



Agenda Item B.4
CONSENT CALENDAR
Meeting Date: August 21, 2018

TO: Mayor and Councilmembers

FROM: Michelle Greene, City Manager

CONTACT: Luke Rioux, Finance Director

SUBJECT: Response to the Santa Barbara County Civil Grand Jury Report Regarding "Pensions in Santa Barbara County"

RECOMMENDATION:

- A. Review staff's recommended responses to the Santa Barbara County Civil Grand Jury (Grand Jury) Report regarding – "Pensions in Santa Barbara County"; and
- B. Authorize the City Manager to sign and transmit the City's Response (Attachment 2) to the Presiding Judge of the Superior Court, a copy to the current impaneled Grand Jury, and to file a copy with the City Clerk's Office.

BACKGROUND:

On June 18, 2018, the City received the Santa Barbara County Civil Grand Jury report entitled "Pensions in Santa Barbara County" (Attachment 1). The City Council is required to respond to this report within 90 days of receiving it, which provides the Council until September 16, 2018, to reply to the Grand Jury.

California Penal Code 933(c) states "no later than 90 days after the grand jury submits a final report on the operations of any public agency subject to its reviewing authority, the governing body of the public agency shall comment to the presiding judge of the superior court on the findings and recommendations pertaining to matters under the control of governing body" and further states "All of these comments and reports shall forthwith be submitted to the presiding judge of the superior court who impaneled the grand jury."

DISCUSSION:

On June 18, 2018, the 2017-18 Santa Barbara County Civil Grand Jury issued a report about pension systems of nine principal public agencies in Santa Barbara County in response to complaints received. The report addressed the County of Santa Barbara Employee Retirement System (SBCERS), which is not part of the California Public Employee Retirement System (CalPERS) risk pool, and the eight municipal systems of Buellton, Carpinteria, Goleta, Guadalupe, Lompoc, Santa Maria, Santa Barbara, and

Solvang, which manage 32 plans within the CalPERS risk pool. Given the public concern about the viability of defined benefit pensions in the County, the Jury analyzed risks to the County and municipal pension systems over the period 2018-2047. The report states that the Jury reviewed:

- The audited financial reports of the County of Santa Barbara and of the eight cities for various years plus related data in the public domain and as provided by the eight municipalities; and
- The 2014, 2015, and 2016 CalPERS valuation reports for the 32 plans within the eight municipal systems, plus related data in the public domain and as provided by the municipal plan administrators.

Six large municipal plans with high solvency risks are highlighted in the report: Carpinteria Safety, Lompoc Safety, City of Santa Barbara Miscellaneous, City of Santa Barbara Fire, City of Santa Barbara Police, and City of Santa Maria Miscellaneous. According to the report, these plans have 78 percent of the total of unfunded liabilities among the 32 municipal plans.

Eighteen (18) municipal plans were at moderate solvency risks (range of 0.70 to 0.90) and have a weighted average 2017-18 funded ratio 0.71, which included the City of Goleta's Miscellaneous and PEPRa Miscellaneous plans, with a funded ratio of 0.79 for miscellaneous and 0.90 for PEPRa. According to the report, these plans have 22 percent of all unfunded liabilities.

It is important to note, following the issuance of the Grand Jury report, the City received its latest CalPERS actuarial valuation report in August 2018. The funded ratio for the Miscellaneous plan has increased to 0.82 and 0.95 for the PEPRa Miscellaneous plan.

The "Pensions in Santa Barbara County" report has three findings (Findings 1, 8 and 9) and two recommendations (Recommendations 1 and 2) that require a response from the City. A draft response letter to the Grand Jury is attached (Attachment 2). Council is asked to review the draft response and authorize the City Manager to sign the response letter and transmit it to the Honorable Patricia L. Kelly, Superior Court Presiding Judge.

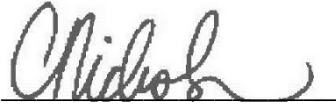
FISCAL IMPACTS:

There are no fiscal impacts to the drafting, approval and transmission of the response to the Grand Jury's findings and recommendations.

ALTERNATIVES:

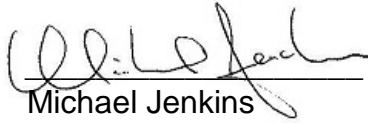
Responses are required by Penal Code 933.05. Therefore, there is no alternative to responding to the Grand Jury's report.

Reviewed By:



Carmen Nichols
Deputy City Manager

Legal Review By:



Michael Jenkins
City Attorney

Approved By:



Michelle Greene
City Manager

ATTACHMENTS:

1. Grand Jury Report Dated June 18, 2018
2. Draft Response Letter to the Grand Jury

Attachment 1

Grand Jury Report Dated June 18, 2018

PENSIONS IN SANTA BARBARA COUNTY

SUMMARY

The 2017-18 Santa Barbara County Jury (Jury) received complaints about the nine principal public pension systems in Santa Barbara County (County) – the County of Santa Barbara Employee Retirement System (SBCERS), which is not part of the California Public Employee Retirement System (CalPERS) risk pool, and the eight municipal systems of Buellton, Carpinteria, Goleta, Guadalupe, Lompoc, Santa Maria, the City of Santa Barbara and Solvang, which manage 32 plans within the CalPERS risk pool.¹ Following those complaints and given the public concern about the viability of defined benefit pensions in the County, the Jury analyzed risks to the County and municipal pension systems over the period 2018-2047.

The Jury found the highest risks in the plans of Lompoc (six pension plans), the City of Santa Barbara (four pension plans), and Santa Maria (seven pension plans), which are the largest in the County. It found moderate risks in Guadalupe (five pension plans) and Solvang (three pension plans). It found minimal to moderate risks in Buellton (two pension plans) and Goleta (two pension plans). Risks in SBCERS are moderate and well managed.

INTRODUCTION

Citizens and public officials have occasionally expressed concern about the viability of public pensions in the County.² An independent analysis³ of the risks to California's public defined benefit pension systems found that several of the Santa Barbara systems have among the highest employer's contributions rates in the State and that such high rates might not be sustainable without new revenue or changes in benefit structures. Such claims justify a transparent analysis by the Jury of threats to the viability of pension plans in the County.

