Santa Maria
All-America City

CITY OF SANTA MARIA
OFFICE OF THE MAYOR
AND CITY COUNCIL

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BY:

The Honorable Judge Patricia Kelly
Presiding Judge of the Superior Court of Santa Barbara County
312 East Cook Street
Santa Maria, CA 93454

Honorable Judge Kelly:

The 2017-18 Santa Barbara County Civil Grand Jury recently released its report entitled "*Pensions In Santa Barbara County.*" The Grand Jury has requested the Santa Maria City Council respond to Findings 3, 6, 7, 8, 9, and 10, and Recommendations 1 and 2 within 90 days of the report issuance.

RESPONSE TO THE GRAND JURY FINDING REGARDING PENSIONS IN SANTA BARBARA COUNTY

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.

City Response to Finding 3: Disagree Partially. The City agrees that its current funding ratios in non-PEPRA plans are lower than the City would like. However, a funding ratio is a measure at a point in time and in and of itself is not a predictor of a plan's solvency. Rather, a lower funding ratio is a signal that action may need to be taken to improve the ratio in the long term.

The use of the funding ratio as the predictor of whether the City will be able to pay retirement benefits is misleading because a current funding ratio does not take into consideration actions that CalPERS and the City are taking to address the decline in funded status of its plans. For example, CalPERS lowering the discount rate from 7.5 percent to 7 percent reduces, in the long run, a plan's dependence on investment returns. Although lowering the discount rate increased the City's required contributions and is posing to the City significant challenges in paying for those escalating costs over the next five (5) years, the City recognizes that those increases are needed to improve funded status of all retirement plans.

The City created second level (Tier II) pension plans back in 2011 for fire, police and miscellaneous groups. Tier II plans have a lower benefit level than Tier I plans and over time, will reduce the benefits paid out of the plan. Again, in the long term, these lower level benefit plans will help improve the funding status of all plans.

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 actuarial values. Managing that liquidity risk requires that Santa Maria maintain high total employer contributions to its pension plans until at least 2034.

City Response to Finding 6: Disagree Partially. The City agrees that positive annual cash flow (annual contributions greater than benefits paid out) is preferred and over time that simply must occur in order for a pension plan to fund retirement benefits. However, the Grand Jury's analysis is based on annual cash flows rather than cumulative cash flows. In addition, the Grand Jury's analysis assumes that the City has and will not take action to improve its financial position. As stated in response 2 above, the City was proactive in addressing mounting pension costs when it created second level (Tier II) pension plans back in 2011. Since Tier II plans have a lower benefit level than Tier I plans, over time Tier II plans will reduce the benefits paid out and improve cash flow. The City has and will continue to explore ways to reduce costs and increase revenues to minimize the number of years with negative cash flows.

Finding 7: The City of Santa Maria faces greater pension risk 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.

City Response to Finding 7: Disagree Partially. The City agrees that greater revenues per capita would improve the City's ability to pay required pension contributions and lower the City's pension risk. The City acknowledges that General Fund revenue per capita is lower than that of the cities of Santa Barbara and Lompoc.

However, the Grand Jury's assumption that the City of Santa Maria's pension risk is higher because of their lower General Fund revenue per capita is misleading because it does not take all factors into account. For example the Grand Jury's analysis does not take into account that Santa Maria has (both currently and historically) a much lower number of employee-to-population ratio than Santa Barbara, San Luis Obispo, and Lompoc. In fact, Santa Maria's employee-to-population ratio at 4.76 (per 1,000 residents) is almost half that of Santa Barbara's ratio of 9.26, San Luis Obispo's 8.93 and Lompoc's 8.14.

Another factor not considered by the Grand Jury, is that not all pension costs are (nor can they be) funded by General Fund revenues. For instance, employees in the Utilities Department are funded by Water Resources and Solid Waste funds – both of which are Enterprise Funds that by law cannot be comingled with the General Fund. Lastly, the Grand Jury's analysis does not take into consideration new or significant changes to sources of revenues. For instance, large new retail developments, such as Enos Ranch whose multiple tenants began opening in September 2017, is increasing the City's sales tax revenue and is expected to continue to provide a steady revenue stream. While the City recognizes that the revenue increase from Enos Ranch is not enough to fund the increases in pension obligations, the increase in revenue helps the City pay for pension and other operating costs.

