November 8, 2006

The Honorable Robert S. Boyd, Presiding Judge Sonoma County Superior Court
and
The Honorable Melinda A. Cabral, Foreperson, Sonoma County Grand Jury
2005-2006
County of Sonoma
Hall of Justice
600 Administration Drive
Santa Rosa, California 95403

Dear Judge Boyd and Foreperson Cabral,

On October 23, 2006 the City received your letter of October 17, 2006 in which you asked for responses to the Grand Jury Report of “Impact of Yesterday’s Promises” in the form required by Penal Code Section 933.05 by October 27, 2006. City Manager Jeff Kolin responded to your request on October 26, 2006. The response was faxed and mailed on that date.

The earliest Council meeting that the City Councilmembers could discuss your request was last night, November 7, 2006. This issue was discussed at last night’s meeting, and the Santa Rosa City Council concurs with the response given to you by the City Manager. I’ve attached a copy of that letter for your review.

I apologize for not being able to respond to you by October 26. Thank you for the opportunity to respond to the Grand Jury’s recommendations.

Sincerely,

Jane Bender
Mayor

JB/sks
attachment

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October 25, 2006

The Honorable Robert S. Boyd, Presiding Judge Sonoma County Superior Court and
The Honorable Melinda A. Cabral, Foreperson, Sonoma County Grand Jury 2005-2006
County of Sonoma
Hall of Justice
600 Administration Drive
Santa Rosa, California 95403

Dear Judge Boyd and Foreperson Cabral,

We appreciate the hard work and careful thought that went into this year’s Grand Jury report. The Grand Jury’s attention to the area of post employment benefits addressed an important issue of concern to all of us. The Santa Rosa City Council has been extremely careful in approving both pension benefits and other post employment benefits for City workers. We think that we have used an approach that assures a fair outcome for both our employees and our taxpayers.

Our response to the recommendations included in the “Impact of Yesterday’s Promises” section on page 23 of the Grand Jury’s published report follows. Our Chief Financial Officer, Mr. Michael Frank, and I prepared this response with assistance from members of the City’s staff.

City of Santa Rosa - Response to the Sonoma County Grand Jury Final Report dated June 27, 2006
(The Grand Jury’s recommendations are shown in bold typeface.)

R1 The grand jury recommends that Supervisors, council members and financial officers should verify that health or other lifetime benefit promises are secured properly and in compliance with reserve funding standards.

We agree with this finding. The recommendation requires further analysis including completion of actuarial reports for each program offered by the City, it also requires development of IRS Section 115 Trusts and obtaining IRS opinion letters regarding the tax status of the trusts, hiring corporate trustees for the trusts, hiring investment managers for trust assets and negotiating trust details with each covered bargaining unit. The City expects to have these tasks complete for all of its employee medical trusts by June 30, 2007.

We offer the following additional information regarding the City of Santa Rosa’s efforts to secure benefit promises in compliance with generally accepted actuarial standards.
Retirement - The City of Santa Rosa covers all its employees with pension annuities offered by the California Public Employees Retirement System (CalPERS). Separate plans cover Local Fire, Local Police and Local Miscellaneous employees. Those plans are subject to actuarial analysis annually and funding levels are adjusted to pay for the normal cost of benefits, unfunded actuarial liabilities and gains and losses in the PERS investment portfolio. The CalPERS local agency plans are widely used and provide a defined benefit program that is attractive to workers and is portable among local agencies. This helps the City attract and retain qualified workers. In recent years CalPERS has worked cooperatively with local agencies to implement actuarial policies intended to stabilize contribution rates while providing a sound basis for funding pension obligations.

Retiree medical benefits - The City has agreed to provide varying levels of retiree health benefits and is in the process of conferring with each of the nine labor units that have negotiated some level of retiree health benefits. These meetings will establish the terms of irrevocable medical expense trusts for funding and payment of these benefits. As the City reaches agreement with each unit it will secure IRS approval of the trust and will appoint trust administrators and investment managers. Managers and confidential employees are not covered by retiree medical benefits.

All City of Santa Rosa retiree medical benefit plans agreed to in memoranda of understanding with labor units are characterized by the following common provisions:

1. All plans are funded by contributions based on defined percentages of compensation ranging from .65% to 3.00% which are allocated to retiree benefits rather than wages in negotiated labor agreements.

2. No benefits paid out are tied to medical premiums. They are considered stipends to offset retiree health care costs and range from $80 to $617 per month. Stipends are limited to amounts that can be funded by the defined contribution. Medical premium costs do not affect the benefit level.

3. Regular actuarial analyses that comply with the requirements of Governmental Accounting Standards Board Statement No. 45 - Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions (GASB 45) will form the basis for reviewing and adjusting benefit levels in future years.

4. The annual contribution to the irrevocable trusts now being formed is expected to equal or exceed the Annual Required Contribution that is calculated for full funding of the benefit under GASB 45 in all future years. The benefit will be fully funded.

5. The City will separately experience rate retiree health premiums so that it will not incur implicit rate subsidies as a result of blending rates for active and retired employees.

Note that for public safety plans where the City offers CalPERS medical coverage the City is also obligated for a minimum monthly contribution for each retiree (currently $12.23). The future obligation associated with this contribution is not expected to be material but the annual
October 25, 2006
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contributions to fund this obligation will be deposited in the medical trust accounts in conformance with the criteria established by GASB 45.

The City’s PERS actuarial reports are attached to this response. These reports outline the level of funding for the City’s retirement programs.

R2 The grand jury recommends that the Board of Supervisors and/or City Council enlist actuarial expertise to audit this asset/obligation disclosure.