PEPRA is the California Public Employees' Pension Reform Act, which took effect on January 1, 2013. It "changes the way CalPERS retirement and health benefits are applied and places compensation limits on members" (<https://www.calpers.ca.gov/page/about/laws-regulations/regulatory-actions/pepra>). The summary of PEPRA, which may be found at <https://www.calpers.ca.gov/docs/forms-publications/summary-pension-act.pdf>, defines its effects

¹ In this Report a "pension plan" is a given package of retirement contributions and benefits, for example, the Miscellaneous Plan of the City of Goleta. A "pension system" is the set of pension plans under one management; for example, the pension system of the City of Goleta consists of the Miscellaneous Plan of Goleta and the PEPRA Miscellaneous Plan of Goleta.

² 2010-11 Santa Barbara County Grand Jury Report: "Local Government Post-Employment Benefits in Santa Barbara County: Complicated and Costly."

³ [http://www.cacities.org/Resources-Documents/Policy-Advocacy-Section/Hot-Issues/Retirement-System-Sustainability/League-Pension-Survey-\(web\)-FINAL.aspx](http://www.cacities.org/Resources-Documents/Policy-Advocacy-Section/Hot-Issues/Retirement-System-Sustainability/League-Pension-Survey-(web)-FINAL.aspx)

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in such important areas as definition of classic and new members, benefit formulas, retirement ages, replacement plans, and “Employer Paid Member Contributions.”

Table 1 presents measures of system size, assets and liabilities in the eight municipal systems and in SBCERS. As Table 1 shows, the eight cities of the County manage 32 plans that participate in the CalPERS risk pool.⁴ The ninth system – the SBCERS – manages 15 different plans in a separate risk pool. The SBCERS plans, like those of the eight cities, are governed by the California State Public Employees’ Pension Reform Act (PEPRA) which took effect in January 2013. Each of the eight municipal pension systems manages a Miscellaneous Plan for employees hired before December 31, 2012 and a PEPRA Miscellaneous Plan for employees hired after that date. There are separate plans for the police and fire services in Guadalupe, Santa Maria, Lompoc and the City of Santa Barbara, including PEPRA variants, except in the City of Santa Barbara.

Table 1: Santa Barbara Pension Systems in Recent Fiscal Years

City	Population	Plans in system	2016-17 Active Staff	Forecast 2017-18 Contributions	Forecast 2017-18 Contributions	2015-16 Accrued Liability (AL in \$, 000s)	2015-16 Market Value of Assets (MVA in \$, 000s)	2015-16 Unfunded Accrued Liability (UAL in \$, 000s)
	(~mid-2018)	(number)	(FTE)	(\$, in 000s)	% payroll			
Buellton	5,021	2	19	330	15.8	8,102	6,027	2,076
Carpinteria	13,553	3	43	868	18.9	26,575	19,255	7,320
Goleta	30,850	2	60	957	11.2	13,220	10,526	2,693
Guadalupe	7,252	5	31	504	11.5	12,625	9,644	2,981
Lompoc	43,712	6	395	9,727	40.1	261,383	180,153	81,230
Santa Barbara	91,930	4	1,035	38,434	51.6	965,108	645,059	320,049
Santa Maria	103,642	7	498	15,962	31.7	397,017	275,946	121,071
Solvang	5,363	3	35	662	27.1	14,786	10,924	3,862
Municipal totals	301,323	32	2,116	67,445	41.4	1,698,815	1,157,533	541,282

⁴ There are a total of 76 pension plans in the County, of which 32 plans are in the eight cities and one is managed by the County. The other 43 are in Special Districts, Fire Districts, Insurance and Risk Management institutions, a Law Library, the various sanitation districts, and other public institutions. This Report does not discuss those 43 plans. Nor does it analyze the California Teachers Retirement System or other non-pension benefit systems in SB County.

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County of Santa Barbara	148,677	15	4,218	171,858	48.8	2,742,012	2,156,247	585,765
County totals ⁵	450,000	47	6,334	239,303	NA	4,440,827	3,313,780	1,127,047

METHODOLOGY

To carry out its analysis, the Jury reviewed:

- the audited financial reports of the County of Santa Barbara and of the eight cities for various years plus related data in the public domain and as provided by the eight municipalities;
- the 2014, 2015, and 2016 CalPERS valuation reports for the 32 plans within the eight municipal systems, plus related data in the public domain and as provided by the municipal plan administrators;
- SBCERS Annual Reports and data provided by SBCERS; and
- published analyses of public defined pension plans included in the sample of this report.

Based on the information in the documents reviewed and from the interviews with various officials of the eight cities, the County and SBCERS, the Jury constructed a numeric model to verify the existing risk analyses for 32 municipal plans and to conduct complementary risk analyses of those plans as discussed in Appendix B. The Jury examined the risk analyses done for SBCERS and notes salient findings therefrom. <http://cosb.countyofsb.org/sbcers/default.aspx?id=19048>

This report applies the CalPERS definitions of various technical terms, as shown at <https://www.calpers.ca.gov/page/employers/actuarial-services/employer-contributions/public-agency-actuarial-valuation-reports>, and in the Glossary found in Appendix A.

OBSERVATIONS AND ANALYSIS

Risks to the Pension Systems

Solvency and Liquidity of Pension Risks ⁶

⁵ Notes to Table 1: "FTE" is Full Time Employee. "Contributions" include employee contributions, normal cost employer contributions, and contributions to repay unfunded liabilities. "Accrued Liability" means, "The total dollars needed as of the valuation date to fund all benefits earned in the past for current members," as shown in Appendix A ("Glossary"). "Market Value of Assets" is the net present value of assets held by a pension date on the stated valuation date. "Unfunded accrued liability" means, "When a plan or pool's Value of Assets is less than its Accrued Liability, the difference is the plan or pool's Unfunded Accrued Liability." Sources: CALPERS Valuation Reports, 2015-16, for municipal plans, aggregated to system levels, and municipal CAFR 2016-17; SBCERS Valuation Reports and SBCERS Annual Reports.

⁶ Appendix B gives some simple pension analytics for this report.

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The Jury defined “solvency risks” as threats to the long-term capacity of the plan to pay benefits. The indicator of this risk is its “funded ratio” -- the market value of assets (MVA) divided by the value of actuarial liabilities (AL) at the end of a fiscal year.⁷ A plan with a funded ratio less than 1 is said to be “underfunded.”

