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February 7, 2014

Rob Feckner
President, Board of Administration
CalPERS
400 Q Street
Sacramento, CA 95811

Anne Stausboll
Chief Executive Officer
CalPERS
400 Q Street
Sacramento, CA 95811

RE: League Support for Recommended Mortality Projection and Amortization and for Phasing Policy with Additional Options

Dear President Feckner and Ms. Stausboll:

On behalf of California's cities, I appreciate the opportunity to provide input to the CalPERS Board as it prepares to adopt changes to its actuarial assumptions concerning mortality and retirement age. The League and its member cities understand that responsible changes to these assumptions, combined with others that preceded them, are likely necessary even though they will have a major impact on employer contribution rates, and thus city budgets and services, for years to come.

Based upon the information we have received from our membership, deliberations of our internal advisory bodies, and rationale set forth in this letter, the League supports the CalPERS staff recommended 20-year mortality projection with continuation of the Board's 20-year amortization and 5-year phasing policy, beginning in 2016-17; however, we respectfully request two additional options: (1) a more aggressive pre-funding option for those few local units that may be able to afford to do so; and (2) a 20-year amortization and 7-year phasing option for those local governing bodies that adopt a resolution requesting that option. We are <u>not</u> recommending a 15-year mortality projection, a 30-year amortization period or more rapid phase in and amortization of the cost of the new assumptions.

We are requesting the additional options because it is difficult and we believe ultimately unwise to fashion a one-size-fits-all approach for all local employers in light of the real disparity in the fiscal capacity of cities to absorb the resulting costs. Further, while the state's improving fiscal condition may provide opportunities for more aggressive phasing in of payment of the state's liabilities, our research raises concerns that imposing such an approach on all cities at the same time would likely cause drastic service reductions in some cities and even more dire consequences in others.

League's Outreach and Survey of Cities

In order to educate city officials about these potential changes, the League and its City Employer Committee on CalPERS, have regularly attended and reported on CalPERS Board meetings and Employer Roundtables, distributed CalPERS staff reports, published several newsletter articles and conducted a recent webinar on this subject that attracted nearly 400 participating locations and likely over 1,000 participants.

Last month we also designed and distributed a survey to determine the potential impacts of the possible mortality and retirement age assumption changes on city budgets and services. The survey also included a question to solicit the recommendations of city officials concerning the amortization and phase in options under consideration by the Board. A copy of the survey is attached.

The mortality and retirement age impact survey was distributed to City Managers, Finance Officers and Human Resource Directors. It was also made available to the California Special Districts Association and California State Association of Counties for their use. Surveys were completed and returned by 100 cities throughout California; responding cities represent 27% of the California population living in CalPERS covered cities and are fairly representative of the League's membership.

The Financial Impact on City Budgets and Services Varies

Using CalPERS data estimating changes in employer rates, responding cities entered financial and payroll data to calculate potential net employer impact as a percentage of the city general fund (see question 4). Impacts ranged from a low of 0.1% to a high of 5.9% of the city general fund. The median value for the low end of the range was 1.3%; the median for the high end impact was 2.5%.

The Substantial Majority of Surveyed Cities Prefer Board's Existing 5/20 Policy

The final survey question asked the responding city official to express a preference for one of the Board's proposed amortization and phase in options. While difficult local fiscal conditions caused some respondents to request a 30-year amortization period, the vast majority opted for more expedited options. Of the 83 respondents who completed this question, **62%** preferred existing Board policy of a 5-year phase in and a 20-year amortization. In combination with those who selected the 7/20 approach, **84%** of the respondents preferred the 20-year amortization period

One respondent said "We strongly feel that while difficult, it is best for us to 'take the hit' the sooner the better to minimize long term costs." As another bluntly stated, "I would favor a five year phase in as pushing more of this cost off into the future is what got us into this situation to

begin with." Other cities indicated a desire for other options or more flexibility; these comments are incorporated into our suggestions below.

City Preferences for Phase in and Amortization Options

Phase in/amortization option	Respondents preferring this option
5/20 (current policy)	62%
5/30	16%
7/20	22%

The New Assumptions and Amortization/Phase In Policies Will Have Significant Service Impacts in Many Responding Cities

Since 2007 most cities have struggled to balance their budgets and have reduced services due to the recession, state actions diverting local funds or adding new unfunded mandates, the dissolution of redevelopment agencies, and growing unfunded liabilities for retiree health care, infrastructure maintenance, and other debts. In the last six years, cities have spent down reserves, deferred maintenance and capital items, renegotiated contracts, established new retirement tiers, applied for grants, eliminated COLAs, implemented furloughs and layoffs, restructured debt, cut travel and training, reduced operating hours, restructured programs and raised (or attempted to raise) taxes, rates and fees. As you know, the financial pressures facing some cities have pushed them into bankruptcy, and others are reportedly facing serious insolvency and possible bankruptcy.

