



CITY OF PACIFIC GROVE
300 Forest Avenue, Pacific Grove, California 93950

AGENDA REPORT

TO: HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: Director of Management and Budget James L. Becklenberg

MEETING DATE: May 21, 2008

SUBJECT: CONSIDER A RESOLUTION OF INTENT TO TERMINATE THE CITY'S CONTRACT WITH THE CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM (CalPERS) FOR EMPLOYEE RETIREMENT BENEFITS.

A resolution of intent to terminate the City's contract is the first step required by CalPERS to begin the actuarial analyses required to terminate the City's contract for retirement benefits.

RECOMMENDATION:

Approve a resolution stating the City's intention to terminate its contract with CalPERS for employee retirement benefits.

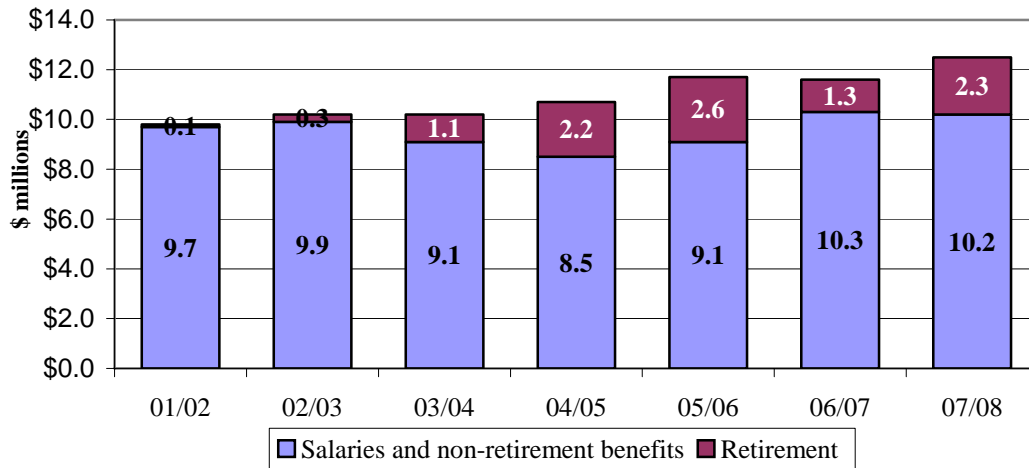
BACKGROUND:

Since 1956, the City has provided retirement benefits to employees through the California Public Employee Retirement System (CalPERS). CalPERS provides a defined retirement benefit based on a benefit formula, years of service, and a benefit "factor," that varies among agencies based on individual contracts with CalPERS. Virtually all public agencies in the state are members of CalPERS, though several very large agencies, such as the City/County of San Francisco, Los Angeles, and San Diego, to name several, offer their own defined-benefit retirement plans, comparable to CalPERS.

The FY 2007/08 General Fund budget includes \$2.3 million for employee retirement costs, which represents 18% of General Fund personnel costs. The City's annual retirement contribution, and its underlying liability to CalPERS for the value of benefits owed to retired employees, can vary widely on an annual basis because of factors inherent to its defined-benefit contribution structure. According to CalPERS, approximately three of every four dollars paid in retirement benefits comes from earnings on the CalPERS investment portfolio. For this reason, the City's CalPERS contributions dropped to a low of approximately \$100,000 in FY 2001/02 in the immediate wake of the technology sector boom in the late 1990s. However, following the steep stock market downturn of the early 2000s, retirement costs spiked from approximately \$100,000 in FY 2001/02 to \$2.2 million in FY 2004/05. With the exception of FY 2006/07,

when the City realized significant one-time savings from refinancing historical retirement cost debt, these costs have remained at this approximate level since then.

Retirement Costs (FY 2001/02 – FY 2007/08, General Fund)



The structure of CalPERS benefits and its heavy reliance on investment returns exposes the City to wide swings in the underlying liability for long-term employee retirement costs. When the value of long-term benefits owed to employees exceeds CalPERS assets for paying for them, the liabilities are considered “unfunded.” The amount of the unfunded liability, amortized over a number of years, is factored into the City’s rates and causes sharp increases in rates such as those the City experienced several years ago. Such an increase was reportedly a factor in the recent decision by the City of Vallejo in filing for bankruptcy.

The risks notwithstanding, it is important to note that the CalPERS retirement plan is an extremely important tool for attracting and retaining high-quality employees, especially police officers and firefighters. It is virtually ubiquitous in California public employment. As noted previously, several large cities have established independent defined-benefit plans, and their benefit formulas, especially for public safety employees are consistent with the CalPERS benefit. Especially if the City were to remain at a competitive disadvantage for salary in the police and fire ranks, it could be very difficult to attract and retain qualified employees without the CalPERS benefit. Staff believes the City could devise a competitive compensation package without a defined-benefit retirement benefit, but it may require significant increases in salary and potentially other costly benefits.