The Jury defines “liquidity risks” as threats to a plan’s annual cash flow. One specific measure of liquidity risk is that benefit payments to retirees will exceed the sum of contributions - employee, normal cost employer, and payments on the unfunded actuarial liabilities (UAL) - plus the return on the MVA in any given year. A second measure of liquidity risk is that total employer’s contributions - normal cost employer plus payments on the UAL - exceed some threshold ratio to municipal payroll. The first indicator of liquidity risk used in this report is the number of years, between 2018 and 2047 with plan negative cash flow, meaning benefit payments are greater than the sum of contributions plus return on MVA in a given year. A second indicator is the number of years following 2017-18 in which the employer’s contribution to payment of the UALs exceeds the employer’s normal cost contribution, both expressed as a share of municipal payroll.⁸

Solvency Risks in the Municipal Plans

Appendix C gives funded ratios for the 32 municipal plans. The Jury defines three categories of solvency risk for this Report: high risk, moderate risk and minimal risk. Plans with funded ratios less than 0.7 are said to be at “high risk” because they have elevated ratios of unfunded liabilities to assets. Plans with funded ratios greater than or equal to 0.7 and less than 0.9 are said to be at “moderate risk” because they have lower ratios of unfunded liabilities to assets. Plans with funded ratios greater than or equal to 0.9 are said to be at “minimal risk” because their ratios of unfunded liabilities are low compared to their assets.

There are six large municipal plans with high solvency risks: Carpinteria Safety⁹; Lompoc Safety, City of Santa Barbara Miscellaneous, City of Santa Barbara Fire, City of Santa Barbara Police, and City of Santa Maria Miscellaneous. Those plans show a weighted average 2017-18 funded ratio of 0.67 (range of 0.63 to 0.68) and hold 75 percent of municipal liabilities in the County, not counting SBCERS liabilities. The six plans at high risk have 78 percent of the total of unfunded liabilities among the 32 municipal plans. Santa Maria has taken steps to end their policy of employer contributions in lieu of employee contributions in its pension plans; this step moves some of the burden of repaying its unfunded pension liabilities from the City to its active employees.

⁷ The CalPERS Valuation Reports define the AL “as the total dollars needed as of the valuation date to fund all benefits earned in the past for current members.” The Valuation Reports further define the Present Value of Benefits (PVB) as the “total dollars needed as of the valuation date to fund all benefits earned in the past or expected to be earned in the future for current members.” For the new PEPRAs, which began in 2014, the PVB is higher than the AL because the former counts expected future benefits for current members and the latter does not.

⁸ We use “municipal payroll” rather than “plan payroll” because municipal revenue is fungible and can be used to pay pension liabilities from any plan in a given system.

⁹ Among the six plans with “high” risk, the Carpinteria Safety Plan is closed with no active members and no payroll. Projecting with the current CalPERS actuarial discount rate, the Carpinteria Safety Plan will fully amortize its UAL by 2047.

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There are 18 municipal plans at moderate risk. They have a weighted average 2017-18 funded ratio of 0.71 (range of 0.70 to 0.90), 25 percent of the total amount of all municipal liabilities and 22 percent of all unfunded liabilities.

There are eight municipal plans¹⁰ at minimal risk. They have a weighted average 2017-18 funded ratio of 0.95 (range of 0.91 to 1.00) and less than 1 percent of actuarial liabilities in the 32 plans.

PEPRA is the California Public Employee's Pension Reform Act, which reduced pension benefits for employees hired on or after January 1, 2013. The 12 PEPRA plans have less than 1 percent of the municipal liabilities and a weighted average funded ratio of 0.90. The 20 non-PEPRA plans have more than 99 percent of municipal liabilities and an average funded ratio of 0.68.

CalPERS Risk Analysis

CalPERS analyzes pension fund risks with respect to "discount rate assumption." The actuarial discount rate is a nominal rate that converts the flow of future annual liabilities – payments to pension holders – into net present value terms, as given by the term AL in equation (1). See Appendix B. The CalPERS Valuation Reports present funded ratios for each plan at discount rates of 6 percent, 7 percent, and 8 percent. The resulting funded ratios are shown in Appendix C (column labelled "Funded Ratio (range by discount rate)"). At a discount rate of 6 percent, the lowest rate modeled by CalPERS, the Safety Plans of Lompoc and the City of Santa Barbara, and the Miscellaneous Plan of Santa Maria have funded ratios less than 0.6; at a discount rate of eight percent, the highest rate modeled by CalPERS, the plans at greatest solvency risks (Lompoc Safety, Santa Barbara Safety Police and Safety Fire) do have higher funded ratios but they rarely increase above 0.75.

CalPERS further reports the effects of "future investment returns" on participating plans. CalPERS simulated returns at a plus 7 percent long-term average, a plus 3 percent average (called here the "second worst rate"), and a minus 3 percent average (called here the "worst rate") over the period 2019-20 to 2022-23.

Table 2 summarizes the CalPERS analyses of investment returns, as presented in its June 30, 2016 Valuation Reports for each of the 32 funds, aggregated to the system level for each city.

The CalPERS liquidity risk analysis for each plan first "determine[s] the effects of various future investment returns on required employer contributions" over the period 2017-18 through 2022-23. The "required employer contributions" are the employer's normal cost contributions plus required payments of the UAL, expressed as a percentage of the municipal payroll in each system. The lower returns have weak effects on the ability of most plans to sustain benefits; for example, cutting the CalPERS return from the actuarial average of plus 7.0 percent to the postulated "worst" of minus 3 percent would only increase the ratio of employer contributions to total payroll by more than 1 percentage point in five of the eight municipal systems (this is the change from column (1) to column (2) in Table 2). The weak effect of low returns on employer contributions is partly due

¹⁰ Among the eight plans with "minimal" risk, the Solvang Safety Plan is closed with no active members and no payroll. Projecting with the current CalPERS actuarial discount rate, the Solvang Safety Plan will fully amortize its UAL by 2026.

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to the structure of the CalPERS analysis, which assumes that returns revert to the actuarial investment return of 7 percent after only four bad years.

