



January 5, 2017

**TO:** Honorable Mayor and City Council

**FROM:** Edward C. Starr, City Manager 

**SUBJECT:** CITY MANAGER'S WEEKLY REPORT: December 16, 2016-January 5, 2017

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## **CITY MANAGER/ADMINISTRATIVE SERVICES DEPARTMENTS**

- This past December, the nation's largest pension trust fund, the California Public Employees Retirement System (CalPERS), reduced its projection of future earnings by a half-percentage point from 7.5 percent to 7 percent over the next 3 years, with corresponding incremental increases in employer/employee payments over an 8-year smoothing period. The approved plan differs from the original recommendation presented to the CalPERS Board of Directors—that plan would have lowered the discount rate immediately to 7 percent. The CalPERS Board last lowered the discount rate in 2012, from 7.75 percent to 7.5 percent.

The latest reduction is a recognition that the fund's investment returns have been in steep decline and that CalPERS, which now is just 68 percent funded, is looking to higher contributions from government agencies to make up the difference and solve its long-term unfunded liabilities. The pension fund reported just a 0.61 percent return on investments for the fiscal year that ended on June 30, 2016, which is dramatically lower than the 7.5 percent assumed rate of return.

Absent any dramatic turnaround on its portfolio, analysts project a 47 percent chance that CalPERS' funded status will drop below 50 percent—a decline regarded by economists as a point-of-no-return since the grave negative cash flow will require significant liquidation of assets, further diminishing investment returns. In fact, CalPERS' own advisers see a prolonged period of relatively low earnings and say the system shouldn't count on more than 6.2 percent annually, long-term. In effect, the fund is in a low-growth (investment) environment, and it's expected to remain that way over the next 5 to 10 years according to the Board. Under a less than 50 percent funded status scenario, CalPERS would seek to further increase employer contributions, ultimately forcing a number of cities into bankruptcy.

The 3-year reduction of the discount rate adopted by the Board will result in average employer rate increases of about 1 percent to 3 percent of normal cost as a percent of payroll for most miscellaneous retirement plans and a 2 percent to 5 percent increase for most safety plans. Additionally, many employers will see a 30 to 40 percent increase in their annual unfunded accrued liability payments. These payments are made to amortize unfunded liabilities over 20 years to bring the Fund to a fully funded status over the long-term. For Montclair, the change is expected to add an estimated \$800,000 to \$1 million on top of current pension costs.

As approved by the Board, the plan provides 3 steps to incrementally move the discount rate from 7.5 percent to 7 percent. With each step, the impact of the rate change to unfunded liability payments will be phased-in over 8 years. The steps are as follows:

- FY 2018-19: rate reduced from 7.5 percent to 7.375 percent;
- FY 2019-20: rate reduced from 7.375 percent to 7.25 percent; and
- FY 2020-21: rate reduced from 7.25 percent to 7 percent.

The Board's plan does not account for two critical pieces of necessary reform: (1) it lacks a mechanism to address employer/employee benefit structures; and (2), the extended phase-in period will result in local governments paying more to meet their pension obligations because of the accrued interest on their unfunded liabilities. The longer phase-in period will, however, provide some short-term relief to cities facing budget challenges, providing extra time to fully meet the increases in pension contributions.

Nonetheless, reducing the "discount rate" to 7 percent will force employers and employees to kick billions more into the system to slow the growth of CalPERS' unfunded liabilities—a debt now exceeding \$150-plus billion—half of CalPERS' total fund market value, which currently stands at approximately \$303 billion.

The increased employer contributions generated by lowering the discount rate will not, however, erase CalPERS unfunded liability debt, which is likely to keep growing if CalPERS' investment earnings continue to fall short.

