



# CITY OF DALY CITY

333 - 90TH STREET

DALY CITY, CA 94015-1895

PHONE: (650) 991-8000

Sent Via Email: grandjury@sanmateocourt.org

August 17, 2018

Honorable V. Raymond Swope  
Judge of the Superior Court  
c/o Charlene Kresevich  
Hall of Justice  
400 County Center, 2<sup>nd</sup> Floor  
Redwood City, CA 94063-1655

Re: 2017-2018 County of San Mateo Civil Grand Jury Report "Soaring City Pension Costs – Time for Hard Choices"

Dear Judge Swope:

We are in receipt of the Grand Jury's final report "Soaring City Pension Costs – Time for Hard Choices". Pursuant to your July 17, 2018 request for response, the Daly City, City Council held a public meeting on August 13, 2018 and approved this response. The City of Daly City responds to the Grand Jury's findings, conclusions and recommendations as follows:

## **Findings:**

F1. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F2. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported contribution payments to CalPERS on the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F3. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Unfunded Liabilities (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A. Each City has been required to make large Amortization Cost (as defined in this report) payments of principal and interest to CalPERS on those Unfunded Liabilities. These payments have diverted money that could otherwise have been used to provide public services or to add to reserves.

**Response:** The City agrees with the finding.

- F4. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported Funded Percentages (as defined in this report) for the City's pension plans in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F5. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported what the Unfunded Liabilities (as defined in this report) for the City's pension plans would have been if the applicable Discount Rate applied to calculate them had been 1 percentage point lower in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F6. Each City's CAFR for the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017 reported general fund total expenditures for that year in the amount set forth beside its name for that year in Appendix A.

**Response:** The City agrees with the finding.

- F7. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's general fund total expenditures for that year set forth beside its name for that year in Appendix A in the column entitled "Contribution Payments as % of General Fund Total Expenditures."

**Response:** The City agrees with the finding.

F8. In each of the fiscal years ending June 30, 2015, June 30, 2016 and June 30, 2017, each City's contribution payments to CalPERS on the City's pension plans represented the percentage of that City's covered payroll for the City's pension plans in the amount set forth beside its name for that year in Appendix A in the column entitled "Contribution Rate (i.e., Contribution Payments as % of Covered Payroll)."

**Response:** The City agrees with the finding.

F9. In FY 2017-2018, each City (excluding Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside) has paid CalPERS for its Normal Costs (as defined in this report) and Amortization Costs (as defined in this report) in the amounts set forth beside its name on Table No. 4. (The Cities of Atherton, Colma, Foster City, Hillsborough, Portola Valley and Woodside are not included in Table No. 4 because the source for that table did not included data for them.)

**Response:** The City agrees with the finding.

F10. As a result, among other things, of CalPERS' decreasing its Discount Rate from 7.5 percent to 7 percent by FY 2020-2021, its reduction of future Amortization Periods from 30 to 20 years, and its use of updated mortality assumptions reflecting projected increases in the longevity of Members, each City faces increasing pension contribution payments to CalPERS which are likely to more than double by FY 2024-2025.

**Response:** The City agrees with the finding.

F11. Principal and interest payments on each City's Unfunded Liabilities will increasingly impair such City's provision of public services, impair the security of employee salary and pension Benefits, and/or result in proposals for revenue increases. Paying down Unfunded Liabilities early results in large savings. Every City in the county would save substantial money by paying down their Unfunded Liabilities early.

**Response:** The City agrees with the finding.

F12. The financial documents for each City reviewed by the Grand Jury show that no City has adopted a long-term financial plan with at least a 10-year time horizon to address rising Normal Costs and Amortization Costs that includes each of the following:

- objectives, such as achieving a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years or maintaining the cities' share of Normal Costs below "n" percentage of payroll,

- policies to achieve these objectives, such as making supplemental payments to CalPERS to reduce their Unfunded Liability, keeping salary increases below the actuarially assumed increase rate, capping the cities' share of Normal Costs, reducing operational costs or increasing revenue,
- measures to implement such policies,
- processes to monitor progress in implementing the measures, and
- alternative financial strategies, or a "Plan B," that may be used in the event that CalPERS' assumptions are not met in future years.

**Response:** The City agrees with the finding.

- F13. Despite the fact that rising pension costs and Unfunded Liabilities are a significant problem for each City, no City (except for Redwood City, the City of San Mateo, the City of Burlingame, the City of Belmont and the City of Menlo Park) includes specific, annual projections of future pension contribution costs in their budgets published in the finance section of their websites.

**Response:** The City agrees with the finding.

**Recommendations:**

- R1. The Grand Jury recommends that, by December 31, 2018, each City schedule public hearings to engage its residents in addressing the city's increasing pension costs and to develop a long-term plan to address them.

**Response to Recommendation 1:**

The recommendation has been implemented.

All the City Council meetings are conducted openly in compliance with the Brown Act, and its records are maintained publicly in compliance with the Public Records Act.

At the City Council budget study sessions in April 2018, pension information included pension obligation bonds, CalPERS actuarial assumptions change and its impact to the City budget, unfunded pension liabilities, funded ratio, projected CalPERS employer contribution rates and projected employer contribution for miscellaneous and safety members over the next 10 years, were presented to the City Council and the public.

In addition, the City has retained an outside consultant to assist with the development of a Long-Term Financial Plan. The long-term financial forecast through Fiscal Year 2028 including pension costs and recommended actions were presented to the City Council in June 2018.