Table 2: Pension System Liquidity Risks Caused by Revenue Growth and CalPERS Investment Returns

	<u>Average revenue growth (3% /year)</u>		<u>Negative revenue growth (- 2 % year)</u>	
	<u>CalPERS average return</u>	<u>CalPERS worst return</u>	<u>CalPERS average return</u>	<u>CalPERS worst return</u>
	(1)	(2)	(3)	(4)
Buellton				
Employer's contributions of pay	15.8	16.7	15.2	16.1
Years of negative cash flow	0	9	2	16
Carpinteria				
Employer's contributions of pay	17.9	19.0	17.9	19.0
Years of negative cash flow	9	10	9	10
Goleta				
Employer's contributions of pay	7.9	8.3	8.0	8.3
Years of negative cash flow	0	0	0	0
Guadalupe				
Employer's contributions of pay	10.6	11.2	10.6	11.2
Years of negative cash flow	6	6	6	6
Lompoc				
Employer's contributions of pay	40.5	41.7	40.5	41.7
Years of negative cash flow	8	7	8	7
City of Santa Barbara				
Employer's contributions of pay	50.2	51.9	50.2	51.9
Years of negative cash flow	8	8	8	8
Santa Maria				
Employer's contributions of pay	30.0	31.2	30.0	31.2
Years of negative cash flow	7	7	7	7
Solvang				
Employer's contributions of pay	23.7	24.8	24.8	26.0
Years of negative cash flow	5	5	5	5

Source:

Calculated by 2017-18 Grand Jury.

In Santa Maria, liquidity risks are lower than in Lompoc and the City of Santa Barbara in that Santa Maria projects no years of negative cash flows. However, Santa Maria would have negative cash flow if CalPERS investment returns fall below their projected actuarial values.

Complementary Risk Analysis

The Jury did a complementary risk analysis that considered the effects of “revenue shocks” on the municipal pension plans. A “revenue shock” is an unexpected fall in municipal revenue, due to, for example, the effects of the Thomas Fire on property valuations and business activity. Revenue shocks are modeled for the eight municipal plans as follows:

- A six-year period from 2017-18 through 2022-23 in which municipal revenue, from all sources, grows at a rate of minus 2 percent per year; compared to
- A six-year period from 2019 through 2024 in which municipal revenue, from all sources, grows at the rate as projected by CalPERS of plus 3 percent per year

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- Both scenarios are computed under an average CalPERS “future investment return” of plus 7 percent and again under a “worst” investment return of plus 3 percent.

Table 2 shows that cutting revenue projections from the CalPERS projected average of plus 3 percent to minus 2 percent would not add much to the fiscal burden of the plans consolidated at the city levels under a “worst return” scenario; this is the change from column (2) to column (4) in Table 2. However, the effect of lower revenue projections would be much stronger for the Lompoc (3 percent), Santa Barbara (4 percent), and Santa Maria systems (2.20 percent) in increased employer’s contributions, as shown by the change from column (2) to column (4) in Table 2. The City of Santa Barbara is the only one of the four cities¹¹ that has not created a separate PEPR plan for new members of its police force hired after December 31, 2012. (It has created a PEPR plan for new fire department employees hired after that date.)

Effects of the PEPR Law

The PEPR law of 2012 that went into effect in 2013 made significant changes in California pension systems. PEPR plans typically increased the retirement age at which members became eligible for a given benefit formula, changed the annual benefit factor for which members become eligible, capped the annual salary used to calculate the benefit base, and forbade the practice of “Employer Paid Member Contributions” for new PEPR members. While specific PEPR options vary within each plan and system, the general effect of the PEPR law will be to reduce future liabilities. Though specific PEPR plans do not yet cover 1 percent of the total liabilities across the 32 municipal plans in the County, they do seem to be more solvent than the older plans; the 12 PEPR plans have a funded ratio of 0.90 and the 20 non-PEPR plans have a funded ratio of 0.68. It is not possible with the information available to the Jury to calculate funded ratios for PEPR options *within* the Miscellaneous Plans of the largest cities (Lompoc, Santa Maria and the City of Santa Barbara),¹² in which most of the AL are held.

Policy Measures Beyond the PEPR Law

Funding the SBCERS and many of the municipal plans could, at some point, require new policy measures by governments. Such new measures might include freezing public salaries or drawing on General Fund (GF) reserves to pay employers contributions.¹³ Accordingly, we have modeled the pension systems of the three largest cities (Lompoc, Santa Barbara and Santa Maria), noting that those systems hold 96 percent of the AL in the eight cities.

- Freezing public payrolls -- the Jury examined the effect on total employer’s contributions rates of freezing public payrolls for 5 years, beginning in 2019-20; and
- Drawing on GF Reserves -- the Jury considered the effect on total employer’s contributions rates of lowering the GF reserve target from 25 percent of GF revenue to 20 percent.

¹¹ Buellton, Carpinteria, Goleta and Solvang contract with the County of Santa Barbara for public safety services and therefore do not have municipal pension plans for their safety services.

¹² Lompoc, Santa Maria and the City of Santa Barbara include PEPR options for new hires in their Miscellaneous Plans without having separate “PEPR Miscellaneous Plans,” as do Buellton, Carpinteria, Goleta, Guadalupe, and Solvang.

¹³ Increases in employees’ contributions cannot be modeled because they are part of labor negotiations and hence feasible solutions are unknown.

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Neither measure had any significant effect on total employer's contribution rates in Lompoc, Santa Maria or the City of Santa Barbara.

One other possible measure would be to freeze capital spending. The Jury was unable to examine the effect on total employer's contributions rates of freezing public capital due to the wide disparities in relative capital spending among cities and between the cities and the County. Moreover, because much of capital spending at all levels depends on grants from the State and from the Federal Government, such spending has a random element outside the control of city and County governments that cannot be easily modeled. Another measure might be to cut numbers of staff by attrition or layoffs. The Jury did not look at the potential impact of staff layoffs given that the terms of any future layoffs would have to be negotiated with labor unions and it is impossible to predict the outcome. The Jury notes that city and County governments could analyze all existing taxes and revenue sources under their control for possible increases.

