



CITY OF MILPITAS

455 EAST CALAVERAS BOULEVARD, MILPITAS, CA 95035-5479
GENERAL INFORMATION: 408-586-3000 www.ci.milpitas.ca.gov

April 18, 2017

Santa Clara County Civil Grand Jury
Superior Court of California
Attention: Tamara Davis, Deputy Manager of Jury Services
191 North First Street
San Jose, CA 95113

RECEIVED

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CIVIL GRAND JURY

Dear Ms. Davis:

The 2016-2017 Santa Clara County Civil Grand Jury has asked for the City of Milpitas to review the 2011-2012 Civil Grand Jury report titled "An Analysis of Pension and Other Post Employment Benefits" and the corresponding recommendations to provide 1) the City's view of the recommendations, 2) whether the recommendations were accepted, and 3) the City's plan for future action. The City last provided feedback to the Santa Clara County Civil Grand Jury on these recommendations on September 6, 2012.

The economic climate of California has changed since the report "An Analysis of Pension and Other Post Retirement Benefits" was prepared. In particular, CalPERS has experienced poor rates of return. As a result, the CalPERS Board lowered the discount rate in 2013 from 7.75% to 7.5%, which increases the CalPERS employer rates. The rate of return continues to be below expectations and the CalPERS Board voted in December 2016 to lower the discount rate further from 7.5% to 7.0% over the next three years. This additional change to the discount rate will have a tremendous financial impact on employers as employer rates will increase up to 20%.

The City has prepared the following updates to the Findings and Recommendations presented in the original report.

Finding 1: Public Sector employees are eligible for retirement at least 10 years earlier than is common for private sector employees.

Recommendation 1: The Cities should adopt pension plans to extend the retirement age beyond current retirement plan ages.

Response: The City of Milpitas adopted two-tiered pension plans for miscellaneous employees on October 9, 2011 and for public safety employees on March 6, 2012. For miscellaneous employees hired into the second tier CalPERS retirement plan, the formula changed from the first tier 2.7% at age 55 to 2.0% at age 60. For public safety employees hired into the second tier CalPERS retirement plan, the formula changed from 3% at age 50 to 3% at age 55. The second tier increased the retirement age for employees hired after the date of adoption and reduced the benefit level for new employees. The final compensation for employees hired into the second tier for both plans is based on the highest three years.

On January 1, 2013, CalPERS implemented the California Public Employees' Pension Reform Act of 2013 (PEPRA). The pension reform bill impacts new public employees and establishes a cap on the amount of compensation that can be used to calculate a retirement benefit. "New" non-safety miscellaneous members hired after January 1, 2013 are placed into a 2% at age 62 retirement tier and "new" safety members are placed in a 2.7% at age 57 plan. New members are required to contribute at least 50% of the total normal cost for their plan.

A "new" member is defined as a CalPERS member who first established CalPERS membership on or after January 1, 2013 and is not eligible for reciprocity with another California public retirement system; or a member who established membership prior to January 1, 2013, and who is rehired by a different CalPERS employer after a break in service of greater than six months. Anyone who does not fall into the definition of a "New" member is considered a "Classic" member or employee.

PEPRA further limited the categories of compensation that can be considered "pensionable" for new members, reducing their benefit at retirement. Similar to the City's second tier, the new PEPRA formulas are also based on the highest three year average rather than highest twelve-month.

Finding 2: Campbell, Gilroy, Los Altos Hills, Los Gatos, Milpitas and Palo Alto have adopted second tier plans that offer reduced Benefits, which help reduce future costs, but further changes are needed to address today's unfunded liability. Santa Clara County and the cities of Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga and Sunnyvale have not adopted second tier plans.

Recommendation 2A: Santa Clara County and the cities of Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga and Sunnyvale should work to implement second tier plans.

Response: Recommendation 2A does not apply to the City of Milpitas.

Recommendation 2B: For Gilroy, Los Gatos, Milpitas and Palo Alto, which have not implemented second tier plans for MISC and Public Safety second tier plans should be implemented for both plans.

Response: Recommendation 2B was fully implemented. The City of Milpitas adopted two-tier pension plans for both miscellaneous employees and public safety employees on October 9, 2011 and March 6, 2012, respectively.

Recommendation 2C: All Cities' new tier of plans should close the unfunded liability burden they have pushed to future generations. The new tier should include raising the retirement age, increasing employee contributions, and adopting pension plan caps that ensure pensions do not exceed salary at retirement.

