



**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:** June 18, 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.*

**CEQA STATUS** This action does not constitute a "Project" as defined by CEQA.

**RECOMMENDATION:**

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

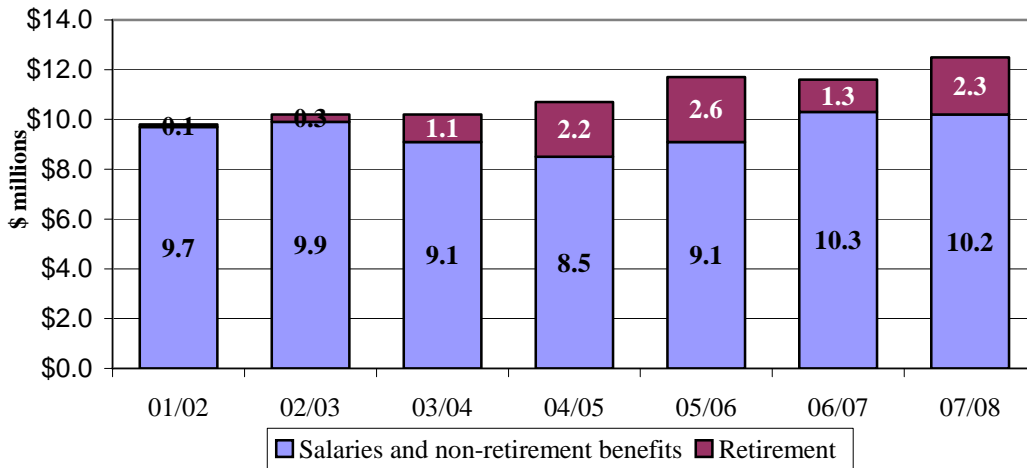
**BACKGROUND:**

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.

It should be noted that both the Police Officers' Association (POA) and General Employees' Association (GEA) have expressed concerns regarding the impact of terminating the PERS contract and the effect this action would have on both existing employees and the ability to recruit new employees. At this time, the GEA recognizes that this action is a first step in a long process and has agreed not to object to the process moving forward for the purpose of obtaining more information. It is understood that the City will be required to enter into formal meet and confer sessions with each of its employee associations prior to a formal action to terminate the PERS contract.

On the other hand, the POA is still requesting that this item not be considered by the Council at this time. Due to the fact that this item is a preliminary step that does not bind the Council to a particular action, we do not believe that the consent of each employee association is required.

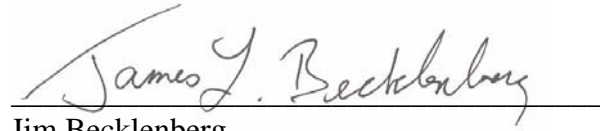
### **FISCAL IMPACT:**

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:

A handwritten signature in cursive script that reads "James J. Becklenberg". The signature is written in black ink and is positioned above a solid horizontal line.

Jim Becklenberg  
DIRECTOR OF MANAGEMENT AND BUDGET

REVIEWED BY:

A handwritten signature in cursive script that reads "James J. Colangelo". The signature is written in black ink and is positioned above a solid horizontal line.

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; and,

**WHEREAS**, this action does not constitute a “Project” as that term is defined under the California Environmental Quality Act (CEQA), CEQA Guideline section 15378.

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

SECTION 1. The City Council determines each of the Findings set forth above to be true and correct, and by this reference incorporates those Findings as an integral part of this Resolution.

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.

SECTION 3. If any provision, section, paragraph, sentence, clause or phrase of this resolution, or any part thereof, or the application thereof to any person or circumstance is for any reason held to be invalid or unconstitutional by a court of competent jurisdiction, such decision shall not affect the validity of the remaining portions of this resolution, or any part thereof, or its application to other persons or circumstances. The City Council hereby declares that it would have passed and adopted each provision, section, paragraph, subparagraph, sentence, clause or phrase thereof, irrespective of the fact that any one or more sections, paragraphs, subparagraphs, sentences, clauses or phrases, or the application thereof to any person or circumstance, be declared invalid or unconstitutional.

SECTION 4. This resolution shall become effective immediately following passage and adoption hereof.

**PASSED AND ADOPTED** BY THE COUNCIL OF THE CITY OF PACIFIC GROVE  
this 18<sup>th</sup> day of June 2008, by the following vote:

AYES:

NOES:

ABSENT:

APPROVED:

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DANIEL E. CORT, Mayor

ATTEST:

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CHARLENE WISEMAN, City Clerk

APPROVED AS TO FORM:

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DAVID C. LAREDO, City Attorney



**Actuarial Office**  
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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 black ink that reads "Barbara J. Ware".

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

**California Public Employees' Retirement System**  
[www.calpers.ca.gov](http://www.calpers.ca.gov)