Rationally, to significantly address the reality of underfunded pensions and CalPERS' poor record on investment earnings, the discount rate should have been lowered by at least another full percentage point to 6 percent; but CalPERS already overburdened employers by increasing mandatory employer contributions by approximately 50 percent since 2012 to make up for investment losses during the Great Recession and other factors. Several of these steps include:

- 2012: CalPERS lowered its annual projected earning rate from 7.75 percent to 7.5 percent.
- 2013: CalPERS changed amortization and smoothing policies that spread rate increases or decreases over a 5-year period.
- 2014: CalPERS adopted new demographic assumptions that show retirees are living longer and retiring with higher pensions.
- 2015: CalPERS approved a new funding risk mitigation policy to incrementally lower the discount rate during good economic times.
- 2015: CalPERS revised its pool strategies and assessed unfunded liabilities separate from employer contributions.

In addition, CalPERS continues making decisions that have proved adverse to the long-term health of the fund, including the continuation of premium pay components added into final-year earnings, despite a prohibition by the Public Employee Pension Reform Act (PEPRA) of 2012 and its refusal to support sensible pension reform. By its own failures, CalPERS has switched the debate from the legislative arena to the courts, where decisions over the past few years have initiated the process of change.

Of course, the root of the pension fund's fiscal crisis was born in CalPERS' strong support and sponsorship of Senate Bill 400 (1999), a bill that encouraged local governments to adopt more costly pension plans, including the 3 percent @ 50 retirement formula for public safety employees—a plan that has proven detrimental to the long-term integrity of the pension system.

Legislators, courts, and economists are now recognizing that if it is not economically or politically possible to finance the pension promises, the system's only long-term hope for solvency may lie in reducing those promises.

It has long been assumed that a 1955 state Supreme Court decision that evolved into the "California Rule" makes it legally impossible to do so. The California Rule is a set of regulations and court rulings that (1) guarantee government workers the pension in place on the date they were hired; (2) allow pension benefit changes only if the change is in the employee's favor; and (3) pensions cannot be reduced, except for new hires.

One recent appellate court decision handed down in August 2016, however, indicates the California Rule is not as sacrosanct as it appears. That court decision stemmed from a lawsuit filed by unions in Marin County, seeking to overturn a ban on "pension spiking" that Governor Brown and the Legislature enacted as part of PEPRA. The state Supreme Court has agreed to rule on the case, *Marin Association of Public Employees vs. Marin County Employees' Retirement Association*, over the next few months. If the ruling is ratified, it could allow public

employers to guarantee their workers' pension benefits already earned, but reduce benefits going forward.

The appeals court ruled last August that PEPRA could be applied to current employees in Marin County and across the state. But the state's high court voted unanimously to put that ruling on hold while it reviews the issue for a future statewide resolution. The state Supreme Court also said it would await another ruling by the appellate court on a similar case involving sheriff's deputies in Alameda County.

PEPRA was intended to curb pension "spiking," the practice of boosting retirement benefits by increasing an employee's pay during the final years of employment. Spiking is often done by cashing out unused vacation time, sick leave, compensation for use of one's car, and other non-monetary benefits.

PEPRA clearly applies to employees who were hired after January 2013. The issue in *Marin* was whether they also applied to those who had been hired before 2013 and were still on the job.

State Supreme Court rulings going back more than 60 years have said public employees have a vested right to a pension from the day they are hired. That makes the pension plan a binding contract between the employee and the state. A dozen other states follow the California Rule, which largely prohibits states from reducing an employee's future pension benefits.

Unions representing Marin County employees invoked the California Rule in a lawsuit after the county's Retirement Association applied the new anti-spiking laws to reduce the pensions of workers who were on the job in 2013 and subsequently retired. Union lawyers noted the state's high court said in 1983 that any reduction in an employee's future retirement benefits "must be accompanied by comparable new advantages" so that the employee breaks even.