In light of this reality, the survey asked cities to comment on two specific financial issues:

1) Ability to absorb increased costs without lasting service impacts; and
2) Likely budgetary actions to manage the increased costs.

A handful of cities reported long term or contingency plans to absorb some or all of these costs over time; however, to some extent their forecasts depend on stability in the greater economy. (e.g., "as long as we don't have a recession, we should be OK.") However, for the most part, cities noted efficiencies and substantial cuts already enacted due to the recession and reported limited to no ability to absorb increased costs without affecting services. Some example comments include:

- "We already reduced our workforce by 20% over the last 3 years. "
- "We have already reduced over 150 General Fund positions in the last 10 years."
- "From FY 2007-08 to FY 2013-14 the number of budgeted full time positions was reduced by 32%."

- "Employees have been placed on a 10% furlough for four years. Significant cuts to staffing have occurred. City hall, animal shelter and library hours were all cut. Police services were reduced by 15%."

- "The city has made significant cuts over the last five years to manage the over 40% decline in revenues since 2008."

- "Service cuts were already implemented to balance the budget. During the severe recessionary downturn 14% of full time positions were frozen or eliminated, with a 10% furlough on remaining staff. Reduction in sheriff patrols, services for senior and recreation programs. Cancelled capital projects and equipment purchases."

- "Prior actions taken in response to economic hardship leave few additional options."

Reacting to the anticipated increases in PERS costs, most cities stated more cuts will be needed and service levels will be affected.

- "The City has exhausted all the possible cost reduction options that have minimum impact on level of service. The additional cost increase will force the City to look into options on reducing the service level or imposing additional taxes. "

- "The City has already cut expenditures as much as possible and would not be able to absorb any more without impacting services."

- "While revenue is increasing, the City would likely not be able to absorb such significant increases without affecting service levels."

- "Through labor negotiations, reductions in workforce and efficiency improvements the city has corrected a structural deficit. These increases could not be absorbed without an impact on services."

- "Like most cities such a large percentage of our general fund is consumed by Public Safety and at some point as PERS costs continue to escalate if we are not able to get special taxes approved (as we know that is very difficult to do) we shall have to make significant cuts in Public Safety."

- "While the City is projecting balanced budgets and a necessary reserve, increased PERS costs….will require changes in operations."

We share these stories <u>not</u> to resist the proposed changes; *cities share your commitment to ensuring a viable and sustainable pension system for their employees*. As one responder put it, "All cities have an inherent interest in ensuring that the long-term benefit model offered by CalPERS is managed and fashioned in a manner that allows for lasting affordability, predictability and employee value."

Recommendation

While fiscal conditions remain difficult at the local level, cities accept that changes are necessary. We encourage the Board to work with us to find ways to manage the financial impacts of these changes. To that end, we recommend the following:

- Adopting the CalPERS staff recommended 20- year mortality projection with a 5-year phase in and 20-year amortization as the default periods, effective in 2016-17.

- Providing two options to the default 5-year phase in and 20-year amortization default periods:
    1. A more aggressive pre-funding option for those employers that can afford to pay down this liability quicker and at the same time experience the financial benefits. A request for this option should be supported by a resolution of the city council explaining the reasons for the request.
    2. A 7-year phase in and a 20-year amortization option, provided the request for the option is supported by a resolution of the city council explaining the reasons for the request.

While we appreciate the 7-year phase in and 20-year amortization option may result in somewhat higher costs in the long run, it may provide some needed financial relief to some cities. We are not recommending a 15-year mortality projection, a 30-year amortization or more rapid commencement of the phase in of the costs of the new assumptions before 2016-17. Our research would not support such policies.

We appreciate the staff's participation in our member education activities and the Board's interest in receiving employer input. Pico Rivera City Manager Ron Bates and I plan to represent the League at the Board's meeting on February 18 in order to discuss these ideas further. Thank you for your consideration.

Sincerely,

Christopher McKenzie
Executive Director

c. Alan Milligan, Chief Actuary, CalPERS

Attachment: Copy of blank League CalPERS Survey