DISCUSSION:

At its November 19, 2007 meeting, citing potentially catastrophic financial risk associated with the CalPERS defined-benefit retirement plan, the City Council directed staff to develop a defined-contribution retirement plan – similar to a private sector 401K plan -- for all new employees. Since then, the City has begun identifying key legal questions for further analysis, discussed potential other retirement system models and costs with the Budget and Finance Committee, and begun a dialogue with CalPERS regarding the City’s intent.

At this time, staff does not have answers to key questions about employee property rights to existing benefits or definitive costs for an alternative system. Preliminary legal and financial analysis suggests that 1.) the City has an obligation for the defined benefit to existing retirees and employees; and 2) the costs for a defined-contribution alternative plan could be comparable to the costs for the existing CalPERS plan. The financial advantage to the defined-contribution plan would be in its relative predictability and the City's increased control over the benefit as a matter of City policy.

Staff is bringing this item forward at this time, without comprehensive answers, because CalPERS requires the resolution of intent to terminate the contract before they will begin the actuarial analysis required to determine the costs related to termination. Importantly, the resolution before the Council today is only the first step of a lengthy process to terminate the contract. **The City Council will have additional decision points and opportunities to reconsider along the way.** Based on a letter from the CalPERS Senior Pension Actuary (attached), staff believes that the process to terminate will take approximately two years from start to finish. To complete the process the City Council will be required to vote to terminate the contract after the initial actuarial valuation, which could take six months to prepare, and then again following a final valuation.

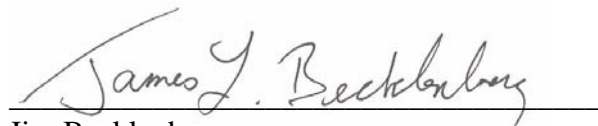
FISCAL IMPACT:

Transitioning to a defined-contribution employee retirement may not generate cost savings in the near- to medium-term future. The most critical factor in comparing potential costs of a new system with the current one is the potential for unfunded liabilities, which at this point is undetermined. The financial benefit to be derived from the change is in gaining control over retirement costs which the current defined-benefit model does not provide.

ATTACHMENTS:

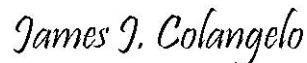
- Draft Resolution
- Letter dated May 8, 2008 from CalPERS

RESPECTFULLY SUBMITTED:



Jim Becklenberg
DIRECTOR OF MANAGEMENT AND BUDGET

REVIEWED BY:



Digitally signed: I have reviewed this document

James J. Colangelo
CITY MANAGER

RESOLUTION NO. ____

**RESOLUTION OF THE CITY COUNCIL OF THE CITY OF
PACIFIC GROVE TO COMMUNICATE ITS INTENTION TO TERMINATE
ITS MEMBERSHIP AGREEMENT WITH THE CALIFORNIA PUBLIC
EMPLOYEE RETIREMENT SYSTEM (CALPERS)**

WHEREAS, the City of Pacific Grove experienced dramatic increases in retirement system costs between FY 2001/02 to FY 2004/05 due to factors associated with a defined-benefit retirement system; and

WHEREAS, the annual required contribution amounts for the CalPERS retirement system do not transparently communicate the underlying obligations to City employees borne by the citizens of Pacific Grove; and

WHEREAS, the City of Pacific Grove wishes to have more control over financial resources and the total costs for compensating employees; and

WHEREAS, the City of Pacific Grove recognizes its obligation to meet and confer with organizations representing employees who could be affected by changing retirement systems before the City Council makes any final decision about terminating its membership agreement with CalPERS;

NOW, THEREFORE, THE COUNCIL OF THE CITY OF PACIFIC GROVE DOES RESOLVE AS FOLLOWS:

SECTION 1. The foregoing recitals are adopted as findings of the City Council as though set forth fully herein.

SECTION 2. The City of Pacific Grove intends to terminate its retirement system membership agreement with the California Public Employee Retirement System, pending the outcome of required actuarial valuations performed by the California Public Employee Retirement System.

PASSED AND ADOPTED BY THE COUNCIL OF THE CITY OF PACIFIC GROVE this day of May 2008, by the following vote:

AYES:

NOES:

ABSENT:

APPROVED:

DANIEL E. CORT, Mayor

ATTEST:

CHARLENE WISEMAN, City Clerk

APPROVED AS TO FORM:

DAVID C. LAREDO, City Attorney



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May 8, 2008

Jim Becklenberg, Finance Director
City of Pacific Grove
300 Forest Avenue
Pacific Grove, CA 93950

Re: Termination Valuation

Dear Mr. Becklenberg:

This letter is to confirm that the process for plan termination can be very lengthy. The initial valuation can take as long as 6 months to prepare. Then once a resolution to terminate is submitted, a year must elapse before it can be finalized. The final termination valuation could take another 6 months. This means the entire process will probably take about two years from start to finish.

I hope this gives you an idea of what to expect, but please feel free to contact me if you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "Barbara J. Ware".

Barbara J. Ware, FSA, MAAA, EA
Senior Pension Actuary, CalPERS

California Public Employees' Retirement System
www.calpers.ca.gov