- R2. The Grand Jury recommends that, by December 31, 2018, and annually thereafter, each City publish a report on its website detailing its pension obligations. The report should include, at a minimum, the following:
- a) The City's total pension contribution costs under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such costs in each of the following 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - b) The City's total Unfunded Liabilities under all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Unfunded Liabilities in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - c) The City's Funded Percentage across all plans, and also broken out into subtotals for all Miscellaneous Plans, and all Safety Plans, for each of the 3 preceding fiscal years as well as estimates for such Funded Percentages in each of the next 10 fiscal years, assuming CalPERS' actuarial assumptions are met.
  - d) The percentage of the City's general fund expenditures and covered payroll represented by the pension costs described in (a) above (using estimates of general fund expenditures in future fiscal years).
  - e) In addition, estimated information for all projections regarding the next 10 fiscal years set forth in items (a) through (e) above should be presented using a Discount Rate that is 1 percentage point below CalPERS' then-current Discount Rate.

**Response to Recommendation 2:**

The recommendation has not yet been implemented, but will be implemented by July 2019.

The City engages an outside consultant to prepare the pension actuarial report for the miscellaneous and safety members every two years. The actuarial reports will include projection over a 10-year horizon and other information requested by the Grand Jury. The next actuarial report will be completed by July 2019.

- R3. The Grand Jury does not recommend specific policies or implementation measures to address pension costs. However, it recommends that, by no later than December 31, 2018, and annually thereafter, each City instruct its staff to deliver a report to the City Council in connection with the City's financial plan evaluating available options to address pension costs and that each City hold public hearings to discuss and consider such options no less than every other fiscal year. These include (but may not be limited to):
- Regular supplemental payments to CalPERS (beyond those required by CalPERS) to accelerate the amortization of their Unfunded Liabilities.
  - Irregular supplemental payments to CalPERS (beyond those required by CalPERS), as when a City has a budget surplus or receives special non-recurring revenues.

- Electing to apply shorter Amortization Periods (that is, less than 20 years) to their Unfunded Liabilities.
- Issuing pension obligation bonds.
- Establishing substantial reserves that can be applied in the future to help meet rising pension costs and/or accelerate amortization of Unfunded Liabilities.
- Establishing Section 115 trusts for the exclusive purposes of meeting rising pension costs and/or accelerating amortization of Unfunded Liabilities.
- Reductions in general fund operating costs other than pensions.
- Seeking additional general fund revenues that can be applied directly to paying pension costs or that can offset general fund budget shortfalls that would otherwise occur.
- Keeping employee salary increases at or below the levels assumed by CalPERS.
- Negotiating cost-sharing agreements with employees under which employees pay a portion of the City's pension costs (without at the same time agreeing to offsetting compensation increases).
- Maintaining growth in employee salaries and COLAs at or below the assumed CalPERS rates.
- To the extent allowed by law, consider the recommendation of the League of California Cities to renegotiate employee contracts to bring the pension Benefits of Classic Members in line with PEPRA Members, for future work. In particular, ensure that the salary used to determine final retirement compensation is based on the average of the final 3 years of employment (rather than highest 1 year), and that the salary is not enhanced by "spiking," such as by including overtime, unused vacation or sick leave, purchases of "air time," and the like.

**Response to Recommendation 3:**

The recommendation has been implemented.

Funding for the pension costs and Council priorities were presented to the City Council at the budget study sessions in April 2018 when the City put together the biannual budget.

In addition, the long-term financial forecast through Fiscal Year 2028 including pension costs and recommended actions were presented to the City Council in June 2018.

The City has prudently taken actions to manage its pension liabilities. In 2004, the City issued Pension Obligation Bonds (POBs) and proceeds were delivered to CalPERS to prepay pension unfunded liabilities.

The City is committed to pay down pension unfunded liabilities due to CalPERS actuarial assumptions change. The City has implemented a multi-pronged approach to address

long-term fiscal and pension challenges and to ensure the sustainability of the City's finance into the future.

1. Maintain General Fund unassigned fund balance equal to 15% of annual budgeted expenditures. Prior year surpluses of revenues over expenditures will be used to reduce unfunded liabilities for pension or other post-employment benefits.
2. Participated in Section 115 Trust Program to pre-fund pension unfunded liabilities.
3. Develop Workforce Management Strategies to reduce operating costs, evaluate alternative service delivery models to maximize efficiency, and align staffing with service demand.
4. Identify potential voter-approved taxes and other revenues.

R4: The Grand Jury recommends that, by June 30, 2019, each City develop and publish a long-term financial plan to deal with rising pension costs, and update that plan annually. Such a plan should include:

- Specific objectives, such as identifying a target Funded Percentage, eliminating the Unfunded Liabilities over "n" years and maintaining the City's share of Normal Costs at "n" percentage of payroll.
- Policies to achieve these objectives.
- Specific measures to implement the policies.
- A process to monitor progress in implementing the measures and in achieving the objectives.
- Consideration of alternative policies and measures, or a "Plan B," that may be used in the event that CalPERS's actuarial assumptions, especially the Discount Rate, are not met in future years.

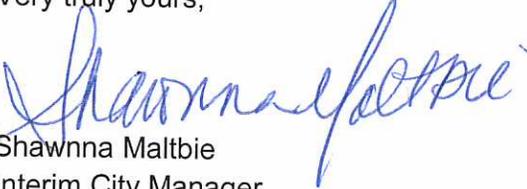
**Response to Recommendation 4:**

The recommendation has not been implemented, but will be implemented by June 30, 2019.

The City of Daly City appreciates the opportunity to provide written responses to the San Mateo County Civil Grand Jury Report "Soaring City Pension Costs – Time for Hard Choices."

Should you or the Grand Jury require any additional information, please contact me directly at (650) 991-8127.

Very truly yours,

A handwritten signature in blue ink, appearing to read "Shawna Maltbie".

Shawna Maltbie  
Interim City Manager

cc: City Council

Annette Hipona, City Clerk

Rose Zimmerman, City Attorney