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.

City Response to Finding 8: Agree.

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.

City Response to Finding 9: Disagree Partially. There is no question that if CalPERS lowers the discount rate, it will increase the City's contribution rates and lower plans' funded status. However, historically, CalPERS has phased-in changes in actuarial assumptions that significantly affect agencies' rates. This method has allowed more time to address the increase in required contributions. The Grand Jury's conclusion assumes that CalPERS will deviate from taking a phased-in approach and reduce the discount rate to 6 percent in one year or short period of time. In reality, CalPERS Risk Mitigation Plan calls for the discount rate to be lowered from 7.0 percent to 6.5 percent over a period of approximately 20 years (beginning with actuarial valuations of the fiscal year ending June 30, 2019). Assuming CalPERS uses the same strategy to further reduce the discount rate to 6.0 percent, agencies will have more time to adjust for the increases in contribution rates.

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.

City Response to Finding 10: Agree

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.

City Response to Recommendation 1: This recommendation has already been implemented, most recently as part of the City's 2018-20 Budget process. City departments were asked to reduce their operating budgets to fund the increase in CalPERS required contributions. In order to accomplish this, dozens of positions are not being funded for the next two fiscal years. That is being done in addition to the City's low employee-to-population staffing ratio of 4.76 employees per 1,000 residents, as mentioned in the City Response to Finding 7. In addition, vacant positions are being held open longer to achieve a salary savings goal of $3.0 million. In terms of capital projects, City staff submitted 118 projects for consideration and of those 9 are being deferred until funding can be obtained.

Regarding revenues, the City continues to evaluate its revenue sources distributed to the City through other agencies (such as sales tax) to ensure the City receives the full amount due to the City. The City will also be conducting a city-wide user fee study to determine whether the City's fees are covering costs of services provided to its customers. In additions, the City is aggressively seeking grants to fund capital projects, equipment and special programs.

Prior to the 2018-20 budget cycle, the City negotiated cost-sharing agreements with several employee groups. As a result of those cost-sharing agreements, and also due to City pension reforms since 2011, employees are contributing more towards their pensions.

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.

City Response to Recommendation 2: This recommendation has been implemented. The City has included public discussions and impacts of the increase in pension costs during its 2014-16, 2016-18 and 2018-20 budget cycles. The City includes pension information within its budget and Comprehensive Annual Financial Report (CAFR), both of which are public documents and are posted on the City's website. Staff also presents to City Council a quarterly financial report that compares actual expenditure and revenues to date, to budgeted amounts. These reports also are posted on the City's website.

The City has been very proactive in providing information to employees, as well as members of the community. The City has a separate section on its Intranet with various articles regarding pension costs and projections of escalating costs. The City Manager wrote about escalating pension challenges in his employee newsletter message in June and July 2016, and again in June and July 2017. On June 21, 2017, the City Manager wrote a four-page white paper to employees about the CalPERS pension-related fiscal tsunami; on August 3, 2017 the City Manager spoke with employees about the pension tsunami coming, meaning the huge jump in contribution rates, and that it would take all of us to solve the problem. The City Manager presented the same message to City Council (in open session) on June 20, 2017, and again on August 15, 2017. The City has also issued news releases and given news media interviews about its three-tiered pension plans and how the City is addressing mounting pension costs.

As noted in Recommendation 1, the City is addressing the escalation of pension costs by reducing operating budgets, looking for additional revenue sources, and working with employee groups to establish cost-sharing agreements. Also, the City supports legislation to give employers more options in terms of amendments to pension plans.

The City has and will continue to provide the City Council, employees and the public with the status of the City's pension plans and steps to meet current obligations, to ensure benefits are delivered to retirees.

The above concludes the City's response to the Grand Jury's Report on *Pensions In Santa Barbara County*. The City of Santa Maria respectfully submits this response to the Grand Jury and thanks you again for all your efforts associated with this 2017-18 Grand Jury Report.

Alice M. Patino

ALICE M. PATINO
Mayor

✓ cc: Santa Barbara County Grand Jury