But the First District Court of Appeals ruling said the high court has used the word "must" in only a single pension-related ruling, and has said in other decisions only that any cut in benefits "should" be offset by increases. "Until retirement, an employee's entitlement to a pension is subject to change short of actual destruction," Justice James Richman said in the 3-0 ruling. The government may not impose a "radical reduction in benefits or a fiscally unjustifiable increase in employee contributions," but may lower future benefits as long as the employee remains eligible for a "reasonable pension." The judge said PEPRA's anti-spiking laws would result in relatively modest reductions, for legitimate reasons, and would not immediately harm employees who could choose to receive the additional compensation before they retired.

In seeking state Supreme Court review, lawyers for Marin County employees said the ruling contradicted decades of decisions by the state Supreme Court and appellate courts and were unfair to workers.

Last week, a second ruling from the First District Court of Appeals in *Cal Fire Local 2881 et al v. California Public Employees Retirement System et al* (<http://www.courts.ca.gov/opinions/documents/A142793.PDF>) provided additional support to the *Marin Association of Public Employees vs. Marin County Employees' Retirement Association* ruling. In this second decision, the court said the Legislature's action in eliminating the right of public employees to buy additional retirement credits was "wholly reasonable" and did not violate any binding promises made to the employees. The ruling deals only with those who were employed when the law took effect in 2013.

PEPRA repealed a 10-year-old law that allowed employees with at least 5 years of service to purchase up to 5 years of credits before retiring. For example, a worker who retired after 20 years could receive a pension based on as much as 25 years of contributions.

Although that law was intended to not increase costs to government employers, employers' contributions did increase because CalPERS failed to properly amortize employee costs for service credit purchases. PEPRA barred employees from purchasing future retirement credits starting in 2013.

The 2013 law was challenged by a union of 6,000 state firefighters, supported by other state and local labor organizations. They argued that they had a "vested," or established right to pension benefits that were in effect when they were hired, and that the state broke its contractual promise to them by eliminating those benefits. CalPERS appeared to support the union argument in a publication which told employees that benefits they had been promised could not be decreased without their consent.

But the appeals court said even vested pension rights can be reduced or eliminated in California as long as employees still receive a pension that is "substantial" and "reasonable." That language came from a 1978 state Supreme Court ruling, which also said that any cutbacks in employees' pension plans, to be considered reasonable, "should be accompanied by comparable new advantages."

But "should" does not mean "must," the appeals court said in Friday's ruling. The employees "are entitled only to a reasonable pension, not one providing fixed or definite benefits immune from modification or elimination," Justice Martin Jenkins said in the 3-0 ruling. Because the pre-PEPRA law allowed employees to purchase credits for time they had not actually worked, the justice said it did not serve the usual purposes of a pension system and the Legislature acted reasonably in repealing it.

- Last September, Governor Brown signed Assembly Bill 626 (AB 626) creating significant new requirements for administering the claims process for public works projects in California.

Codified in section 9204 of the Public Contract Code, AB 626 establishes, for contracts entered into on or after January 1, 2017, a claim resolution process that must be applied to any and all claims by contractors in connection with a public works project. The Bill also creates a process whereby a subcontractor, who may lack legal standing to assert a claim against a public entity (including charter cities and charter counties), may make a claim through the contractor.

The Bill defines a claim as a separate demand by the contractor for one or more of the following: (1) a time extension for relief from damages or penalties for delay; (2) payment of money for damages arising from work done pursuant to the contract for a public work project; or (3) payment of an amount disputed by the public entity, as specified.

AB 626 requires a public entity, upon receipt of a claim sent by registered or certified mail, to review it and, within 45 days, provide a written statement identifying the disputed and undisputed portions of the claim. The 45-day period may be extended by mutual agreement or, until after the next meeting of the governing body of the public entity, if the governing body must approve the disputed and undisputed portions of the claim. The Bill also requires any payment due on the undisputed portion of the claim to be processed within 60 days.

If the claimant disputes the public entity's written response, or if the public entity fails to respond to a claim within the time prescribed, the claimant must demand a meet and confer for settlement of the issues in dispute. The public entity must then schedule a meet-and-confer conference within 30 days for settlement of the dispute.

