed $480,100 toward current retiree OPEB premiums and the

District's irrevocable trust account (CalPERS CERBT account) for the fiscal year ending June 30, 2014.[35]

Soquel Creek Water District Employee-Employer Contribution Rates 2014-15

	Bargaining Unit	Employee Contribution	Employer Contribution
Soquel Creek Water District	Misc. Tier 1 Misc. Tier 2 PEPRA	8% 8% 6.25%	14.556% 14.083% 6.25%

Source: Soquel Creek Water District, Request for Information Response, January 1, 2015

Prior to September 15, 2013 the District paid the employer and employee share of the contributions to CalPERS.

Appendix L

Laws, Regulations and Standards for Pensions

The law governing California pensions is the California Public Employees Retirement Law found in California Government Code beginning with section 20000. An independent organization, Government Accounting Standards Board (GASB), issues statements that establish standards of accounting and reporting which also apply to pension costs. GASB statements 43, 45, 67, 68 and 71 are applicable to retirement systems. In addition, CalPERS conducts an annual actuarial report of the jurisdiction's retirement system and each public agency conducts a comprehensive annual financial audit (CAFR).

Appendix M

The various measures that were analyzed give different perspectives on the risk associated with the funding of the system. When looked at together, these risk measures show that there is still considerable risk in the funding of the system. The risk of low funded status has been reduced considerably over the last few years by the adoption of a new asset allocation and new assumptions and by changes to the smoothing policies. However, this improvement has come at the expense of increasing employer contributions and this has put additional strain on contributing employers.

In the short term, contribution rate levels are expected to increase unless the System experiences a period of exceptional investment returns. The rates will probably remain high for an extended period to eliminate the unfunded liabilities.

Pension plans at CalPERS are becoming more mature. That is, the ratio of retired members to active members is increasing. Along with the benefit levels, this has resulted in an increase in the asset to payroll levels. This means that volatility is having a greater impact on employers than it had in the past.

Changes to accounting standards (GASB Statement 68) may affect employers' willingness to accept the current level of risks associated with the sponsoring of a defined benefit pension plan as the magnitude of unfunded liabilities and pension expenses are now reported on the basic financial statements. This may result in pressure to change their risk profile by making changes to actuarial or investment policies and/or benefit levels.

Pension reforms implemented effective January 1, 2013 will afford employers some relief in the longer term both as to level and volatility of contributions but this will be minimal in the short term.

The work on Asset Liability Management has shown that there remains considerable risk in the funding of the system. There is a substantial risk that, at some point over the foreseeable future, there will be periods of low funded status and high employer contribution rates. Should this coincide with a period of financial weakness for employers or if such a period occurs before we recover from the current funding shortfall, the consequences could be very difficult to bear.

Combined, the measures discussed above indicate that employers will be under continuing financial stress for many years unless there is a period of exceptional returns in the markets.

Should this stress result in employers electing to terminate their contracts with CalPERS, there could be significant or even devastating consequences to our members. Most plans are between 40 and 60 percent funded on a hypothetical termination basis. While staff will make every effort to collect any shortfall if a plan were to terminate their contract, any uncollectable shortfall will raise the specter of benefit reductions to the level that the benefits are funded.

The report shows that there is a significant amount of risk being taken in the funding of the system. The probability that the system will face a period of severe stress is still at a level that may be unacceptable. Staff urges the Board to review these results carefully and determine whether or not they feel that changes are necessary to improve the soundness and sustainability of the system.[1]