SBCERS Risk Analyses

SBCERS managed about \$2.16 billion dollars in assets on the valuation date of June 30, 2017.¹⁴ The funded ratio was 0.78 on that valuation date. The SBCERS analysis done of its discount rate sensitivity gave values from 0.66 at a discount rate of 6 percent to 0.86 at a discount rate of eight percent. SBCERS has done a comprehensive analysis of its systemic risks, in addition to modeling the discount rate, and the Jury has nothing different to complement the SBCERS analysis. It further notes that SBCERS has achieved portfolio returns comparable to those of CalPERS over the past 25 years.

CONCLUSION

There are substantial liquidity and solvency risks to the sustainability of many of the public defined benefit pension plans in the County. Management of those risks may require new policy measures. The 2017-18 Santa Barbara County Grand Jury concludes that the State of California, in passing the new PEPPRA law, which went into effect on January 1, 2013, has already imposed a statewide measure which has had a modest positive effect on the liquidity and solvency of the Santa Barbara County public pension systems. However, if there are additional fiscal shocks, such as an exogenous fall in tax revenue or a period of low returns on pension assets held by CalPERS, then other new policies may be required. Such measures could be to reduce salaries and other non-pension benefits, to raise employee and employer contributions or to cut benefits, apply fiscal measures to fund higher employer contributions, as well as start new negotiations with labor unions to raise contributions from employees, or to otherwise modify benefits not covered by the new PEPPRA Law of 2013.

¹⁴ The estimated SBCERS valuation on March 31, 2018 was roughly \$2.8 billion.

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FINDINGS AND RECOMMENDATIONS

Finding 1

Pension solvency risks are moderate in Buellton and Goleta; pension liquidity risks, as indicated by projected years of negative cash flow under projected CalPERS actuarial returns, are nil.

Finding 2

In Carpinteria, Guadalupe and Solvang, pension solvency risks are minimal to moderate, except in the closed Carpinteria Safety Plan. Pension liquidity risks in those cities are higher, with several years in all three cities having projected negative cash flows under projected CalPERS actuarial returns.

Finding 3

In Lompoc, Santa Maria and the City of Santa Barbara, solvency risks are high in the pre-PEPRA plans that have most of the Actuarial Liabilities in the municipal plans.

Finding 4

In Lompoc and the City of Santa Barbara, liquidity risks are high as measured by projected years of negative cash flow. Managing those risks will require employer's pension contributions of 40 percent of payroll in Lompoc and 50 percent in the City of Santa Barbara at least until 2030.

Finding 5

While the City of Santa Barbara does not have a "PEPRA Police Plan," it does respect the 2013 PEPRA Law for those hired after December 31, 2012. Therefore, the absence of a "PEPRA Police Plan" does not adversely affect the funded ratio or other risk indicators for the City of Santa Barbara system.

Finding 6

Liquidity risks in Santa Maria are lower than in Lompoc and the City of Santa Barbara, in that Santa Maria projects no years of negative cash flows. However, Santa Maria would have negative cash flow if CalPERS investment returns fall below their projected actuarial values. Managing that liquidity risk requires that Santa Maria maintain high total employer contributions to its pension plans until at least 2034.

Finding 7

The City of Santa Maria faces greater pension risks because of its comparatively low General Fund revenue per capita, which is less than 50 percent of that of the City of Santa Barbara and less than 67 percent of that of Lompoc. Santa Maria has taken steps to end employer contributions in lieu of employee contributions in its pension plans; this step moves some of the burden of repaying its unfunded pension liabilities from the City to its active employees.

Finding 8

The 12 PEPRA plans in the cities of the County of Santa Barbara have a funded ratio of 0.90 and the 20 non-PEPRA plans have a funded ratio of 0.68. This is a small, but positive, sign that the

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PEPRA law is having the intended effect of strengthening the security of pension benefits in the County.

Finding 9

Funded ratios of the municipal pension systems in Santa Barbara County are sensitive to the discount rate applied by CalPERS. A cut in that rate to 6 percent, from the 2018-19 rate of 7 percent, would push the funded ratios of several municipal systems close to 0.5 and might impose further increases in the employer's contributions in Lompoc, in the City of Santa Barbara and in Santa Maria.

Finding 10

It is unlikely that the largest municipal plans - Lompoc Safety; City of Santa Barbara Miscellaneous; City of Santa Barbara Fire; City of Santa Barbara Police; and City of Santa Maria Miscellaneous - can apply the revised CalPERS amortization schedule of 20 years to all their unfunded liabilities without higher new employer's contributions. Such new contributions would be particularly problematic in Lompoc and in the City of Santa Barbara given the high employer's contribution rates that already apply in those cities.

Finding 11

The solvency risks to the SBCERS plans are moderate and manageable. The SBCERS decision to apply an accelerated amortization schedule to the unfunded liabilities generated during the 2007-09 period of low asset returns is appropriate because it will shorten the period in which high employer contributions are necessary.

Finding 12

The SBCERS policy of not participating in the CalPERS risk pool is appropriate because SBCERS has achieved portfolio returns comparable to those of CalPERS over the past 25 years.

Recommendation 1

That in view of the 12 Findings, the governments of the cities of Buellton, Carpinteria, Goleta, Guadalupe, Lompoc, Santa Barbara, Santa Maria and Solvang and of the County of Santa Barbara analyze capital spending, employer/employee contribution rates, staffing levels, and all existing taxes and revenue sources under their control to identify potential revenue gains and cost savings.

Recommendation 2

That the governments of the cities of Buellton, Carpinteria, Goleta, Guadalupe, Lompoc, Santa Barbara, Santa Maria and Solvang and of the County of Santa Barbara issue public reports, to be discussed at open sessions of their respective governing bodies, on the potential revenue gain and cost-saving measures that may be necessary to ensure continued adequate funding of their pension plans.