AB 626 requires any disputed portion of the claim that remains in dispute after the meet-and-confer conference to be subject to nonbinding mediation, as specified. The public entity can also require arbitration of disputes under private arbitration or the Public Works Contract Arbitration Program, if the mediation does not resolve the dispute.

If the public entity fails to respond to a claim from a contractor within the time periods prescribed in the Bill, the claim is deemed rejected in its entirety. The Bill provides that unpaid claim amounts which are not paid in a timely manner shall accrue interest at 7 percent per annum.

Finally, the Bill requires public agencies to incorporate language in their plans or specifications setting forth these new requirements and claims procedures.

## **COMMUNITY DEVELOPMENT DEPARTMENT/ ECONOMIC DEVELOPMENT**

- Gen Korean BBQ was issued building permits last month to undergo a complete interior remodel of the former Home Town Buffet at Arrow Highway and Central Avenue. Gen Korean is an all-you-can-eat restaurant where you cook the food yourself on a grill at the table, in a neon-lit atmosphere. Its line-up of raw ingredients ranges from higher-end prime cut meats, such as Black Angus steak and American Wagyu Kobe beef, to foodie-adventurer options.

The company is based in California where it has eight locations spread across the Inland Empire.

Anticipated restaurant opening date is late spring.



# FIRE DEPARTMENT

- On December 21, Fire Department staff joined residents at Montclair's San Antonio Vista to celebrate the Christmas season. Children enjoyed delicious food, decorated cookies, received toys, danced, and played video games.



## HUMAN SERVICES DEPARTMENT

- The Montclair Youth Basketball League will start its 2017 winter league games this Saturday in the Montclair Community Center gymnasium.

Approximately 200 children, ages 6-14 years old, are registered for the 7-week program, which is extended by tournament play. Games are played all day on Saturdays with practices during the week.

Come check out Montclair's youth in action!

## POLICE DEPARTMENT

- Police Officer Christopher Zamora was sworn in to duty by Police Chief Robert Avels yesterday. Officer Zamora's start date as Police Officer was December 26, 2016.

He graduated from the San Bernardino County Sheriff's Academy on December 15.

Prior to entering the police academy, Chris was a Police Cadet with the Department, hired in August 2015. Knowing that he always wanted to become a police officer, Chris made every effort to avoid negative peer pressure while growing up. His growing passion to become a police officer prompted Chris to test for a Police Officer Trainee position with the Department. The successful outcome led to Chris entering the academy last July.

Chris is very excited about his career in law enforcement, and he is grateful to the City for giving him the opportunity. Congratulations, Officer Zamora!



Officer Zamora and his mom, Olga

"You are never too old to set a new goal  
or dream a new dream."  
~ C. S. Lewis

## JANUARY 2017

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| 9   | Planning Commission Meeting<br>Council Chambers                               | 7:00 p.m.  |
| 10  | City Manager's Staff Meeting<br>City Hall Conference Room                     | 9:00 a.m.  |
| <b>16</b>   | <b>Martin Luther King Jr. Day – City Offices Closed</b>                       |            |
| 17  | Real Estate Committee Meeting<br>City Hall Conference Room                    | 5:30 p.m.  |
| 17  | Code Enforcement/Public Safety Committee Meeting<br>City Hall Conference Room | 6:15 p.m.  |
| 17  | City Council Meeting<br>Council Chambers                                      | 7:00 p.m.  |
| 18  | Safety Committee Meeting<br>City Hall Conference Room                         | 10:30 a.m. |
| 19  | Public Works Committee Meeting<br>City Hall Conference Room                   | 4:00 p.m.  |
| 23  | Planning Commission Meeting<br>Council Chambers                               | 7:00 p.m.  |
| 31  | City Manager's Staff Meeting<br>City Hall Conference Room                     | 9:00 a.m.  |