We agree with this finding. City staff has met with the City’s consulting actuary to discuss the scope of services required to complete negotiations with bargaining units and to provide information to comply with financial disclosure obligations required by Governmental Accounting Standards Board Statement number 45 “Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions”. We expect this work to be completed by June 30, 2007.

Retirement: As noted above, pension benefit plans are analyzed by CalPERS professional actuarial staff annually.

Other Benefits: GASB 45 specifies financial statement disclosure rules for benefits paid to former employees other than pension benefits. It requires disclosure similar to pensions for plans which include defined benefits, defined contributions or elements of both types of plans. Disclosures specified by GASB 45 include changes in financial statements, footnotes to financial statements and required supplementary information (RSI).

Actuarial Studies are required as part of GASB 45 every two years. As a City with revenue exceeding $100 million, we are required to implement GASB 45 reporting standards for fiscal years beginning after December 15, 2006. This would be the 2007-2008 fiscal year. The City is considering early implementation of the new standard for the current fiscal year. The City will secure actuarial assistance in the formation of medical trusts this year. We will also contract for formal actuarial studies conforming to GASB 45 standards during the winter and spring. These studies will be the first of an ongoing series of analyses that will be conducted every two years for post employment benefits. At this time medical stipends are the only post-employment benefit offered by the City. Any future negotiated benefits will be subject to the same valuation and funding approach.

R3 The grand jury recommends that the advice of an expert should be solicited to consider the fairest most equitable way to offer health care benefits to public employees. This should be disclosed.

We disagree with the finding that the advice of an expert is needed to consider the fairest, most equitable way to offer health care benefits to public employees. The City’s health care program for employees is the result of decisions made over many years of labor relations negotiations. We have hired a Risk Manager long experienced in purchasing and administering health care benefits and she engages professional brokers to advise the City when it secures health care programs. For public safety employees we rely on the expertise of the CalPERS staff in
administering health care programs offered by CalPERS PEMHCA. The City of Santa Rosa negotiates health care benefits in the context of the constraints of its budget and the compensation package it offers to attract and retain qualified workers. We believe the collective bargaining process provides the best forum for developing an approach to providing health care benefits that is fair to the City, its employees and the City's citizens and taxpayers.

R4 The grand jury recommends to build a secure structure for maintenance of employee benefits should not be deferred.

We agree with the finding of the Grand Jury. The City has negotiated provisions to create a secure structure for employee benefits over many years. All labor agreements that are in place have language appropriate to providing this structure for retired employees in addition to active employees. As noted above the analysis and actions needed to implement an appropriate structure for retired employees are underway and should be complete by June 30, 2007.

We offer the following comments as additional information for the Grand Jury. The City of Santa Rosa has actively managed its labor negotiations and the technical details of benefit plan design and administration to provide a secure financial structure for its compensation and benefits. Retirement benefit improvements for pensions and medical stipends have required contributions from employee compensation, often to cover the full cost.

The cost increases for benefit improvements in the pension system have been incorporated in the labor negotiations process. This approach provides a solid basis for fair sharing of the actuarial costs of benefits. Unfortunately, not all risks can be controlled despite good faith solutions negotiated between the City and its employees. For instance, CalPERS suffered severe portfolio losses in the early part of the decade that dramatically increased pension contribution rates for employers. Some analysts indicate that as much as 70% of recent PERS increases were attributable to portfolio losses rather than the benefit increases frequently cited by the press.

Like many prudent cities we managed pension benefit increases through negotiations and incorporated those costs in our financial planning but our wages and benefits budgets were severely affected by PERS portfolio losses. Recent gains in the PERS portfolio have somewhat reduced the financial pain but financial markets will continue to create shocks for our benefit funding plans despite recent changes by CalPERS to improve rate stability. This experience provides valuable lessons for administration of retiree benefit programs in the future.

R5 The grand jury recommends full disclosure of each entity's total benefit obligations along with information describing provisions to secure them. We are requesting this information between the end of each entities current fiscal year and December 31, 2006:

- Number of employees eligible for pension premiums
- Number of retired employees receiving pension benefits
- Financial obligation
- What reserves are in place to insure these pension obligations
- Obligation for health care coverage
- Reserve amount in place
- Amount required by federal authorities to secure these health care benefits.
We agree with each part of this recommendation except for the data regarding the Amount required by federal authorities to secure these health care benefits. We have not fully implemented the recommendation at this time. The City will be able to provide information on employees eligible for benefits and retired employees receiving medical benefits and amounts set aside for retiree medical benefits by December 31, 2006 as recommended by the Grand Jury. We plan to complete GASB 45 compliant actuarial analyses of all retiree benefits as close as possible to the time we are required to implement the GASB 45 standard to make sure we do not incur more costs for actuarial studies than is necessary. However, we will have preliminary actuarial estimates of existing financial obligations for health care coverage for retirees by June 30, 2007. We provided copies of the actuarial status of the City's pension programs in our initial response.

We should note that state and local governments are not subject to federal pension rules or insurance programs. Therefore we cannot report on federal requirements for our programs. Our standards for determining whether plans are funded or are creating unfunded liabilities will be based on those established by the Governmental Accounting Standards Board.

We think that the City of Santa Rosa’s approach of limiting the medical benefit to levels no higher than can be supported by defined contributions of compensation for each unit will result in no unplanned financial obligations. In fact, we expect that surplus funds will be identified in the plans because benefit levels have been set very conservatively.

Thank you for the opportunity to respond to the Grand Jury’s recommendations. Please contact me or Mr. Frank if you have any questions about this response. As noted above, we will provide an update in connection with our work in formalizing medical benefit trusts to assure sound financing of retiree medical benefits.

Very truly yours,

JEFF KOLIN
City Manager

JK/sks