PENSIONS IN SANTA BARBARA COUNTY

REQUEST FOR RESPONSE

Pursuant to *California Penal Code §933 and §933.05*, the Grand Jury requests each entity or individual named below to respond to the enumerated Findings and Recommendations within the specified statutory time limit:

Responses to Findings shall be either:

- Agree
- Disagree Wholly, with an explanation
- Disagree Partially, with an explanation

Responses to Recommendations shall be one of the following:

- Has been implemented, with a brief summary of the implemented actions
- Will be implemented, with an implementation schedule
- Requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a completion date that is not more than 6 months after the issuance of this report
- Will not be implemented because it is not warranted or is not reasonable, with an explanation

City Council of Buellton - 90 Days

Finding 1, 8, 9

Recommendation 1, 2

City Council of Carpinteria - 90 Days

Finding 2, 8, 9

Recommendation 1, 2

City Council of Goleta - 90 Days

Finding 1, 8, 9

Recommendation 1, 2

City Council of Guadalupe - 90 Days

Finding 2, 8, 9

Recommendation 1, 2

City Council of Lompoc - 90 Days

Finding 4, 7, 8, 9, 10

Recommendation 1, 2

City Council of Santa Barbara - 90 Days

Finding 3, 4, 5, 6, 7, 8, 9, 10

Recommendation 1, 2

PENSIONS IN SANTA BARBARA COUNTY

City Council of Santa Maria - 90 Days

Finding 3, 6, 7, 8, 9, 10

Recommendation 1, 2

City Council of Solvang- 90 Days

Finding 2, 8, 9

Recommendation 1, 2

Santa Barbara County Board of Supervisors – 90 Days

Finding 11, 12

Recommendation 1, 2

PENSIONS IN SANTA BARBARA COUNTY

APPENDIX A Glossary

CalPERS Pension Terms

Accrued Liability (also called Actuarial Accrued Liability or Entry Age Normal Accrued Liability) The total dollars needed as of the valuation date to fund all benefits earned in the past for current members.

Actuarial Valuation The determination, as of a valuation date of the Normal Cost, Accrued Liability, and related actuarial present values for a pension plan. These valuations are performed annually or when an employer is contemplating a change to their plan provisions.

Classic Member (under PEPRA) A classic member is a member who joined CalPERS prior to January, 1, 2013 and who is not defined as a new member under PEPRA. (See definition of new member below)

Discount Rate Assumption The actuarial assumption that was called "investment return" in earlier CalPERS reports or "actuarial interest rate" in Section 20014 of the California Public Employees' Retirement Law (PERL).

Funded Status A measure of how well funded, or how "on track" a plan or risk pool is with respect to assets versus accrued liabilities. A ratio greater than 100 percent means the plan or risk pool has more assets than liabilities and a ratio less than 100 percent means liabilities are greater than assets.

GASB 68 Statement No. 68 of the Governmental Accounting Standards Board The accounting standard governing a state or local governmental employer's accounting and financial reporting for pensions. GASB 68 replaces GASB 27 effective the first fiscal year beginning after June 15, 2014.

New Member (under PEPRA) A new member includes an individual who becomes a member of a public retirement system for the first time on or after January 1, 2013, and who was not a member of another public retirement system prior to that date, and who is not subject to reciprocity with another public retirement system.

Normal Cost The annual cost of service accrual for the upcoming fiscal year for active employees. The normal cost should be viewed as the long-term contribution rate.

PEPRA The California Public Employees' Pension Reform Act of 2013.

Present Value of Benefits (PVB) The total dollars needed as of the valuation date to fund all benefits earned in the past or expected to be earned in the future for current members.

Unfunded Accrued Liability (UAL) When a plan or pool's Value of Assets is less than its Accrued Liability, the difference is the plan or pool's Unfunded Accrued Liability (or unfunded

PENSIONS IN SANTA BARBARA COUNTY

liability). If the unfunded liability is positive, the plan or pool will have to pay contributions exceeding the Normal Cost.

OTHER TERMS

Benefit Factor. The percentage of pay to which members are entitled for each year of service.

Complementary risk analysis. Additional risk analysis beyond what is presented in the CalPERS Valuation Reports.

“Employer Paid Member Contributions” refers to the practice of pension plan employers paying the employee’s contributions in some instances.

Pension plan. In this Report, a “pension plan” is a given package of retirement contributions and benefits, for example, the Miscellaneous Plan of the City of Goleta.

Pension system. In this Report, a “pension system” is a set of pension plans under one management; for example, the pension system of the City of Goleta consists of the Miscellaneous Plan of Goleta and the PEPRM Miscellaneous Plan of Goleta.

PENSIONS IN SANTA BARBARA COUNTY

APPENDIX B **Pension Analytics**

Pension analytics for a given plan are expressed by the identity

$$AL - MVA = UAL$$

where AL is actuarial liabilities (expected pension payments to beneficiaries) in net present value (NPV) terms, UAL is unfunded actuarial liabilities in NPV terms, and MVA is the market value of the assets held by the plan at the valuation date. CalPERS defines the AL “as the total dollars needed as of the valuation date to fund all benefits earned in the past for current members”¹⁵. The valuation date of June 30, 2016 is used here for municipal plans in Santa Barbara County because it is the date for which the most recent CalPERS valuations are available.

The “funded ratio” is MVA/AL . A plan with zero UAL has a funded ratio of 1. A plan with MVA equal to 75 percent of its AL has a funded ratio of 0.75. An example is the Lompoc Miscellaneous Plan which, at the most recent CalPERS valuation date of June 30, 2016, had an AL of \$175.1 million, an MVA of \$122.6 million giving a funded ratio of 0.70 (i.e., $122.6/175.1$) and a UAL of \$52.5 million (i.e., \$175.1 million – \$122.6 million).

A second analytic relation is the annual cash flow of a plan, expressed as

$$C + rMVA - PB = CF.$$

The term C is the sum of contributions (employee, normal cost employer, and employer contributions to service the debt represented by the unfunded liabilities), r is the projected actuarial return on assets given by CalPERS, MVA is the market value of assets held for the plan in the CalPERS risk pool, PB is pension benefits paid, and CF is cash flow.¹⁶ An analogous relation holds for SBCERS but without the intermediation of CalPERS.

¹⁵ The CalPERS Valuation Reports define the Present Value of Benefits (PVB) as the “total dollars needed as of the valuation date to fund all benefits earned in the past or expected to be earned in the future for current members.” For the new PEPPRA plans, which began in 2014, the PVB is higher than the AL because the former counts expected present and future benefits for current members and the latter only counts present benefits for current members. The total PVB for the 32 municipal plans is \$1.96 billion.

¹⁶ This formulation does not take account of administration costs at the plan or CalPERS levels, nor does it consider changes in actuarial parameters such as life expectancy or retirement age decisions.

