LOS ALTOS HILLS
CALIFORNIA

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Chief Executive Officer/Clerk,
Superior Court of CA County of Santa Clara
BY D. ALDYCKI

August 30, 2012

The Honorable Richard J. Loftus, Jr.
Presiding Judge
Santa Clara County Superior Court
191 North First Street
San Jose, California 95113

Re: 2011-2012 Santa Clara County Civil Grand Jury Final Report - An Analysis of Pension and Other Post Employment Benefits

Dear Judge Loftus:

The Town of Los Altos Hills is pleased to respond to your report, An Analysis of Pension and Other Post Employment Benefits. We believe that the Grand Jury has identified significant financial issues facing all levels of government across the country. In California alone, Vallejo, Stockton, and San Jose have all identified the increasing costs of pensions and other post employment benefits as impacting their ability to continue to provide adequate levels of services to their constituents.

Before responding in detail to your Findings and Recommendations, it might be helpful to provide a little background on the actions The Town of Los Altos Hills has taken to respond to these issues. We believe that the Town, working within the limits imposed by CalPERS on its participants, has moved proactively to address many of the concerns you raise. Last year, the Town created a second tier to its pension plan which increased the retirement age to 60 for those employees hired on or after September 1, 2011. Employees in the second tier are required to pay seven percent of their retirement eligible salary to CalPERS. In addition, for those employed prior to that date, we are exploring the possibility of "capping" the employer share of pension costs and shifting at least some portion of the cost increases to those employees.

The Town also moved to limit the liability associated with retiree medical benefits by limiting the historically provided benefit to those employed or who were qualified annuitants receiving that benefit as of October 11, 2007. For employees hired after that date and who retire from the Town, medical benefits are limited to the PEMHCA minimum. Last year, the benefit was further limited to the premium cost of the Kaiser plan, and as of January 1, 2013, all employees and qualified annuitants will be required to pay a portion of the costs of their dependents' medical coverage.

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We recognize that in these turbulent times continued vigilance is required. We plan to monitor the Governor's efforts at state-wide pension reform and the possibility on the national level of modifications to the Affordable Care Act. Further modifications to our efforts to provide adequate but sustainable retirement benefits to our employees and annuitants may be necessary.

Finding 1

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

Town Response:

We agree that the anecdotal evidence seems to support the conclusion of Finding #1.

Recommendation 1

The cities should adopt pension plans to extend the retirement age beyond current retirement ages.

Town Response:

The recommendation has been implemented. The Town of Los Altos Hills has created a second tier to its retirement plan which increased the retirement age for new employees from 55 to 60. We acknowledge that this is still five years earlier than most private sector employees, but is the oldest age eligibility allowed under CalPERS' current plans.

Finding 2

Campbell, 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, have not adopted second tier plans.

Town Response:

While we have no direct knowledge of what other cities have done, we agree that the Town of Los Altos Hills adopted a second "tier" to its retirement in 2011.

Recommendation 2A - NA

Recommendation 2B - NA

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.

Town Response:

The recommendation has been implemented for two of the three specific suggestions included in Recommendation 2C. As noted earlier, the Town adopted a "second tier" to its retirement plan in 2011. With the changes made as part of implementation of the "second tier", the Town increased the retirement age 5 years from 55 to 60 and required all employees in this tier to pay 7% of eligible salary to their accounts. Both of these changes are options allowed by CalPERS. The third recommendation to adopt a cap will not be implemented because it is our understanding that the Town has no authority to cap the pension according to the provisions of the contractual agreement with CalPERS. However, practically speaking, exceeding the final year's salary would be highly unlikely given that the Town's plan is a 2% plan and utilizes the average of the last three years' pay to calculate the benefit. A new employee would have to work more than 40 years and exceed 63 years of age to receive more than 100% of their salary at retirement.

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.

Town Response:

We disagree with the finding. The Town of Los Altos Hills has not granted retroactive benefit enhancements and has no plans to do so. The Town has insufficient information to comment on other Cities' actions.

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 the unfunded liability.

Town Response:

The recommendation has not yet been implemented, but the Town intends to adopt such a policy in fiscal year 2012-13.

Finding 4

The Cities are making an overly generous contribution toward the cost of providing Benefits.

Town Response:

While the term "overly generous" is extremely subjective, in hindsight it is hard not to agree, especially as the costs of these benefits continue to rapidly increase, that the employer, whatever level of government that may be, cannot continue to absorb most or all the risks and costs of the various retirement benefits.

Recommendation 4A

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

Town Response:

The Town partially agrees with the recommendation as it applies to pensions and, as noted above, implemented it for new (Tier 2) employees last year. While the Town's current policy is to continue to pay both the employer and employee pension contribution for Tier 1 employees, Tier 2 employees do pay the CalPERS employee rate of 7%. The Town anticipates that the State of California may require the employees pay their share as part of the governor's pension reform. Should the governor's reform efforts fail, Town management will re-evaluate the employee pension contribution for Tier 1 employees next year.

In regards to OPEB benefits, five years ago, the Town effectively created a second Tier for this benefit as well and amended its retiree medical plan to limit the benefit for all qualified annuitants hired after October 11, 2007 to the PEMCHA minimum. In 2012, the Town implemented a cafeteria plan which limited the medical benefit for active and qualified annuitants to the Kaiser plan premium rate. In 2013, the Town will implement a revised cafeteria plan which passes part of the increase in premium cost for dependent care on to the employee and/or the qualified annuitant.

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.

Town Response:

The Town has not separately distinguished Past Service Cost from Normal costs, per se. However through the creation of a second tier for our Pension benefit plan, the Town believes that it has followed the Grand Jury recommendation by requiring employees of the second tier to pay 7% of eligible salary toward the cost of the benefit. This is the maximum allowed by CalPERS.

For retiree medical benefits effective October 12, 2007, we have sharply reduced the benefit for new employees to the PEMHCA minimum and required annuitants who are or will receive the previous benefit package to pay a larger portion of the costs. At the time these changes were made, the Town believed that requiring any further contributions from current employees or annuitants would be too burdensome on a group that had not planned on these increased costs. However, in order to reduce the unfunded liability associated with this benefit, the Town has contributed significantly more than the actuarially required contribution (ARC) for each of the past several years and plans to continue to do so.

Finding 5

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

Town Response:

Based on your report as well as some other reports of which we're aware, we agree with this finding's general conclusion.

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.

Town Response:

The recommendation has been implemented. As noted above, the Town has amended its plan to limit annuitant medical benefits for employees hired after October 11, 2007 to the PEMHCA minimum. In addition, the Town has done an actuarial evaluation of its OPEB plan and for each of the last two fiscal years has contributed more than the ARC in an attempt to reduce the unfunded liability and stabilize future payments.

Finding 6 – NA

Finding 7

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

Town Response:

We agree with Finding 7.

Recommendation 7

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

Town Response:

The recommendation has not yet been implemented, and we agree that most governments may need to "transition" away from defined benefit plans. But rather than a defined contribution plan, we believe that, in the near term, a more realistic and maybe even politically possible objective would be some sort of hybrid plan. The hybrid plan would continue a much more modest defined benefit plan that could provide a relatively safe and secure base retirement income, but would then supplement that plan with a defined contribution plan and/or Social Security. In addition, this new defined contribution plan, which could contain an employer match, would encourage younger employees to save for their retirement, give them a transferable asset while recognizing the risks inherent in retirement planning. Should the Governor be successful in his efforts to have the State adopt a "hybrid" risk sharing pension plan for new hires, the Town would certainly evaluate this option.

Sincerely,

Carl Cahill

Carl Cahill
City Manager