Response: Implementation of a second tier of retirement pension plan and enactment of PEPRA did raise the minimum requirement age. PEPRA further implemented a cap on the retirement earnings possible for new hires. It will take years for cities to realize the cost savings because there are more employees working at the previously adopted tiers of the retirement plans. At this time, CalPERS is including all employees in the same actuarial valuation used to calculate employer required contributions. As more employees are enrolled in the second tier or PEPRA, then CalPERS will be able to conduct actuarial valuations on the various groups.

Finding 3: Retroactive Benefit enhancements were enacted by Cities using overly optimistic ROI and actuarial assumptions without adequate funding in place to pay for them.

Recommendation 3: The Cities should adopt policies that do not permit Benefit enhancements unless sufficient monies are deposited, such as in an irrevocable trust, concurrent with enacting the enhancement, to prevent an increase in unfunded liability.

Response: The City of Milpitas contributed money to a trust through CalPERS California Employers' Retiree Benefit Trust (CERBT) to pre-fund OPEB obligations. The prefunding efforts have yielded positive progress so far to help pay for retiree medical obligations. The City of Milpitas has started exploring similar plans for pension obligations.

With respect to unfunded pension liabilities, Government Code Section 7522.44 (a provision of PEPPA) expressly prohibits the application of benefit enhancements on a retroactive basis.

Finding 4: The Cities are making an overly generous contribution toward the cost of providing benefits.

Recommendation 4A: The Cities should require all employees to pay the maximum employee contribution rate of a given plan.

Response: The City of Milpitas employees have been paying the maximum employee contribution rate for years. Miscellaneous employees pay 8% and public safety employees pay 9%.

Recommendation 4B: The Cities should require employees to pay some portion of the Past Service Cost associated with the unfunded liability, in proportion to the benefits being offered.

Response: The City of Milpitas previously negotiated through MOUs with employee groups to require employees to contribute a certain percentage of their salaries toward City's share of the pension costs, in addition to the employees' maximum share. Employees' contributions ranged from 7% to 15.4%. However, as a result of collective bargaining, the City agreed to reduce the amounts that employees had previously agreed to pay to offset the City's employer contributions. It did so to assist in the recruitment and retention of qualified staff. Currently, two of the City's five bargaining units contribute 1% toward the employer contribution.

Fire safety employees implemented a cost-share of 3% of the CalPERS employer rate through the collective bargaining process for a contract amendment under Government Code Section 20516 effective June 28, 2015. Any future changes will need to be negotiated with the individual bargaining groups, while still maintaining the City's ability to attract and retain top talent.

Finding 5: The Cities are not fully funding OPEB benefits as evidenced by large unfunded liabilities and small funded ratios.

Recommendation 5: The Cities, should immediately work toward implementing policy changes and adopting measures aimed at making full OPEB ARC payments as soon as possible.

Response: The City continues to fund the full Annual Required Contribution (ARC) every year. The City of Milpitas' unfunded liability had increased from \$29.7 million as of June 2011 to \$36.0 million as of the last valuation (June 2015). This increase is due to the increased number of retirees, increased life expectancy, and rising healthcare costs.

Finding 6: The City of San Jose permits the transfer of pension trust fund money, when ROI exceeds expectations, to the SRBR, despite the fact that pension trust funds are underfunded.

Recommendation 6: The City of San Jose should eliminate the SRBR program or amend the SRBR program to prevent withdrawal of pension trust money whenever the pension-funded ratio is less than 100%.

Response: Recommendation 6 does not apply to City of Milpitas.

Finding 7: The Cities' defined benefit pension plan costs are volatile. Defined contribution plan costs are predictable and therefore more manageable by the Cities.

Recommendation 7: The Cities should transition from defined benefit plans to defined contribution plans as the new tier plans are implemented.

Response: This recommendation still needs further exploration to determine feasibility and the ability to continue to attract quality employees for key positions.

However, even if the City were to determine that a transition to a defined contribution model is feasible, adopting a defined contribution pension plan for future employees is statutorily prohibited for entities participating in CalPERS even though it is well-settled law that governmental entities may provide any pension benefit they deem appropriate for future employees subject to compliance with other requirements under federal law such as the mandatory Social Security requirements. That is, the Public Employees' Retirement Law states that participation in the CalPERS is compulsory for all employees within the covered classification (i.e. miscellaneous or safety for city entities). Thus, legislative change will be necessary in order to permit CalPERS participating entities to offer defined contribution pension plans to future employees.

Should you have any questions or concerns regarding our response, please call Milpitas City Manager Thomas C. Williams, Milpitas City Manager, at 408-586-3050.

Sincerely,

A handwritten signature in black ink, appearing to read 'Richard Tran', written over the word 'Sincerely,'.

Richard Tran
Mayor
City of Milpitas

c: Milpitas City Council
Thomas C. Williams, City Manager