APPENDIX C – Santa Barbara Municipal Pension Plans, 2017-18

City	Plan	2017-18 GF	2017-18 Payroll in 000s \$	2017-18 Total Contributions in 000s \$	2015- 2016 AL ²	2015- 2016 MVA ²	2015- 2016 UAL ²	Funded Ratio (MVA/AL)	Funded Ratio (range by discount rate)	Solvency Risk
Buellton	PEPRA Misc.	2,095		12	31	28	3	0.90	.66 -13	Moderate
Buellton	Misc.	2,095		317	8,071	5,998	2,072	0.74	.63 - .8	Moderate
Carpinteria	Safety Plan	906		204	9,342	6,365	2,976	0.68	.6 - .72	High
Carpinteria	Misc.	906		632	17,149	12,814	4,335	0.75	.63 - .8	Moderate
Carpinteria	PEPRA Misc.	906		31	83	73	9	0.89	.61 -15	Moderate
Goleta	PEPRA Misc.	1,443		110	328	294	33	0.90	.69 -1.	Moderate
Goleta	Misc.	1,443		846	12,891	10,231	2,660	0.79	.64 - .87	Moderate
Guadalupe	Misc.	3,060		258	6,957	5,182	1,774	0.74	.62 - .8	Moderate
Guadalupe	PEPRA Misc.	3,060		10	24	22	2	0.89	.66 -11	Moderate
Guadalupe	PEPRA Safety Police	3,060		40	103	92	11	0.89	.7 - .98	Moderate
Guadalupe	PEPRA Safety Fire	3,060		8	7	6	0	0.93	.69 -16	Minimal
Guadalupe	Safety	3,060		187	5,531	4,340	1,191	0.78	.64 - .86	Moderate
Lompoc	Safety Plan	13,883		2,993	84,988	56,367	28,621	0.66	.55 - .72	High
Lompoc	Misc.	13,883		6,246	175,064	122,561	52,502	0.70	.59 - .75	Moderate
Lompoc	PEPRA Safety Police	13,883		101	210	188	22	0.89	.68 -11	Moderate
Lompoc	Safety Police Second Tier	13,883		133	365	340	25	0.93	.66 -18	Minimal
Lompoc	Safety Fire Second Tier	13,883		95	409	382	27	0.93	.73 -13	Minimal

PENSIONS IN SANTA BARBARA COUNTY

City	Plan	2017-18 GF	2017-18 Total Contributions in 000s \$	2015- 2016	2015- 2016	2015- 2016	Funded Ratio	Funded Ratio	(range by discount rate)	Solvency Risk
Lompoc	PEPRA Safety Fire	13,883	156	344	313	31	0.91	.66 - .14	Minimal	
Santa Barbara	Misc. Plan	66,300	23,270	538,824	367,521	171,302	0.68	.57 - .73	High	
Santa Barbara	PEPRA Safety Fire	66,300	45	276	251	25	0.91	.66 - .15	Minimal	
Santa Barbara	Safety Fire	66,300	7,041	177,687	112,520	65,166	0.63	.53 - .68	High	
Santa Barbara	Safety Police	66,300	8,076	248,320	164,765	83,555	0.66	.56 - .72	High	
Santa Maria	PEPRA Safety Fire	49,079	149	317	281	35	0.89	.67 - .1.	Moderate	
Santa Maria	Misc.	49,079	8,645	214,526	145,538	68,987	0.68	.57 - .73	High	
Santa Maria	PEPRA Safety Police	49,079	549	1,072	953	118	0.89	.66 - .11	Moderate	
Santa Maria	Safety Fire First Tier	49,079	2,210	57,908	41,990	15,918	0.73	.61 - .78	Moderate	
Santa Maria	Safety Fire Second Tier	49,079	181	759	725	34	0.95	.68 - .1.11	Minimal	
Santa Maria	Safety Police First Tier	49,079	4,168	121,692	85,719	35,972	0.70	.59 - .76	Moderate	
Santa Maria	Safety Police Second Tier	49,079	57	741	737	3	10	.77 - .1.11	Minimal	
Solvang	PEPRA Misc.	1,100	21	51	46	4	0.91	.64 - .17	Minimal	
Solvang	Misc.	1,100	629	14,172	10,374	3,797	0.73	.61 - .79	Moderate	
Solvang	Safety	1,100	9	562	502	59	0.89	.75 - .96	Moderate	
TOTAL		720,452	67,444	1,698,815	1,157,533	541,282	NA	NA	NA	

Attachment 2

Draft Response Letter to the Grand Jury



July 19, 2018

CITY COUNCIL

Paula Perotte
Mayor

Stuart Kasdin
Mayor Pro Tempore

Roger S. Aceves
Councilmember

Michael T. Bennett
Councilmember

Kyle Richards
Councilmember

CITY MANAGER
Michelle Greene

Honorable Patricia L. Kelly
Superior Court Presiding Judge
County of Santa Barbara
1100 Anacapa Street
Santa Barbara, CA 93101

RE: Response to 2017-18 Santa Barbara Civil Grand Jury Report
Titled Pensions in Santa Barbara County.

Dear Honorable Judge Kelly,

The 2017-18 Santa Barbara County Civil Grand Jury recently released its report entitled, Pensions in Santa Barbara County. The City of Goleta is named as an affected agency and is required to respond to the applicable findings and recommendations within 90 days of the receipt of the report.

The purpose of this letter is to provide responses from the City to Findings 1, 8, and 9, and Recommendations 1 and 2 contained in the report dated June 18, 2018. The responses to the findings and recommendations are as follows:

FINDINGS

Finding 1:

Pension solvency risks are moderate in Buellton and Goleta; pension liquidity risks, as indicated by projected years of negative cash flow under projected CalPERS actuarial returns, are nil.

Response to Finding 1: Agree.

Finding 8:

The 12 PEPRA plans in the cities of the County of Santa Barbara have a funded ratio of 0.90 and the 20 non-PEPRA plans have a funded ratio of 0.68. This is a small, but positive, sign that the PEPRA law is having the intended effect of strengthening the security of pension benefits in the County.

Response to Finding 8: Agree.

As of June 30, 2017, the City of Goleta Miscellaneous pension plan had a funded ratio of 81.8%, while our PEPRA Miscellaneous plan had a funded ratio of 95.0%. In the case of Goleta, it appears PEPRA law is having the intended effect of strengthening the security of pension benefits.

Finding 9:

Funded ratios of the municipal pension system in Santa Barbara County are sensitive to the discount rate applied by CalPERS. A cut in that rate to 6 percent, from the 2018-19 rate of 7 percent, would push the funded ratios of several municipal system close to 0.5 and might impose further increases in the employer's contributions in Lompoc, in the City of Santa Barbara and in Santa Maria.

Response to Finding 9: Agree

Goleta agrees that funded ratios of the municipal pension system in Santa Barbara County are sensitive to the discount rate applied by CalPERS and a cut in that rate to 6 percent would adjust the funded ratios, and might further increase employer contributions in some cities.

RECOMMENDATIONS**Recommendation 1:**

That in view of the 12 Findings, the governments of the cities of Buellton, Carpinteria, Goleta, Guadalupe, Lompoc, Santa Barbara, Santa Maria and Solvang and of the County of Santa Barbara analyze capital spending, employer/employee contribution rates, staffing levels, and all existing taxes and revenue sources under their control to identify potential revenue gains and cost savings.

Response to Recommendation 1: Has been implemented.

Goleta has always conducted the fiscal analyses contained in Recommendation 1 and does so through the annual budget process, where capital spending, operating expenditures, staffing levels, all existing taxes and revenue sources are analyzed. This process also includes reviewing general fund reserve balances to ensure consistency with the City's prudent reserve policies, as well as assessing the City's economic environment, revenue streams, unanticipated expenditures, and future liabilities. The budget process also includes updates to the City's five-year financial forecast for the general fund, adjustments to the capital improvement program (CIP) budget, and review and forecast of all revenues and expenditures related to the CIP. This process allows the City to continually make adjustments when necessary, such as utilizing other special revenue funds when appropriate, resulting in cost savings to the general fund and adoption of a structurally balanced budget. In addition, Goleta continues to utilize the annual lump sum prepayment option for the unfunded accrued liability as outlined in the CalPERS Actuarial Valuation report, resulting in additional annual savings.

With regard to employer/employee contribution rates, Goleta recently adopted a new Memorandum of Understanding (MOU) with its employee bargaining units through a process which included a thorough review and analysis of CalPERS employer/employee contribution rates in the current and future years. In an effort to address future cost increases to the City, the MOU included a cap on the employer contribution rates in effect at December 1, 2020, subject to change through negotiation. This will result in employees contributing more toward pension costs in the future.

Goleta also continues to look to other potential revenue enhancements, including updating its investment program, ongoing sales tax audits, and applying for grants to fund capital projects and special programs. The City also plans to conduct a transient occupancy tax audit, to ensure revenues are being appropriately collected and remitted. In addition, Goleta is currently conducting a city-wide user fee study and updated development impact fee (DIF) nexus study. The user fee study will determine whether the City's fees are recovering the costs of services provided and also identify potential other fees the City should be collecting. The DIF nexus study will provide an update to our current impact fees that provide a mechanism for new development projects to contribute financially to the one-time cost of improving and expanding infrastructure and facilities.

Recommendation 2:

That the governments of the cities of Buellton, Carpinteria, Goleta, Guadalupe, Lompoc, Santa Barbara, Santa Maria, and Solvang and the County of Santa Barbara issue public reports, to be discussed at open sessions of their respective governing bodies, on the potential revenue gain and cost-saving measures that may be necessary to ensure continued adequate funding of their pension plans.

Response to Recommendation 2: Has been implemented.

City of Goleta has long been aware of the importance of cost-saving measures and the need to reduce the City's pension liabilities. As early as June of 2011, before PEPRAs took effect in January of 2013, the Council received a public report on pension cost-sharing options, and voted to require employees to pay their full 7% Employee share of pension costs.

In addition, the City provides public reports and review of City finances and pension information at City Council and Finance and Audit Standing Committee meetings on an ongoing basis. This includes pension information discussed annually by the City's external auditors when reviewing the Comprehensive Annual Financial Report (CAFR) and during the budget adoption process that includes rising pension cost information due to changes in the CalPERS discount rate. Included in the annual budget document is an updated five-year forecast that accounts for these increases. Based on the five-year forecast, the City is able to absorb these costs under our conservative financial projections and maintain a structurally balanced budget, but at the same time has continued its efforts to minimize the impacts of these rising costs. Reports to Council

and the Finance and Audit Standing Committee, the CAFR and budget documents are all public documents and are posted on the City's website.

In addition, on a quarterly basis, City Council receives a presentation and financial report that compares budgeted amounts to actual expenditures and revenues to date. Included in this quarterly financial report are the review of General Fund reserves, which has a category related to pension unfunded accrued liability (UAL). At year-end, overall total revenues and expenditures are reviewed and any savings are recommended to reserve categories, which may include additional contributions to the City's pension UAL reserve account. A UAL funding policy and strategy is under development and will be recommended for adoption by City Council.

Goleta's Finance and Audit Standing Committee also has discussed rising pension costs and liabilities, and has received presentations on this subject. These discussions included: 1) establishing a possible Section 115 trust for pensions to use as a tool for pension budgeting; 2) a presentation on software that will assist with pension liability forecasting; 3) changing the current amortization schedule for maximized interest savings; and, 4) reviewing reserve policies to set aside additional funding for pension UAL. In regard to the amortization schedule, Goleta staff has been in contact with its CalPERS pension actuary and is looking further into changing the amortization schedule for its pension UAL from 30 years to 20 or 15 years, and will continue its discussion with the Finance Committee and the City Council. All options and combination of options will be compared and analyzed, to see what may be most advantageous for Goleta, while allowing for flexibility and responsiveness to changes in the economic environment and maintaining a balanced budget.

Conclusion

The City of Goleta appreciates the opportunity to provide detailed responses to the Grand Jury's findings and recommendations. Addressing the unfunded liabilities of public pensions is critical. CalPERS' decision to lower the discount rate as a way to reduce volatility presented a fiscal challenge all participating agencies must face over the next five to eight years. The City of Goleta is in good financial condition, and has a record of sound budgeting and fiscal prudence, which, combined with the proactive steps we are taking to reduce our UAL, will allow the City to address the challenge of increasing pension costs successfully.

If you have any questions please contact me at (805) 961-7501.

Sincerely,
Michelle Greene
City Manager

cc: Santa Barbara County Grand Jury